LOUISVILLE BUSINESS FIRST

MONEY

Be aware of the type of financial adviser you choose

The financial services industry can be a minefield for average investors, who often cannot tell how their financial advisers are compensated and whether they are putting the investors' interests first.

The confusion arises because financial advisers are held to different legal standards of care when providing investment advice to clients, operating under either a "fiduciary" or "suitability" standard.

In essence, fiduciaries are legally bound to hold clients' interests first and make all investment decisions on that basis.

The suitability standard requires brokers and dealers to put their clients in suitable investments based on their objectives, risk tolerance, resources or age.

A subtle difference, however: Under suitability, a financial adviser considering two similar investment funds for a client can sell the one with the highest commission without disclosing it to the client, whereas a fiduciary would be in violation of his or her duty for not disclosing all of the facts.

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It has been estimated by the President Obama's Council of Economic Advisers that "non-fiduciary" advice costs Americans 1 percentage point of their return annually on their retirement assets, which amounts to roughly $17 billion per year.

If the estimated costs and drag on performance are close to accurate, this is a tremendous disservice to investors saving for retirement.

To address this issue, the U.S. Department of Labor is in the process of proposing rules that would require all financial advisers overseeing retirement assets to act with fiduciary duty.

In other words, financial advisers managing retirement assets would have to work in the best interest of clients.

Sounds pretty reasonable, right?

However, the outcome on the proposals are unclear at best. Because the new rules are a potential threat to Wall Street and would cut advisers' fees substantially, they are being heavily lobbied against by financial professionals who prefer to work under the suitability standard.

Regardless of how this debate gets resolved, there are actions investors can take to help find financial professionals who are both qualified and will work in your best interest.

Here are just a few of the questions you should be asking when considering a financial adviser:

What qualifies you to be a money manager?

Look for: Information that will tell you if they are an experienced and proven investment professional or a just salesperson. Do they have the proper education, training and credentials?

Avoid: Fancy-sounding titles that don't mean anything.

What is your investment philosophy and process?

Look for: A good money manager will have a well-articulated investment philosophy and process that is disciplined and has been proven over time.

Avoid: Promises or guarantees of high returns with little or no risk and overly complex sales pitches.

How are you compensated and how much am I really paying?

Look for: Transparency. You should get clear and transparent disclosure on all of the fees you will be paying, including fees paid directly to the adviser and fees built into the products they use and sell.

Avoid: Hidden fees, vague or overly complex answers that don't fully disclose your costs and conflicts of interest.

There are many good financial advisers out there who operate under the fiduciary and suitability standards.

Knowing where the potential conflicts lie and asking the right questions can help you find the right one for your situation.

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This article appeared in Louisville Business First on May 15, 2015 on page 38.