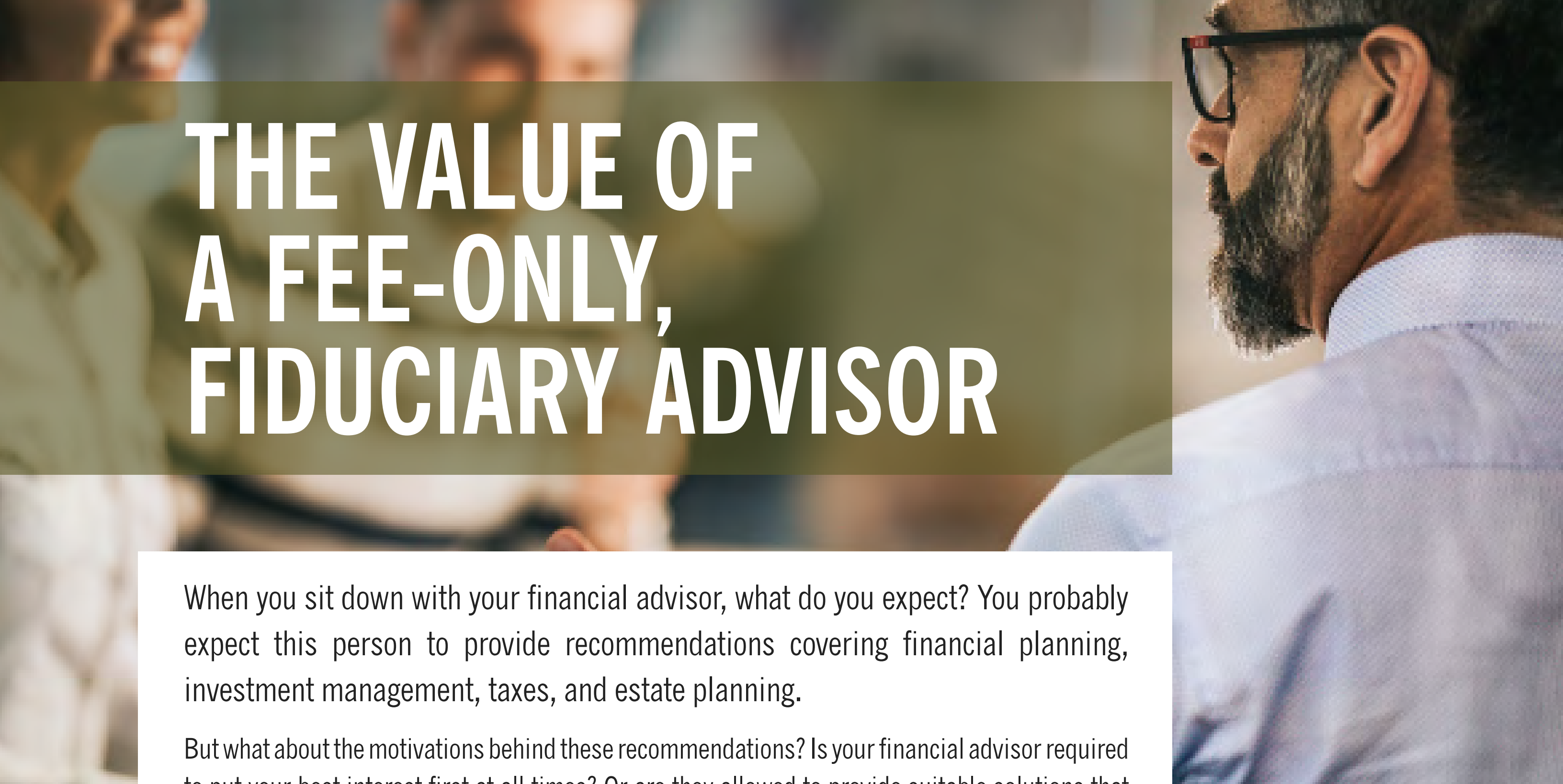

# THE VALUE OF A FEE-ONLY, FIDUCIARY ADVISOR

When you sit down with your financial advisor, what do you expect? You probably expect this person to provide recommendations covering financial planning, investment management, taxes, and estate planning.

But what about the motivations behind these recommendations? Is your financial advisor required to put your best interest first at all times? Or are they allowed to provide suitable solutions that also benefit their interests?

The answer to these questions can surprise new clients that we work with. In this article, we wanted to explore the fiduciary standard of care and explain how this can impact the quality of financial guidance you receive. As sworn fiduciaries, we would be happy to answer questions about what's covered.

## THE FIDUCIARY STANDARD AND THE BEST INTEREST STANDARD

Here is the headline: In the financial world, two different – albeit nuanced – standards of care exist. As a client, you have the option to choose which standard is right for you and your portfolio.

