

Confronting the "F" Word

Publication title: **Gaining Trust**

Is Your Advisor a Fiduciary?

"How do I know I can trust you?" That is a question many investors ask their financial services professionals, upon whom they depend for guidance in achieving their goals. Recent changes in the ethical rules of two of the industry's governing bodies help to reveal the answer.

A Ruling from the SEC

Many investors have noticed subtle new disclosure materials from their financial advisors over the past few months, particularly if they invest with one of the country's big brokerage firms. In a long anticipated ruling, the Securities and Exchange Commission (SEC) recently illuminated one of the financial services industry's dirty little secrets: your broker is not legally required to place your interests first.

The new rule took effect on January 31, 2006. Look for this type of disclosure on your brokerage statement:

Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours.

Beyond the Label

Professionals using a variety of labels—such as "financial advisor," "financial consultant" or "wealth manager"—are under different legal obligations to consumers, depending upon how

Summary: Confronting the "F" Word

The objectivity of your advisor's guidance, incentives that motivate that advice, and your legal recourse are all impacted by whether or not you choose a fiduciary.

New language required by the SEC on brokerage accounts (ruling January 31, 2006):

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This article was published by the *High Country Business Review*.

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they are actually regulated. Regardless of the image of trust they project, such a professional may not even have to put your interests first—legally.

One key distinction to look for is whether or not you have a “brokerage account” or an “advisory account.” An advisory account, with a Registered Investment Advisor (RIA), assigns a “fiduciary duty” to your advisor, meaning that your interests come first and with undivided loyalty. On the other hand, a broker is only required to determine that the product sold to you is “suitable,” which may simply mean that you can afford to lose your investment.

In addition, the new rule restricts what brokers may do who are *not also* RIAs:

- they *may not* call themselves “financial planners” and may not provide financial planning services;
- they *may* receive compensation from product providers without informing you; and
- they *are not required* to monitor your ongoing situation.

And having a “fee-based”—rather than a traditional commission based brokerage account—still will not provide you with the benefits of a fiduciary advisor.

Consumers encounter a tricky area when the advisor is registered as both an RIA and a broker—and may, from time to time, choose the capacity in which he deals with you. The best antidote to this dilemma is to ask questions of your advisor, such as whether the offered account is a “brokerage” or an “advisory” account and what conflicts of interest might exist in the recommendation of certain products.

Proposed New Standards from the CFP® Board of Standards

In a related development, the regulatory body setting ethical standards for CERTIFIED FINANCIAL PLANNER™ certificants has drafted a new code of ethics with provisions on fiduciary responsibility. For the first time, CFP® practitioners will be held to a fiduciary standard in working with clients, unless the advisor specifically disclaims such responsibility in writing to a client.

Making a Selection: Fiduciary or Broker?

If your advisor is not explicitly acknowledging or acting in a fiduciary capacity, it is difficult to know if she is placing your interests above all other loyalties. Obviously, receiving direction from a broker is not inherently a bad thing; however, the safest approach with any advisor is to clearly define the relationship—and the resulting order of priorities of the advisor—at the outset.

While knowing that a fiduciary must place the client’s interests first is enough for some investors to decide between an RIA and a broker, others may want more details. In my next column, I will explore how your advisor’s loyalties and compensation may affect your investment experience. The objectivity of your advisor’s guidance, incentives that motivate that advice, and your legal recourse are all impacted by whether or not you choose a fiduciary.