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Aging investors and conflicts for advisors

No one disputes the fact that significant numbers of our population are growing older, as the Baby Boomers move into the next phase of their lives. More and more people are looking to retire from their primary employment, maybe to continue to work part-time out of necessity or even desire. However, as our population ages, there is increased risk of cognitive decline which can present a dilemma for financial advisors.

Recently, the White House Council of Economic Advisors released in February "The Effects of Conflicted Investment Advice on Retirement Savings" (www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf). This report focuses on retirement savings, specifically IRA accounts. But it brings out some much larger issues. Most middle class Americans are ill equipped to act as their own investment advisors. Most people turn to professionals to assist them in choosing an investment strategy that suits them. It is likely that many professional advisors are working for their clients in the best way possible. However, as people age, they may not understand fully all that the professional is offering. Moreover, "financial advisers are often compensated through fees and commissions that depend upon their clients' actions. *Such fee structures generate acute conflicts of interest: the best recommendation for the saver might not be the best recommendation for the advisor's bottom line* [emphasis added].

One such area I encounter from time to time in my practice is the sale of inappropriate annuities. An annuity is a financial product that is like life insurance in reverse: you pay a premium and get your money back over time with interest earned added. Annuities are used in many situations and contexts, and can be a good investment strategy for many. Annuities come in many forms with different investment goals. To simplify, there are two main types, deferred and immediate. How much interest one earns depends on the investment type and the client's needs. The commission for the advisor is often tied to the type. During the Great Recession, many annuities increased in value faster than other investments due to the guarantee of interest added.

The problem comes in when older investors are approached about deferred annuities and do not understand the implications from investing in such a vehicle. For instance, a couple in their 80's who are convinced to invest $100,000 in a deferred, variable annuity might not understand the implications of such an investment. In general, these investments are not available for withdrawal for 10 years after investing without a large surrender penalty except for some set amount after a certain period of time. It may be that one or both of the couple needs long term care within that 10 year period and is unable to easily access the money. It may be the investment advisor does not fully understand the implications himself, and does not explain it to the client so that they understand. Also, the client may already have some cognitive decline and relies upon the professional to choose the best product. Again the conflict arises between an older investor with possible health issues and the advisor's bottom line.

This is a dilemma that will not be solved easily. Professional investment personnel should educate themselves on the long term effects of their investment advice weighing it against the sophistication and cognitive sharpness of their clients. Investors need to try to understand the products that they are buying, perhaps taking a trusted family member into confidence to be sure that they understanding fully before buying.