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CARNEGIE
INVESTMENT COUNSEL

Most investment firms don't count on you asking questions.

Big mistake.

Four Questions

TO ASK BEFORE HIRING A FINANCIAL ADVISOR

by Gary P. Wagner, AIF®

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Thank you for requesting this guide

We designed it to provide a basic understanding of important aspects of hiring a financial advisor. It is clear you understand the value of hiring a professional to help you manage your investments and give you planning advice.

However, once you decide to take this step, you face the myriad choices of the financial industry, which can leave you feeling confused and overwhelmed. We understand it can be challenging to know who has your best interest at heart. When it comes to investing for your future, you should have clarity and confidence you are making the right decision.

With that in mind, finding a trusted and competent financial advisor can be one of the most enjoyable aspects of investing. For those of us at Carnegie, the feeling is mutual. The most rewarding aspect of our job is working with interesting people and developing long-term relationships as we guide clients through these aspects of life's journey.

To your success,

Gary P. Wagner, AIF®
Principal, COO of Carnegie Investment Counsel

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Question No.1

"Are you a fiduciary?"

The term "fiduciary," which was obscure terminology just a few years ago, has become more widely understood. Many investors realize they should hire a fiduciary (or have been told as such), but what does the term really mean?

Under the Investment Advisers Act of 1940 (the "Advisers Act"), Registered Investment Advisers (RIA) have an obligation to act as a fiduciary. Similarly, individuals who are registered as Investment Adviser Representatives (IAR) of an RIA must also meet this fiduciary standard. In short, a fiduciary is required to act in the best interest of their clients or disclose when they are not and under what circumstances. Thus, a fiduciary advisor must reveal any conflicts of interest or situations where they are not prioritizing their clients' interests. You can find this disclosure information in the ADV, PART 2A filing of the advisory firm.

When seeking an advisor, you should understand that RIA firms, and their Investment Adviser Representatives, are legal fiduciaries.

What does it mean to *act as a fiduciary?*

An RIA needs to act in their clients' best interests.

An RIA needs to place their clients' interests ahead of their own.

An RIA must disclose all conflicts of interest.

Other “financial advisors” who are not affiliated with an RIA are not legal fiduciaries.

The following are examples of advisor types who are not legal fiduciaries:

REGISTERED REPRESENTATIVES OF BROKER-DEALER FIRMS

Registered Representatives (“registered reps”) or “brokers” are held to a “best interest” standard. This means they must act in their client’s best interest **at the time of the recommendation.** They are also required to disclose any potential conflicts of interest and financial incentives they have for the sale of the products. If a client’s needs change over time, a broker is not required to revisit that original recommendation.

In practice, brokers are typically part of a sales-driven culture that compensates them based on sales, but, in most situations, not for providing ongoing advice. Brokers do not have a duty to give their clients ongoing unbiased advice designed to reflect their clients’ ongoing needs.

The following are examples of how these standards *play out in practice.*

REGISTERED REPRESENTATIVES

A registered representative of a broker-dealer must act in a client’s “best interest” at the time of the recommendation. In many situations, the broker has no obligation to review and monitor client investments to ensure they continue to be in the client’s best interest.

INSURANCE AGENTS

Insurance agents who sell annuities are also subject to regulation. Each state requires agents to be licensed and regulates them accordingly. Fixed annuities can be sold by insurance agents, but variable annuities are considered securities, and agents who sell them must also be registered with a brokerage firm and are regulated by the SEC and FINRA. A fixed annuity is an insurance product and is regulated at the state level. In most states, insurance agents selling fixed annuities are held to a reasonable care and diligence standard, but, like registered representatives, they do not have a continuing obligation to advise a client about the availability or sufficiency of insurance coverage.

Different annuity types have different costs. Generally, the more complex an annuity is, the more it will cost. For example, a fixed annuity generally has lower costs than a variable annuity. Annuities with special add-ons or "riders" can also increase the cost of an annuity but provide additional benefits, such as long-term care insurance. Like all securities products, variable annuities have advantages and disadvantages (see FINRA's article on Variable Annuities), and generally have higher costs and commissions than mutual fund products. Registered representatives of broker-dealers who offer variable annuities are held to the "best interest" standard of care discussed above.

FINANCIAL REPRESENTATIVES OF BANKS

Bank financial representatives can offer various financial products, such as mutual funds, annuities and retirement accounts, but their advice might be influenced by the bank's own products and incentives.

COMMISSION-BASED FINANCIAL PLANNERS

These planners receive compensation through commissions on the financial products they sell rather than a flat fee or percentage of assets under management, potentially leading to conflicts of interest.

Question No. 2

"What are my total fees?"

Another complex aspect of financial services today is understanding the total fees paid. Depending on the amount of assets you have to invest, some of the following may not apply to your situation.

MUTUAL FUNDS, ANNUITIES OR SEPARATE ACCOUNTS

Most investors do not understand how to look at a mutual fund's expense ratio. According to Investment Company Institute and Morningstar, in 2019, the average U.S. stock fund had a simple average expense ratio of 1.24%. On a $500,000 investment, this amounts to over $6,000 in extra fees every year. Annuities can charge exit fees in excess of 10%. Separate accounts may charge fees ranging from .5% to 3%, in addition to fees charged by the brokerage firm.

TRADING COMMISSIONS

Many brokers charge trading commissions every time a security is bought or sold. Full commission firms may charge several hundred dollars on each transaction, depending on the size of the order and possibly the complexity of the trade. The broker is paid out of those commissions, so whose interest do they have in mind when making recommendations?

OTHER COSTS

There are many ways your broker may be earning fees. While there are too many to list in this guide, *some of these include:*

PAYMENT FOR ORDER FLOW

Some brokerage firms that offer "no commissions" make money by selling your trade to a third party. This may affect the quality of execution, meaning the trade may not get the best fill price.

