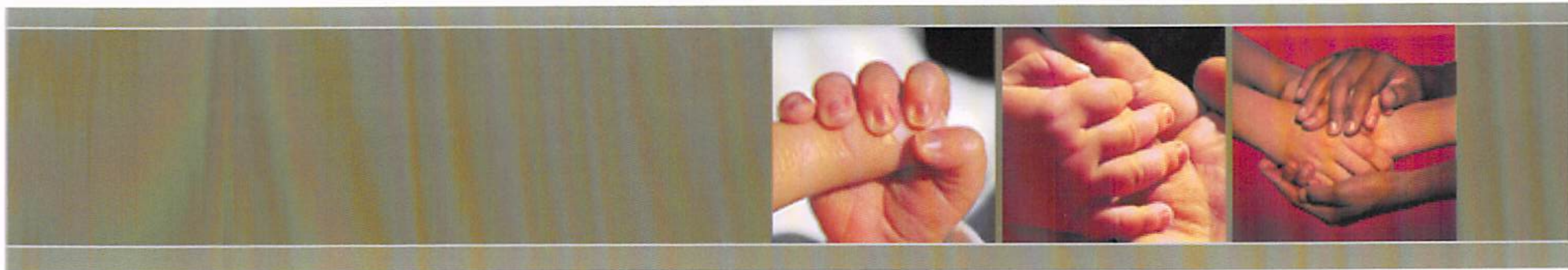
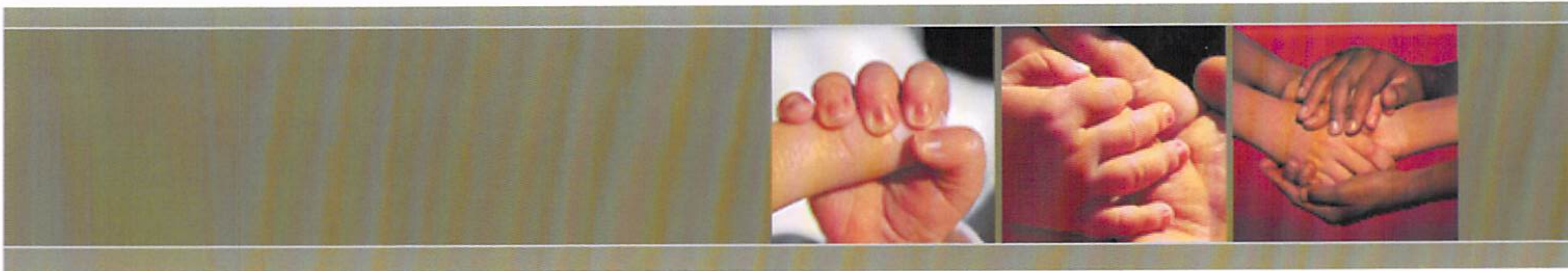
The Financial Maze:

How to Choose, Manage and Evaluate an "Advisor"



Session 1

- Industry Trends
- Broker and Investment Advisor Models
- Interviewing Advisor Candidates
- Background Reports
- Review of an Agreement



Session 2

- New Client Process – what to expect
- Data Intake Forms and Confidentiality
- Typical First Year
- How To Evaluate Performance
- How and When to Say Goodbye

Competing Business Models

Broker

- *Suitability Standard*
- *Product Sales*
- *Commission-based*
- *Retain Custody*
- *Series 63, 6*
- *Limited Platform*
- *Captive Solutions*
- *Incentive to "churn"*

Examples include Merrill Lynch, JP Morgan, Wells Fargo, Morgan Stanley

Investment Advisor

- *Fiduciary Standard*
- *Service Orientation*
- *Fee-based*
- *Non custodial*
- *Series 65, CFP, CFA*
- *Open Platform*
- *Independent Solutions*
- *Incentive to service*

Examples include Edelman Advisors, Mason Securities, Dominion Wealth

Two Industry Standards

Suitability Standard

- *Suitability test: "must meet the client's investing objectives, time horizon and experience"*
- *Invites conflict of interest without requirement for disclosure of same*
- *Supports proprietary products/platforms*
- *These are standards required of a Registered Investment Advisor and monitored by SEC*

Two Industry Standards

Fiduciary Standard

- *Highest ethical standard in the industry*
- *Requires the Advisor to always act in the best interests of the client*
- *Independent platform/products/recommendations are required with substantiation of analysis*
- *Full disclosure of compensation and conflicts of interest*

Comprehensive Approach

Charitable Giving

Financial Planning

Estate Planning

Investment Management

Insurance

Tax Planning

Tax Preparation

Questions and Research

- Are you acting under the fiduciary standard and will you put that in writing?
- What licenses/certifications/credentials do you hold?
- What services are provided? What is your specialty?
- How do you charge for your services? How are you compensated?
- Copy of sample statement?
- What is your typical client profile? References ?
- Investment philosophy of the firm? Am I involved in decisions-how?
- Describe your investment platform and range of options?
- New client process, frequency of contact, voicemail or live person during business hours, sample reports?

