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The Changing Roles of the Investor and the Investment Advisor

How "Conflicted Advice" is Changing the Conversation About Investment Success

Recent media headlines have generated discussion about the U.S. Department of Labor's pending rule about fiduciary responsibility. The topic is being shared both nationally and globally, from The White House to major news sources – and it could completely change the face of investing.

As an investor, what should you look for in light of recent information about conflicted advice? And as an advisor, how is success in investing conveyed and measured? This whitepaper looks at these important points in light of pending changes to fiduciary rules and responsibilities.

The White House Highlights Conflicted Advice: 2015 Report Warns Advisors of Potential Losses

Investors have many choices, including from whom they choose to take advice. Unfortunately, there are a number of advisors who operate under a business model that has been estimated to be costly to clients. Early in 2015, The White House released a report titled, "The Effects of Conflicted Investment Advice on Retirement Savings." Commission-based advisors, according to the report, put their clients at risk because they impose sales charges and don't offer an objective viewpoint on investment products they sell to clients.

The report says that investors who take conflicted advice can see up to a 12 percent loss in potential growth in their IRAs over a 30-year period. While not all advisors lose money for their clients, the report spells out how conflicted advice can lead to less productivity. By comparison, investors who listen to fee-only advisors get a more objective viewpoint and potentially better returns. The terminology between fee-only and fee-based advisors is confusing, and confusion is often advantageous to fee-based advisors who make additional profits from commissions rather than solely through fees.

There's another type of challenge for investors to navigate in addition to conflicted advice. It's the advice presented by robo-advising tools, which can be void of human problem-solving and intuition skills.

The Rise of the Robo-Advisor: Investors and Flawed Advice

In recent years, more automated investment services have entered the market to appeal to the DIY investors looking toward technology to help guide their investment decisions, rather than a live advisor that offers the human touch. An article in *U.S. News & World Report* in September 2015 proposed that robo-advisors might be utilizing flawed financial theories. "Many robo-advisors use modern portfolio theory," the article states, "which is a financial hypothesis that attempts to maximize a portfolio's expected return for a given amount of risk."

Modern portfolio theory challenges include the definition of risk and the fact that the model relies on historical returns and volatility, leaving out the important aspect of current market conditions. Finally, a machine doesn't get to know the investor. Most robo-advisors will only ask a few questions to determine risk tolerance and goals for the future, which is an extremely impersonal approach and more likely inadequate.

The Department of Labor Fiduciary Rule: The Pending Rule that Could Change the Face of Investing (and How Investors Work With Advisors)

Near the end of 2015, President Obama remained steadfast on a proposal that is aimed at protecting investors from high-fee investments that compromise their retirement portfolios. The Department of Labor, which is currently evaluating comment letters regarding the rule, expects the final fiduciary rule language to be announced in 2016.

The fiduciary rule would impact anyone who gets paid for giving individualized advice to a retirement plan sponsor, participants in a retirement plan, or IRA owners. It affects brokers, registered investment advisors, insurance agents and any other kind of advisor. It would also require the fiduciary advisor to act impartially, always advising according to what he or she believes is in the client's best interest. President Obama has "fast tracked" the rule, but the Department of Labor continues to gather feedback.

The Department of Labor recently released a fact sheet about the need for creating a widespread fiduciary rule, including:

- Investors lose an estimated $17 billion a year due to conflicted advice.
- The new rule will protect families from conflicted advice by requiring retirement advisors to abide by a fiduciary standard, thus putting their clients' best interests before their own.
- These protections could save tens of billions of dollars for middle class and working families.

Breaking Down the Terminology: Cutting Through Confusion for Investors

Fee-only vs. fee-based: A fee-only advisor charges investors a fee that is generally a set retainer or percentage of the overall portfolio amount. The fee-only advisor is already conducting business under the fiduciary rule, meaning they must keep their clients' best interests in mind with every piece of advice they offer.

In contrast, a fee-based advisor earns at least some of their income from commissions they earn selling investment products. Although some may work on a fee basis for certain clients, selling investment products (and earning sales commissions) is a substantial part of their income.

Non-conflicted and unbiased advice: The opportunity for investor success may rise when the investor receives non-conflicted and unbiased advice from an investment professional. These are professionals who are not swayed one way or the other by a commission. Therefore, they seek out only the opportunities that best match the needs of the client.

When selecting an advisor, an investor should know basic key terms to avoid confusion, along with considering which type of advisor best meets their needs. This is especially important as the terms continue to receive numerous media mentions and reports (thus potentially causing even more confusion). Investors can also come prepared with a list of questions related to the ways an advisor gets paid and the advisor's philosophies toward working with clients. This may include learning whether or not the advisor is conversational in tone, or formal; whether they prefer stories or jargon for communication with clients; and how they react to market volatility, for example.

