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WHETHER TO CONSULT A FINANCIAL ADVISOR OR DO IT YOURSELF

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WHETHER TO CONSULT A FINANCIAL ADVISOR OR DO IT YOURSELF

Whether to Consult a Financial Advisor or Do It Yourself

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Cynthia Sharp (J.D., LL.M. (taxation)) dedicated close to 30 years building a successful law practice serving thousands of clients. At the pinnacle of her career, she sold her interest in the practice and established The Sharper Lawyer. She is also a contributor to the American Bar Association's Publications Board of Solo, Small Firm and General Practice Division's upcoming publication The Lawyer's Guide to Buying, Selling, Merging, and Closing a Law Practice. Cynthia's social media column appears on a regular basis in the GPSolo eReport. Take a look at the website and blog of The Sharper Lawyer for up to date information and commentary on relevant topics: www.thesharperlawyer.com.

From The Lawyer's Guide to Financial Planning, Section Three

Managing One's Own Investment Portfolio

According to a 2012 *Investopedia* article,[1] the market share of online brokers increased by three percentage points while the market share of other retail brokerages lost four percentage points. This apparent uptick in the number of do-it-yourself (DIY) investors can be attributed in part to the relatively easy access that the public now has to the same or similar information relied on by financial professionals. Plummeting values of professionally managed portfolios over the past few years have also led some investors down the path of self-management, apparently with the attitude that they couldn't do any worse than their brokers.

Many decide to go with a discount broker in order to save fees. The trade-off for lower fees is that no personalized investment advice is offered, since the role of the firm is to execute trades. While risk assessment tools, a myriad of calculators, and research findings are offered by most of the rated discount brokers, individual investors are responsible for weighing options on their own regarding issues such as asset allocation, choice of funds, and post-retirement draw-down amounts. Investors must also rigorously monitor their own progress and make strategic adjustments where appropriate. Those determined to invest on their own must first conduct a thorough study of the discipline of financial planning in order to gain a complete understanding of relevant concepts. Knowledge of what drives financial markets and the ability to interpret trends and analyze financial statements are among the preliminary prerequisites to beginning a successful DIY investment strategy.

SmartMoney annually ranks discount brokers. The 2012 Broker Rankings can be found at http://online.wsj.com/media/smbrokersurvey0612.gif. Factors taken into account include the firm's range of investment products and research tools, speed and reliability of websites, customer service, and fees. Top-ranking Fidelity is described as "[o]ffer[ing] the biggest selection of funds and the most comprehensive website" while tenth-ranking Wells Trade was criticized because "[o]nline trades were slow to execute. Got low marks for its website, trading tools and research offerings."[2] The survey found the average price of a stock trade through a discount broker to be $7.96 in 2012, compared with $8.27 the previous year.[3]

The Role of the Financial Professional

In contrast to do-it-yourselfers, another category of investors (such as busy lawyers) defers responsibility for financial planning to their advisors. The "do-nothing-at-all" crowd (so dubbed by Bill Harris writing for *Forbes*) may end up with "expensive products, such as excessively high-priced mutual funds and other more expensive investment vehicles that provide large commissions for advisors but little overall value to the investor himself."[4] Perhaps some people turn over all decision making to their advisors because they are already overwhelmed and are too busy with their own business or career or because they lack adequate financial knowledge to make informed decisions. This section will equip the investor with fundamentals to take into account when choosing a financial professional and defining his or her role. Keep in mind that a key role played by an advisor is to remain dispassionate, as it is often very difficult to be objective with respect to your own money. Whether to hire a stockbroker, investment advisor, financial planner, accountant, insurance agent, broker, or other type of professional to help plan financial affairs can be a confusing proposition. As a group, they offer a wide range of investments and products, hold a variety of designations, and have a number of different compensation methods. To further complicate matters, the definitions of the terms are fluid, depending upon the services offered or products sold by the individual or firm. Those interested in delving further into the definitional aspect are directed to the website of the U.S. Securities and Exchange Commission (SEC)5 and to the website of the U.S. Financial Industry Regulatory Authority (FINRA).[6]

No matter the label, the professional chosen should be the person who can best serve the investor's needs, and the initial step is to specifically define those needs. The personal assessment process will identify whether assistance is needed in development of a detailed strategy or financial plan for meeting all financial goals or whether the engagement will be limited to services such as advising with respect to investments, business, insurance products, income tax reduction, retirement, or estate planning. The most important objective is to choose someone with whom there is chemistry and a sense of trust. Seeking referrals from other attorneys, professionals, or friends is a wise move.

