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The Investment Industry Should Tell All

By Donna Skeels Cygan
Principal, CFP, Essential Financial Planning in Albuquerque

GUEST COMMENTARY: The financial industry has earned its tarnished reputation. From 2002 until 2006 several large brokerage firms, banks, mutual fund firms and insurance companies were collectively fined over $2 billion by the Securities and Exchange Commission for a variety of allegations including internal sales contests, late-market trading, and conflicts of interest caused by brokerage firms' having a preferred list of mutual funds they recommend to their clients.

Eliot Spitzer led many of the inquiries and seemed to have a personal vendetta for cleaning up the financial industry to make it a safer place for individual investors. Most of the firms paid the fines quietly without admitting guilt, in an attempt to minimize the media coverage and the negative publicity.

Today, however, much of the scrutiny is waning, so the financial industry seems to be quietly reverting to its old ways. This would be an excellent time for regulators and elected officials to draft disclosure policies to help protect American consumers. The concept of full-disclosure laws is very broad, but we have to start somewhere. I recommend we establish a full-disclosure law in the area of fees and commissions on investment and insurance products.

As a fee-only comprehensive financial planner, I readily admit that I am biased in favor of transparent, honest disclosure about fees. The term "fee only" means there are no commissions or compensation based upon the products my firm recommends to our clients. Instead, our clients pay us a flat annual fee that covers financial planning and asset management services.

The majority of the financial industry still works on commissions, but some investment firms are now offering a "wrap" fee for investment management. Wrap fees typically range from 1 percent to 3 percent of the investment account total. I am not suggesting that one form of fee is better than another. Whether a consumer pays a commission, a wrap fee, or a flat fee is not the issue. The issue is that the American consumer has a right to full disclosure regarding the fees and commissions he or she is paying.

As an example, let's look at an annuity that may be sold by a stockbroker, an insurance agent, a financial adviser or an investment representative in a bank. It is common that annuities have commissions of 10 to 12 percent. Therefore, the salesperson or adviser should have to disclose— verbally and in writing— that his or her commission will be $25,000 if you decide to buy an annuity for $250,000 that pays a 10 percent commission. The people who sell annuities will often respond by saying "but your $250,000 is not reduced by $25,000— therefore, you should not be concerned about the commission." I would respond that even if the $25,000 is not subtracted from the initial amount invested, a savvy investor must realize that the $25,000 commission that is paid to the salesperson comes from somewhere. It may be paid by the insurance company's reducing the future gains if it is a variable annuity, reducing the fixed return if it is a fixed annuity, from high surrender penalties, from high annual fees, or from paying out less on a monthly basis than would be possible if the steep commission were not present.

I recently received an e-mail from a well-known national insurance company. The e-mail described how to win a trip to Rome in May 2007 for selling a large amount of life insurance or fixed annuities during 2006. The trip includes five nights and six days in Italy for the top 80 producers and their guests, with virtually all expenses paid by the insurance company. The e-mail also describes another sales promotion called "Cash is King," that provides additional cash payouts (above the standard commissions) for selling indexed annuities between July and September of 2006. I do not sell insurance or annuities, and I was not supposed to receive the e-mail. I suspect the insurance company bought an e-mail list of financial advisers, so I was included.

Should there be a law prohibiting sales contests without disclosing the potential conflict of interest to the consumer? In my view, yes. The rules for earning the trip to Italy state that variable products are not eligible in accordance with a ruling by the NASD effective 1-1-1999. This would suggest that the NASD created a rule to prevent firms from offering trips for selling variable annuities. However, evidently the NASD did not specify that the firms cannot provide trips to their salespeople based on fixed annuity or life insurance sales.

Does the example imply that the entire financial and insurance industry is tarnished? Of course not! However, it does show that fees, commis and conflicts of interest are rarely disclosed. In regard to annuities, I would argue that negative tax and estate planning issues should also be disc

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Much of the financial industry would fight a full-disclosure law. However, you can protect yourself by requesting that the financial person recommending you buy a product disclose the fees and commissions in writing. Simply ask "Can you please put your recommendations, your commissions and all of the fees in writing for me?" and ask that he or she mail you the written disclosure within one week. If you receive it, you then take some time to get a second opinion, and go onto the Internet to search for recent articles about the product, the firm, etc. An educate consumer is a wise consumer. Otherwise, the best advice for dealing with the financial industry is "Buyer Beware."

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NAME: Donna Skeels Cygan
TITLE: Principal, CFP
COMPANY: Essential Financial Planning in Albuquerque, www.essentialfinancialplanning.com

From the Executive's Desk