How a Fiduciary Can Benefit You

In the investment world there are so many unique words, abbreviations and acronyms that it can feel like a different language. One term you might be hearing lately is "fiduciary." A fiduciary is an organization or a person that ethically and legally must act in another's best interest, usually with respect to finances. The fiduciary is required to manage financial affairs not for their own benefit, but for the benefit of another person. Most investors believe they have a trusted professional or fiduciary who gives real advice that benefits them, but did you know that anyone can call themselves a "financial planner?"

All financial representatives are held to a minimum standard of conduct. The most widely adopted standard in the financial services industry has been the "suitability standard" which only requires that investments are appropriate for the customer's goals, experience, and timeframe. Although most employers prefer advisors have a degree, a college education is not a requirement for entering the industry.[1,2,3] Some insurance salespeople or financial company representatives have only a high school diploma prior to obtaining their financial or insurance licensing.[4] The "suitability standard" is designed to make sure that salespeople in the industry know their customer's financial situation and recommend suitable products; however it does not call for that "advice" to be in the client's best interest.

Other professionals, including Investment Advisor Representatives and CERTIFIED FINANCIAL PLANNER ™ professionals operate under the "fiduciary standard." This means that in addition to recommending a suitable investment, they must also put the client's best interest first, act with prudence, provide full disclosure, and strive to identify, manage, or eliminate conflicts of interest. It is a much different and more complex standard. Having a four-year college degree is a requirement for certification from the CFP Board. Beyond the degree, a CFP® professional must have taken additional preparation courses in financial planning, risk management, tax planning, estate planning, and investments from an accredited college or university, pass a two-day, ten-hour exam that includes two case studies, and have at least three years of financial work experience. To be allowed to use this title and the marks of a CFP® professional, the person must have achieved all of the rigorous requirements of the CFP Board. In addition to the initial comprehensive certification process, there are ongoing requirements for renewal. The CFP® professional designation represents a high level of proficiency, integrity, and professionalism in the financial services industry.

Education requirements are not the only difference between those operating under the "suitability standard" and those who follow the "fiduciary standard". The primary source of income for those following the "suitability standard" is a commission that is earned through transactions (buying and selling). This is a major area of potential conflict. For example, under the "suitability standard" if one of the appropriate products provides a higher commission, the advisor can choose that product over another similar product with lower fees. Many believe this can encourage these advisors to sell one company product ahead of competing products that might cost less. Expenses are an area to pay close attention to and sometimes the higher the commission to the advisor, the higher the cost to the investor.

Under the "fiduciary standard" the investment professional should act in the best interest of their client and should not select a fund or product on the basis that it would give him or her higher compensation. The fiduciary must do a thorough analysis taking into account all available information. They must fairly manage and fully disclose any unavoidable conflicts and strive to find the best option for their client. A key difference for the fiduciary is in terms of their loyalty and focus on the client. The compensation of a fiduciary should seek to avoid conflicts of interest and typically it is from a management fee tied to the account value rather than a commission. Under this standard paying attention to investment costs and avoiding unnecessary expenses are important factors to helping a client reach their goals.

Finally, you will notice a difference in the process between the two standards. The "suitability standard" means you are asked financial questions so the representative can get a clear picture of your financial situation and then determine if the product is appropriate for your situation. The "fiduciary standard" is much more involved and takes into account a great number of considerations. The fiduciary will strive to assure that fees are reasonable and that investments are diversified and consistent with the objective. Under this standard, conflicts of interest are taken into account and the recommendations should consider the purpose of the investments. True financial planning usually involves multiple subject areas, such as insurance, budgeting, tax planning, estate planning, and life goals. There is significant time spent on data gathering, defining the relationship, and analyzing and evaluating the client's financial situation. The recommendations will cover a wide range of subjects and possibly provide alternatives to consider.

There is little question that the "fiduciary standard" is designed to better protect investors but it is difficult for individuals to know if they are working with a salesperson or a professional when there are dozens of different titles and descriptions in the financial world. The most important question to ask your current advisors is "are you a fiduciary?" Educating yourself about the titles and designations in the financial industry can go a long way to helping you find a trusted professional who has your best interest in mind.

This article written by Sandra J. Wagner, CFP®. Sandra has been helping people with their finances since 2001. She is a CERTIFIED FINANCIAL PLANNER™ professional and CEO of Wagner Planning.

1) http://www.investopedia.com/ask/answers/091815/financial-advisor-required-have-degree.asp
2) http://wealthpilgrim.com/financial-advisor-training-real-world-advice-from-a-successful-cfpr/
3) https://www.kitces.com/blog/are-the-licensing-and-other-requirements-to-become-a-financial-advisor-too-easy/
4) http://www.howtobecome.com/how-to-become-an-insurance-agent