THE FIDUCIARY STANDARD

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In the October 2018 issue of Financial Planning, Bob discussed the fiduciary standard. A fiduciary is someone who puts the best interests of someone else first. In the financial planning world, a true financial planner puts the interests of the client ahead of his or her own interests.

Who is not a fiduciary according to Bob? Financial advisors who work for banks, brokerage firms, and wire houses.

Bob doesn't pull any punches. Referring to those financial advisors, "they are hired predators who, in many cases, will feast on their customers' assets at every opportunity and won't be overly concerned about helping them reach their destination."

Tough words, to be sure. But he was just getting started.

"Brokerage representatives are agents of the firm and sit alongside their branch managers watching out, first and foremost, for their best interests on the commission grid, not to mention the wire house's bottom line."

He adds this joke: "Over the years I've repeatedly heard the unfunny joke that a great investment benefits the customer, the firm, and the broker all at the same time. Well, two out of three ain't bad." (Keep reading; there's a quiz in your future.)

Bob concedes that financial advisors must "prey by the rules" set by the SEC. But those rules give the advisors broad leeway to sell investments that are "suitable." Suitable means that an investment doesn't necessarily have to be the best thing for the client. Nor does it mean that the advisor can't charge high fees when selling the product to the client. Bob continues, "the investment might actually make money for the customer, but the broker wins by getting the customer to pay more than he or she would have had to pay for similar types of investments."

In my many decades in the accounting and financial planning professions, I have found that Bob's words ring very true: consumers cannot "distinguish between people who represent the interests of a large brokerage firm and those who, embracing a fiduciary standard, work in the best interests of their clients."

Phrased another way, consumers don't know the difference between being a client in a profession and being a customer in an industry.

Let's compare two business models:

MODEL #1

Jack is an advisor at the ABC Financial Group. The Group is owned by thousands of shareholders. Its stock is traded on an exchange. In other words, ABC Financial Group is a traditional bank or brokerage house.

Here's that quiz I promised: For whom does Jack work (choose all that apply)?

A. The customer
B. The shareholders of ABC Financial Group
C. Jack and his boss

If you chose B and C, you are correct. The answer can't be all three because the interests of the customer will almost never align with the interests of the shareholders. Jack works for the shareholders and, if he wants to keep his job, he needs to keep his boss happy (who has to keep his own boss happy and so on up the food chain).

Here's one of my favorite examples of this dilemma. A client inherits $500,000. What will Jack tell her to do with that $500,00? Buy products from the ABC Financial Group, of course.

Still with me? Good. Let's look at a different model.

MODEL #2

Joan is a financial life planner at the XYZ Planning Group, which she owns. Joan charges a fee for financial life planning services, but sells no products. She makes her money by helping her clients make good decisions regarding taxes, saving, estate planning, insurance planning, social security planning, investing, and anything else that will help her clients achieve their goals in life, particularly financial security.

If her client inherits $500,000, Joan will make sure that her client is fully funding her retirement accounts, her health savings account, and any other tax-favored accounts. She might set aside some money so that her client can keep funding those accounts for the foreseeable future. Joan will look at her client's debts, including her home mortgage, in order to decide if the inheritance should be used to pay off those debts. If there is money left over, Joan will likely recommend some low cost ETFs or mutual funds. Or maybe some CDs if the money will be needed in the near future. Or maybe some alternative investments if the client needs more diversification. And after preparing a retirement income analysis and concluding that her client is in good shape, Joan might also suggest that her client take that exotic vacation.

CONCLUSION

Joan is a fiduciary. She works for the client and puts her clients' interests first. She sells advice, not products. She is part of a profession and she has clients.

Jack is not a fiduciary. He puts the interests of his company's shareholders first. He sells products, not advice. He is part of an industry and he has customers.