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The Advicer

'They're not required to tell you that, but you should know.' 4 questionable, but legal, things some financial advisers do with your money

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By Jennifer Booton (Follow)

Is your financial adviser ethical? GETTY IMAGES/ISTOCKPHOTO

There are many people out there who will offer to give you financial advice. And while most of them are ethical and trustworthy, sometimes you'll find that some advisers take action on your behalf that you might consider unethical, even though it's totally legal. It's important to be aware of these possible scenarios so that you can protect yourself as an investor. (You can use this tool to get matched with an adviser who might meet your needs.)

We spoke with a handful of advisors to understand when actions taken by advisors slip into questionably unethical terrain. Their best advice on how to protect against every single one of these? Communicate, ask questions, and demand transparency. Here are some legal, yet questionably unethical, things some financial advisors might do:

They aren't forthright about being a fiduciary

Pros say the most important thing you should look for in an advisor is that they're a fiduciary, meaning they've legally committed to putting your best interests above their own. But "just because someone says they're a fiduciary, doesn't mean they are," says Kashif Ahmed, a certified financial planner and founder and president of American Private Wealth. You'll want to do a background check on the person (here's how). And "you should rely on your instinct: are they being sincere or are they full of it? Some people wear many hats, so they may be acting as a fiduciary in one role and as a broker trying to sell you a product in another. Some will tell you this, but they're not required to. Make sure you ask questions and get it in writing." (Here are the 15 questions you should ask any adviser you might hire.)

Experts say you may want a certified financial planner, or CFP, as they act as fiduciaries and complete extensive coursework and pass an exam. "They have to pass the CFP certification exam (with a pass rate of 60%), which means a third of people don't pass. They also have to demonstrate that they're fit for certification and make an ongoing commitment to act ethically with their clients," says Leo Rydzewski, General Counsel of the CFP Board.

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We reached out to the National Association of Personal Financial Advisers for comment on these points, and they pointed us to this article.

They don't disclose all aspects of compensation

There are various ways in which financial planners and advisors get paid. Common forms of payment include getting commissions on transactions, subscription/retainer fees, a percentage of assets under management and fixed fees for specific services. The unethical behavior occurs when an analyst isn't honest about how they're being paid.

"One of the first questions people should be asking when they work with an advisor is: how do you get compensated?" says Erika Safran, founder and principal at Safran Wealth Advisors. "There's no free lunch: you have to pay for advice, plus many investments have their own internal expenses" (like the fees

lunch: you have to pay for advice, plus many investments have their own internal expenses" (like the fees associated with them). By asking these questions, you will become aware of the true cost and learn whether other decisions and investment strategies are available that could reduce your overall burden, says Safran.

“The most egregious thing is when they don’t disclose to you that their choices are being [tainted] by some reward they may get with their firm,” says Ahmed. Some firms offer internal reward levels that reward their advisors for achieving certain quantitative milestones. These rewards can be monetary or tangible products, such as the bigger hotel room at the company’s annual retreat. “They’re not required to tell you that, but you should know,” says Ahmed.

Still another way analysts can act unethically regarding fees is by not disclosing that they’re being compensated by an outside product manufacturer, like a mutual fund, annuity, or insurance company.

“You want to know if they stand to gain from giving you financial advice,” says Rydzewski. “Maybe there are different kinds of conflicts of interest that come into place. Conflicts of interest in and of themselves aren’t disqualifying, an individual is going to get paid and you expect them to get paid. But there are different kinds of compensation that the consumer wants to know about. Do they have a business relationship with the companies that are providing the products you may be buying? If you know that, you can take that into account as you’re making your decisions.”

“Ideally, an advisor should not receive compensation from anyone other than the client,” says Safran. “But if they do, it’s unethical not to disclose.”

They find only ‘suitable’ opportunities

Some investment advisors operate under the suitability standard set by the Financial Industry Regulatory Authority (FINRA), which requires that advisors ensure an investment or recommendation on behalf of their clients is merely “suitable,” without specifically requiring that it be in the client’s “best interest.”

However, certified financial planners and other types of advisors that are legally bound to act as fiduciaries must abide by a best interest standard that requires them to put their clients’ interests ahead of their own. Rather than merely understanding their client’s financial situation and objectives and recommending suitable products and advice, they must avoid conflicts of interest, provide full disclosure of any that do exist, and find the best overall solution for their clients.

“Here’s an example: To meet a client’s investment objective, the advisor sells all existing positions and moves the cash to a managed account,” says Safran. “The client now has a tax liability on the gains and pays extra for that ‘managed account.’ Is it suitable? Sure. From a fiduciary perspective, is it in the client’s best interest? No. Could the client’s objective have been met with actions that did not incur higher fees and taxes for clients? The answer is most likely, yes.”