ALWAYS RUN A BACKGROUND CHECK at FINRA.ORG/Brokercheck

The New York Times

February 18, 2010

Broker? Adviser? And What's the Difference?

By PAUL SULLIVAN

THE Great Recession has intensified a long-running debate: who is better able to look out for your money, a broker or an independent adviser?

Now that the shock of last year's losses has worn off, many investors are reconsidering what their financial professionals did — or failed to do — for them. At the same time, many brokers are trying to refocus themselves as advisers. Fed by the discontented, the debate has taken on a new urgency.

At the center of the discussion are business practices and regulatory guidelines that are rarely understood by the client and often blurred in practice. Brokers are governed by the "suitability rule," which requires them to have "reasonable grounds for believing that the recommendation is suitable," according to the Financial Industry Regulatory Authority. Registered financial advisers are supposed to adhere to a higher standard — "fiduciary responsibility," an ethical and legal requirement that the investor's best interest comes first, not the adviser's own financial gain.

The conventional view of the two camps goes like this: the brokers at the big firms have access to every product imaginable, but may be pressured to sell you one of them and earn more if they do. They are not obligated to get you the best price for what they advise you to buy or sell — or even to be free of conflicts.

The independent investment advisers proudly promote their independence and lack of conflicts. If their clients feel that the fiduciary responsibility was not met, they have legal recourse through the state courts. Brokers counter that the advisers lack the infrastructure and support of a big firm that would protect clients in the event of irregularities in their accounts or with their advisers.

In practice, though, the two standards seem to confuse investors. Congress is now considering a provision that could alleviate some of this confusion by requiring brokers to act in their clients' best interest. "I don't know if more than 10 to 20 percent of my clients understand the difference," said Susan Fulton, president of FBB Capital Partners, a fee-only adviser outside

Washington. "The investment advisory and brokerage businesses don't make it clear."

Adding to the confusion is that the difference between a broker and an adviser is not always black and white. Consider Shawn Rubin and Kelly Campbell, money managers at two very different firms.

Mr. Rubin, a managing director in the wealth management group at Morgan Stanley Smith Barney in New York, has thick binders lining one wall of his office. Each contains information on a client — mortgages, life insurance, property and casualty policies, wills, tax returns, charitable giving. The last section contains investment breakdowns, the only part of the binder he is paid to oversee, as a broker.

"Ninety percent of my time is spent on things I'm not compensated on," he said, sitting in a modest office that gives little indication that he manages more than $800 million for 50 wealthy clients. "I want to be a trusted adviser, the chief financial officer for my clients. You end up doing a lot more than just financial stuff."

Mr. Campbell, in contrast, is an independent adviser in Fairfax, Va. His business model is mixed: 60 to 70 percent of it is fee-based, he estimated, and the rest comes from commissions for selling products. This would seem to violate the standard of fiduciary responsibility, but the way Mr. Campbell sees it, he has one foot in each camp, and there is no conflict.

"Having the ability to do both is extremely important," he said. "I've been very clear about this. I say this is the piece on which we'll be charging you a fee, and this is the part where we'll charge you a commission."

So Mr. Rubin, the broker, acts like the head of the family office; Mr. Campbell, the fee-based adviser, occasionally sells commission-based products. They render the traditional definitions obsolete.

Most registered investment advisers started at brokerage firms, and many left, they say, because they grew tired of the conflicts of interest. This trend is accelerating, says Schwab Adviser Services, which acts as a custodian for $590 billion in assets managed by 6,000 advisers. It said 2009 was its best year for signing up new advisers, with 172 new teams and $13 billion in assets.

The big brokerage firms, meanwhile, scoff. "I've read that advisers are leaving here at record levels, but in the fourth quarter we had historically low attrition levels among our financial advisers," said Sallie L. Krawcheck, president of Bank of America Global Wealth and Investment Management. She reeled off the advantages to being with a big firm, like continuing education for brokers and products and loans offered by other parts of the firm.

