ARE YOU GETTING INDEPENDENT AND OBJECTIVE INVESTMENT ADVICE?

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NEPC Private Wealth

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Set your investment portfolio up for long-term success: pick an unbiased financial advisor who puts your interests above all else.

In theory, every investment consultant or financial guide should be objective and trustworthy while having no conflicting interests. In practice, however, it can be challenging to find an advisor who is truly independent and has your best interest at heart. Further compounding the matter are recent changes in regulations that dilute the responsibilities of a fiduciary.

As a registered investment advisor (RIA) working with clients of all types and across all asset classes, NEPC believes our clients come first in everything we do. Their needs are our priorities. It is this philosophy that guides us as we seek the best investment solution for our clients while steering their portfolios through entire market cycles. And it is why we choose to retain our independent ownership in an industry rife with consolidation and cross-selling.

THE (GOLD?) STANDARD

Before selecting a financial advisor, it is important to understand the standards and rules governing advisors. While this is not legal advice, it is important to understand the different types of advisors and their respective regulatory framework.

Registered investment advisors are regulated by the Securities and Exchange Commission (SEC) or state securities regulators in accordance with the Investment Advisors Act of 1940 and/or applicable state law. Investment advisors are generally bound by fiduciary standards that require them to put their client's interests above those of themselves or their firm.

On the other hand, broker-dealers—who can also sell securities and investment products—are regulated under the Securities Act of 1934. Historically, they have been held to a suitability standard, meaning that recommendations to clients must be appropriate for their circumstances.

Our clients come first in everything we do.

In June 2019, the SEC approved a package of rules around the advice given to clients that was intended to raise the standard of conduct for broker-dealers, making it more consistent with the rules for RIAs; the rules were also aimed at creating disclosures to improve transparency around how RIAs and broker-dealers make money. This package included *Regulation Best Interest*, requiring broker-dealers to act in the best interest of their clients, which was different from the earlier standard. In the package, the new *Form CRS Relationship Summary,* which is to be delivered to a client at the beginning of a relationship, requires disclosures that are more consistent between RIAs and broker-dealers. There is ongoing discussion around whether the new guidance weakens the fiduciary standard for RIA's. Critics contend that language changes around the term "fiduciary" and an interpretation that appears to allow conflict disclosure to be sufficient to avoid them weakens the standard while the SEC debunks that theory.

Indepedence Checklist

√ Compensation
√ Products
√ Allocation Policy
√ Ownership
√ Customization
√ Due Diligence
√ Fine Print

Regardless of that debate whether the new regulations ultimately tighten or loosen the fiduciary responsibility standards for RIAs or create more parity between RIAs and broker-dealers, there are practical steps that clients can take to determine if the advisor is, in fact, objective and independent and working in their best interests.

OUR CHECKLIST

Central to the theme of a client's best interest is the presence of potential conflicts of interest. To help codify the intent to avoid such conflicts, advisors such as NEPC have a *Code of Ethics* that stresses the importance of avoiding activities, interests and relationships that might interfere with, or give the appearance of interfering with, placing the interest of the clients first. Each of our partners and employees read and affirm this code annually. While this is a good starting point, the following are practical steps we recommend investors take to assess if an advisor is truly independent and objective:

1. **Compensation**
   Advisors can be paid in different ways, either explicitly or integrated into other charges that a client may bear. To be considered unbiased, an advisor should be compensated explicitly by their clients, and only their clients.

   However, there are other fees or compensation that can sneak into an arrangement either by fee sharing with managers, referral fees from managers, or receiving other types of compensation from managers for recommending their product, for instance, fees for being included in an advisor's database. Other types of compensation advisors may receive: soft dollars generated by the clients' assets or, as in the case of broker-dealers, from commissions related to buying a product.

2. **Products**
   - Some advisors offer internally managed or affiliate products which may end up in a client's portfolio. These advisors may charge management fees for these products in addition to the fee paid for advice, creating an incentive to include those products in client portfolios. Additionally, an advisor's individual compensation may be tied to the amount of internal product used in clients' portfolios. These questions need to be asked:
   - Are the implementation solutions limited to the internal products or are outside products an option?
   - Is the internal product the best-in-class solution for my portfolio?
   - If this product underperforms, does the advisor have the wherewithal to recommend a termination of this product?

3. **Allocation Policy**
   Occasionally, advisors will recommend capacity-constrained strategies. Advisors should have a clearly defined policy in place to deal with highly sought after opportunities. The policy should treat clients equitably and avoid

situations where one client may be favored over another, for instance, steer clear of favoritism towards larger-fee or discretionary clients.

4. **Ownership**
   Different ownership structures introduce different incentives for advisors. A publicly-traded organization is answerable to shareholders and has to manage their expectations, perhaps diverting resources away from clients. Conversely, small advisors may lack the resources to develop tools or hire personnel to optimally serve a client.

5. **Customization**
   Advisors may use a customized approach, tailored to an individual client. Others may use a model portfolio approach that makes for easier implementation and lower expenses, but may not take into consideration a client's unique needs.

6. **Due Diligence**
   A challenge is to determine whether the advisor's research team approaches its task with an open mind without preconceived ideas about the outcome of its due diligence to ensure the investment strategy or product is in the client's best interest. Certainly, researchers come with biases based on their experience, which allow them to whittle down viable options from a large array of offerings. To this end, interviewing the research team can provide an insight into the advisor's approach and method.

7. **Fine Print**
   Ask to see copies of the advisor's policies and *Form ADV* and make sure you understand them. While disclosures at the end of materials may seem dull and unimportant, they contain important information required by regulators to outline existing conflicts. Also, seek legal advice, when needed, to make sure you fully understand any advisor's obligations to you.

Seeking an independent and unbiased advisor for you or your family for your investments will go a long way in helping your portfolio achieve its long-term goals. So, don't hesitate to ask your potential advisor the tough questions. Any advisor you consider should be transparent and forthcoming and welcome your queries. An advisor who puts your interests first is one who is truly working for you.

DISCLAIMERS AND DISCLOSURES

- Past performance is no guarantee of future results.
- All investments carry some level of risk. Diversification and other asset allocation techniques do not ensure profit or protect against losses.
- The information in this report has been obtained from sources NEPC believes to be reliable. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.
- The opinions presented herein represent the good faith views of NEPC as of the date of this report and are subject to change at any time.
- This does not constitute legal advice. We recommend that clients seek their own legal and regulatory advice should they have questions regarding the nature of legal issues mentioned in this paper or their specific agreements and relationships.

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