Suitability Standard vs. Fiduciary Standard:
The Controversial Debate You May Have Heard Nothing About…Until Now.
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Whether you are on the giving or the receiving end of financial advice, appreciating the difference between these two concepts is essential. In this post-2008 era, much of what was broken about the financial services industry has been addressed via the Dodd-Frank Act. However, something remains amiss: the *variability of standards* among various types of financial advisors[1]. It's one of the first points of distinction I make when meeting with prospective clients. Here's why.

Suitability Standard
According to FINRA.org, the Suitability Standard is in place to protect customers so that a broker or financial advisor may only recommend and sell an investment product if it is suitable and appropriate for that client. Here's an example: a broker or advisor has determined that the client can invest in a mutual fund based on their risk tolerance, time horizon, and liquidity. There are two very similar mutual fund products offered by the bank where they work. Fund A carries a 1.5% sales load (read: fee or commission paid to the broker or advisor for selling this product) and Fund B carries a 3% sales load[2]. Which to pick? Because the broker/advisor is bound by the Suitability Standard, either fund can be sold to the client in good faith. Compare this to the much more stringent Best Interests/Fiduciary Standard.

Best Interests/Fiduciary Standard
In this model, the advisor is held to the highest standard of care: the advisor must advise and carry out what is in the best interest of the client. This means that the client's interests are always put above the interests of the advisor. Importantly, in this model, any conflicts of interest must be disclosed to the client at the onset of the relationship. Using the example above concerning Fund A and Fund B, if an advisor bound by the Best Interests/Fiduciary Standard were to find him or herself in this same situation, he or she would likely be in violation if Fund B was recommended to the client because it carried a higher sales load and thus, a higher commission. Fund A would be the clear choice because it is a comparable investment with a lower fee. The advisor also has a "duty of loyalty and care" which means that the portfolio you build together will not be 'set it and forget it'; rather, the advisor has a duty to monitor the assets and ensure the portfolio evolves as your financial situation evolves.

Conclusion
The question remains: if the broker/advisor can sell either fund and both are suitable, what would motivate him or her to sell the fund with the lower sales load fee? In this example and in countless real-life examples, the client is largely both unaware of the options available or the choice made behind the scenes by the broker/advisor and is at a potential financial disadvantage. Additionally, the Suitability Standard does not require that the professional rendering advice monitors the investment after it is purchased; no "duty to care" exists in this model. Inherent conflicts of interest exist and determining whether objective advice is being delivered is a guessing game. Be sure to partner with a true fiduciary, such as a CERTIFIED FINANCIAL PLANNER™ professional[3], who will deliver objective advice and ensure your financial well-being is in good hands.

Footnotes:

[1] The SEC does not limit the size of sales load a fund may charge, but FINRA does not permit mutual fund sales loads to exceed 8.5%. Source: http://www.sec.gov/answers/mffees.htm#salesloads

[2] http://www.thefiduciarystandard.org/

[3] http://www.cfp.net/about-cfp-board/cfp-certification-the-standard-of-excellence

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