"The business has gone through brokerage to investment management to wealth management," she said. "Now clients want us to take it more broadly than that."

What may matter more than the array of services is the mind-set of the adviser. When a broker tells a client to buy or sell something, the suitability rule does not mean the broker has to be free of conflicts of interest. After all, the broker's salary is ultimately paid by the brokerage firm, which has various products to sell. But brokerage firms say they are trying to eradicate that appearance of conflict.

"A real important piece is that compensation never be slanted to selling our own product," said Patrick O'Connell, vice president at Ameriprise Financial, a brokerage firm. "We're in the process of completing an acquisition of Columbia Management. If an adviser was paid more to use a Columbia fund and not a Fidelity fund, which is also on our platform, that would be problematic."

But others still hold to the traditional distinctions. "There are people who are very successful brokers who do a great job every day," said Kemp Stickney, chief fiduciary officer at Wilmington Trust, a century-old fee-based trust company. "But if you think about it from an investment point of view, the way a lot of brokerages work is they sell you a bond out of their inventory. Because we're not an investment banking firm, we have to ask for bids from four, five, six different firms before we buy a bond for our clients." (Ms. Krawcheck says the array of products that Bank of America keeps in inventory is a benefit to clients.)

Advisers like Mark Matson, chief executive of Matson Money, said brokerage firms should get out of the advisory business altogether. "The problem is they hold themselves out as offering advice and value-added services," he said. "They should just tell clients, 'I work for a brokerage and I'm going to suggest some things, and you have to make the decision if they're right for you.' "

This is where the fiduciary standard gets invoked. Rooted in trust law, that standard means that an adviser has to act impartially and solely for the benefit of the client, avoiding conflicts of interest and self-dealing.

"It's never about us; it's about our clients and their interests," said R. Hugh Magill, chief fiduciary officer at Northern Trust. "They entrust their assets to us for management. But the more subtle distinction is they entrust their family to our care."

Asked how an adviser who leaves a brokerage can become a fiduciary, Mr. Magill said: "It takes time to learn these things. Are they going to pick up 'Fiduciary Responsibilities for Dummies?' You learn it by example."

During the depths of the financial crisis last year, Mr. Matson, a former broker who speaks of fiduciary responsibility with the zeal of the converted, took that responsibility to an extreme. He resigned from about 250 accounts because he felt the clients were doing things not in their best interests — namely trying to time the market.

"This is what the average adviser can't do," said Mr. Matson, who manages $2.4 billion. "A client has a $1 million account that has gone down 30 percent, and he says, 'I feel uncertain and want to be in cash.' The adviser knows you can't time the market, but he says if I don't do what he says, I'm going to lose this account and the $10,000 fee. That adviser has a wife, family and expenses. He can't say no."

But many investors still select their advisers — whether at a brokerage firm or on their own — based on the advisers' skill and personality, according to a new study by the Oechsli Institute, a research group.

"The most important factors in selecting the adviser is the reputation of the individual and the impression that person makes in terms of professionalism and competence," said Matt Oechsli, the chief executive. "The trust you have for the firm goes up if you trust the adviser; if you don't trust your adviser you don't trust the firm. This is the first time this has been inverted."

The Oechsli report, "The New World Adviser," found that clients with $250,000 to $10 million in investments were more worried about clear, timely communication and quick problem resolution than about investment performance. A majority of respondents on the lower end of the investment range said they did not believe their adviser was doing a great job, it found, and were looking for a better option.

That may be heartening to the registered investment adviser who has left a big firm to go solo. But what it really means is that the onus is on the individual adviser. Someone like Mr. Rubin, whose platform was switched from Citigroup to Morgan Stanley when Smith Barney became a joint venture last year, understands the importance of service over brand.

"Our goal is staying ahead of what the client needs," Mr. Rubin said. "When they write check 180 and we know they have 200 checks, we send them another book. That service makes them more inclined to put large amounts of money here on which we generate our compensation."

Of course, some investors do not have enough money to attract the interest of a top adviser. It should not come as a surprise that the level of personalized service gets ratcheted up with wealth level. Mr. Rubin's clients have a minimum of $5 million with him, while Mr. Campbell's clients have $1.5 million to $2 million. Most registered investment advisers require a

minimum investment of $1 million, though some will accept clients with $500,000.

"If you have less than $250,000, you're not going to get that first-class level of service," Mr. Oechsli said. "You'll probably get a review once a year, quarterly contact. There's nothing wrong with that."

