

asseenin



Capital District Business Review

Fee-only compensation eliminates conflicts

Once upon a time, back in the '70s, I rented a small apartment, about 20 feet by 40 feet. When I called to get a phone installed, they put me on hold, and then got back on the line with a recommendation for two phones, with push-button dialing and other features, that could be mine for a mere \$50 or \$60 a month.

I told them no, and asked for and received the basic service I had always gotten at about one-quarter of their proposed price.

It's easy to make this kind of decision about phone service because we understand the services offered and can make decisions about them ourselves; expert advice is not really necessary.

Other products, however, are not so obvious. Insurance and investments are two areas where the traditional sales approach is for an insurance salesperson or stock broker to provide their expertise in helping people to select the option best for them. However, since these people are compensated by commissions, frequently the products sold are as unnecessary and overpriced as the two-phone choice I mentioned above.

Some members of these professions even take advantage of their position of expertise and the trust placed in them by members of the public, and routinely make ill-advised choices for their clients based solely on the commissions to be collected. There are, of course, some individuals in both professions who really do try to make

the best selections for their clients, with their clients' interests being placed ahead of their own.

However, if the best choice for a client is term insurance or Treasury securities, it takes a real saint to recommend a product on which little or no money is to be made, particularly when there usually are a number of similar but more expensive commissioned products available for sale. The financial pressure tends to focus attention on the sale, not on the client.

On Paying for Expert Advice

William C. Jerome

A typical broker walks in the door every morning with the expectation that he or she will generate \$700 in commissions that day. The incentive to review the performance of existing portfolios is not great compared to the need to earn that day's income.

As a result of the obvious conflict of interest a commissioned salesperson has, most people wonder whether their representative is acting in their best interests. Without an objective, expert opinion - and without sufficient knowledge themselves to choose - the nagging doubt that they may be paying too much for insurance or investments remains.

The easiest way to eliminate both this doubt and the temptation for salespeople to abuse their relationships with clients is to remove the com-

missions. As salaried stockbrokers and fee-only financial counselors slowly become more available, people will realize that there is a choice, and that commissioned salespeople are not the place to go for objective advice.

Already, people are dealing in greater and greater numbers with discount stockbrokers and no-load mutual funds. Inexpensive insurance policies are becoming more available by mail. Eventually, the salespeople themselves will see that in order to retain their clients and to serve them better, they will need to move to a non-commissioned compensation.

My business is based on this philosophy. The long-term relationships founded which provide the most benefit for the client and their representative are based on mutual trust for each other. Commission-based payment structures cast doubt on whether both parties have the same interests and interfere with the trust necessary for such relationships.

The public is becoming increasingly aware of the benefits of a fee-only relationship with their financial adviser, and I expect that commissioned salespeople will eventually become obsolete, as salaried or fee-only alternatives replace them.

**Jerome is a Financial Planner
in Glenville, NY.**

June 29, 1992