THE FIDUCIARY OPPORTUNITY

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OPPORTUNITY OF A LIFETIME

As the fiduciary debate continues, advisors can seize the moment to adopt the highest standard of client care.

Regulatory reform is coming. Whether it will require all advisors to operate under a universal fiduciary standard is still undecided, but change is a certainty—in one form or another.

However, advisors don't have to wait for Washington to dictate the delivery of optimal care for their clients. They have an opportunity now to better align their interests with those of their clients.

The extreme market disruptions of the past two years have eroded trust in the industry. But advisors who can demonstrate that they're acting as fiduciaries can solidify client relationships and attract service-oriented investors—because investors are strongly signaling they want a heightened level of service.

"When clients become aware of the difference between the fiduciary standard and the alternatives, they overwhelmingly want the fiduciary standard," says Blaine Aikin, president of Pittsburgh-based fi360, which trains investment advisors in fiduciary matters.

Understanding Fiduciary Responsibility

Envestnet's recent whitepaper, *The Fiduciary Opportunity: Succeeding in a Changing Advisory Landscape*, explores the widespread confusion about what constitutes fiduciary duty, based on the findings of a nationwide poll of investors and advisors.

Most investors believe, incorrectly, that the fiduciary standard already applies to anyone giving advice.

Investors might not be completely knowledgeable about the fiduciary issue, but there's no question that they want advice that's objective and free from conflict. Clients want to know that each of their investments was chosen because it was the best investment for them.

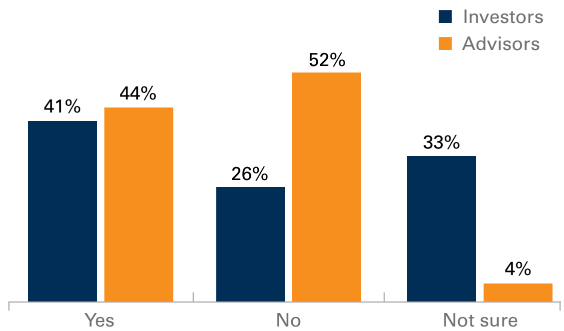
"What's in the client's best interest should be in our best interest as advisors," says Bill Schiffman, president of Schiffman Grow & Co. in Columbus, Ohio. "It's hard for me to see why as an industry we wouldn't want this."

To clear up the confusion, Aikin suggests that advisors sit down with each of their clients and articulate their fiduciary duty. "You're able to eliminate the uncertainty associated with your service by laying out what the fiduciary standard does and how you apply it," he says.

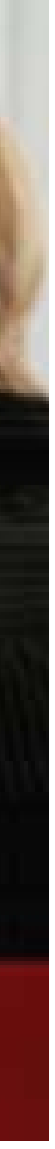
Adopting the fiduciary standard goes a long way toward aligning advisor and client interests. It's a standard that leaves little room for conflicts of interest, opaque pricing and sloppy monitoring.

"Our intention is to provide advice that's best for our clients and be in the position to make money when our clients make money," says Antonio Camejo, president at Portfolio Resources Advisor Group, Inc. in

TO THE BEST OF YOUR KNOWLEDGE, ARE ALL FINANCIAL ADVISORS SUBJECT TO THE SAME OBLIGATION TO ACT IN THEIR CLIENTS' INTEREST?



Source: 761 investors and 504 advisors were surveyed—Envestnet Fiduciary Standards Study



Miami, which includes both investment management and brokerage services.

For Schiffman, the fiduciary duty is the logical standard to apply to his view of holistic financial planning. This type of relationship is not transaction based, but takes the entirety of a client's financial life into account.

"Clients don't want to talk about stocks," notes Schiffman. "They would rather talk about what's going on in their lives."

Preparing for Change

As with any change, adopting the fiduciary standard will involve a learning curve. And it may not be easy for some. But it is likely to be a case of short-term pain for long-term gain.

"Advisors are going to have to learn more about how to be a comprehensive confidante," says Schiffman. "They might need to learn more about taxes, life insurance, property and casualty insurance, education funding or inheritance."

To understand the scope of potential changes, advisors should review their current business practices, suggests Aikin. "Then you will see those that line up with what is expected of you as a fiduciary," he says.

Of course it's not necessary to tackle the fiduciary challenge all at once. Up front, advisors might need to revise their risk tolerance questionnaire for new clients to be more detailed and involve greater data gathering. This can then be applied to existing clients during annual reviews. "It's a lot easier to adopt a more rigorous fiduciary process with new clients than to redo the way things are done with existing clients," Aikin says.

In addition, advisors should adopt investment policy statements, a sound due diligence process and processes for ongoing monitoring of client portfolios.

