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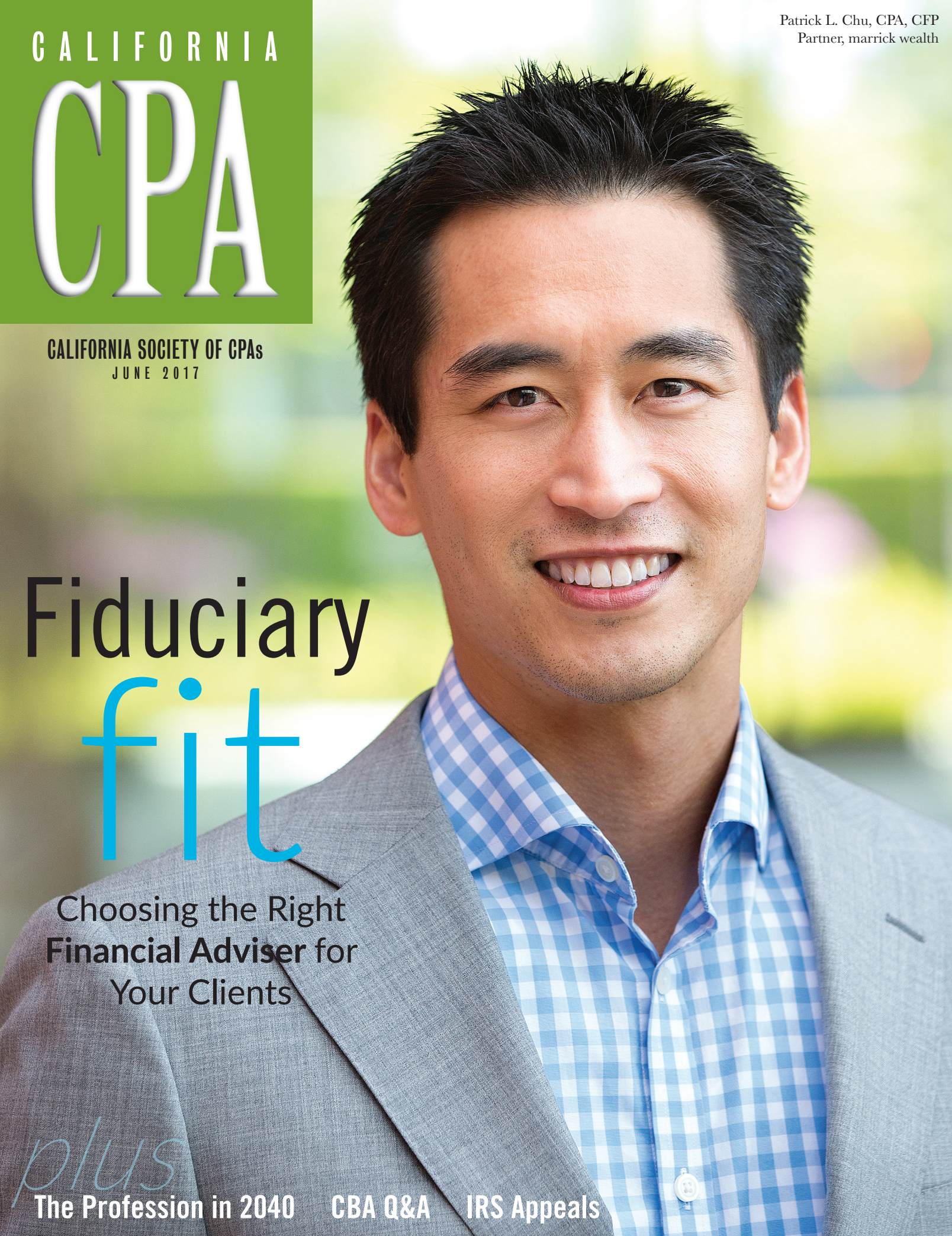

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Fiduciary fit

Choosing the Right **Financial Adviser** for Your Clients

plus

The Profession in 2040 CBA Q&A IRS Appeals

Fiduciary & Fit

How to Find the Right Financial Adviser for Your Clients

Entrusting your client's financial matters to another professional is a difficult task. Deciphering between business models, fee structures and services is enough to make you want to pass the responsibility on to someone else. But as CPAs, we're protective of our clients, and want to help them when opportunities arise. Here are some key issues to consider when selecting the right partner to help you and your clients navigate the complexities of personal finances.

