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July 2016

"The financial industry is a service industry. It should serve others before it serves itself" *—Christine Lagarde, Managing Director, The International Monetary Fund*

To our clients and friends:

After carefully contemplating a topic to write about in this quarter's newsletter, I've elected to address a subject which has recently been plastered all over the financial press. No, it is not the "Brexit", in which United Kingdom voters elected to abandon the European Union. It's the concept of the "fiduciary" standard and service to one's clients.

New Developments in the Rules Governing Brokers

The big news in the investment world is the new fiduciary rule issued by the U.S. Department of Labor (DOL). The new rule requires anyone providing financial advice on a retirement plan (403b, 401k, etc.) or retirement account (IRA, etc.) to act as a fiduciary.

This is the government's attempt to rein in the some of the fleecing done by brokers, insurance agents and other so-called "financial advisors". This new rule takes effect in mid-2017 and early 2018 (in stages), but has already been challenged in court by the brokerage and insurance industries and may never see the light of day as a result.

What is the Fiduciary Standard?

As many commentators have noted, this subject generally elicits yawns from people. The risk in trying to discuss the concept of a "fiduciary" is that people's eyes tend to quickly glaze over. Talk about an inherently boring subject!

It seems that the average person simply doesn't know the difference between a stockbroker or insurance agent and a Registered Investment Advisor (RIA). This is alarming but perhaps not surprising. After all, who really has the capability of getting the attention of the consumer to explain such differences?

It turns out that John Oliver (of late-night television fame) does.

A friend had sent me a You Tube video link of his June 12 broadcast, in which Oliver cleverly unmasked the hypocrisy of the "mainstream" financial services industry (namely, those who are ***not*** Registered Investment Advisors and thus do ***not*** adhere to a strict fiduciary standard). It was well worth taking the time to view this 20-minute video.

In essence, Oliver exposed a financial system riddled with conflicts of interest.

The fiduciary standard requires a Registered Investment Advisor (RIA) to act in the best interests of their clients, without regard to their own personal interests. All other so-called "financial advisers" (non-RIAs) have been exempted through various loopholes from such a common sense requirement, which was the thrust of Oliver's well-reasoned argument.

A Client Perspective of the Fiduciary Standard

Admittedly, over the years, I've learned a great deal from the relationships developed with my clients. Learning is clearly a two-way street in that respect.

Offered the chance, I have eagerly sought the "advice" of my clients in the past on how best to explain the concept of the fiduciary standard. I've wondered how to highlight the differences between my service model and that of a stockbroker, registered rep or so-called "adviser" affiliated with a broker-dealer, brokerage house or insurance company.

During one very enlightening conversation with a client who has been with my firm for over 10 years now, I decided to record some of his observations—comments which were direct and concise. Without any coaching from me, this is what the client suggested that I say to a new or prospective client (again, these are *his* words, not mine):

1. "Please remember, I am not a stockbroker and have no products to sell" (not true for the stockbroker, insurance agent or broker-dealer rep)
2. "My fee is clear, straightforward and transparent" (not true for the others)
3. "As a **fiduciary**, I must abide by all the disclosure rules set by the SEC and New York State for independent Registered Investment Advisors" (not true for the others)
4. "Brokers are not required to follow the rules for fiduciaries and are allowed to be paid fees and charges which are not visible to the consumer" (true under current law, but potentially subject to change based on the new fiduciary regulations promulgated by the Department of Labor as discussed above)

Unlike these other groups, Registered Investment Advisors (RIAs) serve clients in a fiduciary capacity, much like an attorney or an accountant serves their clients.

RIAs are held to a higher standard of prudence than traditional brokers or insurance agents and are required ***at all times*** to place the client's best interests ahead of their own. As Oliver so aptly stated in his commentary, now there's a novel idea!

Consequently, when a client works with an RIA—whether discussing insurance, retirement, estate planning or tax strategies, or investments—*each and every* recommendation is being made in the client's best interest. Not just those that will put money in the pocket of the brokerage firm or send the broker, insurance agent or registered rep on a trip to Hawaii or another exotic location!

Elevator Speech

People who you meet for the first time might ask what you do. If you're retired, the answer is easy. But if you're still in your career, and if you only have a few seconds to explain, the response to this question is what some might call an "elevator speech".

For my "elevator speech", I might say something like this: "*We are a fiduciary organization. That means we do not sell investment products in order to get paid by an employer, by another company or by a third party. Instead we work only for our clients and only in their best interests."*

Given a little more time, I might elaborate further by saying something as bold as this: "We are not financial advisors. That is what financial *salespeople* call themselves to get around the issue of taking full responsibility for what they recommend. Instead we bear full responsibility for all of our recommendations and actions."