Though investors are generally pleased with their own advisors, they are cynical of the profession as a whole, Envestnet's *Fiduciary Standard Study* found. Even advisors themselves are skeptical about the practices of their colleagues. Most financial advisors polled by Envestnet said they agree that while they look after their clients' best interests, a lot of other advisors do not.

"If we can, as an industry, put together certain basic standards that everyone can agree to, that's going to give clients a lot more confidence when they go to an advisor," says Camejo.

DEFINING THE FIDUCIARY STANDARD

It's clear that confusion persists among both investors and advisors about fiduciary responsibility. According to survey results presented in Envestnet's whitepaper, *The Fiduciary Opportunity: Succeeding in a Changing Advisory Landscape*, four in 10 investors believe that all financial advisors are obligated to act in their clients' best interests, while one-third are not sure. Many advisors are similarly confused: four in 10 (including 63% of wirehouse brokers polled) believe that all advisors provide service under a fiduciary standard.

What exactly is the fiduciary standard?

Broadly speaking, fiduciary duty means placing your clients' interests above your own. Advisors who act as fiduciaries must consider whether an investment is priced well relative to available alternatives, even if doing so would compromise the revenue they receive. They must disclose potential conflicts of interest and have their clients acknowledge these in writing. They must also perform due diligence and ongoing monitoring of investments to ensure that they continue to meet client goals.

Acting as a fiduciary means keeping a watchful eye on the three C's: cost, complexity and conflict.

Advisors should take care to:

- Ensure that the recommended security meets the client's needs
- Document the benefits of a recommended security to justify the cost, complexity and/or conflicts or any other negative attributes
- Show evidence of the evaluation of any available alternatives to the recommended security that may better meet the client's needs
- Not recommend securities that have features clients do not need or want if there are feasible alternative securities available with similar benefits and without the undesired aspects

Such scrutiny of the three C's does not imply that firms should only recommend the cheapest or simplest securities available; these, in fact, may not be in the best interest of clients. The reality is that determining the differences between two securities can be challenging and may involve judging a host of quantitative and qualitative factors.

THE HEALTH OF CLIENT/ADVISOR RELATIONSHIPS

At first blush it seems like a paradox: Most investors polled are perfectly happy with their advisors, but they are skeptical of the financial services industry as a whole. According to Envestnet's whitepaper, *The Fiduciary Opportunity: Succeeding in a Changing Advisory Landscape*, almost three-quarters of investors polled gave their advisors an "A" for integrity. Yet 73% say they are more cynical about the financial industry.

The fact is that the recent financial crisis has made the client/advisor relationship even stronger. The majority of investors value advice more than ever and believe they need greater guidance. Most people who have advisors believe that their investments have fared better than other people's investments.

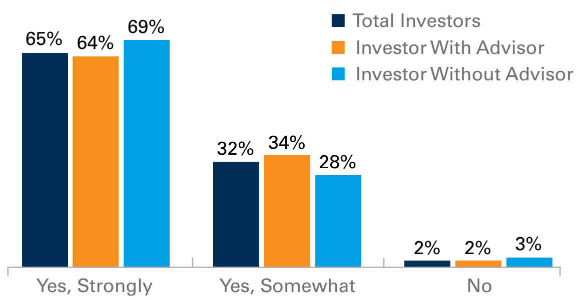
But the relationship isn't perfect. Just 40% of investors with advisors say their advisors clearly explain how they are compensated. Most would not want their advisors receiving incentives to recommend one investment over another. But the majority of investors say they can't assess if those incentives are being paid.

Adopting the fiduciary standard could build on the strong points of client/advisor relationships and strengthen the few weak areas. In fact, when investors are informed about the fiduciary option, an overwhelming majority (two-thirds) say they would strongly support legislation that holds all advisors to the same standard of client obligation.

Advisors who openly disclose fees and explain conflicts of interest, and who conduct thorough due diligence, can only win the added respect of clients.

But there's no reason to wait for new regulatory direction—it's clear that investors already want advisors to show that they have their best interests at the heart of the relationship.

WOULD YOU SUPPORT SUCH A REGULATION THAT HELD ALL FINANCIAL ADVISORS TO THE SAME STANDARD OF SERVICE WHEN DEALING WITH THEIR INVESTOR CLIENTS?



Source: 1023 investors were surveyed—Envestnet Fiduciary Standards Study

Adopting fiduciary duty as a business practice can help clients see advisors in a whole new light. "The fiduciary standard entails far more comprehensive financial planning and estate planning," Schiffman observes. "It's far better for the client."

And there's a strong business argument to adopt this standard as well. "Advisors who embrace the fiduciary standard will see a significant enhancement in client happiness and referrals," Schiffman adds.

