

Fiduciary or Suitability Standard

An easy decision if we really want advisors to act in the best interest of their clients!

Submitted By: Michael J. Steele, MBA, CLU, ChFC

I am a Fee-Based Registered Investment Advisor providing comprehensive financial planning and wealth management services. I operate under the Fiduciary Standard of Care and am not affiliated with a broker dealer. Below, I have provided you with an actual case in which the Suitability Standard of Care failed miserably to protect a recently widowed, unsophisticated, 74 year old female. The female is my mother-in-law.

The advisor that took advantage of her is a dually registered CFP®. It appears the advisor selects between the Fiduciary/Suitability Standard of Care based upon the financial outcome that provides the greatest return for his pocketbook—a practice that is widely accepted and encouraged in the Broker Dealer/FINRA environment. I know this because my securities licenses have been held at Prudential, New York Life, Ameritas and MidAmerican Financial Services prior to my RIA transition and the example below is a common practice promoted at each firm.

CASE OVERVIEW

Variable Annuity Replacement: Client: Allison (74 Year Old Widow, Little Prior Investment Experience)

Allison was advised by her broker to surrender a mature variable annuity and purchase a new Jackson National Perspective II variable annuity. The Advisor also sold the Widow a **\$10,000 REIT**. The Advisor also manages additional client assets under a “Fee” agreement. RMDs and Asset Management Fees are pulled from the annuity. **Question:** Have these recommendations placed Allison in a better position following the implementation?

BACKGROUND

**Old Annuity Value: \$216,000 Est. Death Benefit: Guaranteed/Unaffected by Market Performance
No Surrender Charges**

New Annuity Value following Transfer: \$173,000 (\$43,000 Decrease in Value) Est.

Broker Action: 1035 Exchange from Old VA to New VA = Transfer Locked in Market Losses/Lowered DB
Old Value: \$216,000 New Value: \$173,000

New Annuity: Locked in Lower Initial Value and Death Benefit (New 6% Commission (**\$10,740**) for Broker)
Added Income Rider for a 74 Year Old Widow (Unnecessary Expense: Widow well funded)
Created New 7 Year Surrender Penalty for Early Withdrawal (RMD's are excluded)
Increased Annual Expenses

Annuity Expenses: Annual Fees: \$179,000 * 3.70% = \$6,623 Annually for VA + AUM Fees for Remaining Balance

1.25%	Management and Administration Fee
0.90%	Guaranteed Income Rider
0.70%	5% Bonus Fee
0.85%	Average Sub Account Fee
3.70%	Annual Ownership Expenses

REIT: Very aggressive and unsuitable recommendation for inexperienced investor. (7% Commission for Broker)

OUTCOME

The only winner in this transaction was the broker. Allison lost an estimated \$43,000 in Death Benefit, reentered into a new Seven Year Surrender Period, locked in investment losses and in all probability, will never fully recover from this recommendation. RMDs and Asset Management Fees are being pulled from the annuity? Why? Broker already received full compensation on the annuity and is keeping the AUM account at full value to increase his fees on these assets.

STANDARD OF CARE ANALYSIS

Fiduciary Standard of Care: If the advisor was operating under the Fiduciary Standard of Care he would have taken the following actions.

1. He would have verified all expenses, sources of income and assets.
2. He would have disclosed that exchanging the old annuity for a new one would sacrifice approximately \$43,000 in death benefit.
3. He would have disclosed that he would be receiving a 6.0% commission on the exchange of the annuities. He would disclose that a no-load Variable Annuity was available with an income rider.
4. He would have disclosed that a REIT is very aggressive. He would have also disclosed the 7% commission for the sale of the REIT.
5. He would have told the client **not** to exchange the old annuity for a new annuity.

Suitability Standard of Care: The Advisor was acting under the Suitability Standard of Care and these are the actions that were taken.

1. He reviewed the old annuity statement and recognized that the annuity was outside the surrender period and eligible for a 1035 exchange with no penalties.
2. He may or may not have reviewed the widow's cash flow, expenses and other assets to determine if an income rider was really worth the additional expense.
3. He suggested that the client move the annuity and purchase an expensive income protection rider.
4. He completed the Broker Dealer's Replacement form, listed income rider protection as the reason for exchange. (Client has Excellent Retirement Cash Flow. Long-Term Care insurance in place in case of health catastrophe.) Why not propose a no-load Variable Annuity with income rider—No Commission.
5. Submitted to broker dealer who rubber stamped the transaction and initiated the exchange.

If the Fiduciary Standard is the benchmark for physicians, attorneys and accountants, is it not the time to elevate the standard of care in the financial services profession? I have operated under both the Fiduciary and Suitability Standards. Based on my personal experience, I strongly propose that the SEC invoke a **Fiduciary Standard of Care** for all parties operating in the Financial Services Industry. The benefit for clients, practitioners and the industry would be invaluable.

Sincerely,

Michael J. Steele, MBA, CLU, ChFC