VirginiaBusiness.com
The fiduciary standard benefits investors
By Michael Joyce

When choosing a financial advisor, investors are well-advised to consider carefully the ethical standard to which different categories of advisors are held. These legal standards vary greatly within the investment industry — and can directly impact investors' returns and overall wealth-management plans.

The advisors who are held to the highest ethical standard in the investment industry are Registered Investment Advisors (RIAs). RIAs are legally obligated to meet the "fiduciary standard": that is, their investment recommendations must be solely in the best interest of their client. When an RIA is developing a wealth management plan, he or she must ensure that the client's interests come first.

Brokers, on the other hand, have a considerably lower threshold of accountability to clients when compared to RIAs. Brokers are required to recommend products they view as "suitable" for their clients. Unlike the fiduciary standard followed by RIAs, this "suitability" standard means that a broker may suggest higher-priced investment products to a client — even if the broker is aware of lower-priced options. Most investors do not realize this difference in standards, even though it can be an important consideration when making investment decisions.

Since many brokers make a commission on the products they sell, potential conflicts of interest can impact the quality of advice the investor receives. Some possible conflicts of interests in the commission model of broker compensation that many investors are unaware of include:

• A commissioned advisor may be tempted to make recommendations that pay higher commissions when a less expensive and/or more profitable alternative is available.
• A commissioned advisor might be motivated to recommend that a client convert non-cash assets such as real estate and collectibles to cash that can be reinvested so that the advisor can collect commissions.
• A commissioned advisor might be incented to advise a client to make investments so that the advisor may collect a commission, when in actuality holding cash may be a better recommendation at the time.
• A commissioned advisor may be tempted to unnecessarily buy and sell securities to generate commissions. (This practice is often referred to as "churning.")

It is expected that the Securities and Exchange Commission will extend a stricter fiduciary standard to brokers within the next five years. In April, the Wall Street Journal reported that those who support adopting a fiduciary standard for brokers do so because they believe the average investor does not understand the differences in the ethical standards that apply to different types of advisors. They argued, this "leaves the door open to abuses by brokers intent on selling products that pay them a commission, whether those investments are the best option for the buyer or not."

Until this stricter fiduciary standard is required for brokers, though, investors seeking advice on their wealth-management plans might be better served by someone who is already held to the fiduciary standard, has no incentive to promote less-than-ideal products and is legally obligated to work in the client's best interest. When it comes to your financial future and security, having the additional protection of a fiduciary standard is a wise investment.

Michael Joyce, CFA, CFP, is the president of Richmond-based JoycePayne Partners. He is responsible for the firm's overall investment strategy, management of investment portfolios and financial counseling services. Joyce can be contacted at mjoyce@joycepaynepartners.com.

© 2014 JoycePayne Partners