NH BUSINESS REVIEW

Does your advisor meet the fiduciary standard?

New federal rule sheds light on what investors should look for when getting financial advice

By Stephen G. Davis | July 8, 2016

As New Hampshire residents plan for their retirement, they have plenty of issues to keep them up at night. Chief among these worries are such financial issues as outliving their money, the impact of inflation on their purchasing power and their ability to pay for skyrocketing health care costs in their later years.

Should consumers also have to worry about whether the person giving them retirement advice is working in their best interest? Absolutely not. And that is not merely my opinion, but the opinion of the U.S. Department of Labor.

On April 8, 2016, the DOL released its final fiduciary rule, which aims to raise investment advice standards on retirement accounts by changing the way advisors can counsel clients on retirement assets. The regulation will be phased in and in full effect by Jan. 1, 2018. It requires financial professionals to abide by a "fiduciary" standard by putting their clients' best interest before their own profits when discussing retirement investment advice.

The last time the government made a major update to the policies surrounding retirement advice was more than 40 years ago with the passage of the Employee Retirement Income Security Act (ERISA) in 1974. The basic rules governing retirement advice have not been meaningfully updated since that time, despite substantial shifts in our private retirement system away from defined benefit plans and into self-directed IRAs and 401(k)s.

Even though advisors operating by the "fiduciary standard" have been available to the public for some time, the DOL rule has shed light on the differences in standards of advice and what investors should look for when selecting a retirement advisor.

In their ruling, the DOL cited a financial system where firms can benefit from backdoor payments and hidden fees often buried in fine print. A White House Council of Economic Advisors analysis found that these conflicts of interest result in annual losses of about 1 percentage point for affected investors—or about $17 billion per year in total.

The DOL reasoned how this conflict of interest affects individual investors: "A 1 percentage point lower return could reduce your savings by more than a quarter over 35 years. In
other words, instead of a $10,000 retirement investment growing to more than $38,000 over that period after adjusting for inflation, it would be just over $27,500."

In light of the new ruling, it's important for consumers to research and evaluate financial professionals (even ones they've worked with for years) by making a checklist of questions to ask when considering making retirement investments:

1. Do all investments fall under the DOL ruling?

No. The DOL ruling focuses on retirement savings only. Taxable investment accounts are not affected by the new
rule. For instance, if you work with a broker
and you want him to purchase stocks for you, those investments would not fall under the DOL ruling.

2. What is the difference between fiduciary and suitability standards?

A fiduciary advisor must put the client's best interest first and disclose any conflicts of interest that may occur. Advisors who live under a "suitability" standard can recommend products they deem are suitable for that client's needs, but just because they are suitable does not mean they are in the client's best interest.

3. How do I know if an advisor is a fiduciary?

One way to find out whether your adviser is a fiduciary or not is to ask if they are a Registered Investment Advisor (RIA). Registered Investment Advisors are required by law to act as a fiduciary and put their clients' interest first.

4. How does my advisor get paid?

Is your advisor commission-based, fee-based or some combination of the two? When you meet with an advisor, ask how they are being paid, if they are being paid by transaction and how much they receive per transaction. Also, ask if they receive more by recommending a specific financial product.

5. What DOL changes take immediate effect?

Some components of the rule go into effect within a year and another set will take two years.

Eventually, your financial advisor will ask you to sign a document called a "best interest contract," which will establish a fiduciary relationship between the two of you. Once that is in place, any advice you get on retirement savings will have to meet a standard that is about your needs.

While the DOL ruling provides much-needed consumer protection, remember that a certain amount of the burden remains on the individual. Consumers must do their due diligence when looking for a financial advisor. It's okay to put faith in the DOL ruling, just don't put blind faith that the ruling alone will provide you with the advisor that fits your needs.

Stephen G. Davis is founder and president of S.G. Davis Financial Group, LLC, an independent financial planning firm with three New Hampshire offices located in Concord, Nashua and Keene. He can be reached through sgdavisfinancial.com or call 603-715-2335.ruling.

This article appears in the July 8 2016 issue of New Hampshire Business Review