TOP 4 QUESTIONS
TO ASK BEFORE HIRING A FINANCIAL ADVISOR

by Gary P. Wagner, AIF®

Are you looking to change financial advisors? Are unnecessary risks making you feel uneasy? Or are your current advisor fees derailing your investment performance?

Whatever the reasons, you are feeling the need for a change. Here are four questions we recommend you ask any prospective group or advisor you review.

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

Gary P. Wagner, AIF®

Principal, COO of Carnegie Investment Counsel

QUESTION

ONE

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 (RIAs) have an obligation to act as a fiduciary. Similarly, individuals who are registered as investment adviser representatives (IARs) of an RIA must also meet this fiduciary standard.

WHAT DOES IT MEAN TO ACT AS A FIDUCIARY?

- RIAs need to act in their clients' best interests.
- RIAs need to place their clients' interests ahead of their own.
- RIAs must disclose all conflicts of interest.

In short, fiduciaries, like Registered Investment Advisers (RIA), must work on behalf of the client or disclose that they do not and under what circumstances. Thus, fiduciaries must reveal when they have conflicts of interest or are not placing their clients' interests first. 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.**

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 the clients' ongoing needs. Here are examples of how these standards play out in practice.

REGISTERED REPRESENTATIVE:

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.

INVESTMENT ADVISER REPRESENTATIVE:

An investment adviser representative (IAR) of an RIA has an ongoing fiduciary responsibility to ensure that he or she makes recommendations in the best interest of his or her clients. Therefore, if a client informs his or her investment adviser representative of a change in financial situation, such as the loss of a job, an IAR would review the client's investment portfolio and make recommendations to deal with this loss.

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 that 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, do not have a continuing obligation to advise an insured 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 that offer variable annuities are held to the "best interest" standard of care discussed above.

QUESTION

TWO

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.

QUESTION

THREE

HOW DO YOU GET PAID?

As mentioned above, 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.

SEEK TO UNDERSTAND

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.

WE RECOMMEND

BETTER YET, AVOID THE PROBLEM ALTOGETHER BY WORKING WITH AN ADVISOR WITH TRANSPARENT FEES BASED ON ASSETS UNDER MANAGEMENT AND NO ADDITIONAL COMPENSATION.

FEE-ONLY RIAS RECEIVE COMPENSATION ONLY BASED ON THE SERVICES OFFERED, AND THESE FEES MUST BE CLEARLY DISCLOSED. ALSO, FEE-ONLY RIAS THAT ARE NOT AFFILIATED WITH A BROKER-DEALER DO NOT RECEIVE COMMISSIONS OR EARN COMPENSATION BY SELLING FINANCIAL PRODUCTS OR INSURANCE. AN RIA SHOULD COMMIT TO THIS IN WRITING.

Carnegie
INVESTMENT COUNSEL
since 1974

SEEKING OUT ADVICE

IS AN **IMPORTANT STEP**

IN THE EVOLUTION OF

YOUR **FINANCIAL LIFE.**

QUESTION

FOUR

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.

WE RECOMMEND

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 CRUCIAL STEP IN THE EVOLUTION OF YOUR FINANCIAL LIFE. FINDING AN INDIVIDUAL OR FIRM WHO 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.

At Carnegie, we know you want to be a confident investor. To do that, you need a strategic investment plan that meets your specific goals. Plus, you need a trusted advisor to oversee that plan.

You have worked hard for what you own, and you want to preserve and grow it. That is why we partner with you to develop an investment plan you understand and feel comfortable with.

Carnegie has been serving investors since 1974 and has been recognized as Financial Times Top 300 Registered Investment Advisors. Our structure is built to avoid conflicts of interest. We serve clients by the fiduciary standard.

READY TO WORK WITH A FIDUCIARY? SCHEDULE A COMPLIMENTARY CONSULTATION.

CALL | 800.321.2322
VISIT | CARNEGIEINVEST.COM
EMAIL | INFO@CARNEGIEINVEST.COM

ABOUT THE AUTHOR

Gary P. Wagner, AIF®

Gary Wagner serves as a Portfolio Advisor and Principal/COO at Carnegie Investment Counsel. He works directly with clients to provide investment and strategic wealth advice. He sits on Carnegie's Investment Committee and manages the firm's strategic initiatives and operations.

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Carnegie Investment Counsel

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The Financial Times 300 Top Registered Investment Advisers is an independent listing that was produced annually by the Financial Times. The FT 300 is based on data gathered from RIA firms, regulatory disclosures, and the FT’s research. The listing reflected each practice’s performance in six primary areas: assets under management, asset growth, compliance record, years in existence, credentials, and online accessibility. This award does not evaluate the quality of services provided to clients and is not indicative of the practice’s future performance. Neither the RIA firms nor their employees pay a fee to The Financial Times in exchange for inclusion in the FT 300. Carnegie was listed in the FT 300 from 2016 through 2020. The Financial Times suspended its ranking in 2021.

Carnegie Investment Counsel | T. 800.321.2322 | E. info@carnegieinvest.com

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