What Is Fiduciary Advice?

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Anyone searching for investment advice is undoubtedly confronted with many choices of service providers operating under titles such as *certified financial planner, financial consultant, registered investment advisor, stockbroker,* and *insurance agent*. These titles can be confusing because on the surface it is not clear whether these professionals are legally required to have a client's best interest in mind when making investment recommendations.

Many investors may have read that the Department of Labor (DOL) announced a substantial overhaul in the regulation of financial advice given on retirement savings. Central to this discussion are two terms: fiduciary and suitability. What does it mean for an advisor to operate on a fiduciary standard, and how does this differ from a suitability standard?

THE FIDUCIARY STANDARD

The DOL has described a "fiduciary" as someone who is required to put their clients' best interest before their own profits. Fiduciaries include registered investment advisors, advisors to mutual funds (like Dimensional), and others who hold themselves out to be fiduciaries (like trustees and certain retirement plan consultants).

Probably most importantly, clients can expect that a fiduciary will act with transparency and avoid prohibited conflicts of interest.

Fiduciaries are required to act impartially and provide advice that is in their clients' best interest, and in doing so, must act with the care, skill, prudence, and diligence that a prudent person would exercise based on the current circumstances. A fiduciary must avoid misleading statements about fees and must avoid conflicts of interest.

Fiduciaries are typically compensated by payment of a fee rather than a commission. Fiduciaries to retirement plans, plan participants, and IRAs are also prohibited from receiving payments that create conflicts of interest unless they comply with the terms of certain exemptions issued by the DOL.

Fiduciaries are personally liable for breaches of their fiduciary duties. For example, if there is a loss caused by a breach of fiduciary duty, the fiduciary must make the plan or IRA whole by restoring any losses caused by the breach and restoring to the plan or IRA any profits made through the use of plan or IRA assets. Civil actions to obtain appropriate relief for a breach of fiduciary duty may be brought by a participant, beneficiary, fiduciary, or the US Secretary of Labor, and the fiduciary may be subject to excise tax penalties.

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THE SUITABILITY STANDARD

Historically, representatives of a broker-dealer are required under the securities laws to judge the *suitability* of a product for a prospective investor, based primarily on that person's financial goals, income, and age. Unless agreed otherwise, under this standard the rules do not legally require a recommendation of the most cost-effective product, a disclosure regarding conflicts associated with the investment, or disclosure of the compensation received when making that recommendation. Under the new DOL rule, it may mean that common forms of broker compensation, such as commissions and revenue sharing, will be restricted.

A SINGLE STANDARD OF ADVICE

As many financial advisors are dual registered as both brokers and investment advisors, it can be difficult to determine under which standard investment advice is given. A primary goal of the recent regulatory changes was to create a single standard for retirement financial advice based on a *fiduciary* model. Many clients already receive fiduciary advice, and for those clients the change in rules will not have much impact. Following the new DOL rule, it may be the case that professional financial advice for retirement assets (whatever the source) is subject to a level fiduciary standard.[1] However, as with any investment advice, clients should conduct their own research, ask questions, and learn more about the reputation and philosophy of an advisor.[2]

1. Note that in certain circumstances, information provided by advisors or brokers may not be treated as fiduciary advice. Some examples of these exceptions from the new DOL rule are providing general investment education, simple "order-taking" (executing an order to buy or sell without providing a recommendation), or certain "robo-advice."
2. For informational purposes only and not for the purpose of providing tax or legal advice. You should contact your tax advisor or attorney to obtain advice with respect to any particular issue or problem.

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