What Doctors and Families Have That Advisors Don't

The CFA Institute's Bob Stammers argues that financial advice is ultimately about behavior change, which only a relationship of trust can foster.

By Gil Weinreich Editor-in-Chief Research Magazine NOVEMBER 20, 2014

Clients want advice from someone they know has no ulterior motives. Imagine your doctor asked you to lose 10 pounds but you demurred. Maybe he's telling *all* his patients in order to lower demand for Twinkies and the like so he can have more affordable access to junk food for himself.

That scenario is, of course, utterly absurd. Nobody would suspect a medical professional of short-changing a patient for such crass reasons, yet something along those lines does nag at the conscience of investors in their quest for financial advice.

They worry that the professionals proffering the advice are pushing products from which they themselves will profit but which may or may not be good for them, and even if beneficial, perhaps not optimal.

That is why, says Bob Stammers, the CFA Institute's director of investor education, so many people looking for financial advice go to friends and family when they have important decisions to make.

Ironically, the friends and family members may have little knowledge about finance; the advantage they have is that they are not suspected of having any ulterior motives. In short, they are trusted.

"People really want that education and information at the point of decision making," says Stammers in an interview with ThinkAdvisor.

"When they make decisions, they usually ask for advice," he continues, "so an advisor can offer advice at time when people are willing to digest it.

But to do that, you have to build relationships of trust," something the financial services industry is uniquely ill-equipped to do, says Stammers, who notes the industry remains in its familiar dead-last spot on an annual global survey of trust, well behind the automotive and pharmaceutical industries, and even taking a back seat to media and banking.

But this industry and societal problem can in some sense provide an "opportunity," says Stammers, for individual advisors to build trust one investor at a time.

To further that ambition, the CFA Institute is actively promoting its **Statement of Investor Rights** (SEE BELOW), a campaign aimed at empowering consumers through awareness of what they should expect from the professionals serving them.

The **10-point list** (SEE BELOW) includes the right to objective advice (No. 2), to disclosure of existing or potential conflicts of interest (No. 5) and fee transparency (No. 8).

"If you work under an ethical code, there should be no problem providing all these rights," says Stammers, who says these ethical expectations flow from the investment process inherent in his own CFA Institute's charter.

So how does an advisor, whether or not he or she is one of the 120,000 CFA charter holders worldwide, break down the barriers to trust amidst a public that has duly noted the Madoff affair, the LIBOR scandal and the Wall Street firms that sold clients mortgaged-backed securities and then shorted them, making money on both sides of the trade?

"That stuff gets into people's heads and they remember it," comments Stammers, who advises advisors on a two-step trust-building process:

"First you build credibility, then you demonstrate integrity. You build credibility with past experience, with credentials like the CFA charter. As people do more and more due diligence, they'll start looking for people who have these characteristics."

"But then you articulate the ethical framework you work under," he continues, specifying that by unambiguously explaining how you get paid and by clarifying the potential for conflicts of interest and how you seek to avoid them, you are demonstrating your integrity.

For advisors already convinced of their ethics or bored with the topic, Stammers offers a key insight as to why they should make ethics a primary daily focus, and why the medical profession is a relevant comparison to their own work.

It comes down to the role advisors believe there are providing in investor education.

"Investor education is a misnomer," the CFA Institute's director of investor education says. "It's really about behavior change: How do you provide investors with the principles and best practices so that they can change their behavior to start doing correct things—by making better decisions and avoiding common mistakes that often plague investors."

Investors will summon the courage to make these difficult changes when they can repose as much trust in their financial advisor as they have in their doctor.

And given the poor public image of the financial services industry today, the onus is on individual financial advisors to pave a path of trust that enables positive investor outcomes, Stammers argues.

Statement of Investor rights

Ten rights that any investor should expect from financial service providers.

1. Honest, competent, and ethical conduct that complies with applicable law

Globally, financial laws and regulations differ, but all investors have the right to honesty from financial professionals. Honesty does not just mean a truthful answer to your questions; it also means transparency and forthrightness on the part of the financial professional.

Ideally, the financial professional should give you all the information that affects the financial decisions you make as well as the information that pertains to the financial decisions made on your behalf.

