

Financial Planners

Source: Consumer Federation of American and National Institute for Consumer Education.

The way in which a financial planner is compensated can directly affect the advice he or she gives clients. A relatively small percentage of the individuals offering financial advice actually get paid exclusively for giving such advice. The majority earn some or all of their income selling mutual funds, annuities, insurance, and other financial products to implement their recommendations. "Advisers" who are also salespeople, however, inevitably face a conflict of interest and will almost certainly be tempted to steer clients into products in which they have a financial interest. The greater the adviser's dependence on commission income, the greater the conflict. In the end, that conflict could cost you both in out-of-pocket expenses and in the quality of advice you receive.

Long-Term Cost

One of the chief attractions of commission-based financial planning is that it appears affordable. Typically, commission-based planners charge a relatively low fee or no fee, for the "advice," expecting to earn the real money on the back end, when they sell the products to implement their recommendations. When you buy a product to implement that plan, however, a percentage of the money you spend goes to pay a commission to the planner. Ultimately, the price you pay includes not just the commission itself, but the money it would have earned over time had it been invested. In assessing the costs of financial planning, therefore, you have to include the cost of implementation.

Quality of Advice

The increase in implementation costs is not the only price you pay for commission-based planning. You may also pay in the form of poor advice. After all, when a financial "adviser" earns most of his or her money as a financial salesperson, the product sales tend to drive the process.

In the worst case scenario, the planning becomes nothing more than window dressing to attract clients for the real money-making business of selling products. Clients are offered one-size-fits-all plans that inevitably lead to the purchase of a handful of high-commission products.

Even those commission-based advisers who attempt to offer comprehensive financial advice still can find themselves biased by compensation considerations when it comes time to implement their recommendations. After all, the more the adviser lowers the initial fees to attract business, and the more time he or she spends on the planning process, the more he or she must earn in the implementation phase to make that investment of time pay off.

Under such circumstances, even the best of commission-based planners is unlikely to recommend no-load or low-load products, for example. Other less scrupulous planners may recommend an investment, such as a particular mutual fund or annuity, simply because of the special incentives or higher commissions they receive.

The temptation for planners to recommend higher commission products carries another risk for clients. Product sponsors tend to offer higher commissions on those products that are more difficult to sell, because they are riskier. Thus, in pushing higher commission products, the planner may encourage you to take unnecessary risks with your money.

"Fee-Only" May Be Your Best Choice

So, if you are looking for objective financial advice, a fee-only financial planner is probably your best bet. Fee-only financial planners are compensated solely by fees paid by their clients. They can be paid in a variety of ways—a flat fee or retainer, an hourly fee, a percentage of assets under management, or a percentage of income from investments. The key is that they do not accept commissions or compensation from any other source.

Fee-only financial planning does not necessarily eliminate every conceivable form of conflict-of-interest. When fee-only planners "sell" portfolio management services, for example, they may have a financial incentive to recommend those services to clients. The fee-only approach is, however, subject to fewer conflicts than any other form of financial advice. Furthermore, because fee-only planners are compensated solely by the client, there are no hidden third parties in the relationship and thus, no divided loyalties.

The Financial Planning "Name Game"

If a fee-only financial planner is probably your best bet, what about all those other planners out there? As consumers have started to wake up to the conflicts of interest that result from commission-based compensation, more and more financial planners have adopted confusing terminology designed to obscure how they are compensated. Here are a few of the most common that you should be on the look-out for:

Fee-and-commission. This is the now somewhat out of fashion term for a planner who earns a fee for developing a financial plan, then earns commissions selling the products to implement that plan. For years, planners were able to sell this arrangement as being in their client's best interests on the grounds that they were more objective than commission-only salespeople and more affordable and convenient than fee-only planners.

Since consumers have become more conscious of the total costs of fee-and-commission planning and the incentives commission-dependent planners have to steer them into costly and possibly inappropriate products, few planners now use this relatively candid terminology, though the majority continue to practice in this fashion.

Fee-based. This is today's more fashionable terminology for fee-and-commission financial planning. The conflicts are the same, but the candor is gone. Some "fee-based" financial planners will tell clients they can work either on a fee-only basis or on a fee-and-commission basis if the client wants to implement the plan through them. Somehow, however, the bulk of their clients end up as fee-and-commission clients. The term "fee-based" is misleading, so you

should be wary of those who use it.

Fee-offset. Under a fee-offset arrangement, a planner imposes a fee for drawing up a strategy, then reduces up to 100 percent of that fee to account for any commissions that may be earned in implementing the plan. The problem of commission bias is less obvious, but it remains. After all, if a financial plan costs \$2,000 and the planner earns \$10,000 in commissions for selling the needed products, he or she will be able to pocket \$8,000 in conflict-producing commissions ...even after totally offsetting the cost of the original plan.

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Additional Information

A variety of useful information can be obtained from state financial regulatory agencies, particularly the securities agencies that can be found in the blue pages of your phone book.

You can call the North American Securities Administrators Association at (202) 737-0900 for the phone number of your state security agency or the National Association of Insurance Commissioners at (816) 842-3600 for the phone number of your state insurance department.

Your planner may not be registered at the state level because the firm has more than \$25



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million in assets under management and is required to register with the Securities and Exchange Commission (SEC). You can call the SEC at (202) 942-8088. Their website is www.sec.gov .

Many fee-only financial planners are members of the National Association of Personal Financial advisers (NAPFA). For a list of fee-only financial planners in your area, call NAPFA at 1-800-FEE-ONLY or visit their homepage at www.feeonly.org