



Finding an Honest Financial Advisor

Someone recently forwarded an article to me. The article's titled "Finding an Honest Financial Advisor" and it's written by Prof. Kent Smetters of the Wharton School at the University of Pennsylvania, a top-notch business school with Ivy-league bearings. So, I thought I'd share Prof. Smetters wisdom with you as we all start off this new year of investing.

He says there are three key "insider" questions that individuals should ask financial advisors as part of the screening and selection process: the *interview* process, if you will. These questions are:

1. **Do you accept commissions of any form?** Prof. Smetters says (and I agree), the best answer is usually "no." Simply because you don't want to walk into a showroom and walk out with a product that gives the sales guy the biggest commission even if what he sells you isn't right for you, or isn't the best quality, or doesn't offer the best value for money. Because I want you to know, if you didn't already, that financial advisors are often paid commissions to promote financial products: typically investments, insurance, annuities and loans. And companies that offer the crappiest plans for consumers typically reward financial advisors the most for offloading this junk on to you. Also, when someone says they are "independent," don't confuse their *independence* with lack of bias to promote *commission-rich* products.

Now, as Prof. Smetters says (and I again concur), there indeed are some very good advisors who work on commission and do their best to give you unbiased advice, but they are more the exception than the rule. And ultimately, any commission paid to a financial advisor comes out of profits you provide to the company: as sales loads, management charges, surrender penalties or back-end charges: so you are the one holding the bag on this too.

And to give commissions a \$ perspective, Prof. Smetters cites an example where a typical investor loses over \$95,000 to commissions over a 35-year IRA investing cycle: so we are talking real money here. So even though a small percent amount in commissions may not sound so bad, it certainly adds up and is that much less that is available for your retirement.

2. **Are you “fee based” or “fee only?”** As Prof. Smetters says, the best answer is “fee only.” Because fee-only advisors only collect fees to dish out advice and receive no commissions, whereas fee-based advisors collect fees to advise you as well as commissions on products you sign up for. Thankfully for most investors, our federal government is *on it* and is pushing for rules that increase transparency for individual investors.

Now, in my opinion, you should always ask your advisor for something called an ADV Part 2: which is a form where advisors have to, by law, check a box if they operate on commission: so this way you are doubly sure that your advisor is being straight with you. Where an advisor refuses to share his ADV-2 with you, just strike him off your shortlist.

And remember: this is YOUR money. You are completely justified to ask your financial advisor for a complete breakdown of the components of your plan that clearly show fees, commissions, investment amounts, etc. And the good news is, by your doing so, your financial advisor may be willing to lower costs if you think they are excessive. So here’s your opportunity to bargain a little.

3. **At all points in time, will you serve me as a fiduciary?** Fiduciary basically is a legal responsibility that your advisor has to always act in your best interests. Fee-only advisors are required to be fiduciaries at all times, whereas fee-based advisors are not required to act in your best interests but are held to the lower standard of recommending investments that are *suitable* to your needs: and the latter, of course, opens up a lot of room for maneuvering in ways that seldom benefit you.

So, I’d even urge you to have your financial advisor document each investment in writing and check one of two boxes: *fiduciary* or *suitability*. If you’re being sold a *suitable* product, always ask if there’s one that better suits your needs. Moreover, you can always seek a second opinion on specific investments. And fortunately, with the Internet, it’s easy to search for unbiased opinions and common *gotchas* diligently documented by investors who have been *burned* and are outraged and share all their learning’s so you don’t have to suffer their fate.

So in conclusion, as I always say, it’s your money: you have the right to ask all the questions you want before committing to an investment. No one can force you to buy an investment, and if something sounds too good to be true but you only get the offer if you *act now*, your best bet is to walk away. Never rush into investments you’re not comfortable with, and never shy away from asking your advisor tough questions each and every time. Because he will then save his corny investments for those who don’t quite question him. And by asking him repeatedly, you’ll only make sure he serves your interests well. Remember, he’s your financial advisor, not your best friend; so push him hard, get the best deal and always save your money and invest it in a manner that’s best for you.