Unlike brokers, RIAs will never tell you to "read the prospectus carefully before you invest"—that is their job! An RIA takes full responsibility for what is recommended and stands behind those recommendations at all times. The other "advisers" are simply not held to the same legal standard of conduct. The new DOL rule may change that.

Labels (and Titles) are Confusing

The bottom line is that individuals who provide financial "advice" use a wide variety of confusing and overlapping titles such as "financial planner", "financial consultant", "financial advisor", "investment advisor" and "wealth manager". The question you must ask this person is: "Are you acting as a ***fiduciary*** in every aspect of your business and in your relationship with me, your client"?

Don't be fooled. A broker acts simply as an agent, a salesperson who handles securities transactions for clients. Under current law, clients do **not** have to be notified of *payment incentives*, conflicts of interest, disciplinary history or a broker's qualifications *unless the client asks.* These people are *not* fiduciaries.

Brokers can recommend a product that pays them more over a product that pays them less, as long as the recommended product is still "suitable". This creates an obvious conflict of interest.

This is not the impression you get when you see their print and TV ads. They want to have it both ways, giving the impression of offering ongoing personalized financial advice but insisting that they be held to a lesser—*not a fiduciary*—standard.

Many of the brokerage houses, insurance companies and broker-dealer reps have now gone so far as to create a separate "RIA arm" of their primary business. This permits them to have two different business models in existence at the same time, which is doubly confusing. The SEC has begun to focus on this practice in its most recent audits.

Taking the Fiduciary Oath

In closing, I would like to cite a well-respected Professor of Finance at Western Kentucky University who has advocated for years in support of the fiduciary standard, Ron Rhoades. I met Ron several years ago at a Financial Planning Association (FPA) conference and as we were chatting realized that we were both attorneys, and were both admitted to the New York and Florida Bars. We are also both committed proponents of the fiduciary standard. Ron has published a fiduciary oath which he asks *every* investment professional to take in order to, in his words "avoid ambiguous interpretations and to prohibit the most severe conflicts of interest so as to actually earn the trust of our clients". Ron believes only a handful of so-called "advisors" are willing to sign the oath.

*"**I AFFIRM TO YOU, MY CLIENT, THAT I AM A BONA FIDE FIDUCIARY INVESTMENT ADVISOR. I COMMIT AT ALL TIMES DURING ANY ASPECT OF OUR RELATIONSHIP TO THE FOLLOWING CORE FIDUCIARY OBLIGATIONS:** "I will always put your best interests first. I will not seek to remove my 'fiduciary hat.' I will always be your trusted advisor during our trusted-advisor-client relationship. I will act with prudence; that is, with the skill, care, diligence, and good judgment of a professional. I will recommend to you only prudent investment strategies backed by solid evidence (through extensive back-testing or through academic research which has withstood the test of time); if an investment strategy is recommended to you that cannot be shown to be prudent, I will ensure that you are fully aware of the risks of such strategy. I will conduct extensive due diligence on both the investment strategies and investment products which I recommend to you. I will ensure that the total fees and costs you pay for the receipt of investment and financial advice and in relation to the implementation of any strategies will be fully disclosed (or at least estimated, when not quantitatively known). I will ensure that the total fees and costs you pay are reasonable."*

"I will not mislead you, and I will provide conspicuous, full and fair disclosure of all material facts. I will explain these facts to you. I assume the obligation to ensure your understanding of these important facts."

"I will avoid conflicts of interest. I will never sell you a proprietary product of my firm, nor a product from any affiliated firm, nor a product from any firm in which I hold a material interest. I will never accept 12(b)-1 fees unless they are fully and completed credited by both me and my firm against the investment advisory fees that you pay to me. Neither I nor my firm will ever receive payment for shelf space or soft-dollar compensation or other forms of revenue-sharing payments. I will avoid all other forms of material third-party compensation to the extent that I can reasonably do so."

"I will fully disclose and fairly manage, in your favor, any unavoidable conflicts. I will ensure your complete understanding of these few and rare conflicts of interest, when they occur. I will seek out and obtain your intelligent, independent and informed consent to such unavoidable conflict of interest. Even then, I will recommend the best course of action for you, in adherence to my continuing obligation to act in your best interests and to ensure substantive fairness exists at all times.

"For my trusted advice and expertise as your financial guide and educator, I require only reasonable professional fees, fully disclosed and agreed to in advance of any specific product recommendations."

Sincerely,

Andrew J. Fama, JD, AEP, RFC, MHA, Registered Fiduciary
Principal, Fama Fiduciary Wealth LLC, Registered Investment Advisor