



# THE FIDUCIARY STANDARD AND THE INDIVIDUAL INVESTOR

**KIMBERLY FOSS**

President and Founder

CFP®, CPWA®

Some investors may recall the discussion around President Trump's January 2017 decision to delay implementation of a rule proposed by the Department of Labor (DOL) to require any financial professional providing investment advice to holders of IRA accounts to operate according to a fiduciary standard. The rule, often shortened to "the fiduciary rule," would have mandated that anyone providing investment advice or products for IRA accounts was required to give advice that was in the client's best interest.

It's fair to ask: What is wrong with a rule that requires those providing financial advice for owners of IRA accounts—or any other investment account, for that matter—to always give advice or otherwise conduct their business in a way that is in the client's best interest? After all, isn't that what any investment client should expect?

As it turns out, the answer isn't so simple. In fact, after the "fiduciary rule" was delayed, it was ultimately struck down by the Fifth Circuit Court in March 2018. When the Securities and Exchange Commission (SEC) subsequently proposed new rules for some broker-dealers in an attempt to close a perceived gap in the expected standard of advice and service provided to investors, they were met with stiff opposition from many of the most well-known names in the financial industry, including several large Wall Street firms.

## Understanding What Is at Stake

To understand what the disagreement is about—and why it matters to you as an individual investor—it's important to get clear on a couple of key terms. First of all, you need to understand what is meant when a financial professional is referred to as a "fiduciary." Here's a definition, from LetsMakeaPlan.org, the website of the Certified Financial Planner® (CFP®) Board: a fiduciary is professionally and ethically committed to "act in their client's best interests, at all times when providing financial advice to a client."

What does it mean, in real-world terms, to act as a fiduciary—always in the client's best interest? The CFP® Board Code of Ethics requires that a fiduciary advisor will:

1. Place the client's interests above their own interests or the interests of their firm.
2. Avoid conflicts of interest with clients or obtain informed consent and properly manage the conflict.
3. Continue to put the client's interests first, even when acting under a conflict of interest.
4. Comply with the terms of the client engagement and follow client directions, so long as they are reasonable and lawful.
5. Act with care, skill, prudence, and diligence based on the client's goals, risk tolerance, objective, financial status, and personal circumstances (Source: <https://www.letsmakeaplan.org>).

By comparison, many broker-dealers and other providers of financial services are required only to meet the standard of “suitability.” In other words, they may recommend any product or service to a client or prospective client as long as they judge it to be “suitable” at the time of the recommendation.

### Suitability Standard vs Fiduciary Standard

Suppose you want to buy a car. You don’t know much about cars, but you have a list of characteristics that you would like your new car to have. As it happens, your list of characteristics exactly describes features available only with a particular vehicle—let’s say it’s a Toyota Highlander. But you don’t realize that (remember, you don’t know much about cars), and you go to the first car lot you see: a Ford dealership.

The salesperson listens to your list of characteristics and says, “Based on your description, I believe a Ford Explorer would be suitable for you.” And she proceeds to sell you a Ford Explorer. The salesperson has upheld the suitability standard. She has not told you that a Toyota Highlander would have exactly fulfilled your requirements, because the suitability standard does not require that. She has also not told you that she will receive a commission for selling you the Explorer that she would not receive if you buy a Highlander, because the suitability standard doesn’t require that, either. The suitability standard requires only that the person providing the product or service judges it to be suitable for you at that particular time.

What if your car salesperson had been acting according to the fiduciary standard? In that case, after listening to your description, she would have said, “It sounds like you would be best served by a Toyota Highlander. We don’t sell those here, but you can go to the Toyota dealer down the street and find one there. Here is a list of prices for that type of vehicle, and the dealer can tell you how much of your purchase price goes toward any selling fees or commissions.”

See the difference? Suitability only requires that the provider believes the recommendation to be suitable to your needs at the time. It does not require that you be informed of the conflict of interest that exists (the salesperson receives no commission if you don’t buy a car from her dealership). It does not require that you be informed as to how your best interest is being served. It does not require that the provider place your interests above those of herself or her employer. Fiduciary duty, on the other hand, requires that your interest comes first, regardless of the effect on the provider. Further, if the provider were to receive a commission or other compensation as a result of their work with you, they would be required to tell you that—and put it in writing—prior to delivering the product or service.

Obviously, though buying a car is an important transaction, it typically doesn’t have the same type of long-term ramifications as investing for retirement or to fund your child’s education. That is precisely why it is vital, when you are looking for investment or financial planning advice, to understand what type of standard is governing your provider’s behavior. Not only

that, but you will want to be assured that your provider will continue to operate according to your best interests as your financial needs and goals evolve and change over time—not just at the time of the initial transaction. To guarantee that your provider is adhering to the highest and most demanding standards on your behalf, you should seek out a professional who is a fiduciary—with all the obligations and requirements that implies.