Is the Adviser Held to a Fiduciary Standard?

The term "fiduciary" has been a hot topic over the past couple of years. Many people, both inside and outside of the financial services industry, do not quite understand what being a fiduciary really means. According to the AICPA, being held to a fiduciary standard of care means that an adviser *has a legal duty* to act solely in the best interests of the beneficiary. If a recommendation results in less compensation, it should not matter; the client comes first at all times.

A recent change proposed by the Department of Labor Fiduciary Duty Rule (currently delayed) requires that advisers maintain fiduciary responsibility over clients' retirement accounts. The proposal imposes tougher standards regarding management, products, documentation and fees for retirement accounts. But in practice, investment management encompasses both retirement *and* non-retirement accounts. So how can an adviser be a fiduciary to a retirement account, but have different standards apply to a client's non-retirement assets? For many individuals, their non-retirement accounts comprise the bulk of their assets.

The proposed DOL rule is a step in the right direction and brings awareness to the importance of fiduciary responsibility, but it's not a solution. It's only the start of a comprehensive overhaul of the fiduciary standard and its application to adviser-client relationships.

For now, looking to the business structure first can help determine whether you are working with a fiduciary. A Registered Investment Adviser (RIA) has a legal fiduciary duty to their clients, while broker-dealers abide by a suitability standard. The suitability standard is different than the fiduciary standard, in that an investment recommendation must only be suitable for a client; there is no legal fiduciary responsibility. This doesn't mean you can't receive good advice from a broker-dealer, but you should understand how legal obligations affect the client-adviser relationship.

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How Is the Adviser Paid by Clients?

Fiduciary responsibility aside, the financial services industry is full of conflicts of interest. Fee calculations are like a giant black box. Part of a CPA's role as a fiduciary is helping clients understand the fees they are paying for services, how those fees are collected and that they are receiving value for reasonable fees. Often overlooked, fee structures can affect both the business and its advisers' behavior. There are three common fee structures for advisory business models:

Commission-based: This model centers on transactions, where advisers are paid commissions by selling products such as insurance, stocks, bonds, funds and annuities. Broker-dealers (and their registered representatives) and insurance agents operate under this model. In some situations, commission-based portfolios can have lower annual expenses than percentage-based assets under management fee models, if using a buy-and-hold strategy. However, getting paid by commissions can also encourage unnecessary product sales and trading to generate revenue. The challenge for the adviser is to remain impartial when recommending products or other service providers.

Fee-only: This model includes RIAs and their investment adviser representatives. Here, the only fees the adviser receives come directly from clients; the adviser is independent and there are no commissions. Fees are commonly charged hourly, as a flat fee, or as a percentage of assets under management. The fee-only model minimizes conflicts of interest and allows for more objective advice. With no commissions, advisers are not beholden to companies or products. It's a mutually beneficial relationship, where a growing portfolio benefits both the clients and the adviser. However, clients should be wary of the complacent fee-only adviser, who is not regularly monitoring accounts and just collecting a check. Commission-based advisers argue that by ignoring commission-paying products, an adviser might overlook a potentially superior product. The good news is that in light of the DOL proposal and fiduciary movement, companies are creating no-commission versions of traditional commission-paying products, such as annuities.

Fee-based: This is a combination of the above two models, where fees can be charged and commissions can be collected from products the advisers are licensed to sell. Under this model, you will find hybrid and dually-registered advisers. Fee-based advisers have the most flexibility regarding available products, but the fee arrangement can be a bit puzzling for clients: Is the adviser wearing the "commission" hat or the "fee-only" hat?

It's somewhat confusing at first, but research can help you help your clients select the fee structure that best suits their situation. Your goal should be to ask enough questions to ensure that an adviser's interests are aligned with your client's.

Does the Adviser Provide Comprehensive Financial Planning or Just Investment Management?

