

## Is Your Financial Advisor On Your Side?

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From traditional brokers to independent financial advisors, where can high net-worth investors turn for objective financial advice that meets their specific needs? The year 2008 served as a wake-up call to many wealthy investors and left them wondering just what was going on with their investment portfolios. As banks and brokerage firms react to the policy changes enacted by Treasury officials in Washington D.C., investors are concerned that their brokers might not even be around to manage their families' savings. If their broker is still employed, he is likely to be facing his own challenges in these rough markets. He must manage the delicate balancing act of keeping his job by meeting a revenue quota and allocating enough time to focus on analyzing and rebalancing his current clients' portfolios.

Conflicts of interest in the money management business are plenty, and investors need to ensure that the advice from their financial advisor is as independent and objective as possible. The financial advisory space is crowded, and the landscape of Wall Street has changed dramatically in the last year alone. Performance is one concern, but ensuring that your financial advisor's interest is aligned with yours should be the primary concern. Some questions you may want to ask your advisor:

*1) How are you compensated?*

Pay close attention to the answer, as it might determine the likelihood of hidden or undisclosed fees associated with the investments recommended by your broker. Often a fee is "built-in" or considered part of the purchase price, and this may take the form of a "sales load" (a charge passed along to the selling broker) or higher "expense ratio" (various costs of the fund comprise this ratio) in the case of buying a mutual fund. Brokers may also receive a "placement fee" (a one-time commission paid to the selling broker) and/or "trailer fees" (ongoing quarterly servicing charges) for each client they line up to invest in a particular "alternative" investment, such as a hedge fund or private equity fund.

*2) Is the product being recommended an “internal” product?*

Brokerage firms typically incentivize their brokers to push products which will render the most revenue to the firm. These investments are considered “internal” in the respect that the firm has a fiduciary interest in selling them. The needs of the individual investor or the suitability of an investment may not even be considered when a particular recommendation is made.

In a sustained bull market, any particular investment may perform well, and as far as the client is concerned, the initial reason for choosing a particular investment may not even matter as long as its value increases. From the broker’s perspective, regardless of whether the investment increased or decreased in value, his commission was earned at the time of sale. Looking back on a year such as 2008, an investor might have been served better with some objective advice.

### **The New Age of Independence**

Financial advice will always be in abundance, but where can an investor turn when it comes to managing their life-long accumulation of wealth in a way which is suitable to their own specific situation? In the past, high net-worth investors have felt most comfortable having their assets held at one of Wall Street’s popular top-tier firms, dealing with a highly-compensated “private banking” associate in an expensive suit, feeling assured that the best and the brightest minds were providing insight into managing their portfolio.

The landscape has changed.

Many of these bright individuals realized that they could better serve their clients in an independent environment, where the needs of the client come before the necessity to generate revenue for their firms - hence, the proliferation of Registered Independent Advisors over the last two decades.

In the financial advisory business, there are three main categories that financial advisors fall into. First is the “Full-Commission Broker,” which most investors are familiar with. Most of these representatives make their living off of revenue generated from commissions on products sold,

while some are able to generate revenue from fee-based payments – the latter often leading clients to believe they are receiving the benefits of a typical “fee-only” advisor. These firms will typically offer investment banking services, which can conflict with the best interests of investors.

The two types of advisors often associated with “independence” are “Independent Broker-Dealers” (IBD’s) and “Registered Investment Advisors” (RIA’s). Independent Broker-Dealers are registered with, and regulated by, the National Association of Securities Dealers (NASD). Although some IBD’s operate fee-based businesses, their NASD securities licenses also allow them to charge commissions on securities transactions and product sales, which most do. If a broker is affiliated with an Independent Broker-Dealer, his brochure or business card might read “Securities offered through\_\_\_\_\_.” This may indicate a focus on securities or product sales rather than advice.

By contrast, Registered Investment Advisors are registered with the Securities and Exchange Commission (the “SEC”) or their state securities regulator. They are regulated by the Investment Advisors ACT of 1940, which means they have a fiduciary responsibility to act in the best interest of their clients. Fee-only investment advisors do not accept any commissions from funds they advise their clients to buy. As a result, there is usually no incentive for a fee-only investment advisor to recommend one particular fund or product over another. Their only source of revenue is a fee which is typically based solely on assets under management. The larger a fee-only advisor grows his clients’ assets, the better he does. This arrangement exposes investors to few, if any, conflicts of interest and directly aligns his interests to those of his clients.

When selecting an independent RIA, make sure you do your homework. You might want to perform a background check on the advisor. RIA firms are required to make available an “ADV Form,” (also kept on file with the SEC), a comprehensive report containing financial information about the firm. Most importantly, you must ensure they are using a highly reputable and independent custodian, as this is where your assets will be held.

### **Can I Benefit From the Help of an Independent Advisor?**

High net-worth investors may fall into one of the following categories when it comes to their financial advisory relationship – 1) those who have grown complacent with their current broker due to a long history of working with them (“Jim has *always* been my broker, and he even knows all of

my kids names!"), 2) those who believe they could be better served elsewhere but don't have the time or energy for the research involved, and 3) those who are actively looking for professional guidance to help manage their financial investments as opposed to leaving their financial future up to chance.

Some investors may consider a financial advisory relationship when their financial affairs have become so complex that they cannot effectively manage them alone. Triggering factors may include extraordinary income due to an asset sale, executive compensation, business liquidation or changes in family dynamics requiring revisions to an estate plan.

The first step in the reevaluation process is to consider an objective advisor with whom you not only feel comfortable, but whom you believe will help achieve your family's financial goals. The relationship you build with your financial advisor is one of the most important relationships you'll ever have. You will be disclosing personal information about your family's finances as well as your financial goals and concerns. Your advisor will help to guide you in making some of the most important financial decisions throughout your life. Ideally, the relationship will span many years and perhaps into the next generation.

### **Complex Investments**

Some high net-worth investors may fear cutting-the-cord with their private bankers due to the varied and multiple investment products they are invested in. This is where doing your homework in researching independent advisors can really pay off in the long run. While some independent RIA's might focus exclusively on providing low-cost, passive strategies of investing solely in mutual funds or exchange traded funds ("ETF's"), many are versed in highly sophisticated strategies involving private equity, hedge funds, options, insurance-policy investments and beyond. These particular independent advisors often provide advice on a client's entire financial portfolio, and only after arduous due diligence on specific investments will they determine whether they are appropriate for a client's asset allocation.

## Conclusion

Sometimes it can take a major shake-up in the markets to incite investors to reevaluate the advisor with whom they have entrusted their financial future. Otherwise, investors attempting to go it alone may realize that their goals of preservation and growth may be better served with the professional guidance of a knowledgeable advisor. Whichever the route that led to this decision, choosing an objective, independent advisor who understands your family's financial goals and will work hard to help you achieve them can be the soundest advice of all.

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