That means the one looking out for your interests may have to be you.

Copyright 2010 The New York Times Company

advertisement

INVESTING

How the fiduciary standard protects you

By Sheyna Steiner • Bankrate.com

Highlights

- Investors should pay attention to the regulations surrounding the fiduciary standard.
- Some financial planners or advisers do not have to put their client's best interest before their own.
- Find out if your adviser operates under the fiduciary standard and which licenses he or she has.

Nearly four years after Lehman Brothers' collapse, systemically important financial institutions still engage in excessively risky trading and firms continue to exploit unsophisticated investors. Goldman Sachs was singled out in March for just such sins by a departing employee in a widely publicized op-ed in the New York Times.

Yet many at high levels continue to rail against meaningful financial reform, most famously Jamie Dimon, CEO of JPMorgan Chase, who has loudly opposed proprietary trading rules, even as JPMorgan Chase lost $2 billion on a big bet on corporate bond derivatives.

What's behind the resistance? Some financial firms don't want change because they believe it would impact their profits. And realistically, those who benefit from the status quo are rarely happy to embrace change.

So what will it take to reign in Wall Street excesses? Possibly rebuilding ethics from the ground up, starting with the way brokers treat retail clients. Read on to learn how you can be streetwise when you deal with these crafty Wall Street types.

The fiduciary standard -- What is that?

When it comes to financial reform, individuals should pay the most attention to the regulations surrounding the fiduciary standard. It sounds complicated, but it essentially refers to the guidelines that spell out the obligations financial services professionals have to their clients.

Currently, there are two standards that advisers and financial planners are held to -- the suitability standard and the fiduciary standard. The suitability standard gives advisers the most wiggle room: It simply requires that investments must fit clients' investing objectives, time horizon and experience.

"You can satisfy the suitability standard by recommending the least suitable of the suitable options, as long as it falls within the general suitability test," says Barbara Roper, director of investor protection for the Consumer Federation of America.

SHARE THIS STORY

Like Be the first of your friends to like this.

Share Tweet

LinkedIn Delicious Reddit

Stumbleupon Email story

More On Fiduciary Duty And Investing:

Fiduciaries, financial literacy

The suitability standard invites conflicts of interest pertaining to compensation, which can vary greatly from one product to another.

"And you don't have to disclose your conflicts of interest. You don't have to appropriately manage your conflicts of interest or minimize your conflicts of interest. So what that means is often the products that are best for the broker have higher costs for the investor," Roper says.

Spy on your financial planner

Investing news and advice

Create a news alert for "investing"

The other standard of care, the fiduciary standard, basically charges advisers with putting their clients' best interest ahead of their own. For instance, faced with two identical products but with different fees, an adviser under the fiduciary standard would be compelled to recommend the one with the least cost to the client, even if it meant fewer dollars in the company's coffers -- and his or her own pocket.

Unfortunately, many investors can't distinguish among financial planners and advisers. Studies have shown that individual investors don't know who is a fiduciary or what a fiduciary actually is.

How to discern among financial advisers

The majority of investment advice providers are not trying to rip people off. But it's hard for average investors to know which type of adviser is held to what type of standard -- suitability or fiduciary.

For broker-dealers that are held to a suitability standard, the compensation system is set up in a way that can lead to conflicts of interest. But TV advertising suggests otherwise.

"You can never educate investors to understand that their financial adviser is a salesperson who doesn't have to act in their best interest when multimillion dollar marketing campaigns are designed to lead them to exactly the opposite conclusion," says Roper. "The titles and the descriptions of the services are designed to make them think they are in a trusted advisory relationship."

Increasing investors' education would go a long way toward unveiling the information gaps that currently exist between professionals and their clients. Many times investors don't know a lot about the products they are sold, but they should, at the very least, know what kind of adviser they're working with.

Questions to ask your adviser

- Are you acting under the fiduciary standard? Can you put that in writing?
- Which licenses do you have?
- Are you a registered investment adviser? Can I get a copy of your form ADV (SEC/state regulators registration form)?
- If you are not acting as a fiduciary, are you willing to fully disclose all conflicts of interest and the amount of compensation received from advice and products recommended?

There is an easy way for them to find out an adviser's level of accountability.

"Ask one simple question: 'Are you acting under the fiduciary standard, and will you put that in writing?'" says Tim Hatton, president and founder of Hatton Consulting and author of "The New Fiduciary Standard: The 27 Prudent Investment Practices for Financial Advisers, Trustees and Plan Sponsors."

