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Fiduciary Responsibility Places Client's Interest First

Fiduciary is the hot buzz word in the financial planning community these days. There have been some rather significant changes and court rulings in the past year or so that have revolved around whether financial advisors should be held to a fiduciary standard. The movement has been towards requiring all financial planners to act as fiduciaries, which, in my opinion is a good thing as there are potentially less conflicts of interest and more protections for the consumer.

What does fiduciary mean? Essentially, it means the advisor must put the client's interest first and recommendations to the client are required to be in the client's best interest, even if that means the recommendations are not necessarily in the advisors best interest.

Why are fiduciaries such a hot topic these days? To answer this question a bit of background is required. Financial planners are required to be licensed as Registered Investment Advisors (RIA's). Registered Investment Advisors must adhere to the Investment Advisor Act of 1940, act as fiduciaries and put their client's interests first. Back in 1999 the SEC proposed a rule that exempted stockbrokers from registering as investment advisors if they only provided financial planning advice that was "incidental" to their practices as brokers. This rule became informally known as the Merrill Lynch rule, probably because Merrill Lynch was one of the larger firms to benefit from the ruling. But, the perception is that the stockbrokers are doing much more financial planning than what most people would consider incidental. Watching the ads on TV, they certainly give the appearance of being financial planners, rather than just stockbrokers.

So, the Financial Planning Association (of which I am a member) sued the SEC over the ruling and the perceived double standard. This spring, the court agreed with the FPA that brokers must be registered as financial planners or stop providing advice to their clients. Only time will tell what the long term ramifications of the court ruling will be.

Another significant development in the past year or so is the Pension Protection Act of 2006 enacted by ERISA. ERISA oversees the qualified retirement plans such as 401(k) plans. As part of the Pension Protection Act, ERISA now requires that only fiduciary advisors may provide advice to participants (meaning employees) in qualified retirement plans. This means that the salesman who is selling a company a 401(k) plan might not be able to provide advice to the employees about which specific mutual

funds he or she should invest in within the 401(k). If the salesman is going to benefit by employees choosing mutual fund A over mutual fund B, the company must hire an independent third party to give specific advice to their employees.

Finally, the Certified Financial Planner Board of Standards has been updating the rules that all CFP® certificants must adhere to. As it stands now, one of the proposed rule changes is that all CFP® professionals must act as a fiduciary whenever providing material elements of financial planning. The language isn't as strong as requiring all CFP® practitioners to act as fiduciaries all the time but at least it requires CFP® professionals to act as fiduciaries most of the time, which is at least moving in the right direction.

What does all this discussion regarding fiduciaries mean for consumers? Hopefully, as more financial planners are held to a fiduciary standard, it means better protection for consumers, more disclosure of how an advisor is paid and less conflicts of interest. This ultimately should result in a higher degree of trust between advisors and clients.

Consumers should ask the tough questions of a potential advisor (or their existing advisor). The tough questions include understanding exactly how the advisor is compensated, whether the advisor pays or accepts referral fees, whether the advisor receives any incentives or awards for selling certain products and is the planner involved in any other businesses that might be a conflict of interest. And of course, the two most important questions of all are whether the advisor is operating as a fiduciary and is the advisor licensed as a Registered Investment Advisor.