Third Quarter Newsletter 2005

VIGIL Strategies

Taking you where you want to be

President's Message

Who Should You Trust?

Conflicts of Interest Influence the Recommendations You Receive

If you have ever visited a car dealership to shop for a car, you know that the salesperson will make every effort to determine what you need and to convince you that what he/she has got to sell you exactly meets your needs. You'd be floored if they told you "we've got something that is okay for you, but what you really need is the XYZ model being sold by my competitor down the street." We are aware of the salesperson's conflict – they only get paid if they convince us to buy what they have to sell – and how it affects their recommendations to us. We respond with guardedness and wariness as a result.

These same types of conflicts of interest often affect the guidance we receive on financial matters. Unfortunately they are not as apparent to or expected by us, in part because they are starting to affect recommendations from unexpected and/or surprising sources. I'd almost say these conflicts are hidden from us, although the actual fact is that often they are disclosed - in writing that we don't read or don't fully understand. And so as a general rule we do not give nearly enough regard to the many conflicts in the financial advice business and how they influence the recommendations we receive.

Within the past few weeks we have seen several examples of these conflicts of interest manifesting themselves in recommendations to unsuspecting clients:

1. An attorney, in an ongoing business and/or referral fee arrangement with a broker, advises a client that only this particular broker is capable of handling a transaction. In reality several other brokers at that firm, as well as several other firms, are capable of handling the transaction in exactly the same way.
2. A bank, which received an upfront commission for selling the product in the first place and receives an ongoing payment for convincing the client to keep it there, advises a retired client to annuitize their equity-index annuity. In reality, the client didn't belong with a stock market exposed investment in the first place, let alone via an equity index contract with sizeable downside risk masquerading as a guarantee and poor upside market participation. Locking in today's low interest rates for the client's life by annuitizing to avoid a whimsical "penalty" is another self-serving recommendation.
3. An accountant advises a small charitable endowment fund to invest its assets in a mutual fund carrying a front-end load (sales charge). This identical fund can be purchased directly from the mutual fund on a no sales load, lowest possible internal cost basis, which would result in much higher returns for this charity on the exact same investment. Either the accountant didn't know any better – which is possible – or the accountant is affiliated with a broker that pays the accountant some of the commissions he/she receives as a result of the recommendation.
4. A trust department of a bank provides a professional firm with a list of mutual funds to use as investments for the firm's retirement plan. Since

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most bank trust departments recommend few, if any, funds that are not their own, the fact that this recommended list contains none of the bank's own funds gives the first impression that the funds have been independently and objectively selected. However, upon further review it is discovered that the fund is paying revenue sharing to the trust department to garner its recommendation to use their funds, a common practice in the mutual fund industry that is not known to clients and consumers.

One of these clients, upon learning the true facts about what was influencing the recommendations they received, remarked about what a "dirty" business financial services has become and how difficult it is to know who to trust anymore. Indeed.

Since it is our job to know these things and take them into account when advising clients, none of the above was particularly surprising to us. However, it has been my privilege over the past 3 years to serve on the Compensation Committee of the National Association of Personal Financial Advisors (NAPFA). If you are not aware, NAPFA is the Country's foremost advocate of the Fee Only approach for delivering financial advice. The Compensation Committee reviews the manner of compensation of applicants for membership into NAPFA to ensure the integrity of their Fee Only compensation claim prior to acceptance. I can succinctly summarize that experience by saying that it is truly amazing what bright, motivated minds can come up with to influence the recommendations of clients' advisors with very little if any knowledge by the client. And it is truly a dirty business when you couple bright ideas with advisors willing to take part in schemes to mask the influence these arrangements have on their recommendations.

So who do you trust these days? I know for sure you can trust members of NAPFA, a small but growing group of practitioners eschewing the subterfuge of financial influence to provide financial advice motivated solely by the client's best interest. Where else can you go as the waters get muddied about who is doing what and paying whom? I don't know. All I can say is that it is truly a dirty business, and people who are good at it make you feel as if they are advising you rather than selling you something that benefits them. Your best bet may be to adopt the same wary, guarded approach you use in other shopping in your life, even though all of the concerns are not as readily apparent to you.

Tom Batterman
President
Vigil Trust & Financial Advocacy

Do You Sell On eBay? IRS Is Interested

Hawking baby clothes, old CDs, and sandwiches resembling the Virgin Mary on eBay have netted folks anywhere from pocket change to serious cash. According to eBay, which calls itself the "world's online marketplace," 135 million people are registered to use their website. In 2004 more than $34 billion worth of merchandise was sold and 430,000 people reported that they make a significant portion or all of their revenue from selling on eBay. That's a lot of buying and selling.