Investors should also ask which licenses the adviser has: the Series 7 or Series 65. The former allows brokers to sell securities.

Registered investment advisers are fiduciaries and they must have the Series 65 license. Some advisers may have both.

"I am a registered investment adviser with the (Securities and Exchange Commission), and that means that I cannot legally collect a commission, and I am not what's called dually registered (under both licenses). So I can't

even legally collect a commission when I make a recommendation on any type of product or service," Hatton says.

Whether or not commissions inherently create conflicts of interest is a contentious topic.

If and when the SEC comes out with a rule extending the fiduciary standard to all financial advisers, it's most likely to require disclosure of payments as a way of minimizing the conflict.

It's not just investors who need an education in financial literacy; the industry could use a little schooling as well.

"Financial services executives and reps really need to raise their *ethical* literacy because right now a true professional has an obligation to serve the best interest of their clients. A professional also has an obligation to other members of their profession. And they also have an obligation to society, and all of those things are important," says Blaine Aikin, president and CEO of fi360, a fiduciary education and consulting firm.

Why is regulation necessary?

The Dodd-Frank Act gave the SEC the leeway to decide if broker-dealers should be regulated under the fiduciary standard. The SEC found that a higher standard of care for clients is needed, and it's currently in the process of hashing out the details.

But there is another regulatory movement afoot from the Department of Labor. It's working to change the definition of who is a fiduciary under the Employee Retirement Income Security Act, or ERISA, which is a complex set of regulations governing workplace retirement plans.

"Currently there is a five-part definition of fiduciary. It's very hard to enforce because all five parts have to apply in order for someone to be deemed a fiduciary. There are two parts that are particularly important. One part is that advice given must be regular," says Aikin.

That can be something of a loophole. If a financial professional gives someone personalized advice once, or on anything other than on a regular basis, he or she escapes fiduciary accountability.

The other tricky part of the current definition is that for the adviser to be held to a fiduciary standard, the advice must be the primary source of decision-making.

"What the new definition would say is that as long as it's personalized advice, it's fiduciary. It also goes on to say that it doesn't matter if it is primary advice, the main consideration is that it's advice that was material to the decision," Aikin says.

It's a big change, especially because the definition would apply to IRAs, which are not covered under ERISA.

"This is huge because there is a lot of advice being given to individual investors that is not being held to high standards of objectivity and competence, and investors don't know it," Aikin says.

Conversely, there are stringent limitations on the types of advice plan providers can offer to participants in workplace retirement plans such as 401(k)s. Conflicts of interest are painstakingly minimized.

For instance, a retirement plan administrator giving advice to plan participants receives a level fee no matter which investments are chosen. Or the advice can come from a computer model, as long as it has been approved as unbiased.

As everyone agrees that advisers should not be able to unfairly enrich themselves at the expense of workers' employer-sponsored plans, should IRAs be treated differently?

In an ideal world, ethical behavior would not need to be enforced by regulation. But we are talking about Wall Street, where the bottom line can supersede all ethical considerations. If individuals voted with their wallets and demanded ethical and fair treatment from the financial services industry, everyone would benefit.

Posted:June 19, 2012

Location of article:
http://www.bankrate.com/finance/investing/fiduciary-standard-1.aspx

BBC NEWS

BUSINESS

31 December 2012 Last updated at 07:37 ET

Commission sales are abolished on financial policies

COMMENTS (426)

Financial advisers and sales staff can no longer be paid commissions by the firms whose policies they are selling.

New rules, aimed at eradicating the long-standing practice, are being imposed by the Financial Services Authority (FSA) from now.

The aim is to stop policies - such as private pensions and investments - being mis-sold by sales staff, motivated by commission payments.

Instead, customers must be quoted up-front fees, and be told about charges.

Sales staff or financial advisers will also have to state if they are really independent, or restricted to just selling the policies of particular financial groups.

The reforms form part of a series of changes in the financial services industry called the Retail Distribution Review, and which were first proposed by the FSA back in early 2010.

Linda Woodall at the FSA said: "The changes will improve customer confidence - we want people to feel that they are getting a service from their financial adviser that is relevant to their circumstances and in their best interests.

"These changes are about making the cost of advice clearer, where else would you buy something without knowing in advance how much it costs?

"Customers will now know how much advice is costing them, the service that they are receiving and be reassured that their adviser is qualified."

