



Potential Conflicts within the Investment Industry

There are many different types of Investment Advisors. I am what is known as a "Fee Only Investment Advisor". What that means is that I charge hourly fees for consulting advice to include financial planning, retirement planning and investing. These hourly fees also take the form of a minimum annual fee for portfolio management and ongoing Investment Advisory work. Other than these fees, there are no other fees that I charge. The reason I selected this model for my practice is that I wanted all fees charged to be clear and transparent, not hidden, as is many times the case in the brokerage and investment industry. I also wanted to be able to maintain the ability to give the best advice to my clients without being influenced by earning a higher commission on a given product. Therefore, I earn *no* commissions on *any* products.

Stacking the Deck Against the Individual Investor

Throughout the 90's, stock brokers were compensated on commission schedules based on getting rewarded for the number of transactions executed, not from how well their client's portfolios performed. These commission systems encouraged brokers to recommend potentially questionable trades. Arthur Levitt, Chairman of the Securities and Exchange Commission (SEC) between 1993 and 2001, encouraged the brokerage firms to change to a compensation system more attuned to rewarding brokers for increasing the value of their client's portfolio rather than for executing more trades. As a result, more retail brokerage firms today charge a percentage of assets under management, which is more beneficial to the individual investor. However, these same firms many times earn other commissions and fees that are not transparent to the individual investor. As an example, if a brokerage firm owns a security themselves and sells it to their clients, this is known as a "secondary offering" and *no* commission is charged. This has the appearance of being beneficial to the investor, however, instead of a commission, there is a mark-up charged (also known as a "spread") that is many times *far in excess* of what a commission might have been.

Many of the large Wall Street firms have conflicts that can greatly affect your pocketbook. (Some of these firms are: Morgan Stanley, Bear Stearns, Prudential, Bank of America, Citigroup, Goldman Sachs, Merrill Lynch, and American Express.) The conflicts begin with the fact that most of the large brokerage firms engage in investment banking in addition to the services they provide for the individual investor like you and me. Investment banking includes mergers and acquisitions, initial public offerings (IPO's), and private equity placements. The investment banking clients put pressure on the analysts to write favorable reviews in order to pump up their stock prices. This is a huge conflict of interest that then trickles down to the local brokers who are rewarded disproportionately for moving specific securities. None of these practices are in the best interest of the individual investor. They are solely for the purpose of increased earnings for the brokers and the Wall Street conglomerates. Many brokers are competent and provide a valuable service. However, it can't be denied that they are under corporate pressure to make commission targets, which causes them to focus on the corporate commission goals prior to focusing on the performance of their client's portfolios and the costs paid by the client to achieve the highest possible total returns.

Most mutual funds offered by large Wall Street brokerage firms often have front-end loads (commissions) of 3% - 5%, high expense ratios approaching 2.5%, 12b-1 fees, and possibly other back-end fees. Contrast this with a Vanguard fund that has *total* annual expenses of .20% - 1.25%. The higher fees and commissions will adversely affect the performance of your investment over time. Over 20 - 30 years, the higher fees can in some cases result in a 50% reduction in your total return.

The SEC currently has an investigation underway to see if the managers of large mutual funds and hedge funds are pocketing rebates on stock-trading commissions that should be directed back to investors. If the rebates benefit fund holders, this practice is not illegal. However, some hedge funds don't put the rebate back into their funds, but rather keep it to enrich their managers or their firms. This examination into rebate practices is part of a broader effort by regulators to curb abuses relating to how Wall Street rewards *privileged* clients.

These are all examples of how the investment industry can "stack the deck" against the individual investor. Eliot Spitzer, The New York State Attorney General, has fined many of the large Wall Street firms for their abuses. However, this is not an easy assignment. With the lobbying effort of the large Wall Street firms combined with their substantial contributions to political campaigns, it is difficult for the Eliot Spitzers and the SEC to pass appropriate regulatory changes. They are blocked by the House and Senate. Under review currently are stricter disclosure requirements for the details of all sales charges. These overdue changes are actively being fought by the brokerage industry.

Steps You Can Take to Protect Yourself & Your Investments

1. Know the "business model" of your investment advisor. There are many different "styles" brought to the investment advisory world these days. Some advisors are associated with insurance companies, banks, or brokerage firms (usually commissioned) and others are independent fee-only advisors (no commissions). Make sure you seek out what is right for you.
2. Know how much you are paying for purchases and sales of securities, *prior* to making the transactions.
3. Make sure the advice you are receiving is independent and arms-length.
4. If you are unsure, seek out the advice of an independent fee-only advisor for an analysis of your current situation.
5. Most importantly, be sure that your advisor places *your* interests first and foremost. Your needs are unique to your financial profile and your lifestyle desires. Your advisor should be committed only to you, the client, without the complications of bias or commissions.

Contact me today to perform a free analysis of your current situation, or to create a first-time investment plan that will maximize the performance of your investments.

Four convenient newsletter options from which to choose: (1) Add a friend or relative to the mailing list; (2) Receive this newsletter by email instead; (3) Tell us about a change of address; or (4) Be removed from our mailing list. *Please call or email us today with your preference. If we do not hear from you, newsletters will continue by regular mail.*

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