Be wary of conflicts of interest

People often ask: "How should I choose a financial advisor?" or "how do I distinguish between a capable and an incompetent advisor?". So let's be honest, there are highly competent advisors out there, but, unfortunately there are just as many, if not more, "advisors" that are blatantly rogue. If you end up with the latter, you could find yourself in a serious value destroying environment, detrimental to your health and retirement plans. Traditionally, if an advisor is friendly, approachable and pleasant and has one or a few qualifications (not necessarily a financial degree) you would be inclined to view him as competent. The problem with these gauges are that they can be imitated, whilst the qualifications only indicates that the advisor has met the **minimum** criteria. Unfortunately, the above qualities do not guarantee an adequate or satisfactory outcome. I want to argue that, by using a process of elimination, you can reduce the universe of people that call themselves planners, advisors, brokers and client relationship managers to a point where your chances of finding an appropriate and suitable partner are dramatically improved.

Here is the filtering process:

Begin by removing everyone from your list that doesn't have an appropriate degree and/or a CFP® designation. This sorts out the **minimum qualification** requirement. Don't for one second think that 30 years' experience in the insurance industry will serve as a replacement for a decent qualification; especially if this experience has mostly been gained in a sales, rather than in a planning environment.

Systematically work through the list of possible **conflicts of interest** and determine whether the remaining people on the list would not be influenced by these factors:

1) Is the advisor remunerated through upfront commission earned on products sold or investments placed with certain companies?

If the answer is YES, you should realise that there is (naturally) an incentive for the advisor to sell a specific product because the potential commission earned, relative to the amount of work that needs to be done, is very appealing. The persistence in the industry to sell contractual savings and investment products rather than much cheaper unit trust investments (that pays less or even no upfront commission), is a clear indication that the carrot of upfront commission is simply too tasty for advisors to ignore.

2) Is there any form of incentive bonus via the advisor's employer that is linked to the amount of business that is generated or the number of deals closed with clients?

As far as I'm aware insurance companies and probably also big network type of businesses still use incentives as part of their sales model. In fact, the so called TOP WRITERS (that is what they are called, I kid you not) in the business are often rewarded with lavish holidays and expensive boat cruises. These practices may well be effective in a sales environment but definitely not where the SOLE FOCUS should be on the client's financial well-being (rather than on the advisor's wallet).

Feel free to contact the Author, should you have any questions or comments on this month's article in the TwoCents.
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3) How does the advisor's monthly remuneration work?

We are of the opinion that a **salary** is the most appropriate remuneration model purely because the incentive to "sell" is eliminated. Whether a client follows the advice or not, the advisor's income is not affected. The advisor is remunerated based only on the quality and the appropriateness of the advice that is given. New recruits that work for commission often find themselves in a struggle for financial survival (they have to start from Zero every month). This is definitely not an incentive that you want to be present when a planner has to advise on your financial future. Ask the advisor to disclose his employer's remuneration policy, specifically relating to bonuses and incentives.

4) How are your underlying funds selected?

Be cautious of conflicts of interest when it comes to the allocation of your investment portfolio. There is likely to be an incentive for an advisor to recommend a specific company's funds, if that company is also his employer. This situation should raise concerns, since the fund management company would now be able to earn fees on two levels (advisor fees and fund management fees) where, under normal circumstances, they will only receive fees on one level. The onus is on the advisor to give a detailed breakdown as to why certain funds are recommended. If these are the funds of his employer, be extra cautious. Please note that using own funds are sometimes justifiable.

5)Is there a mechanism in place through which an advisor will be compensated if no product is bought or investment made?

If the potential advisor is not in a position to recoup the time spent on a consultation or the preparation of a financial analysis, there is a much bigger incentive for him to recommend new products of investments, even if the existing products are in order. If you want to avoid a conflict of interest situation, do not agree to an OBLIGATION FREE financial plan. Keep in mind that there are only a few insurance companies that will pay ongoing fees on policies to a new advisor. Usually, the ongoing fees are paid to the advisor who initially sold the product (even if that policy was sold 15 years ago!) irrespective of whether you have appointed a new adviser in the meantime. This situation usually creates a double vulgar incentive since the "previous" advisor tries to sell as much policies as possible whilst the "new" advisor is probably going to try to cancel the existing policy (even though this could be a decent product), to avoid earning nothing on this transaction.

To summarize: If you work with an advisor who **a)** has the necessary minimum qualifications **b)** has the necessary experience or form part of a team that has sufficient industry experience, and **c)** there is no possibility of quick buck to be made out of initial commission, **d)** he will not receive a big bonus or incentive based on the amount of policies sold, **e)** there is no double fee structure, i.e. advisor fees and fund management fees and **f)** if your service level agreement states that he/she can invoice you for time if the fees on your portfolio are not sufficient, then there is a decent chance that you are working with a professional. However, if your prospective new planner has previously worked as a salesman at Joshua Door or at Virgin Active, and he / she only survives on upfront commission and is unable to explain the concept of time value of money, make a run for it!

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