SECURITIES LENDING

If you have a margin account, your broker has the right to lend your securities to other investors. They will charge the borrower interest on the amount of stock borrowed and may or may not compensate a portion of that to you.

HEDGE FUNDS OR PRIVATE EQUITY FUNDS

Assets held by investment companies (mutual funds and some exchange traded funds, for instance), as well as assets of some "qualified investors," are often invested with a hedge fund or private equity fund that is responsible for the security selection. If this occurs, it is likely that there would be a charge of an additional fee, being a percentage of your account value and a percentage of your profits. Plus, just like mutual funds, a part of the fee may be paid back to the broker as part of their compensation.

TAXES

Mutual funds will distribute capital gains when they sell securities passed on to each investor: you have no control over these tax decisions. Managing your taxes with effective gain/loss harvesting and asset location among tax-free and taxable accounts is important.

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Question *No.3*

"How do you get paid?"

As mentioned previously, investment choices can have high fees, hidden fees and fees that can be difficult to determine. The core question is to understand how the person making the recommendation is being paid. It is one thing to determine fees, but it is quite another to understand the motivation behind investment recommendations.

INSIST ON CLARITY

It is essential to ask your advisor to explain how they are paid and how the firm they represent is paid. You want to understand the potential conflict of interests and underlying incentives.

OUR RECOMMENDATION

Avoid the problem altogether by working with an advisor with transparent fees based on assets under management and no additional compensation.

A fee-only RIA receives compensation only based on the services offered, and these fees must be clearly disclosed. Also, fee-only RIAs unaffiliated with broker-dealers do not receive commissions or earn compensation by selling financial products or insurance. An RIA should commit to this in writing.

Seeking out advice is an important step in the evolution of your financial life.

Congratulations on looking to become a more educated and confident investor.

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Question No.4

"Where are my funds held?"

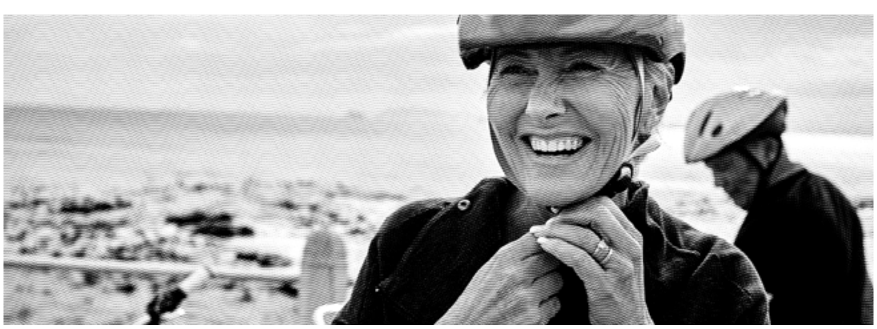
In the wake of multibillion-dollar investment fraud and Ponzi schemes, it is crucial to understand the custodian of your assets, as well as where your trades will be executed.

Hiring a custodian independent of your advisor can avoid potential issues in terms of asset safety and security.

WHAT IS A CUSTODIAN?

A custodian is a financial institution that holds customers' securities for safekeeping to minimize the risk of their theft or loss. A custodian holds securities and other assets in electronic or physical form. Since they are responsible for the safety of assets and securities that may be worth hundreds of millions or even billions of dollars, custodians generally tend to be large and reputable firms.

(Source: Investopedia.)



THE CUSTODIAN ROLE

One of the most important steps you can take to protect your money is to require that your investment advisor works with an independent third-party custodian to hold your account. Doing this creates a security system between your money and your advisor. The custodian serves as the check and balance and gatekeeper of your account. A few examples of large, reputable third-party custodians include Charles Schwab and Fidelity Investments.

Your independent custodian will send you monthly or quarterly statements that detail all activity in your account, including deposits, withdrawals, trades and any deducted management fees. This report gives you complete transparency regarding your money and an official record of your account.

OUR RECOMMENDATION

When you maintain an account with an independent custodian and engage an RIA, it means at least two government regulators are keeping an eye on activity. One or more government agencies regulate your independent custodian, such as FINRA, SEC, FDIC (Federal Deposit Insurance Corporation) and/or state division of banking, and your RIA (SEC and/or the division of securities of one or more of the 50 states).

In summary, while using an independent custodian may seem obvious, far too few investors demand such protection. Seeking out advice is a pivotal step in the evolution of your financial life. Finding an individual or firm that is working in your best interest is crucial. If you share this belief, a Registered Investment Adviser (RIA) may be the right solution for you.

Thank you for reading this guide. We hope it has provided needed and useful clarity about your investment options

At Carnegie, we want you to be a confident investor. Which includes developing a strategic investment plan that meets your specific goals—and working with a trusted advisor to oversee that plan. Because you've worked hard for what you own and want to preserve and grow it.

If you partner with us, know that we've been serving investors since 1974, with a structure built to avoid conflicts of interest. We strictly adhere to the fiduciary standard and will work with you to develop an investment plan you both understand and feel confident in.

In short: together, we'll Invest with Intention.

AND NOW, A QUESTION FOR YOU: READY TO WORK WITH A FIDUCIARY?

SCHEDULE A FREE, NO-STRINGS-ATTACHED MEETING.

BOOK AN APPOINTMENT

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Gary P. Wagner

ABOUT THE AUTHOR

Gary Wagner is Principal and President of Carnegie Investment Counsel. He also works directly with clients to provide investment and strategic wealth advice. Gary sits on Carnegie's Investment Committee and also manages the firm's strategic initiatives and operations.

INVEST WITH INTENTION