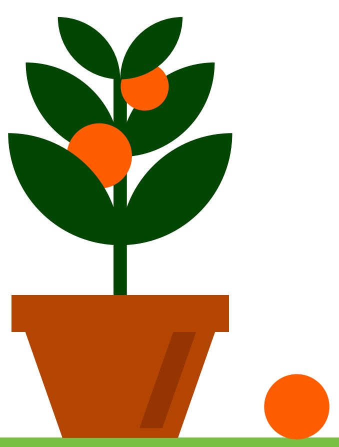
Justwealth

Five questions you should ask your financial representative



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Sometimes, you just don’t know what you don’t know.

And when it comes to managing your investments, the unknown can be overwhelming and downright frightful. Investing is not easy, and many people do not have the time, knowledge or interest to be able to handle things on their own.

When the time comes to get help, many will choose a financial representative by convenience: someone at a nearby bank branch; a referral from a friend; a relative; or even through an advertisement. In most cases, people will settle for the first investment option or financial representative they are presented with because they are either impressed by a slick sales pitch or are overwhelmed by a bunch of numbers, charts and graphs and are too afraid to ask any questions!

The reality is that managing investments can be a very profitable business, and this prompts companies that offer investments to employ (and generously compensate) top-notch salespeople. Sales agents in the investment industry may have titles such as Investment Representative, Investment Specialist, Financial Planner or Financial Advisor. Each agent will highlight the benefits of their products or services to get your business and avoid any conversations that may hinder “the sale”.

Quite often, the topics avoided are far more important than the information provided.

To help investors, we have prepared a list of five questions that you should ask your financial representative whether you are currently working with someone or looking for the very first time. Even if you have a long-standing relationship with a financial representative, it is never too late to ask, and it is your right to know.

If you find the answers to some or all of these questions to be troubling, we invite you to browse through our website and learn about our just approach that puts client interests first.

How much am I paying in fees?

Most financial representatives will respond to this question by stating that “You pay x% on the mutual funds that you own” or “I charge a flat y% on assets under management” (or in some cases a combination of both). Unfortunately, this may be an incomplete answer. Depending on what you own in your account, and the type of company that you are working with, you may be paying other fees which may or may not be obvious. Some of these fees could include commissions, transaction fees, custody fees, annual account fees, currency exchange fees, financial planning fees, inactivity fees or other penalties. Your financial representative should be able to provide answers for all of these categories, however if he/she cannot, seems reluctant, or spends more time trying to justify the amount rather than explaining, that may be a warning sign.

In addition to the direct and indirect fees that you may be paying, be wary of the products that have fees that you “might” have to pay. In particular, some Guaranteed Investment Certificates (GICs) and mutual funds that carry a deferred sales charge (DSC) impose a fee if you redeem your investment before the stated maturity of the investment – sometimes up to 8 years! You may wish to think of this fee as the opposite of a money-back guarantee: if you want to return the product, you will be required to pay EXTRA! This penalty acts as a handcuff to the investor from moving the investment elsewhere. Some countries have taken steps to ban this type of activity, but it is still prevalent in Canada today.

Over the course of your investing time horizon, it is very likely that you will devote a substantial portion of your wealth to cover fees. Also, due to the compounding effect over time, the slightest difference in fees can have a devastating impact on your overall wealth. Ultimately, you are paying fees for a service, and if you are happy with the service, then perhaps it is worth the fees that you are paying. The average cost for Justwealth clients for all of the fee categories listed above is under 0.75%. We invite you to compare the fees of your current provider and Justwealth to determine if the current service that you are receiving is worth the extra money that you are paying.

Please email support@justwealth.com with the subject "Fee Comparison" to have one of our representatives run your data through our Fee Savings Calculator.

How are you compensated?

Compensation for financial representatives usually takes one of three forms: commission based; flat-fee rates; or hourly rates. Your financial representative may try to tell you why their form should be preferred, but we suggest that there are pros and cons to each form and that any form may be suitable depending on an investor's needs.