How Would a New Fiduciary Rule Affect Advisors?

Fee-only advisors are already operating under a fiduciary standard, meaning they are acting in the best interests of the client and operate out in the open with full disclosure. However, the fee-based advisor group may become more vocal should the new rule go into effect. Some of these comments may pertain to “conflicts” the pending rule could cause. A CEO for Raymond James commented in an article at InsuranceNewsNet.com that if disclosures needed to be made on every product it would take more time from the information technology perspective, and it would be costly to all involved.

Justin Kuepper said in an article on Investopedia.com that one of the problems with the fiduciary rule is that it could shift costs to the individual. For instance, should an advisor stop taking commissions on their products, they would recoup their profits through additional fees.

Conveying “Success” Fairly and Responsibly: What Investors Should Know in a Changing Climate

Most would define success with investments as seeing significant returns over time. However, many advisors find that true success is focused on service. If an investor doesn’t believe they’re getting value out of their relationship with the advisor, it’s often an indication that there is a lack of customer-centric sentiment. Kim Brown, president of JNBA Financial Advisors, said they attribute their 96 percent client retention rate to their focus on value of service.

Brown said her company finds success in creating a financial plan that offers clients the framework to meet their specific goals and objectives. This involves being flexible to readjust when necessary. At the end of the day, Brown says investors need to ask themselves if their advisor is helping them to sleep better at night; is the relationship a partnership; and if they feel confident about their financial future. If the answer is “no,” it’s time to move on to an advisor who communicates better and cares more about comprehensive service. As terms related to types of advisors continue to circulate and conversation heightens around the Department of Labor rule, investors are encouraged to remember that service should remain a key element of any advisor’s philosophies.

What to Look for in an Advisor: A Summary to Guide Investors

Due diligence is important as an investor. Ultimately, the decision is not as much about the money. Instead, it’s about the people whose lives are impacted by the money, such as children, grandchildren, charities, and others whom the investor values. Investors can look for the following attributes in their investment advisor, especially as federal reports and media coverage continue to highlight what “conflicted” advice truly means:

- He or she looks at the big picture. This can protect the investor from market swings and emotionally-charged responses.
- A client-centric approach is evident. Make sure the advisor isn’t motivated by sales (rather than investor goals) and that they are willing to disclose how they are paid.
- Communication is a priority. A good advisor will not speak over the clients’ heads. They will take the time to explain potentially complex topics in a language that’s understandable.
- The advisor who is licensed and credentialed. This might include a CERTIFIED FINANCIAL PLANNER™ (CFP®), Chartered Financial Consultant (CFC), Personal Financial Specialist (PSF), or any of over 200 credentials in the financial industry. However, don’t discount an advisor who doesn’t have every single certification. A long list of acronyms can’t replace an advisor’s genuine skill, experience and dedication to investment success.
- Look for a fiduciary. This is a person who has pledged to act in the investor’s best interest always, regardless of pending rules and changes in guidelines.

The Results of Working With a Fiduciary

According to The White House report on conflicted advice, implementing the fiduciary rule could save families more than $40 billion over 10 years. This is possible because the roles and expectations between the advisor and investor can be more clearly defined, due in large part to the fiduciary responsibility a fee-only advisor adheres to. With a high-pressure sales environment out of the picture, advisors and investors may be able to move forward together in a more straightforward way with client goals as the guiding focus.

The Family Investment Center Way – Always a Fiduciary Focused on Clients

The fiduciary rule might be shaking up the industry, but Family Investment Center was founded as a firm that holds the clients' interests as the priority. Dan Danford, CEO and founder of Family Investment Center, was ahead of his time when he established his company as a fee-only business in 1998. What was new and innovative nearly 20 years ago has become a go-to business model for investment advisors who are investor-focused. Danford and his team have never accepted commissions for investor success – believing instead that the success of seeing investors enjoy their plans and goals is the premium outcome. This means investor/advisor roles have also remained consistent, rather than being sharply impacted by potential rule changes.

Family Investment Center offers a team of professionals who know how to communicate complex ideas and offer experience and credentials in finance and investing. Serving clients in 13 states with more than $130 million in assets, the team at FIC continues to prove they are passionate about serving investors.

Conclusion

Investors have options when it comes to investing for their future. The Department of Labor is working to offer protections against retirement savings losses, but Family Investment Center already has the solution investors are looking for today: transparency, communication skills, industry knowledge and experience, all in a non-conflicted, client-centric environment.

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