BNY MELLON
WEALTH MANAGEMENT

Work with a Fiduciary to Ensure You're Getting the Best Advice

When it comes to managing their wealth, people naturally want to work with an advisor they can trust. After sharing their investment objectives, time horizon and past investing experience with their financial advisor, many people rely on that individual for all their investment guidance moving forward. But how can you be sure if your financial advisor or broker is acting in your best interests or their own? A good place to start is to ask them whether they operate under the fiduciary standard or the suitability standard.

HOW ARE THE FIDUCIARY AND SUITABILITY STANDARDS DIFFERENT?

When managing investments and making recommendations to clients, advisors follow the rules and guidelines dictated by either the fiduciary standard or the less stringent suitability standard. The primary difference between them lies in the obligations advisors have to their clients, and as an extension of that, how they are compensated.

Fiduciary: Putting the Client First

Under the fiduciary standard, financial advisors have a legal obligation to put the best interests of the client ahead of their own when making investment recommendations. That means choosing the investments that best align with the client's objectives, and sharing all critical information with the client.

There are many factors to consider when making an investment recommendation. It is the advisor's responsibility to ensure his or her advice is based on the most accurate and complete information. Under the fiduciary standard, the advisor would complete a thorough analysis of the investment, disclose all fees and communicate regularly with the client while building the client's portfolio. In addition, should any potential conflicts arise at any point, the advisor must inform the client and resolve those conflicts in the client's favor.

The issue of compensation can create a potential conflict of interest when investment recommendations are not in the client's best interest. The key point related to compensation is whether advisors have a financial incentive (e.g., commission) to make a certain recommendation. Advisors under the fiduciary standard do not profit based on the investments that are recommended for a client's portfolio. They must base their decisions on what is best for the client and be able to validate recommendations, including any higher costs.

Suitability: Making Adequate Recommendations

The suitability standard, which is used by many brokers, is less demanding. When making investment recommendations, brokers may sell products to their client if there is a reasonable basis to believe the investment fits the client's investment objectives and risk tolerance. It doesn't necessarily have to be the best investment that's available for the client's situation.

Brokers are often paid based on the volume of their sales, and may be paid more for selling certain products. As a result, where there is no fiduciary duty, a broker can recommend investment products that may involve higher costs through commissions and fees. As long as the investment meets the minimum requirements for being suitable, the broker is operating within the rules of this standard.

Focus on the Primary Job Function, Not the Title

Fiduciaries are trained to uphold prudent investment guidelines as they deliver ongoing advice for a fee, whereas brokers are primarily traders, and paid based on those transactions. Titles such as financial advisor, wealth manager or financial planner do not indicate whether the individual is subject to the fiduciary or suitability obligations. The primary function and manner of compensation, not the job title, determine which regulations apply. Someone who is engaged primarily in selling investment products is regulated under the suitability rules. Alternatively, an advisor who is primarily providing ongoing investment advice for a fee is subject to the fiduciary standard.

The most straightforward way to determine when an advisor's recommendations are in your best interest is to simply ask if he or she is a fiduciary and how he or she is compensated.

WHAT DOES THE FIDUCIARY STANDARD LOOK LIKE?

To illustrate what this concept would look like outside of the investment world, let's examine a hypothetical real estate transaction. Assume that you are in the market for a new home and have enlisted a real estate agent to show you some properties. Your family needs four bedrooms and a minimum of three bathrooms. The agent shows you one home that meets your basic requirements. That home has also been listed by the agent's firm for quite some time, and therefore, the agent anticipates receiving a higher commission on this property compared to others. In this scenario, the agent is operating under the suitability standard. The agent's duty lies with the firm and he or she only has an obligation to show you the first home. While that property may reasonably cover your basic requirements, it may not be the best possible option for you.

Alternatively, another agent could show you that same property — as well as a second home that meets your requirements, is in a better school district, and provides better community services and lower property taxes. This agent gathers accurate and complete information on both properties and presents you with all the necessary facts before explaining why the second home is a better option. This agent is operating under the fiduciary standard.

CHOOSING THE RIGHT ADVISOR

As an investor, it's important to understand which standard applies to your investment professional and what motivates his or her recommendations. When selecting a financial advisor, ask if the advisor has a fiduciary duty and an obligation to put the client's interest first. Be sure to also ask about the firm's investment policy. Does it set clear financial goals? How are the advisors compensated? Does the firm guarantee complete fee transparency, and explain all fees in a way that you understand? Does the firm disclose possible conflicts of interest and clarify how those conflicts may affect you?

At BNY Mellon Wealth Management, operating under the fiduciary standard is part of our history, and has always been embedded in our investment approach. We are not compensated on the products we sell, but on our expertise and ability to serve our clients well. Our priority is to meet the needs of our clients and offer the best investment guidance to help them reach their financial goals.

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