What it means for investors: Rules for financial advisers are changing

Lisa Kiplinger, USA TODAY 11:41 a.m. EDT April 6, 2016

Jamie Hopkins, professor at The American College of Financial Services, breaks down the new fiduciary standards and how it will impact you.

A big change for investors is set to come down the pipe Wednesday. That's when the Department of Labor unveils the final version of its long-awaited fiduciary rule, which is designed to ensure that investment advisers are putting their clients' interests ahead of their own when it comes to fees and investment choices. **Liz Davidson,** CEO of financial education company Financial Finesse and the author of *What Your Financial Advisor Isn't Telling You*, helps fills in the blanks for investors ahead of the ruling.

Q: What does the rule mean?

A: Under the Department of Labor's fiduciary rule, financial advisers providing investment advice for retirement accounts (including employer-sponsored retirement accounts, Individual Retirement Accounts and even many Health Savings Accounts) will now be subject to a fiduciary standard, which requires them to put the client's interest first, rather than the looser suitability standard that simply requires that an adviser have a "reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through reasonable diligence.

Hey, investors: New fiduciary rule has your back

A fiduciary standard, on the other hand, requires the adviser and the company to act with the care, skill, prudence and diligence that a prudent person would exercise based on the current circumstances. Both the firm and the adviser must avoid misleading statements about fees and avoid conflicts of interest. This is great news for consumers. The end result is that the new rule will now align the interests of both the investor and the adviser and put them on equal footing when it comes to all the information they both need to make the best decisions.

Q:How do I know if my investment adviser is a fiduciary?

A: Ask to see a fiduciary agreement in writing. If your adviser is compensated even partly from commissions from investments they sell you, they're probably not acting as a fiduciary. The DOL offers this guide for consumers on how to tell if your adviser is a fiduciary. Some examples of personal financial advisers that are already acting as a fiduciary whose status can be verified online are Registered Investment Advisors (RIA) and "Fee-Only" professionals who are members of NAPFA (the National Association of Personal Financial Advisors). Some retirement plan advisers who offer employee benefits already act as fiduciaries, as do

FINANCIAL ATROCITIES

Wealth accumulation is impacted by your savings rate and your return on investment, both of which are amplified by the magic of compounding. As you very well know, it's very difficult to control your rate of return. That is determined, in the main, by Mr. Market and by your asset allocation decision. However, you can boost your savings rate and, in turn, accelerate the growth of your wealth by minimizing your cost of investing. In this letter, we explain how you can do just that. First, we are going to share with you how we analyzed and then drastically slashed two of our new clients' cost of investing. There are two different types of costs: the *visible* and the *invisible*. Here we will focus on the visible cost which we split into (1) *advisor fees* and (2) *fund fees*.

The *Advisor Fee* is what your investment advisor charges you for managing your investment portfolio. This fee should be disclosed clearly in your investment advisory agreement and on the quarterly or monthly statements each time the advisor deducts the fee. The advisor should also disclose the formula he uses to calculate your fees. Most commonly, the advisor's fee is 1% of the value of your investment portfolio. We say most commonly because some advisors charge more. Since it is expressed as a percentage of your portfolio, your advisor's fee goes up as your portfolio value goes up. So during the bull market that started in March 2009, your financial advisor did extremely well. For a 1% of a growing portfolio translates into a growing amount that bolts out of your pocket and lands in your advisor's pocket. Let's take a look at the Table below. Client A's advisory fee was a little shy of 1%, presumably because this client had $3,000,000.00 of assets under management (AUM). But when that seemingly meager 0.9% is translated into dollars and cents, it amounts to a staggering $26,000.00 per year. That's a significant amount of money leaving the client's portfolio, thus retarding its growth and, in turn, diluting the power of compounding. Client B, on the other hand, had only about $900,000. She innocently signed an advisory agreement charging her a 1.15% annual fee, apparently not knowing that she had to cough up an amount north of $10,000.00 in 2015 alone.