Taking Responsibility

But advisors can't go it alone. Preparing for the fiduciary standard requires buy-in from several fronts—in particular, the institution for which the advisor works.

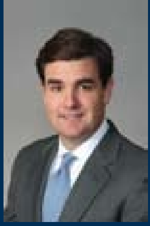
Some firms may not be well suited to allow advisors to practice as fiduciaries. That may be where the real hurdle exists for many advisors.

"The current system makes it very difficult for an advisor who wants to operate as a fiduciary to do so," Aikin says. "Compliance and marketing at some firms are built around suitability and fair dealing, not fiduciary service." They are also built around sales, rather than advice, Aikin notes.

Two-thirds of advisors say they wish that their firms would provide them with a road map of how to better act as a fiduciary, Envestnet's study showed. "[New regulation] would be a good thing for many brokers who are giving advice," Aikin notes. "Their organizations are going to have to support them."

Even if all these pieces come together, the responsibility in applying the fiduciary duty is first and foremost up to advisors themselves. "It's not about the firm the advisor works for," Camejo says. "It's about the integrity of the person." •

Q+A: Exploring the Fiduciary Opportunity



Congress has tabled the final decision on the fiduciary standard until the SEC studies the issue for six months. The issue might be out of the public light for the time being, but it is far from gone, says **Jim Patrick, managing director of Advisor Managed Programs at Envestnet.**

The market disruption of the past two years has negatively impacted client perceptions of the financial services industry. At the same time, according to Envestnet research, investors still value their own advisors. Advisors have a strong foundation for getting ahead of the fiduciary issue and demonstrating the highest level of client care. Patrick further discusses the fiduciary opportunity here.

→ What is the impetus behind potential change in the standard under which advisors serve their clients?

High profile scandals like Bernie Madoff and the market collapse of 2008 to 2009 have been big factors shaping a heightened focus on professional responsibility. In our poll of advisors and investors, investors cited damage to personal financial security, growing investor empowerment and a loss of trust in advisors generally—personal satisfaction notwithstanding—as significant reasons why financial advisor responsibility is now under such close examination.

The other reality is that clients don't discern between a fiduciary and a non-fiduciary. They expect you to embody the trust they've given you.

Our research also shows that many advisors want to do the right thing, but they don't have the practical clarity from their firms to do it.

→ Envestnet's recent whitepaper, *The Fiduciary Opportunity: Succeeding in a Changing Advisory Landscape*, shows that clients are skeptical about the financial services business, yet they are generally pleased with their own advisors. What does this say about the state of client/advisor relationships?

Financial advice is a relationship business. We see that when a rep leaves one wirehouse and goes to another, most of the clients go with them. When they do that, clients are saying that the advisor's personal service matters and trust matters. That feeling has been particularly evident in the last few years, given the large numbers of mergers of all these institutions.

Investors like their own advisors, but there is a lot of institutional distrust. They say, "How can these institutions be taking the other side of my trade?" But to the advisor they are saying, "I trust you. I like you." They separate the individual from the situation.

→ What will it take to restore investor confidence across the industry?

The debate around the fiduciary standard is an opportunity for advisors operating in a variety of regulatory constructs. It's an opportunity to reengage with clients, reaffirm what advisors do and do it with full transparency. Having an investment policy statement that can distill a client's life goals into a single number is an art. If you can do that, you are an advisor whom clients will respect.

→ How can advisors make use of this focus on the fiduciary standard?

This is a tremendous opportunity for advisors to reconnect with clients. Some advisors will need practice management improvements. They will need to leverage technology in some cases. It will also require more research and more due diligence on the three C's: cost, complexity and conflict.

In the end, the best source of client referrals is happy clients. In other words, these are clients who are comfortable and satisfied with how their advisor is handling cost, complexity and conflict.

→ How can Envestnet help?

Our advisor suite is fully integrated across all aspects of financial planning—portfolio analysis, program selection, account opening, servicing, billing, reporting and ongoing monitoring. It's also integrated in a multi-custodian, multi-platform way that gives the full household view. That level of flexibility really sets us apart, and gives an advisor an extraordinary advantage in delivering fiduciary service.

We've also unveiled Fiduciary Oversight Notes (FONs) on our platform. These are akin to sticky notes. At points along the fiduciary process, advisors can either access commentary to guide them through specific aspects of fiduciary responsibility to clients or leave a virtual note that details the decision tree made by advisors. For advisors, the ability to document their process in an integrated way is a very powerful tool for delivering and demonstrating fiduciary care.

To learn more about Envestnet's commitment to helping advisors succeed in business and as a fiduciary, please visit www.thefiduciaryopportunity.com and www.envestnet.com.

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