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THREE THINGS TO LOOK FOR IN A FIDUCIARY FINANCIAL ADVISOR

By: Michael Tove, Ph.D. - July 26, 2020

Picking the right financial advisor could be one of the most important decisions you make. A considerable amount of research and experience have consistently revealed that devising and sticking to a long-term financial plan, particularly one that is professionally made and customized to an individual's needs, has a far better chance of success than anything else. But deciding who to help you with that plan can be as daunting as picking the "right" investment.

There are literally thousands of financial offers out there including through TV ads, free dinner seminars, and even outright direct solicitations. Who do you trust? Your employer's human resources department? Your bank? Your friends and relatives? The internet (rife with "suggestions" that are really advertisements)? And then there are the folks who overtly bash one segment of the financial services world that invariably is competitive to their own (who hasn't encountered the "I hate annuities and so should you" pundits). It all seems so confusing and contradictory.

The good news is you only need three things to look for in a professional financial advisor.

1. Licensing as an Investment Advisor

An Investment Advisor Representative affiliated with a Registered Investment Advisor firm is an advisor with a legal, fiduciary requirement to represent only the best interest of the client and not their own and not that of their employer. In 2020, the SEC enacted "Reg BI" (Regulation Best Interests) which established a "standard of conduct for broker- dealers and associated persons when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities, including recommendations of types of accounts."

Reg BI and Fiduciaries

Among other things, Reg BI mandated that effective July 1, 2020, Investment Representatives who are NOT licensed through Registered Investment Advisors (as Series 65 or Series 66 securities licensees) may NOT refer to themselves as "Advisors" or "Advisers" (either spelling). Reg BI sought to make non-RIAs act in a fiduciary capacity but the regulation stopped short of conveying the full legal responsibility of a fiduciary that is imposed on RIAs. That's the reason that Reg BI applies to registered reps of brokerage firms but not to RIAs who were already held to a higher standard.

CONCLUSION #1: With some exceptions, only a licensed Investment Advisor Representative (emphasis on the term "Advisor") has the legal obligation to act as an investment advisor with a full legal fiduciary responsibility. While other financial representatives are expected to act that way, they are not held to the same standard as a bona fide fiduciary.

2. Independent Affiliation of an Advisor

Regardless of the licensing, when an advisor or financial representative is employed by a big-name firm, whether an investment firm, a bank or an insurance company, the financial products that representative is permitted to offer may be strictly limited to those approved by his/her employer. Regardless of intent and licensing, when the menu of possible financial offerings is artificially curtailed, the advice and recommendations that follow are biased and technically not fiduciary.

CONCLUSION #2: Only a truly independent licensed advisor, without limits imposed by circumstances of employment or differential compensation to recommend one financial product over another, can operate without potential bias or conflicts of interest.

3. Dual-Licensed Financial Advisor

If your independent financial advisor is only securities licensed and not also independently insurance licensed, or insurance-only and not securities licensed then any financial recommendations you receive may be biased toward one industry and away from the other solely because of that licensing limitation. There's a lot of "noise" out there about how terrible one industry is compared with the other. Such talk is highly biased and not fiduciary. Both industries offer valid, legitimate and important solutions in the financial space but only to the extent that product recommendations are individually suitable for a specific purpose. Within all of financial planning, there are very few universal truths, but one that is asserts, "No industry, company, or product is right for everybody and no industry, company, or product is right for anybody's every dollar."

CONCLUSION #3: Only an advisor independently licensed BOTH in insurance and securities (investments) can offer unbiased advice regardless of industry.

In an interview published in Barrons, STANCO 25 Professor of Finance, Emeritus at Stanford University's Graduate School of Business and Nobel Laureate William F. Sharpe said:

"Right now, you tend to have investment advisors for retirees, and insurance advisors or salespersons for retirees, and it's fairly rare to go to somebody who can sell you annuities or invest your money and has no financial incentive to tilt one way or the other. Ultimately, what I'd like to see are people who have knowledge of both annuities and investments, and who are compensated in a way that doesn't influence the decision."

Although offered in direct response to a question about choosing between investments or annuities, Dr. Sharpe's response nonetheless advocates for a higher concept of unbiased advice which is the hallmark of fiduciary planning.

What exactly is a fiduciary?

The term (and concept) dates back to the 1640s and includes two separate, but related components:

1. A fiduciary is someone who is held to a higher standard.
2. A fiduciary is someone who has no artificial bias for or against any segment of the financial services industry other than what is in the best interest of the client.

Unfortunately, anyone can "claim" to be a fiduciary. But only someone who meets all three criteria – licensed advisor, independent of company affiliation, and dual licensed (insurance and securities) – can truly operate without bias and as such, function in that capacity.

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