Many people adopt the team approach, under which their professionals work together. (Note that in some jurisdictions, attorneys are permitted to act as financial planners for their clients.) Others retain several different financial firms, choosing not to put all of their eggs in one basket. Diversification of advisors may have its advantages. Investors whose sole advisor was Bernard Madoff would have felt a lesser financial sting if a portion of assets had been handled by three or even four other advisors. The SEC's Office of Investor Education and Advocacy lists the following as questions that a potential client "should always ask when hiring any financial professional."[7]

- What experience do you have, especially with people in my circumstances?
- Where did you go to school? What is your recent employment history?
- What licenses do you hold? Are you registered with the SEC, a state, or FINRA?
- What products and services do you offer?

- Can you recommend only a limited number of products or services to me? If so, why?
- How are you paid for your services? What is your usual hourly rate, flat fee, or commission?
- Have you ever been disciplined by any government regulator for unethical or improper conduct or been sued by a client who was not happy with the work you did?
- For registered investment advisors, will you send me a copy of both parts of your Form ADV?

The Initialisms: A Clarification

The FINRA website lists close to 100 different designations that may be held by financial advisors, and *The Wall Street Journal* has identified an additional 115.[8] The credentials are not issued by government agencies.[9] For example, the well-regarded CFP designation is issued by The Certified Financial Board of Standards, Inc., which is in turn accredited by the National Commission for Certifying Agencies.

A financial advisor's credentials show a commitment to increasing the knowledge base, at some level, in a particular financial realm. However, an investor should keep in mind that an advisor without a list of designations may produce excellent results, having learned through self-study and experience. Since certain designations in the financial world are relatively easy to obtain, independent research into the requirements may prove worthwhile. The designations can be easily confused since they are often referred to in common parlance by initialisms. FINRA's website offers consumers the ability to "decode the letters that sometimes follow a financial professional's name," determine the continuing education requirements (if any) of the issuing organization, ascertain whether a mechanism is in place for registering complaints against credential holders, and "confirm who holds the credential."[10]

Compensation

Professionals deserve to be compensated. When a lawyer is working on or completes a matter (depending on the arrangement), the client (hopefully) receives an invoice specifically outlining the amount that is being paid out of retainer or that is owed. Although often convoluted and difficult to interpret, bills listing treatment rendered and the exact amounts due are (or at least should be) sent by medical providers to the patient and/or the insurance company. Many investors do not receive invoices detailing specific services provided by their financial planners. A 2011 study conducted by Cerulli Associates and Phoenix Marketing International revealed that 33 percent of investors believed their advisor's services were free, while another 31 percent were unclear as to how their advisor was paid.[11] Of course, people may not understand bank statements, medical and legal bills, or even estimates provided by plumbers. All compensation arrangements should be presented to the consumer in a clear manner.

Any prospective client should feel free at the initial interview to ask for a written fee schedule from the advisor. Full disclosure allows the individual to properly analyze whether a particular compensation arrangement is appropriate for his or her individual circumstance. Awareness of advantages and disadvantages allows the investor to choose which type of service is most suitable for his or her individual needs, which of course dictates the compensation level.

The first issue to address is the level of service needed. Although cost should be the least important aspect of the decision, it is usually the subject of the first question asked. Investors must realize that some firms may provide recommendations, investment advice, and research support, while others may not. The method of compensation will depend upon the services to be provided by the firm.

Advantages and disadvantages exist with each type of compensation structure. The most significant criticism leveled is that each has an inherent conflict of interest, as an advisor may have an incentive to make recommendations profitable to the advisor that are not in the client's best interest. However, the same criticism is often raised in regard to legal fees. Attorneys who operate under a contingency structure may encourage early settlement to avoid spending potentially unprofitable hours in trial. An hourly rate agreement may inspire numerous motions and other questionably necessary legal work in order to drive up the bottom-line fee in the matter. However, honest lawyers do not engage in such practices and neither do honest financial advisors. Full and complete trust of any advisor, on *all* levels, is crucial. Thorough research at the outset and careful decision making with respect to the choice of any professional is critical. The pros and cons of compensation models for financial advisors are discussed in great detail by Daisy Maxey in an excellent article titled "How to Pay Your Financial Adviser."[12]

Common Fee Structures

Fee-Only Compensation

The three main fee-only structures are percentage of assets under management, flat fee, and hourly rate.

