<u>Who is your Financial Advisor? (And does it matter?)</u>

By Randy Christian, ChFC

Many years ago, when I was just starting out in the "financial services business" as an agent for The Prudential Insurance Company, I was a life insurance agent. I signed a contract with "Mama Pru", as we used to call them, to sell Prudential's products to the population at large. This was not any big deal, 1000's of guys and gals of all ages and all previous walks of life undertook this "profession".

Those who survived for the first 3 to 5 years, avoided bankruptcy, divorce, or too excessive debt, were found to be successful. About 70 to 80% of all new agents failed in their first year and of the survivors, about half failed in the second year. We were encouraged to further our professional education to better serve the client and reach the more affluent clientele. We studied for securities licenses to sell mutual funds and variable insurance products, such as variable life insurance and variable annuities. We even earned professional designations, as I did, such as the CLU (Chartered Life Underwriter) and the ChFC (Chartered Financial Consultant). These were no easy schools. In the 80's and 90's each course cost around $350 and now is upwards of $750. Each took several weeks of after-hours study and a 100 question multiple guess test that was intentionally tricky to make sure you knew the stuff. And these were real, academic, study courses. No sales gimmick and closing techniques here. This material was college level academics, insurance product design and actuarial calculations, history of the various insurance products, corporate structure in the business world, social security and other government financial information, tax codes and complex tax/legal/estate/financial planning strategies that are currently being recommended by attorneys and CPA's. To achieve the above mentioned designations required a passing score of 70% or better on all 13 of these courses. After the several years of study and work and achieving these designations, I felt like a professional for sure. Today, there are more "professional designations" than the old timey alphabet soup that came in a red can and Mom heated up for lunch. I have been in this industry for 26 years and spend a full day every day in the business, but I have lost track of the letters at the end of people's names and what they stand for and what is required to attain them. Designations are to indicate a higher level of professionalism and specialized knowledge. Here are a few: CFP, CLU, ChFC, PFS, MSFS, CPCU, and the list goes on and on and on. These above have been here for many years and are considered to be the standards of the industry. They require real study and real cost and take a real commitment to professionalism. Others take a day or two and an open book test. If I'm confused as to what some of these letters mean (CSA, CLTC, AEP) and what is conferred, what about the average person who is struggling with real life retirement/financial/family issues and needs some help in figuring out what to do and how to take care of himself and those he loves and cares for?

(On a side note, back in the late 1980's and early 1990's Forbes magazine had an issue with the picture of chimpanzee in a three piece suit on the cover and the tag line was "Anybody can be a Financial Advisor". It sort of rings home even today.)

So where can the average, middle American in their 50's and older (baby boomers) seeing they need financial planning help, turn? There are several professionals to seek help from as highlighted below.

1- CPA- A Certified Public Accountant. A CPA is a tax advisor and is usually a historian. That is they look at what you did, and help to arrange the information for the least costly tax liability using the tax code. Most won't or don't give forward thinking advice. They are trusted for cash flow, and tax and accounting information, but generally are not licensed for, nor willing to give, insurance and/or investment advice. Some carry an AICPA designation of PFS (Personal Financial Specialist) indicating a higher level academic knowledge of financial planning and insurance and investment strategies and products, but will not give if any specific recommendations due to lack of hands on experience, licensing and regulator restraints.

2- Friends and Family. These folks are certainly available and certainly have their heart in the right place, since they have a degree of personal relationship. However, they usually nod wisely and speak without any objective understanding of your situation, concerns, fears, or the gritty details that are pertinent to the real issues and the situation. Such intimate details should only be shared in confidence with someone who is objective and committed to helping you. Friends and family also know only what has worked for them or what they heard on TV or the radio or from someone else. While well intentioned they have little or no experience, training or education as to all the various alternatives and choices of product, strategies that look good and don't work, or look bad but do.

