# Choosing Your Financial Advisor: The "Buy Side" vs. the "Sell Side"

*Financial markets, and financial matters, are complex. For people whose interests lie elsewhere, they can be—in all honesty—boring to some and overwhelming to others. Most people, even those who enjoy the benefits of wealth, don't really want to spend their leisure time learning about asset allocation, or the taxation of dividends, or quantitative analysis, or whatever. They want their money to provide them with pleasure and satisfaction, not work and headaches.*

So, investors often look for a financial advisor to take over the workload. But choosing a financial advisor may prove almost as daunting a task as learning about investing itself. In today's financial services industry, just about *anyone* can hang out the proverbial shingle as a financial advisor. Some people who do so have impressive qualifications and strong track records; some don't. Advisors' business cards frequently carry an "alphabet soup" of credentials[1], but investors are often hard-pressed to understand what these credentials mean. More importantly, investors may not feel confident they can distinguish a truly trustworthy financial advisor from the many others who may want investors to *believe* they should be trusted.

This paper sets forth some common-sense ideas to help investors evaluate prospective financial advisors. It covers the following topics:

I. The "buy side", the "sell side", and why it matters.
II. Conflicts of interest.
III. Fees and payment methods.
IV. The fiduciary standard.

## I. The "Buy Side" and the" Sell Side"

Wall Street, and the investment business generally, differentiates between two different groups of participants in the capital markets. They are frequently referred to as the "buy side" and the "sell side".

Everyone who has money to invest—that is, who is looking to *buy* investments—is the buy side of the market. Individuals seeking to invest their own money are said to be "on the buy side." So are institutional investors, such as pension plans, university endowments and charitable foundations.

The overall economic interest of the buy-sider is to find investments that will produce the best possible returns, subject to the least possible risk, with the lowest possible fees, the best possible tax outcome, and the most frequent liquidity (i.e. investor ability to access the money). The simpler the structure of the investment, the better. The closest thing to nirvana in the investment world is the best possible combination of these characteristics, since no single investment contains them all[2].

But what about the folks sitting on the other side of the table, who sell these investments to potential buyers (that is, to investors)? What is in *their* best interest? Their interests are usually in opposition to those of the buy-side investor. They often benefit most from selling complex, expensive, risky, and/or illiquid (translation: long-term, "locked-up") financial products.

But most investors either don't realize this or may overlook this important point. Investors may also be unaware of the sometimes-extreme imbalance of information between the buy side and the sell side. The sell-side participants in an

[1] Including, for example, CPA, CIMA, CFA, CTFA, CAIA, CFP, and ChLU. These designate, respectively, Certified Public Accountants, Certified Investment Management Analysts; Chartered Financial Analysts, Certified Trust Financial Advisors, Chartered Alternative Investment Analysts; Certified Financial Planners, and Chartered Life Underwriters. Their holders have earned credentials attesting to their particular expertise in, respectively, auditing the financial statements of public companies (CPA); constructing investment portfolios and assessing managers using Modern Portfolio Theory (CIMA); analyzing financial assets (CFA); investing trust portfolios (CTFA); analyzing alternative investments, such as hedge funds and private equity funds (CAIA); planning the financial lives of individuals (CFP); and placing the appropriate amounts and kinds of life insurance for individuals (ChLU). Some of these designations carry additional requirements, such as for continuing professional education and/or for ethical professional behavior.

[2] For further discussion of this point, please see the Beekman Wealth Advisory article titled *What You Know That Just Ain't So: Conventional Wisdom on Building a Portfolio.*



Buy Side Sell Side 030513 ELECTRONIC COPY.indd 1 3/12/13 8:35 PM

investment discussion are often exceptionally savvy and able to make almost any investment product sound like a fair deal. "Buyer beware" should instead be the investor's instinctive reaction.

## II. Conflicts of Interest Abound

Think about what happens when you walk into a car dealership. You'll probably be greeted quite warmly—especially if you look like you're in the mood to buy a car right away. And you will probably realize that, even if the business cards you're handed when you walk in the door have a title of, say, "automotive advisor", the people proffering them are salespeople. And that they'll will do their best to sell you a car, because that's how they get paid.

And three more points: First, generally speaking, the more expensive the car, the bigger the compensation to the salesperson. Second, the salespeople will be looking to sell a car from the inventory in their own lot —you won't be sent down the street to a competitor, even (or especially!) if the competitor has better cars or better deals. And third, no matter how friendly and concerned the salespeople may seem, or how intelligent and informative they may be, the bottom line is that they work for the dealership, not the customer.

Most people understand that this is how the car sales business works. What many people may *not* understand is that this is also how the investment sales business works.

This is not to imply that there is anything wrong or dishonorable about selling—all of business is premised on selling products and services that people want to buy. Bringing the right products to the right investors is a useful service, and people who provide this service should be compensated fairly. But not all investment products are worth buying, and not all advisors have only the best interests of investors at heart[3].

So the question for the buy side—that is, ***you***, the investor—is, how do you find out how your financial advisor is paid, and whether that entails conflicts of interest?

## III. Fees and Payment Methods

If your financial advisor is a Registered Investment Advisor (RIA), you can ask for an ADV Part 2. This document is required annually of all RIAs by the U.S. Securities and Exchange Commission. It covers business practices, compensation practices, and disciplinary history, as well as the educational and business backgrounds of the firm's principals. It is well worth taking the time to read, especially since, effective in 2011, the SEC began requiring that the document be written in an easier-to-understand narrative form.

