

“Is Your Financial Advisor Acting In Your Best Interest?”

By David Patterson, CFP™ and Erin Preston, CFP™

Financial advisors should have a fiduciary responsibility to their clients. As CFP™ licensees, we are required to act as a fiduciary to our clients. Another way of saying this is that advisors have a duty to look out after their client’s best financial interests. While the majority of money managers and brokers care deeply about doing what is best for their clients, we are continually amazed by how many of our clients’ former advisors seem to have been motivated primarily by commissions and fees, and not by their clients’ best interests.

We’ve compiled a list of questions that you can ask yourself to see if the advisors you’ve worked with (or are considering working with) have had your best interests at heart:

- Did your financial advisors spend time trying to understand your overall financial objectives?
- Did they clearly and completely explain how they are being compensated? If an advisor says to you “I don’t make money unless you do”, we’d suggest you run for the nearest exit. We are unaware of any fee arrangement where that statement would be true.
- If they recommended that you purchase mutual funds, did they explain the differences between Class “A”, Class “B” and Class “C” mutual funds? Did they explain the commission and fees involved with each?
- Did they make you aware that investing larger amounts of money may qualify you for discounts when buying “A” shares of mutual funds? Or, did they just recommend class “B” funds without explaining that they include back-end fees if you sell the fund in the first several years (usually 6 years), while at the same time carrying higher annual management fees than class “A” funds (usually for 5 or more years)
- Did they make any attempt to explain all the different types of risks involved in investing?
- Did your advisors make any real effort to understand your risk tolerance? Or did they just ask if you wanted to be conservative, moderate or aggressive? These are very subjective terms that mean different things to different people. Understanding one’s tolerance for risk requires a more in-depth approach.
- Did they explain the different types of investments that are available, along with the pros and cons of each?
- Did your advisors make any attempt to provide real diversification in your portfolio? Having three or four different funds does not provide the needed diversification when they are all domestic, large-company funds. And, if they only handled a portion of your portfolio, how could they provide the overall diversification that you needed?
- Are the investments your advisors recommended in sync with your risk tolerance? Recently, the portfolio of one of our clients contained a “Diversified Futures Fund”, a highly-risky fund that invested in all types of futures and/or derivatives (investments whose values depends on or is derived from the price of other assets). These types of investments are highly speculative. What’s more, the fund had to earn 8.5% just to cover its expenses! And, to make matters worse, our client had indicated to his advisor that they were moderate-risk investors.

- If your advisors have recommended that you place your investments in a “managed account”, with the investments overseen by various asset managers, was the cost clearly disclosed to you? This type of account can typically cost 0.5% to as much as 2% or more of your account’s value, per year. That may be OK if the managers do a really good job?
- Has it been ages since you’ve heard from your advisors? Do they make an effort to keep your portfolio balanced, or are they more interested in getting new clients? If they have not recommended any changes in the last couple of years, something is likely wrong. On the other hand, if they call every month and recommend a new hot stock, they may be trying to churn the account to generate commissions.
- Have your advisors recommended buying an annuity for your IRA account? The main selling feature of annuities used to be their tax-free growth. But IRA accounts already grow tax free. Therefore, one of prime benefits of an annuity has no value in a retirement account. Annuities often have surrender fees starting at 7% or 8% and then declining to zero over six or seven years (sometimes longer). Advisors often never mention surrender fees. Surrender fees act as a deterrent to moving one’s assets elsewhere and therefore reduce one’s flexibility.
- Finally, have your advisors really listened to you when you talked to them? Did they speak in language you could understand? Did they have your best interests at heart?

The above items address some of the major issues investors should be aware of. Some people say, “I just don’t have time to bother with my own investing.” While that may be true, they can’t afford to casually choose an investment advisor. Saying “but he/she was so nice” just isn’t enough to protect your hard earned money! Make a commitment to invest some time in the selection of an advisor that looks out after your best interests.

David C. Patterson, CFP® and Erin Preston, CFP® are the owners of Patterson Advisors, LLC, a fee-for-service-only financial advisory firm. Patterson Advisors, LLC is a Registered Investment Advisor, registered with the State of Michigan, with offices in Waterford, Michigan and Rochester Hills, MI. Visit www.pattersonadvisorsllc.com for more information.