

Helping Advisors Understand and Fulfill Their Fiduciary Duties

By Raymond M. Mullaney, CEO – April 25, 2024

Many investment advisors will have something like this on their websites:

“We focus on risk management and prudent portfolio selection.

We specialize in understanding our clients’ needs and matching portfolios to their needs.”

How is it, then, that when the market falls by 25%, 35%, 45% or any other significant decline, the account values of their clients fall by similar amounts? If advisors are fulfilling their obligations to manage clients’ risk, why is no one in the industry able to avoid these large market losses?

What exactly are the fiduciary duties of a registered investment advisor? I’m not a lawyer, but I advise you to read the following quotes from the SEC: <https://www.sec.gov/files/rules/interp/2019/ia-5248.pdf>

- 1) Duty of Care - “The duty of care includes, among other things: [...] (iii) **the duty to provide advice and monitoring over the course of the relationship.**” p.12
- 2) “...the investment adviser’s duties include management of the account, [the adviser] is **under an obligation to monitor the performance of the account and to make appropriate changes in the portfolio.**”
- 3) “The formation of a reasonable belief would involve considering, for example, whether investments are recommended only to those clients who can and are willing to tolerate the risks of those investments.” p.15
- 4) “**Item 8 of Part 2A of Form ADV** requires an investment adviser to describe its methods of analysis and investment strategies and disclose that investing in securities involves risk of loss which clients should be prepared to bear. This item also requires that an adviser **explain the material risks involved for each significant investment strategy or method of analysis it uses and particular type of security it recommends**, with more detail if those risks are significant or unusual.”
- 5) There is one mention of “**risk and return characteristics that are hard for retail investors to fully understand**” at the bottom of page 40. What characteristics count as “hard to understand”? When are investment advisors required to fully explain and describe the risks associated with investing to their clients?
 - a. After the market has reached “all-time” highs?
 - b. In stocks with insignificant, highly volatile or completely unpredictable earnings?
 - c. In stocks that have never earned a profit since the first day they traded?
 - d. In stocks that trade at 3, 5 or even 10 times their past historic valuations?
 - e. In companies with significant cash from stock offerings, but little or no cash from earnings?

Investment advisors have a great responsibility to protect their clients from losses. However, traditional industry sources of information have, in the past, failed to warn against or fully disclose the risks of loss investors assume when buying the most popular stocks and funds.

Equity Risk Sciences is a fintech company that uses data science to calculate and rate the statistical probability and magnitude of future stock price movements. ERS works with investment advisors seeking to build great wealth for their clients through exceptional results. We’d like to share the efficacy of our **Fiduciary Risk Rating™ (FRR™)**. Every advisor would be strongly advised to make use of our **FRR™** to reduce, avoid and prevent losses. Call us today to discuss how the **FRR™** would have protected your clients from substantial losses during the crashes of 2000, 2007 and 2021.