## The High Cost of Bad Advice

In its most recent report on the topic of advising standards for retirement accounts, the White House Council of Economic Advisors estimated that biased investment advice costs retirement accounts as much as \$17 billion annually. Reduction in rates of return by as little as 1% per year—because of inferior returns or unnecessarily high fees or commissions—could reduce the amount of money available to fund your retirement by as much as 25% over 35 years (source: Liz Weston, “The Steep Cost of Bad Financial Advice,” *MarketWatch.com*, January 21, 2020). Suppose you are 32 years old and you have \$100,000 in a retirement account to which you are adding \$100 every month. If you are able to earn an average return on your account of 6% from now until your full retirement age of 67, you would have a balance in your account of \$902,330. But if, because of paying too much in fees and commissions or slightly worse performance of your investments, you averaged earning 5% over the same period, your balance at retirement age would be reduced by \$242,350, to \$659,980 (Source: “Compound Interest Calculator” investor.gov).

That’s a pretty steep price to pay, especially if you had access to fiduciary advice. Typically, a fiduciary advisor is obligated to minimize any investment fees as much as possible and to disclose all fees in advance. Fiduciaries are also required

to provide thorough, professionally vetted information about the performance, advantages, disadvantages, and other characteristics of investments they recommend for your account.

## Expenses Matter

You might think that it doesn’t really matter so much which stock or mutual fund you invest in. After all, aren’t they all run by investment professionals? Does it really matter which one you buy, or who you buy it from?

Actually, it matters quite a bit. In fact, one reason that a fiduciary advisor can be advantageous is that most fiduciaries do not receive commissions for selling you products. With other investment and financial professionals, this is not the case. In fact, some mutual funds will offer special promotions or enhanced commissions to encourage brokers and other investment sales people to push their products. Such a situation creates a conflict of interest: the salesperson’s interest in earning a commission or special bonus may unduly influence their decision to offer a particular product to a client, whether or not that product is in the client’s long-term best interest.

But commissions to salespeople are just one of the expenses that can affect your total rate of return. For the large number of investors who put money into mutual funds, it’s also important to consider the fund’s expense ratio. The expense ratio of a mutual fund is a percentage of the total amount of money held by the fund that it collects in order to pay administrative and management fees. Funds that are actively managed—which typically means that the fund manager makes frequent buying and selling transactions in an effort to increase the fund’s return—usually have much higher expense ratios than funds that are more passively managed, such as index funds and exchange-traded funds (ETFs). For many actively managed funds, the expense ratio can

easily be 1% or even more—money that comes out of the fund before you ever see the results in your account.

## Expenses in Real Life

Let's look at another example. An investor—we'll call him Jack—decides to put \$500 into a mutual fund each month. He continues to make monthly investments for 30 years, investing a total of \$180,000. Jack is delighted to realize that his mutual fund has averaged an annual return of 7% over the 30-year period. But Jack hasn't fully realized how the commissions and other fees that he has paid each year have affected his final outcome. Here's a chart that illustrates Jack's experience:

Total annual investment fees	Account value after 30 years	Amount lost to fees
0%	\$588,032.77	\$0
0.25%	\$561,515.53	\$26,517.24
0.5%	\$536,320.22	\$51,712.44
1.0%	\$489,628.12	\$98,404.65
1.5%	\$447,454.73	\$140,578.04
2.0%	\$409,348.84	\$178,683.93

Source: Arielle O'Shea, "Understanding Investment Fees: From Brokerage Fees to Sales Loads," *NerdWallet.com*, June 19, 2020

As you can see, that 7% return earned by the mutual fund didn't fully reflect Jack's experience. Because of the various expenses charged by Jack's advisor and the mutual fund, the 7% total return achieved by the fund actually benefited Jack to the tune of about 5%, after fees.

## Other Benefits of a Fiduciary Advisor

But working with a fiduciary advisor isn't just about saving on fees and other investment expenses. A fiduciary advisor is legally and ethically obligated to consider your complete situation before making any investment or financial planning recommendation. A reliable fiduciary advisor, in fact, will typically not make or recommend any investment or other course of action before spending time listening to you, asking questions about your goals, resources, and priorities, and gaining a thorough understanding of what is most important to you, both now and in the long term.

In other words, a fiduciary advisor does much more for you than simply carry out buy and sell orders. A Certified Financial Planner® (CFP®) or other fiduciary advisor is trained to deal with not only investments, but other complex financial issues that can include taxation, financial planning, philanthropic priorities, and other matters. They are trained to stay with you for the long haul, providing advice and guidance for all the changing financial circumstances of your life and career.

## Types of Financial Advisors

The world of finance and investing can be a pretty confusing place, and that is also true when thinking about the different types of services and advice available. To gain a better understanding of more of the advantages a fiduciary advisor can offer, let's take a look at some of the different types of finance and investment professionals, along with the type of advice and information they can offer. (The source for this section is [LetsMakeAPlan.org/other-resources/types-of-financial-advisors](https://letsmakeaplan.org/other-resources/types-of-financial-advisors))

**1. Stockbrokers.** Sometimes called registered representatives, stockbrokers are licensed by the state or states where they practice. They are trained to buy and sell securities such as stocks, bonds, and mutual funds. They are typically paid by commissions they earn for executing transactions on behalf of their clients. Stockbrokers are registered with a brokerage company that is a member of the Financial Industry Regulatory Authority (FINRA). They must pass a series of exams before they can perform services for clients. They are not required to be fiduciaries.