3- Your trusted Insurance Agent. There are basically two types of insurance agents- Captive and Independent and both ultimately have the same problem when it comes to being an advisor. As for the Captive Agent, his contract with his company specifically states that his interests are for the company benefit. That is the technical, legal definition of 'agent'. Many agents will say they want what's best for you, the client, and they sincerely do. However, what's best is defined as products from their company portfolio, pricing and underwriting guidelines. Also, at the end of the day, insurance agents are paid by commission for making sales. Going back to the 1980's when I began this journey, the first year commissions were lower than they are today and we had "renewal commissions" intended to pay us agents for helping to keep the company's business "premium paying". The renewals were much higher than today. In fact, except for some in the property and casualty business, today's agent commissions are "front loaded" making almost all the commissions paid out in the first year and little or nothing in the future. This is how the insurance company assures itself that the agents will focus on sales, not service. As a result, over the last several years, most insurance agents are forced to provide little, if any, policy service, and the "big sale" of 2 or 3 years ago, is no longer a client to advise, since another sale is working down the street. This creates great conflict for both the agent and the client. Independent agents can be more service oriented than the captive agent, since he is contracted with a number of companies and works with and knows several companies. This benefits the client in a number of ways: he saves the client time and effort in going it alone, he can help to design a plan that is appropriate and suitable for the client, he can verify the underwriting and recommend the best company for the client's needs. Then, in the future he can save the client more time and effort by moving the client from one company to another when it's in the client's best interest. The client doesn't need to start from scratch with a new agent. This can represent a potential conflict of interest, however. Since all insurance agents, whether a company 'captive agent' working for just one company, or an independent working for several companies, all still have the inherent conflict of interest of compensation from sales commissions. Replacing policies can often be in the best interest of the client. Sometimes it is not. If the only form of compensation is the sale of new business, ongoing service to existing clients is necessarily curtailed as a business decision: The agent must write new business to survive. So, while an insurance agent can provide some planning and advice, unless there is a sale in the picture or at a minimum, good strong referrals to someone the client knows who represents a potential sale, the advisory capacity of the insurance agent is limited. Generally, insurance agents also have limited knowledge and/or experience with investment products or planning strategies except as relates to a product solution, as well. Insurance agents can't legally charge a fee for giving advice. Finally, they are held by regulators to a standard of suitability, not a fiduciary standard.

4- <u>Investment Advisor.</u> Someone who is a registered representative for a broker dealer: Meryll Lynch, Wells Fargo, Dean Witter, Bank of America, Wachovia, or an Independent Broker Dealer of an Insurance company. Well a couple of things here: **1-** They, like the captive insurance agent, must sell and manage investment products for the benefit of the company. They are an employee of their company. **2-** The company decides what products from which company the advisor can use. While the variety of products offered is mindboggling, they still work for the company, not you the client. Some are

Investment Advisor Representatives, (IAR) allowing them to charge a fee based on the value of your assets held at their firm which is shared with the company, but because they primarily manage investments they often don't have a good working knowledge of insurance product. **3-** They can't or don't sell or provide insurance products. These products take money (investment dollars) from the company. A good example is as follows: The client wants a guaranteed return, a guarantee of principal, without exposure to current taxation, and can leave the money for 5 years. He loses sleep if he sees that his account value declines at all. A fixed annuity might be a good fit and certainly should be considered. The Broker Dealer advisor might endeavor to steer the client to his company's products rather than consider putting money into an annuity. **4-**The cost of doing business has increased and many of the larger firm's most professional investment advisors, have account minimums of $1 million or more. **5-** Like the insurance agent, the smaller broker dealer registered representative is often paid by commission to sell mutual funds and variable insurance products. **6-**The Registered Rep of a broker dealer is held by regulators to a standard of "suitability" not a fiduciary standard. **7-** Many don't hold the necessary licenses to charge a fee for giving advice, and are on the sell, sell, sell, treadmill like the insurance agent.

So, where does the middle American turn?

5- The new kid (and the future) is the Independent RIA (Registered Investment Advisor). This new breed is the synthesis of the best of the two above without the bad.

   a. An Independent RIA will often have the professional education of ChFC, or CFP. Both of these designations require years of study and years of experience and ongoing continuing education. The RIA will often have experience in all fields of financial planning, from taxes to legal issues to insurance, from Social Security to pensions from estate planning to investments.

