

Fiduciary Matters

Relationships of Trust

Fiduciary matters are matters of trust. In a world rife with corporate scandals, unethical trading and misleading sales practices, knowing where to place your trust can be difficult to discern. How do you equip yourself to recognize the proper level of advisory service? What measuring stick should you use? This paper offers guidelines while educating you about investment professionals who hold themselves to one of the highest standards of trust in the industry: that of a fiduciary.



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‘Fiduciary’ Matters:

AN INDUSTRY IN CONFLICT AND CONFUSION

You may have heard the term “fiduciary” as it relates to investment services. In fact, it’s one of the hottest new buzz words in the investment industry. Even though many have heard the term, few can actually define it. Not surprisingly, most investment professionals do not understand the role and responsibilities of a “fiduciary.”

The importance of fiduciary responsibility has come into the spotlight in recent years because of the rise of corporate malfeasance. The public and regulators reeled from the Enron and WorldCom debacles—the two largest cases of corporate fraud in history. Unethical, illegal, and misleading practices by large brokerage firms, banks, and mutual fund companies have been prevalent. Prominent investment firms have paid multi-million dollar fines to settle charges of unethical trading, sales and other questionable practices. Recently, CEOs and executives of major corporations—including those of prominent investment firms—have been tried and convicted for various illegal activities that hurt shareholders and investors.

This creates a difficult situation for you, the investor. What should you do? How do you know who to trust? What is the *real* definition of a fiduciary, and how do you recognize a fiduciary when you see one? **Said differently, is your financial advisor consistently and properly fulfilling his or her duties to your benefit? In a true fiduciary relationship you are legally supposed to be able to vest the utmost faith and confidence in the fiduciary. In fact, the very nature of such a relationship is conceived of as one in which the beneficiary is relieved of the need to oversee the conduct of the fiduciary. Do you benefit from such a relationship with your financial advisor?**

This paper will help you answer these questions. As an informed investor, you can intelligently assess the quality of the advice you receive. This document will help you understand what it means to

be a fiduciary, explain the components of fiduciary advice, elaborate on the causes of investment industry conflict and confusion, and propose specific ways to recognize a true fiduciary advisor.

Section I examines the concept of a “fiduciary” and explains why the term has risen to important prominence in recent years. We look at professional behavior—and misbehavior. The term “fiduciary” is formally defined, as is the professional’s fiduciary role in investment management. Finally, this section de-constructs the fiduciary’s job, giving you a yardstick with which to measure anyone who claims to act in a fiduciary capacity.

Section II lays out, in a clear and concise format, the critical steps necessary to engage someone to act in a fiduciary capacity. It reviews investment service models and marketing materials. It discusses interviewing potential advisors. Finally, it lists the supporting evidence you need to make an objective hiring decision.

Section III reviews Zero Alpha Group’s (ZAG’s) proprietary *Fiduciary First*SM standards. It also highlights the Standards for Fiduciary Conduct and briefly describes the ZAG Integrative Wealth Management system, and how it incorporates fiduciary standards.

Section IV discusses the benefits for investors when employing professionals who subscribe to strict fiduciary standards. It reviews the attributes of advisors who use core investment principles and philosophies to deliver maximum value and controlled risk. It underscores the implications of using—or not using—a professional fiduciary advisor.

Finally, we pledge to you a level of service that is based on integrity and fiduciary responsibility. **The primary goal of this paper is to clarify and highlight the importance of engaging a financial advisor who embraces the legal and moral responsibilities of a prudent and trusted fiduciary.**

What is a Fiduciary?

(SECTION I)

What caused the concept of a “fiduciary” to be developed? The word “fiduciary” is used as both a noun and an adjective. Under English common law, the word fiduciary has been used as a noun since the Middle Ages to describe a person who is placed in a position of great trust. Typically it referred to someone involved in the use of trusts or the conveyance of property. When used as an adjective, the word fiduciary is used to characterize a relationship of good faith, loyalty, and trust. The word itself originally comes from the Latin word *fides*, meaning faith, and *fiducia*, meaning trust, confidence. A more detailed history of the origins of fiduciary responsibility is contained in Appendix A.

In practical terms, a fiduciary relationship represents the highest standard of care imposed by either equity or law. A fiduciary owes a duty of loyalty to whomever services are provided and is expected to be above reproach in carrying out their duties. They must not put their personal interests before their clients, and they may not profit from their position as a fiduciary without the consent of the person to whom they have pledged their fiduciary duties. The table to the right illustrates several modern definitions of “fiduciary.”