Did you know that eBay earnings are subject to tax? There is a continuing misconception that because online auctions are done over the Internet, there are no taxes to be paid on earnings from them. Many people think of eBay sales as "just for fun" and reporting earned income as unnecessary for smaller dollar amounts. While this may be a nice way to think, the IRS is interested in all earned income regardless of source including from benign eBay sales to income from bribes, gambling, kickbacks, and other illegal activities.

Declaring eBay profits does have a bright side. You may deduct your business expenses related to your on-line sales if certain criteria are met. This includes the cost of goods sold, fees, supplies, and potentially a home office. Check with your trusted tax professional to discuss your earnings and the deductions that might be available to you.

The IRS is well aware that there are a large number of people making a significant amount in extra income through online auctions. Given their ability to easily access information related to transactions that is stored online auction computers eBayers take a risk by not reporting this income. When the IRS comes, and they likely will, taxes and late penalties will consume any deductions you might have been eligible for.

Company Stock–Too Much of A Good Thing?

You've probably heard the story of the receptionist that was given company stock as part of a meager compensation package. As the company grew, the receptionist's stock became increasingly valuable to the point where it was worth millions. This story was so familiar in Silicon Valley, for example, that Microsoft discontinued its employee stock option programs.

Workers in Silicon Valley aren't the only ones who can't seem to get enough company stock. According to the most recent survey by the Employee Benefit Research Institute, more than 10% of workers have 90%-100% of their account invested in company stock. Talk about putting your eggs in one basket. Counting on your employer to fully fund your employment, provide valuable benefits, and secure your retirement is a huge risk.

The risk associated with investing a large percentage of your 401(k) in company stock is so great that the National Association of Securities Dealers (NASD) recently released an "Investor Alert" warning about this risk. Unfortunately for some employees, such investments are sometimes unavoidable. For instance, when the company match comes in the form of company stock that is required to be held for certain periods of time, employees are stuck. Still, when the strings are lifted and employees are free to diversify, they often don't. Many cite emotional connections to the company stock. One client told us, "I've worked so hard at this company and feel like I contribute to the success. I want to make sure I benefit from the success I helped to create."

Yet, the rewards of diversification are well documented. A recent study of 401(k) plans showed that plan with inadequate investment options lag returns of well rounded plans by at least 3 percentage points per year! The lesson is clear-if you are not restricted from selling company shares consider doing so and diversify by selecting from the other available options. After all, you can sell shares within your 401(k) or IRA without triggering taxes. Then use an IRA to fill in any gaps that might exist within your 401(k).

If you are unsure as to how to go about assessing whether or not you have too much company stock, contact your financial advocate. Your financial advocate will assist you with reviewing your stock options, stock purchase plan, and other investment options you might have. Don't feel as though you will miss out on a great opportunity or are being disloyal to your employer by passing on the company stock. This issue isn't whether the company has a great product or service. The issue is what is the critical amount of stock that you need in your portfolio to achieve your long term goals. That may be some stock or that may be zero stock. Your financial advocate will help you answer this question and get on with investing.

Vigil Trust Staff Tapped By UW-Extension To Provide Financial Advice

For the past two years, staff from Vigil Trust and Financial Advocacy have been instrumental in developing and presenting an introductory curriculum on investment matters for the general punlic. This curriculum which has historically been presented in March, has proven so successful that Vigil agreed to help create an advanced investment curriculum for the general public.

This October, Vigil's Trust Officer & Financial Advocate, Anza D'Antonio, J.D., will be presenting on topics ranging from retirement plan options for business owners to understanding the role of the trustee and trust options available. These classes provide valuable information for small business owners and investors seeking a greater level of understanding on investment issues. Other local attorneys and certified public accountants will also be presenting on related topics like business succession issues and tax incentives available to business owners.

Classes will be offered at the UW-Extension offices on River Drive in Wausau on October 10, 17, and 24 twice daily. Classes are free of charge but advanced registration is requested.
For more information or to register please contact Anza D'Antonio at 715-848-8110/800-950-8110, or Family Living Agent for the University of Wisconsin-Extension, Rita Straub, at 715-261-1242/800-238-0153.

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IRS Urges Check Charity Status Before Making Donations to Hurricane Victims

The IRS has advised individuals making donations to help Hurricane Katrina victims to seek out qualified charities by checking an IRS-approved list or by searching for volunteer agencies with whom the Federal Emergency Management Agency (FEMA) is working; information from the IRS is available at http://www.irs.gov/charities, and FEMA-related information is available at http://www.firstgov.gov.

If you have a specific charity in mind, you can make sure that it is a qualified charity by searching the IRA approved list. The IRS website at www.irs.gov has an online feature that allows people to find qualified charities.

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