2. **Independent and objective advice and assistance based on informed analysis, prudent judgment, and diligent effort**

Financial professionals must base decisions on:

- Thorough discussions with you about your needs and circumstances
- Thorough analysis of your needs and circumstances
- Thorough analysis of the products and services that may be used to meet your needs
- Carefully considered and supported judgments that match products and services with your needs and circumstances

3. **My financial interests taking precedence over those of the professional and the organization**

As the owner of the money or the assets in a financial transaction, your welfare must be considered before the welfare of the financial professional and his or her organization. It is through outstanding work and service to your interests that financial professionals earn your trust and continued business. Your money is paying the bills and salaries of these professionals, and your interests need to come before their personal interests.

4. **Fair treatment with respect to other clients**

Fair treatment is not always equal treatment, particularly regarding all of a financial professional's clients. For example, other clients may have different objectives and different risk tolerances, resulting in investment portfolios that are very different from your own. You should not consider it unfair treatment when another client with a riskier portfolio earns higher returns or when another client's less risky portfolio performs better when financial markets decline.

Fairness also means that you should not feel pressured or rushed to make financial decisions.

5. **Disclosure of any existing or potential conflicts of interest in providing products or services to me**

Advice from a financial professional should be based solely on the benefits to you, your financial circumstances, and your financial goals; advice should not be based on a financial professional's personal interests. All financial professionals have an interest in being paid for their work, so you should always ask how the financial professional is paid (e.g., commission, flat fee, etc.) to ensure that his or her personal financial interests are closely aligned with your own.

A financial professional must clearly tell you about any existing or potential conflicts of interest. Because conflicts of interest are not always avoidable, that information must include not only what the conflicts of interest are but also the steps taken to reconcile them in your best interests if they cannot be avoided.

Common examples of potential conflicts of interest include:

- Being compensated for sales, not performance. Financial professionals are often not compensated based on how your investments perform but on how many investments they have sold to you or how much money you have invested with them.
- Selling higher-paying financial products instead of nearly identical but cheaper products.

6. An understanding of my circumstances, so that any advice provided is suitable and based on my financial objectives and constraints

Financial professionals must base decisions on facts directly relevant to your financial circumstances, needs, and goals. Financial advice should feel comfortable to you, and if it does not, you have the right to question financial professionals so that you understand how their advice fits you and your circumstances. The best way to make sure that you understand the advice being given to you is for the financial professional to put the plans created for you in writing. This plan is commonly known as the Investment Policy Statement. If you do not have an investment policy statement, ask the financial professional to create one. If you are just starting a relationship with a financial professional, then make sure that you and the financial professional create one together.

7. Clear, accurate, complete, and timely communications that use plain language and are presented in a format that conveys the information effectively

To understand the performance of a financial product, whether it is a checking account, life insurance policy, mutual fund, or another product, you must be able to understand the information provided by the financial professional or firm. Thus, you must receive communications — electronic, written, verbal, or otherwise — that make sense to you. If you do not understand the information given to you, you have the right to ask questions, request an explanation, and delay agreeing to the advice until the information is made clear.

8. An explanation of all fees and costs charged to me, and information showing these expenses to be fair and reasonable

You have the right to fully understand the expenses you are paying for investment services and products. This is true even if your financial product is as simple as a checking account. Financial professionals should be able to:

- Show that the fees you are paying are based on the same fee schedule as for all other clients who are similar to you
- Show that you are not paying more than other clients with accounts of similar size
- Share information about the fees and costs charged by competitors offering similar products, if such information is publicly available

9. Confidentiality of my information

You have the right to privacy of your personal and financial information. Only financial professionals and their staff directly involved in the investment decision-making or reporting processes should have access to your personal and financial information. Furthermore, your personal financial information should be disclosed to others only if it is required by law, such as through a subpoena, or by a regulator with lawful jurisdiction.

10. Appropriate and complete records to support the work done on my behalf

Financial professionals working on your behalf must document and make readily available to you:

- All information given to you
- All products discussed with and offered to you
- Any decisions that have the potential to affect or have affected your finances (including decisions in which you say no to the product or advice)
- Any and all other pertinent information