The term "financial adviser" is quite vague, covering professionals with differing levels of expertise and service offerings. An adviser could be an insurance salesperson, or could be someone who only works on financial plans. Regardless of role, the adviser should be providing advice. The questions to answer include what type of advice does your client need, what are the adviser's qualifications and how much does it cost?

Financial advisers typically operate under one of three service models: investment management, wealth management and the family office.

The most common type of adviser is the investment manager, where broker-dealers dominate the space. Think of the investment manager as the 21st century stockbroker; the adviser's primary objective is to focus on investment portfolios and to gather assets under management. Financial planning is sometimes included, but at a cursory level. Clients can expect to pay commissions on products, which can include sales charges (loads) on mutual funds. Loaded funds may offer lower management fees, but it's best to avoid them. While FINRA rules state that loads cannot exceed 8.5 percent, most loads are in the 5 percent range. As soon as you buy a fund, it may be worth 95 percent of its purchase price! Investment managers can also charge ongoing management fees based on the amount of your assets under management. For a $1 million portfolio, you can expect to pay about 1 percent ($10,000) per year (AdvisoryHQ.com, 2017 Report, *Understanding Advisory & Investment Management Fees*).

The wealth management model encompasses comprehensive financial planning: insurance planning, tax planning, estate planning, charitable planning, investment management and more. Most RIAs occupy this space.

Anyone from recently married young couple to the high-net-worth retiree can benefit from wealth management. The challenge is finding an adviser at a fair price, with the right qualifications and who will spend the time to educate clients. The best advisers will also coordinate with your client's legal and accounting teams, and provide introductions to other professionals: realtors, lenders, attorneys and doctors.

As you will find with most services, you get what you pay for. Advisers may have minimum fees, minimum portfolio sizes and charge

higher fees for smaller accounts. Under this model, advisers may charge a financial planning fee in addition to an investment management fee (percent of assets under management). Hourly financial planning fees can range from $150 to more than $400, while financial plans can start around $1,500. For ongoing financial planning, expect to pay at least $5,000/year. Factors such as location and adviser experience can also affect fees.

For the rare client that needs help with everything from bill paying, to buying a yacht, to dropping off clothes at the dry cleaners, there's the family office model. Family offices serve the ultra-wealthy (the upper 1 percent), where wealth spans across multiple generations and lineages. A team approach is taken to providing financial and personal concierge services. Clients in this space can pay in the hundreds of thousands for these services.

Understanding your client's needs help you determine which service model is the best fit. Some clients may only need investment assistance or have simplistic financial needs. Robo-advisers can be cost-effective and some, such as Wealthfront and Betterment, offer the ability to receive basic financial-planning advice for an additional fee (about .5 percent). Some advisers may serve a niche, such as small professional groups (physicians, attorneys), and can provide additional value from their experience. For example, they could help implement retirement plans that allow partners to defer more than $100,000 in pre-tax earnings per year. In California, clients in the top tax bracket (39.6 percent federal, 13.3 percent California) would be saving more than $50,000 in taxes for a $100,000 contribution!

Regardless of needs, a good starting point is looking for a Certified Financial Planner (CFP) professional, which requires a bachelor's degree, passing a comprehensive exam and at least 6,000 hours of professional experience related to the financial planning process. This doesn't mean a CFP is an expert, but it's a great foundation and probably the most widely recognized financial designation.

For more complex situations, some advisers possess additional expertise in technical areas, such as taxes (CPA/PFS), investments (CFA) or insurance (CLU). Don't discount experience and technical expertise when helping your client find the right adviser. According to Vanguard, a good adviser can add "about 3 percent" per year to a client's experience. Behavioral coaching, spending strategy, minimizing fees and asset location between taxable and tax-advantaged accounts are the most impactful areas where an adviser can add value.

Conclusion

There has never been a better time to be a financial adviser client. Fees are coming down in the industry, and service offerings are becoming more robust. But you want to find the right adviser for your client's situation. Remember the two most important keys to selecting the right financial partner: fiduciary and fit. Your clients' interests should be aligned with their adviser's, and the adviser should be the right fit for your client.

Additional resources on financial planning can be found at www.napfa.org and www.letsmakeaplan.org. CPA

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