Clients opting for the *percentage of assets under management* system, the most common in the industry, pay the advisor a percentage of assets managed by the firm. Standard fees range from 1 percent to 2 percent annually. An account balance minimum is normally required, often in the $500,000 to $1 million range. Because the advisor's compensation is directly tied to the client's success, he or she has an incentive to grow the account and to minimize losses, which places the interests of the advisor and the client in pari passu.

A scant number of firms base the fee on a percentage of the client's entire net worth plus a percentage of the client's gross income. This gives clients with little liquidity access to the services of a financial advisor. For example, a young attorney earning a healthy income but with little to invest currently due to heavy student loans may be attracted to this type of structure. A *flat fee* may be attractive to investors seeking specific advice or services. This type of person may be of the DIY ilk, simply seeking a professional's opinion or expert direction. Both the flat and hourly fee methods leave implementation of the plan to the client. The following example illustrates this type of arrangement.

Jude Boudreaux, an advisor with Upperline Financial, a fee-only financial-planning firm in New Orleans, offers an introductory financial-planning service for $1,000 a year or $100 a month. Clients get four meetings of an hour to an hour and a half in which they discuss their net worth, budget, and changes that are needed. They meet again later to discuss their progress and any new issues that have arisen. The investors aren't charged extra for telephone calls or e-mails.

While the *hourly rate* option is not widely available, those seeking one-time or ongoing intermittent advice with respect to their portfolio could choose this alternative. The common fear expressed is that the advisor has an incentive to "keep the meter running." A solid agreement and ongoing involvement in the planning process should obviate this concern.

Commission-Only Compensation

Some advisors receive a percentage of the value of each product sold or transaction entered into on a client's behalf. The advantage to the client is that no fees are incurred except for specific individual transactions. A concern often expressed is that a commission-only advisor could put his or her own profit opportunities above the client's best interest. Churning, excessive trading, or abuse of other sales practices is regulated by SEC Rule 15c1-7. It is fair to ask whether the advisor receives a larger commission upon the sale of the firm's products.

Fee-Based Compensation

Some advisors may charge a fee (hourly, flat, or retainer) for development of a financial plan and may subsequently receive commissions at the time of the sale of the insurance and investment products recommended in the plan. The same criticisms cited with respect to commission-only advisors may be applicable here. Investors may opt for this structure in light of the one-stop shopping feature.

Salary-Plus-Bonus Compensation

Financial advisors working for a discount broker typically offer no investment advice and often receive a salary and a bonus. Discount brokers are generally not valued for the advice. Rather, the so-called value is the discount itself.

The SEC's Office of Investor Education and Advocacy suggests that a potential client inquire as to whether the financial advisor's fee is negotiable.13 This author is not personally inclined to negotiate fees with a professional in any field. That being said, certain situations may warrant a request for a more favorable financial arrangement. A large investor such as Donald Trump may exercise more clout than a neophyte with a modest portfolio with respect to negotiating fees or commissions.

Endnotes

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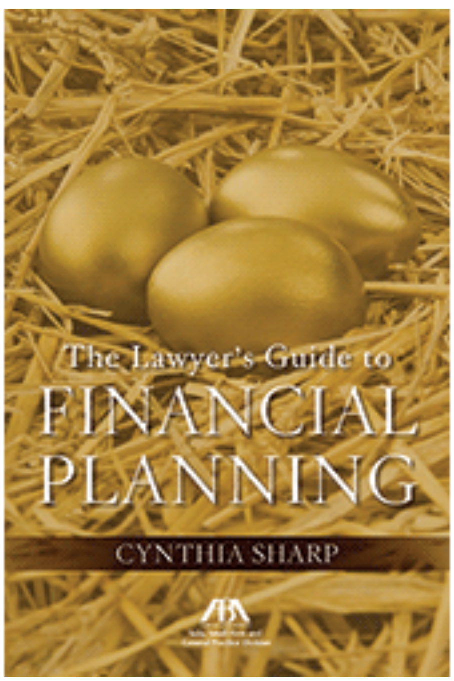

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