FINANCIAL ATROCITY

			COST OF INVESTING					
		INVESTMENT	ADVISOR FEES		FUND FEES		TOTAL FEES	
CLIENT	ADVISOR	VALUE	AMOUNT	%	AMOUNT	%	AMOUNT	%
A	X	3,000,000	26,000	0.9	10,000	0.3	36,000	1.2
B	Y	900,000	10,000	1.2	8,000	0.9	18,000	2.1
TOTAL		3,900,000	36,000	0.9	18,000	0.5	54,000	1.4

But that is not the end of this financial atrocity. There is yet another component of fees: *The Fund Fees*. The average client does not know about this cost, even though it's widely published and is shown in each mutual fund prospectus. It's called the *Expense Ratio* and varies from one fund to another. It ranges from 0.1% to as high as 2%. When you sign an advisory agreement, you most likely give your advisor a discretionary power to select the individual funds for your portfolio. The funds he might choose depend on which family of funds he is affiliated with and whether that family has its own in-house expensive funds to push. Glancing at the Table, you will be appalled to find that client A dishes $10,000.00 in fund fees and client B forks out $8,000.00. The reason client A pays less can be explained by the fact that a large portion of his portfolio is invested in individual stocks and bonds. These are not subject to the expense ratio. Instead, they are subject to trading commissions etc.

Now to shock you a bit more, let's total the two costs! Client A's total expense is a staggering $36,000.00. Client B's stands at an alarming figure of $18,000.00. These fees are dizzying: the funny thing they are

perfectly legal. It gets worse when your advisor deducts his fees in *advance* (before rendering his service) and deprive you of the possibility of compounding those fees.

It gets much worse when you add the invisible costs or if you are unfortunate enough to be *sold* an annuity(s) that you really, really do not need. But selling it provides the annuity promoter with hefty up-front commissions and eats away on average 2-4% from your annuity value. Those who sell these annuities are not yet subject to the fiduciary rule. Hence they put themselves not their clients, first. An outrageous aspect of their behavior is how they wrap the client's IRA or Roth IRA inside an annuity, knowing full well that they are sheltering an already sheltered retirement account. It's like carrying two umbrellas when you only need one. But the advisor and the entity he works for have an incentive to push such annuities in order to garner unspeakable commissions over and above the high running costs and surrender charges, let alone the high fund costs.

Some 10 years ago, a new client, let's call her Samantha, after my favorite actress in "*Sex in the City*" engaged our services. Her investment portfolio contained a variable annuity that was peddled to her by Sylvia, her most favorite broker at ML. Samantha trusted Sylvia fully and thus granted her a full discretionary power on her account. When Samantha joined our clientele, we were stunned by how her *trusted* advisor had churned her account and sold her a variable annuity. Samantha worked as a nurse. She was a divorcee, with a modest portfolio and within striking distance from retirement. When we disclosed to her how her trust in Sylvia was utterly misplaced, judging from the type securities and expensive funds we found in her portfolio, she was speechless and just wanted to close her eyes and to move on. Shortly thereafter, Samantha retired, she was invited to a "*free*" lunch to listen to a presentation on a new annuity. According to the *rule of reciprocity*, this slick shark expected her and the other victims to reciprocate in a very disproportionate way. And Samantha willingly took the bait, signed a contract to exchange her old *bad* annuity for the *ugliest* annuity we have ever come across. She was gullible enough, naïve enough, trusting enough to do this without the courtesy of first seeking our advice. The new annuity was very expensive with commissions bordering on the obscene: 10-11%. We speculate that she was fearful that if she did not take the bait she might be disparaged by the slick promoter as a "*plate licker*."

Facing a jungle full of polar bears, cobras, sharks, etc., what can you do? First, shop around until you find a captain (an independent advisor) who puts your well-being first and who has "skin in the game," i.e. eats his own cooking. That way, if the ship sinks, the captain goes down with it. Second, negotiate your *total* fees down to less than ½%. Third, shun invitations to a "*free lunch.*" There is no such thing.

Finally, we've sliced and diced the U.S. election cycles over a century. The "facts" buttress our investment view that staying focused on economic and market cycles is far more important than obsessing over any single presidential candidate or election year.

In fact, while it may feel like the last few months have been difficult times to invest, we know that it is times like these that create long-term wealth. It is highly probable that political rhetoric has the potential to increase market volatility, but it is unlikely to be durable. When the election results are in, Wall Street will swiftly return its focus to interest rates and earnings, two factors that have more to do with stocks' performance in the long-term than anything else. Ultimately, the pace of economic expansion and earnings growth will drive the future direction of the stock markets. Presidents and political parties rotate, but we are steadfast in our commitment to helping you achieve your investment goals.