Investors may access additional, free information online at http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/ (or simply search the web on "broker check").

As of this writing (February 2013), broker-dealers, unlike Registered Investment Advisors, are not required to file an ADV or similar document. The SEC may be headed down the road toward harmonizing the disclosure requirements for different types of advisors, but this is likely to be quite a long road.

With respect to fees, there are two other ways to find out how much you are being charged, and what the charge covers. One, read the contract you signed when you hired your financial advisor (or the one you're being asked to sign when hiring a prospective financial advisor). Two, just ***ask***.

Your contract will specify how much you have agreed to pay for your advisor's services, and detail exactly what services you are entitled to receive.

For example, did you pay out of pocket by the hour for professional advice from a certified financial planner? If so—and assuming there is no other compensation stream to the planner—then what you paid for was a financial plan and advice. Did you pay a flat fee for an investment project? Then what you paid for, most likely, was answers to a specific question or set of questions at a particular point in time.

If you wrote a check, you know exactly how much you paid, and, when you look at your contract and at the final product you received, you should have a pretty good idea of what sort of value you got for your money. What you

[3] This is not news, of course. See, for example, the classic, *Where Are the Customers' Yachts?: A Good Hard Look at Wall Street*, by Fred Schwed, first published in 1940.

might want to think about is what you *didn't* get, and what you might therefore still need. For example, if you paid an hourly fee for a financial plan, how will you take the next step to begin implementing that plan, and who will help you? If you paid a project fee to get answers to specific issues at a point in time, what happens when new issues arise, or the original situation changes?

What if you didn't pay out of pocket by writing a check? Then perhaps you agreed to pay a percentage of the assets being managed, and that amount was taken out of your investment account. If so, the amount you paid may show up as a line item (a separate amount) on your investment statement. And what you paid *for* was the ongoing management of the value of your assets.

If you didn't write a check and you didn't pay a line-item fee, you still paid-- but it will probably be harder to find out how much, and for what.

Most likely, you paid for investment advisory time and service in the form of fees and/or commissions that were deducted from the return on the investment before that return was reported to you. You will need to read carefully the governing documents pertaining to each investment, such as, the prospectus for a mutual fund, or the private placement memorandum for a private equity investment.

From these documents, you can track down the percentage of the asset value or the percentage of the pre-fee profits that was charged as fees. Then you may need to reach for a calculator to figure out how approximately many *dollars* the percentages translate to[4].

Finally, what about that other way of finding out what your financial advisor is paid? That is, by asking?

No investor need ever hesitate to ask about the fees paid to an advisor for investment products and/or advice. Financial advisors should and do get paid, just like anyone else who provides a valuable service.

Investors, in their turn, have every right to know how much, and for what. It's their money, after all.

A straightforward question about fees should elicit a straightforward, and complete, answer. A financial advisor who won't explain to a client, readily and in plain English, how much the client is paying, and for what, should trigger some concern.

So ask away. The fact of asking can, alone, prove illuminating.

## IV. The Fiduciary Standard

A final, and very important, distinguishing factor among financial advisors is whether they adhere to a fiduciary standard of conduct. Doing so means that the advisor is legally and morally bound to put each client's best interests first. When choosing between two attractive and otherwise-similar investment products, the advisor who is a fiduciary must recommend the one that is likely to provide a better outcome to the investor (such as by charging lower fees), even if that reduces the advisor's own compensation.

Sell-side advisors who are not fiduciaries adhere to a less-stringent "suitability" standard. This means that financial products recommended must be acceptable and reasonable products given the characteristics and needs of the investor[5], but need not put the best interest of the client first.

This is another topic that investors can feel comfortable broaching directly. It is perfectly reasonable to ask a financial advisor to confirm in writing that he or she is acting as a fiduciary, and that the overall relationship is based on a fiduciary standard of conduct. Investors can, of course, choose to rely on a financial advisor who is not willing or able to adopt a fiduciary standard of conduct, but those who do may want to be especially vigilant in protecting their own best interests.

[4] For an in-depth discussion of fees, please see BWA's article entitled *Investing in Private Equity: Understanding Fees.* While this article covers the many complex nuances of private equity fees, it also treats the more straightforward fees charged by mutual funds and other, simpler investment products.

[5] For example, highly speculative securities would generally fail a test of suitability for inclusion in an account intended to finance the purchase of a home within the next year or two, but might be includible under the suitability standard in a portfolio invested with an objective of long-term growth.



Buy Side Sell Side 030513 ELECTRONIC COPY.indd 3 3/12/13 8:35 PM

## Summary

Finding a trusted financial advisor should not be a trial-and-error experience – that can be much too costly. The reality of today's "new normal" investment world — with investors fretting over market volatility and the historically low returns on bonds — has significantly lowered the risk tolerance levels for many investors. Investors' peace of mind may be best served by finding an advisor who has built a reputation for trustworthiness based upon a track record of past success, open dialogue, transparent and competitive fees, and always doing what is in the best interests of the client.

*Elizabeth P. Anderson, CFA, is the founder of Beekman Wealth Advisory LLC, a boutique financial consultancy providing highly customized services to families and individuals. Founded in 2003, Beekman Wealth Advisory's business model reflects its unwavering commitment to the best interests of its clients.*

Publication Date: February, 2013
© 2013, Beekman Wealth Advisory, LLC



Buy Side Sell Side 030513 ELECTRONIC COPY.indd 4 3/12/13 8:35 PM