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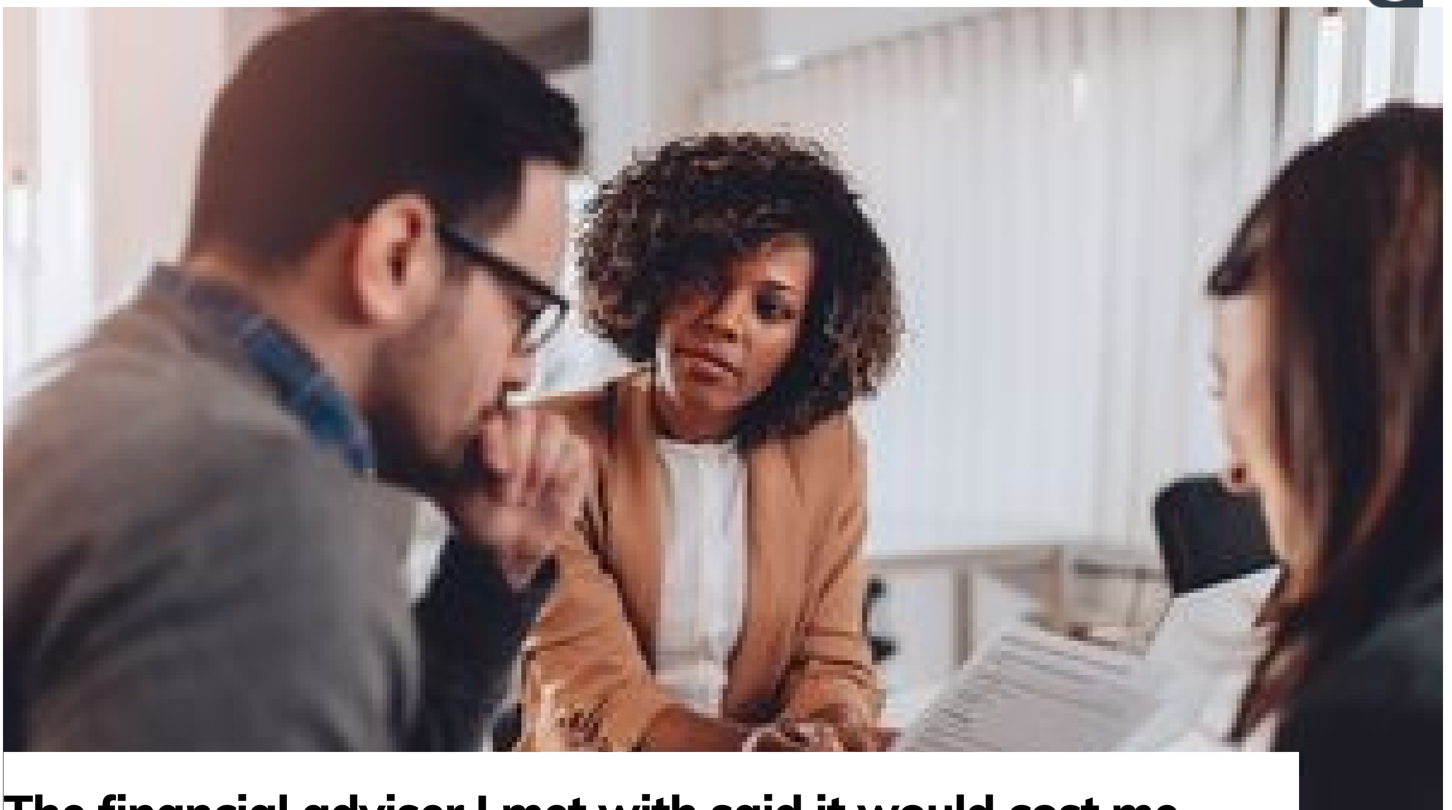
They disempower you

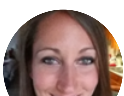
Finally, be aware of advisors who try to explain their investment or financial planning philosophies in overly high-level, complicated ways or don't take the time to explain their thought processes to you. If an advisor does this or refuses to entertain any of your ideas, they're disempowering you from having a say in your own financial future.

"Some advisors will never take action on an idea the client has brought to the table because they want to be in power – I've seen that," says Safran. "If a client does have an idea, it's worth exploring and educating the client about why it might be plausible or why it's not."

"It has to be collaborative," she adds. "And you have to help your client grow and learn and understand the decisions they're making."



The financial adviser I met with said it would cost me about $1,000 a year to use his services. At that price, is it worth it?



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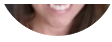

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