

Broker, Advisor, What is the BFD?

A number of years ago, Wall Street marketing executives made a seminal decision to change the title of 'Broker' to that of 'Advisor' or 'Wealth Manager'. Perhaps considered a brilliant marketing move by a profit-seeking Wall Street, the change in professional title naming conventions can be best described as an elaborate shell game that continues to cause confusion for asset owners, investors and beneficiaries alike. Are the titles of Broker, Advisor, or Wealth Manager truly synonymous? The answer to this question needs to be understood as it fundamentally affects the manner in which investors, asset owners, and beneficiaries are serviced and charged. It also has meaningful repercussions to those that oversee assets for the benefit of others, i.e., to those that serve as a "fiduciary". A reexamination of the differences, motivations and incentives is warranted.

"Tell me how a person gets paid and I can tell you how they will behave."

Brokers' compensation, work environment and responsibilities differ quite a bit from those of the Advisor. In short, Brokers are compensated via the placement of financial services products. Obviously, commissions can come in reasonably straightforward forms such as transaction fees, 12b-1 fees or loads for mutual funds among others. They can also come in more subtle forms such as revenue sharing, placement fees or 'trailer commissions'. Brokers do not provide, are not compensated for nor required to provide advice; nor, not surprisingly, are brokers required to operate in the best interest of their client. Rather, brokers operate in a suitability environment whereby they are allowed to sell investment products to a client provided it is 'suitable' for the client. Suitability can be defined a number of ways and candidly is somewhat ambiguous; perhaps based on the level of net worth or the perception of the investors sophistication among others.

Brokers also have production (another name for commission or fee) goals regardless of whether the Broker works for a large Wall Street type firm or in the independent broker dealer world. The more fee/commission generation the more the Broker makes; the lower the fee generation the more chance the broker has of not having a desk to return to in the morning. In the inner workings of the broker dealer world each broker is subject to a grid. The grid determines how much of the gross commissions generated go to the "House" and how much is paid out to the Broker. The more gross commissions generated the higher the percentage which is paid directly to the broker. It's very simple; Brokers are motivated to sell products, which do not need to be in the best interest of the beneficiary; causing a complete misalignment of interests and trust! It is rarely disputed that the best brokers are the best sales people. Rather it is more frequently disputed that the best brokers are the best investment advisors.

Advisors are incented differently from brokers in that they provide advice and are not compensated via the placement of product. Rather, their compensation is

generally in the form of a fee (a flat fee or percentage of assets) outside those paid to the underlying investment vehicle. While brokers operate in a suitability environment and get paid on whatever fee sharing arrangement they can arrange, advisors generally work in a fiduciary environment whereby they must act in the best interests of their clients at all times. In our experience, successful Advisors or Consultants provide their clients with an investment process that is:

Educational: ongoing education for both the Advisor and their Client pertaining to best practices, regulatory and legal considerations

Documented: understanding investment objectives, establishing investment policy statements, developing asset allocation options, on going due diligence of investment strategies etc.

Demonstrated: Implementation adhering to documented goals/ objectives, guidelines and risk profile

Defendable: based on validated investment practice and defendable for both the advisor and their client.

Repeatable: surviving any individual including the advisor or client.

Clear: complete transparency regarding how and how much one is compensated and regarding any perceived or potential conflicts of interest

“Tell me how a person REALLY gets paid and I can tell you how much he or she cares about your interests.”

Investors, asset owners and beneficiaries are best served when their trusted advisors operate and are incented to operate in their best interests. The concept of full disclosure should not be lost on any trusted advisor. Clients should always be encouraged to ask the following questions: “How much is the Advisor being paid and how is the Advisor being paid?” Does the Advisor receive any commission on the sale of investment products? Does anyone else in the Advisor’s organization receive benefit from my account, either directly or indirectly? If you’re “Advisor” cannot give you a definitive answer that may be telling you something.

Is the broker or advisor right for you? We can’t say. But does it matter? Absolutely....the advisor overwhelmingly!