### The best interest standard

Under the best interest standard, advisors must make recommendations that are in the best interests of your financial needs, considering your long-term investment objectives and your tolerance for market risk. They must disclose any conflicts of interest that may be present in the relationship, like commissions, sales incentives, or bonuses that they receive. While this standard is certainly an improvement over prior standards of care, which did not require disclosure, the best interest standard may still encourage an advisor with a broker-dealer advisor to strongly recommend an investment that provides a more favorable outcome to the advisor.

### The fiduciary standard

The fiduciary standard of care takes things a step further by requiring advisors to put your best interest first in all aspects of their work. Solutions that are "suitable," "good enough," or "close enough" don't meet the fiduciary standard. Most importantly, a fiduciary advisor must avoid conflicts of interest when at all possible and inform you of any conflicts that do exist. For this reason, fiduciary advisors do not receive commissions for their work.

## HOW THE FIDUCIARY STANDARD IMPACTS YOUR PORTFOLIO

To understand how these two standards can affect your portfolio, let's consider the process of choosing a new investment fund. In this hypothetical example, we'll call them "Fund A" and "Fund B."

Both funds have nearly identical holdings, and they have performed the same over the last 10 years. The only difference is that Fund A charges an annual fee of 0.50%, and Fund B charges an annual fee of 0.70%. Fund B passes this extra 0.20% along to advisors that recommend Fund B to their clients, in the form of commission.

- If your advisor is held to the fiduciary standard, they are required to recommend Fund A. This is because Fund A provides the same investment performance as Fund B, but it charges lower fees to you, the client. Fund A is in your best interest, so it's the recommendation that your advisor is required to make.
- If your advisor is held to the best interest standard of care, they are allowed to recommend Fund B – with full disclosure of commissions - because it is still in the best interest of your investment needs. When you put money into Fund B, your advisor receives a commission and your advisor may actually be encouraged to use Fund B by their firm, because the firm gets a commission as well. All of this is legal as long as it is disclosed to you.

While the difference in this example was just 0.20% per year, consider this being extrapolated across each fund in your portfolio and over a 30 or 40-year time horizon. The fees can add up, but more importantly, we believe that the best interest standard can still encourage a culture of sales rather than encouraging objective financial guidance. This is the key reason why we work as fiduciaries on behalf of our clients.

## WHY AREN'T ALL ADVISORS FIDUCIARIES?

In the early 20th century, every financial advisor was held to a suitability standard of care; that's just the way that things were. Under the suitability standard (a precursor to the best interest standard), advisors had to make recommendations that were suitable for a client's financial needs, considering long-term investment objectives and tolerance for market risk. They were not required to disclose any conflicts of interest that may be present in the relationship, like commissions, sales incentives, or bonuses that they received.

The fiduciary standard was introduced through the Investment Advisors Act of 1940, and this was the first time that advisors (and their clients) had the option to operate under a different model.

In 2016 there was a major debate in Washington whether or not all advisors that provide investment advice on retirement plans should be fiduciaries. This question was at the heart of the "DOL Fiduciary Rule," and this rule was eventually struck down following months of lobbying from banks, broker-dealers, and insurance carriers. Their reasoning? They felt that the fiduciary standard would make their work too complicated.

Today, it is up to you, the client, to choose which model makes the most sense for you.

## DID YOU KNOW?

The fiduciary standard was introduced through the Investment Advisors Act of 1940.

This represented the first time that advisors (and their clients) had the option to operate under a different model.

## WHAT DOES "FEE-ONLY" MEAN?

Fiduciary advisors are required to avoid conflicts of interest, exactly like the one described in the example of "Fund A" and "Fund B." As a result, fiduciary advisors are "fee-only." This means they get paid in one of two ways.

- **A flat hourly rate for their time:** Under this model, the advisor charges you hourly for their work. The advisor's pay does not depend on which funds, solutions, or products that you utilize.
- **A percentage of assets under management:** Under this model, the advisor charges you a percent of "assets under management" - or the total amount of money that the advisor provides recommendations on. Their incentive is to grow and protect your portfolio, as their pay is directly tied to your portfolio size.

## HOW TO TELL IF YOU ADVISOR IS A FIDUCIARY

The first place to look is their registration. If the advisor (or their firm) is a Registered Investment Advisor (RIA), then you can be certain that person acts as a fiduciary. RIAs, by law, must adhere to the fiduciary standard of care when providing investment advice. If the advisor is not an RIA, considering asking direction questions.

- "How are you paid?"
- "Do you make more money if you recommend certain products?"
- "Are you required to put my best interest before your own at all times?"
- "Are you required to put my best interest before your firm's best interest at all times?"

## FIDUCIARY FINANCIAL ADVISORS IN CHICAGO

Since opening our doors, we've worked as fiduciary financial advisors in Chicago on behalf of our clients. If this sounds like the right fit for you and your portfolio, we invite you to connect with our team.