For commission-based representatives, one distinct advantage is that you only pay a fee when a transaction occurs. For accounts with minimal activity and no recurring fees, this could keep fees low. However, if the size of the commission is large, such as on mutual funds with load or trailer fees, it could be quite expensive. Additionally, this form of compensation carries some potential conflict of interest situations. If your representative is motivated by commissions, he/she may be more inclined to act as a salesperson and not a financial representative. This motivation may result in the representative attempting to persuade you to invest in products that pay them high commissions but may not necessarily be the best choice for you, or transact more frequently than is necessary to increase the compensation that they receive. Institutions that typically employ commissioned-based representatives include bank branches, insurance companies, mutual fund companies, financial planning firms and investment advisory firms (brokerages).

Representatives that use a flat fee structure eliminate the conflicts that exist for the commission-based representative since there is no motivation to sell inappropriate products or encourage frequent transactions as fees are charged as a percentage of assets under management. The flat-fee representatives will usually state that there is an alignment of interest between a client and the representative as both will benefit as your wealth grows.

Be aware: even though you are paying your representative a flat fee, you may still be paying additional fees such as transaction fees, custody fees, mutual fund fees, etc.

In this form of compensation, it is very important to understand all of the fees that you are paying and recognize that lower is better. Institutions that typically use flat-rate fees include financial planning firms, investment advisory firms and investment counselling firms.

Hourly rate or project-based fees are not very common, but may be used by individuals who do not require an ongoing relationship with a financial representative. Rates charged by such providers are typically quite high, making them cost-effective only for very wealthy investors or those who wish to invest without advice. Companies that may charge hourly rates would include independent financial planners, financial consultants, or other industry professionals such as accountants or lawyers.

What are your qualifications?

In the investment industry, the two most important factors to consider when evaluating a financial representative's credentials would be professional education or training and years of experience.

Professional education/training could come in the form of a relevant post-secondary degree, successful completion of industry-sponsored courses or programs, or by attaining a professional designation. Do not be afraid to ask an investment representative for their credentials and do not be intimidated or confused by a bunch of three-letter acronyms. Take the time to learn what is involved with earning each acronym and the sponsoring institutions that issue them, and judge for yourself if the financial representative is adequately trained to provide the advice or service that you require.

While having the proper educational training should be a prerequisite for any financial representative, there is no substitute for practical hands-on experience. Inexperienced financial representatives may be more prone to making investment mistakes or be overwhelmed and unable to soothe client emotions when the investment climate turns unexpectedly negative. By living through periods of multiple market ups and downs, an experienced investment representative should be well prepared to manage client portfolios and their associated emotional reactions to market events with an appropriate degree of humility and sensitivity.

What is your succession plan for when you intend to exit the industry or retire?

It is common for financial representatives to seek out a buyer for the right to assume the financial relationship with their clients. This practice is commonly referred to as "selling their book", and many representatives consider it to be a component of their retirement funds. There is an obvious benefit to the seller, but there may also be a benefit to the buyer who may be a younger individual looking to build a client base quickly. This transaction is fundamentally a business deal and may involve certain guarantees and/or payments from the buyer to the seller over time.

What may be inferred from this practice is that clients of a financial representative essentially become viewed as revenue-generating assets and that the financial representative "owns" them and may trade them at his or her discretion. There have been "How to" books written on the subject and Agencies exist that specialize in making such deals. While having a succession plan with your financial representative is important, we believe that treating clients as "assets" is ethically questionable.

Are you held to a fiduciary standard?

A fiduciary is someone to whom property or power is entrusted for the benefit of another. As it pertains to investing, adhering to a fiduciary standard ensures that the fiduciary (investment representative) will always act in the best interest of the client. Surprisingly, the vast majority of financial representatives are not held to such a standard. Rather, they are held at best to a standard of "suitability" whereby recommendations may not be in the best interest of the client.

As a simple hypothetical example, consider a financial representative faced with the choice of purchasing one of two nearly identical mutual funds (except for fees) for his client. Fund A pays the representative 1.25% commission and has an annual fee (borne by the client) of 2.75%. Fund B pays the representative 1.00% commission and has an annual fee of 2.50%. Under a suitability standard, the representative could choose either fund, but under a fiduciary standard, the representative would be obligated to choose Fund B as it is clearly in the client's best interest.

Firms that are registered as a Portfolio Manager with a provincial securities commission (such as Justwealth) are held to a fiduciary standard.

The Bottom Line

Investors pay a lot of money in fees to financial representatives and the institutions that they represent, and may not have their best interests being served.

We encourage you to speak with your current or prospective financial representative and ask the questions outlined in this document. If you don't like the answers that you receive, it may be a good idea to look elsewhere.

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