Mis-selling scandals

The changes should ensure that independent financial advisers no longer receive payment for their advice by taking a regular cut of their clients funds via commission payments, something the clients may not be aware of at all.

The new policy will apply to the sale of investments such as pensions, annuities and unit trusts, but not to some mortgages and insurance policies.

Alan Higham, an expert on annuities - a pension income for life - believes that there is also a loophole with sales of annuities.

He said that "limited pension advice" - which provides guidance, quotes and explains terms and accounts for about a third of annuity sales - is not covered by the new rules.

This is because the client has made the decision without recommended pension advice from an adviser. If anything is wrong with the choice, then it is the client's responsibility, rather than the adviser's.

Commission-driven sales are thought to have been at the heart of the huge mis-selling scandals of the past few decades, affecting the sale of endowment policies, personal pensions and most recently payment protection insurance (PPI).

Even apart from those scandals, the FSA estimated in 2010 that mis-selling in general was costing UK financial consumers about half a billion pounds a year.

A recent survey for the FSA found that 17% of adults currently take advice from a professional financial adviser and another 32% would consider doing so.

But a third of the respondents thought, wrongly, that the advice was free and that they did not have to pay a charge.

'Danger'

Financial advisers have said that some operators in their industry have given it a bad name. However, some argue that the change in the rules could create issues for those who may not actively seek financial products, such as a pension.

"The danger here is that quality financial advice becomes something only for the wealthy, when in reality, most people need it to some degree - as poor rates of saving across the population only go to show," said Keith Tadhunter, an independent financial adviser at Future Financial in Bath.

But Martin Wheatley, the chief executive designate of the Financial Conduct Authority, said that - although there was a savings gap in the UK - people had not trusted financial services.

"This is part of getting trust back into finance," he said.

He expected the industry to change, with many more options explained through websites for people looking to save or invest in the long-term.

The new policies will also stop, from the end of 2013, the practice of businesses such as fund supermarkets or online discount stockbrokers accepting payments from some of the investment funds whose policies they are selling.

This is also thought to lead to biased sales, which may not be in the best interests of private investors.

Part of these payments has sometimes found its way back to the personal investor in the form of a cash rebate, but they are also used to cross-subsidise the provision of other services, such as stock and shares Isas.

Your comments (426)

Comments

This entry is now closed for comments

Editors' Picks **All Comments (426)**

376. David H
31ST DECEMBER 2012 - 15:53 +5
It's tinkering at the edges, like re-arranging the deck chairs on the Titanic.!

Far bigger fish to fry, HMRC needs to get it's act together and recover the £Billions of outstanding taxes owed would be a good start

62. Ppuj
31ST DECEMBER 2012 - 10:59 -2
Maybe people should spend a bit more time educating themselves as to how these products work. After all, most people would not walk into the first car showroom and buy the car the sales person says is best without thinking about their needs and and doing research.
Or am I overestimating peoples ability to think?

60. Severian
31ST DECEMBER 2012 - 10:57 +14
Many people seem to not understand the difference between an Independent Financial Adviser (who works for you, in exchange for commission or a fee) and a Financial Adviser (who usually works for a bank).

Good IFAs (and there are many of them!) will show you exactly what they are recommending, and will explain how much it will cost you, and why they are recommending it.

Bank advisers won't.

46. JOHNTO
31ST DECEMBER 2012 - 10:45 +12
We need a new financial services bill, so that all sectors can be brought into the 21st century.

This tinkering is just not on, new total structure PLEASE!!!!

40. xyriach
31ST DECEMBER 2012 - 10:38 -5
IMO, anyone investing in anything that they themselves haven't fully understood, read, researched and accepted and understood the risks of is basically asking to get ripped off.

You don't need to understand finance to be able to read and ask questions.

This is another example of the FSA treating symptoms and not the underlying causes of a corrupt system and an incompetent consumer

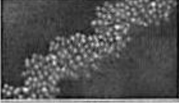
culture.

Comments 5 of 6 Show More

Sign in or Register to comment and rate comments

All posts are reactively-moderated and must obey the house rules.

More Business stories

US Supreme Court bans DNA patents
[/news/world-us-canada-22895161]
Human genes may not be patented, but artificially copied DNA can be intellectual property, the US Supreme Court rules unanimously.
Rupert Murdoch files for divorce
[/news/22895642]
Saudi prince defends libel action
[/news/business-22890237]

BBC © 2013 The BBC is not responsible for the content of external sites. Read more.