**2. Insurance agents.** These persons are licensed by one or more states to sell life insurance, health insurance, and annuities. Because some annuity products contain mutual fund-type investments, many insurance agents are also licensed and registered to sell mutual funds. Insurance agents are not required to be fiduciaries.

**3. Accountants.** These professionals are trained to advise on tax matters and to help you prepare and submit your return to the IRS each year. Many accountants hold the professional designation of Certified Public Accountant (CPA), which requires passing a stringent series of exams and then maintaining professional training each year. These professionals are licensed by the state or states in which they practice. Most accountants and CPAs do not offer investment advice.

**4. Estate planners.** If you require advice on estate taxes or structuring your estate in some other way, an estate planning professional can help you. Many estate planners are also attorneys, which is required for drafting wills, trusts, and other legal documents. Estate planners primarily offer legal advice in connection with estate matters; most do not also offer investment or financial planning advice.

**5. Investment advisers.** These individuals or firms provide advice about investments in exchange for compensation. They are registered with the Securities and Exchange Commission (SEC) and, typically, also with state agencies. Because of their registration, they are sometimes called RIAs, or registered investment advisers. Many RIAs are compensated by fees charged to their clients, usually calculated as a percentage of the assets under management. Many RIAs are fiduciaries.

#### **6. Certified Financial Planner® (CFP®).**

These individuals hold professional certification for meeting the educational, experience, and ethical requirements of the CFP designation and for passing all required examinations and renewal requirements of the CFP Board. CFPs are held to the highest standards of ethics, competency, and professionalism. They are also required to act as fiduciaries in all dealings with clients.

### **Asking the Right Questions**

As you search for an advisor who can help you design a financial plan that is built around your unique needs, goals, resources, and life priorities, you are well advised to work with an advisor who is a fiduciary—who is obligated to place your best interest first in all situations. The best way to assess how a particular advisor stacks up in these important areas is to ask them some important questions and then listen carefully to the answers:

- How do you get paid?
- How do you decide what investments to recommend?
- How will you become familiar with my situation and needs?
- How often can I expect to meet with you about my account?
- What is your practice for returning calls

or responding to emails?

- What if I have questions later?
- Will you give me a list of costs and fees before making an investment?
- What are your qualifications?
- What is your investment philosophy?
- How will you allocate my assets?
- Can you help me minimize the effect of taxes on my investments?

There are many other questions that could be asked, but the answers to these will give you a good idea. Any advisor you work with should be able to answer clearly, without using a lot of financial or investment jargon. You should feel comfortable that all communications are honest, understandable, and display evidence of both professional competence and concern for you and your situation. If the conversation doesn't meet that test, you should find a different advisor.

## Conclusion

Your financial well-being is too important to leave to chance. It is also too important to spend time on advice that isn't targeted toward your best interest. You deserve the type of professionalism, competence, and care that a fiduciary advisor can provide.

## About the Author

I was born and raised in Auburn, California, a town founded in 1849 during the gold rush. One of Auburn's original settlers was my great-great-grandfather, Daniel Austin Rice, the first Wells Fargo agent in the greater Sacramento Valley. A career in finance always seemed to be written in the stars for me.

But it was a dream that was hard to come by. I grew up the youngest of six children from humble means. We didn't have much, but one of the things my parents gave me in abundance was the ability to dream.

In order to achieve my dreams, I learned how to believe in myself. That belief landed me a job at Merrill Lynch post-college, where I was the youngest female account executive at the time. It drove me to leave the commission-driven environment of a stock brokerage firm to establish Empyrion Wealth Management. And it led me to write my book, "Wealthy by Design: A 5-Step Plan for Financial Security," which made it to #7 on The New York Times Bestsellers List.

It all comes down to the power of choice — and my life's work is to give that power to my clients, which include affluent family stewards, women in transition, and thriving retirees. As a fiduciary, I strongly believe in putting people over profit and service above self. My sole priority is to provide my clients with the independent advice, tools, and analysis they need to make the best financial decisions for themselves and their families. Backed by a research-driven, disciplined, and diversified investment philosophy, I'm committed to guiding my clients to new levels of financial abundance and security, so they can soar farther in life than they ever dreamed possible.

In addition to my work as a financial advisor, I'm also proud to be one of the industry's leading personal financial experts and thought leaders. I frequently share my expertise on the markets, financial planning, and investing with some of the nation's most reputable media outlets, including The Today Show, Good Morning America, CNBC, Forbes, The Wall Street Journal, Fox News, Fox Business, MSN Money, Investor's Business Daily, and U.S. News & World Report.



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