b. An Independent RIA can put all the aspects of the client's situation into a plan designed specifically for the client. RIA's are either a) fee based or b) fee only. The fee only advisor recommends product and investment solutions, but often drops the ball when it comes time to implement the plan to put a needed insurance product in place, since they refuse to deal with product that pays a commission. They must refer the client to a stranger to handle the product, leaving the client responsible to make the purchase. A recent article in Finanical Planner Magazine noted that 80% of financial plans were not implemented. The fee based RIA can help work out a plan and stand ready to help implement the plan as well. Sometimes, client's prefer to let the insurance company pay the advisor instead of the client having to write a check. The fee based RIA can handle the insurance/investment products *and* implement the plan. Both types of RIA's usually have an asset management fee structure as well. Usually, the Independent RIA, either fee based or fee only, can manage investments at a lower cost than the broker dealer rep, since there is no insurance company or Broker Dealer company to include in the pricing for the management fee. They use of low cost, no-load mutual funds and ETF's are generally used. Often the Advisor's management fees are negotiable and are around 1% per year, paid out of the investment account at .25% per quarter of the account value on the end of the quarter. This arrangement really puts the RIA on the client's side of the table. As the account value grows, so does the RIA fee. If it declines, so does the fee.

c. For the middle class American, hiring the independent fee only RIA, the client can have his plan set up, but if unable to implement it, money is spent and there is nothing gained, nothing implemented. The totally fee only advisor will not follow through on the implementation of a plan. Many simply manage the investments and nothing more. Hiring a fee based RIA recognizes that sometimes the best, most cost effective thing for the client is to simply use an insurance/investment product or restructure assets and pay a management fee. The Independent fee based RIA has the greatest flexibility in this regard.

d. Regarding the fee only advisors: This school of thought subscribes to the idea that if an advisor receives a commission from the sale of a product, the advisor is influenced by the commission and therefore the advice is not 100% objective. These fee only advisors usually have commission based associates to whom they refer their clients. Having been in the straight commission world for many years myself, it's obvious that there is some sort of mutually beneficial arrangement between the fee only advisor and the captive insurance agent, or broker dealer rep to whom the client is referred, who as we all know, *will receive* a commission for the placement of a product. One doesn't need a degree in Economics to understand that "one hand washes the other" in the business world, especially in the world of investments and insurance. So if the fee only advisor designs a plan that requires the purchase of insurance and refers the client to an insurance professional, because the client doesn't have good relationship with an insurance agent himself, that insurance professional is surely doing something of economic benefit to the fee only advisor, while not actual dollars of commission, that would be illegal, but there is some sort of mutually beneficial economic value, it just makes plain sense. After all, business is business. So the referral itself is something of a lack of objectivity and represents some economic value, not unlike the same conflict of interest which the fee only advisor objects to. The ideal client of the fee only advisor is the high net worth individual who has all the necessary advisors already in place, CPA, Tax Attorney, Estate planner, fee based investment advisor, long term relationship with a professional insurance agents, one for financial products and another for property and casualty coverages, and needs to have his/her plan objectively evaluated for gaps and overlap. All advisors would meet together and discuss and work together for the benefit of the high net worth client's benefit, with no conflict of interest or competition amongst advisors.

e. Both the fee based and fee only RIA is hired by the client and they arrange the payment for the services just like any other service professional. Who would go to an attorney and have him do work without having some idea what he will charge to do what work? Or a CPA? Or a medical service? Even plumbers and lawn maintenance companies costs are discussed up front. Of all the various types of advisors above, only RIA's and investment advisors discuss these issues on the front end.

f. Best of all, the Independent RIA is the only financial advisor held to a fiduciary standard. This means that the client's interests must always come first. Currently, neither insurance agents, nor Registered Representatives of a Broker Dealer are held to this legal standard. They are held to a "suitability" standard. So the RIA must advise in ways similar to the Hippocratic Oath for doctors, or the AICPA standard for CPA and legal professions. The independent RIA works for the client, first and last.

g. This RIA format establishes a mutually beneficial, a long term relationship. The client doesn't have to re-state his goals and objectives and preferences every time he needs to review. The Independent RIA knows client history, family dynamics, values and concerns and some of the client's experiences.

h. Annual, Semi-annual, Quarterly or Monthly reviews are part of the service. And because the Independent RIA can handle all aspects of the client's financial situation, the service isn't limited to the performance of the stock market and the investments, but a true update of the financial situation, hopefully allowing the client to get on with the non financial issues of his/her life. (ie: 'get a life')

So, who is your financial Advisor? A captive insurance agent? A wire house employee? A Broker/Dealer employee? Your buddy at the hair shop? One of your co-workers who seems to have it together? Or maybe a syndicated radio talk show host whose main job is to get people to listen, so ratings go up and the station can charge higher advertising rate? Money Magazine? AARP? Yourself?

Who is working for you first and foremost really and truly? And, does it matter?

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