

Fee Only and Fiduciary Responsibility

I recently read an article about how to find a financial advisor/financial planner. The first admonition was to make sure you looked for a person who was “fee only”. The second piece of advice was to determine if the advisor operated as a fiduciary.

Most people have a feeling for the meaning of “fee only” but I find that with respect to the meaning of “fiduciary” there is a real misconception. To be on the safe side, I am going to take time to define each of the terms.

Fee Only Advisors

Sometimes the best way to define something is to state what it is not or what it does not do. Fee only advisors DO NOT accept commissions. Fee only advisors DO NOT sell products. Clients pay a fee only advisor for the advice they receive. They operate the same way an attorney does.

Some investors might say what difference does it make? The advisor is going to get paid either way and it is going to cost me. The consensus of opinion in the industry and which I believe is that accepting commissions can create a conflict of interest. Here is an example. If a client has \$100,000 to invest there are numerous vehicles that could be used. One choice might be an annuity. The commission would be \$5,000-\$7,000. The advisor would receive 80-95% of that commission within 2-4 weeks.

If on the other hand, the choice for investing is a diverse portfolio with an investment fee of 1%, the advisor would receive \$250 within the next three months. The next fee would be based on the value of the investment at the end of the following quarter.

Two things are important here. First, the advisor has a continuing interest in the investor when using the diverse portfolio investment while the investment in the annuity is a done deal.

Second, does the advisor have a conflict over the fact that his/her bank account will have \$5,000 added to it in two weeks or \$250 in three months? I believe that the great majority of advisors will put the investor’s interest first but my personal choice is to avoid the potential conflict and operate my firm as FEE ONLY. In the interest of complete disclosure, in the past, I worked as a fee based advisor which means I either accepted fees or commissions.

Fiduciary Responsibility

When I received the designation of Certified Financial Planner™ I agreed to operate as a fiduciary. Being a fiduciary means that in everything I do in my practice I MUST put the client's interest first. That is the same standard to which an attorney must adhere. A fiduciary is someone who has undertaken to act for and on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. A fiduciary has both a legal and ethical obligation.

Your first reaction might be that my broker does the same for me. That probably is true EXCEPT your broker does not have a fiduciary responsibility to do so. A broker operates under the concept of "suitability" i.e. is the product suitable for the client. Further, your broker does not work for you. He/she works for the broker dealer. Examples of broker dealers are Smith Barney, Merrill Lynch, Edward Jones and Fidelity. There is controversy going on now in the industry because the Securities and Exchange Commission (SEC) wants to require brokers to be fiduciaries. The broker dealers are fighting against the SEC.

Here is another misconception. A sponsor of a 401k plan i.e. the employer, often believe that the administrator of the plan, in most cases broker dealers or insurance companies, is the fiduciary of the plan. That is not true. Unless the sponsor has taken definite steps to transfer the majority of the fiduciary responsibility, it is retained by the employer. The Department of Labor has proposed new regulations with regard to 401k plans and addressing fiduciary responsibility is in their cross hairs.

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