Why is this important now? Over the past few years, investment firms in positions of trust have paid substantial fines, and in some cases been indicted on felony charges arising from conduct that involved various forms of fiduciary breach and/or outright illegal activity. Whether these transgressions arose as a result of simple oversight or flagrant disregard of their responsibilities, well-known investment firms, brokerage firms, and mutual fund companies have paid fines up to hundreds of millions of dollars. They further agreed to change their practices relating to the illegal activity and breaches. Such breaches were directed towards specific individuals, or in many cases, the investing public at large.¹

Sadly, investors continue to be misled by the influence and past reputation of some of these firms. In fact, many firms who have agreed to pay large fines may now be attempting to salvage their reputations and reform their ways only in reaction to “being caught” and “being forced” by regulatory authorities to reimburse injured investors.² This makes it difficult for investors to know how genuine the “reform” is or how long it will last.

You should be skeptical of fiduciary inferences from long-established firms whose compensation models have resulted in biased recommendations. **You should also be wary of any advisor who is unwilling to clarify his or her fiduciary status, or who displays a reluctance to disclose how their processes fulfill their fiduciary responsibility.** And, why wouldn’t an investment provider’s interests be aligned with yours? Almost every case of conflict is based on compensation.

Figure 1 compares the roles of fiduciary advisors to other investment providers, while Figure 2 illustrates various compensation methods.

In reaction to the breaches of trust, organizations such as NAPFA (*National Association of Personal Financial Advisors*), the FPA (*Financial Planning Association*), and the *Center for Fiduciary Studies*³ now provide standards which can help you select an advisor to serve you as a fiduciary. Following these guidelines will allow you to distinguish between true fiduciary advisors and salespeople posing as fiduciaries. As discussed in the following pages, there are substantial benefits to working with a fiduciary advisor employing a prudent and well-documented investment process.

Fiduciary Defined:

Fiduciary: *n.* A person who stands in a special relationship of trust, confidence or responsibility in his obligations to others, as a company director or an agent of a principal.

The American Heritage Dictionary, Second College Edition, Houghton Mifflin Company, Boston, MA 1982, 1985.

Fiduciary: A person who is responsible for managing the assets of another person and stands in a special relationship of trust, confidence, and/or legal responsibility.

*The Center for Fiduciary Studies*³.

Fiduciary Duty: Any action, performance, task, or observance owed by a person in an official or implied fiduciary capacity.

Fiduciary Relationship: A relationship in which one person is under a duty to act for the benefit of another on matters within the scope of the relationship.

Black's Law Dictionary, Eighth Edition, West Group, a Thomson Business, St. Paul, MN, 2004.

Comparison of Fiduciary Advisors to Other Non-Fiduciary Investment Providers

Figure 1

CHARACTERISTICS	FIDUCIARY ADVISORS	NON-FIDUCIARY INVESTMENT PROVIDERS
THE PLAYERS	Professional Fiduciary Advisors	Bank Sales Reps (Brokerage), Wirehouse and Independent Brokers, and Insurance Agents
REGULATORY	SEC Registered Investment Advisor (RIA) (If < \$25 million, RIAs are state regulated)	Primarily Self-Regulated by NASD
FIDUCIARY SERVICES	Acknowledged Fiduciary Status (Statutory) Ongoing Comprehensive Financial Advice	Generally Limited or No Fiduciary Responsibility or Related Liability ⁴ Transactional: Sell Securities, Investments, and Insurance Products
STANDARDS	"Fiduciary" Standard	Must Only Make "Suitable" Recommendations (unless discretionary authority assumed)
TRANSPARENCY	Provide Full Disclosure via ADV	Minimal Disclosure Requirements
COMPENSATION	Typically Fee-Only for Investment Management ⁵	Commissions, 12(b)-1 and Transaction Fees
COMPETITIVE ADVANTAGE	May Provide Objective Integrative Wealth Management	Often Very Skilled at Developing Relationships and Selling Products
DISCRETION	Typically Assumes Discretionary Authority	Transaction-based; Typically No Discretion
FUNCTION ROLE	Planners, Advisors, Consultants, and Managers	Salespeople

Investment Professional's Method of Compensation

Figure 2

FINANCIAL PROFESSIONAL	METHOD OF COMPENSATION	ACTS AS FIDUCIARY?
BROKER	Commissions	Typically Not ⁴
REGISTERED INVESTMENT ADVISOR (RIA)	Fee-only for Investing: Asset-based or Project Fee as Agreed upon by the Client ⁵	Yes
FINANCIAL PLANNER	Fees, Commissions, or Both	Sometimes ⁶
FINANCIAL ADVISOR	Fees or Commission	Sometimes
PRIVATE BANKER	Fees or Commission	Sometimes
INVESTMENT CONSULTANT	Fees or Commissions	Typically Not
WEALTH MANAGER	Typically Asset-based Fee for Investing ⁵	Yes
TRUSTEE	Fees and/or Proprietary Products	Yes

Components of Fiduciary Advice

Figure 3



Models Describing Investment Service Delivery

Figure 4

INVESTMENT SERVICE MODEL	TYPE OF COMPENSATION	IMPLICATIONS FOR INVESTORS
TRADITIONAL BROKERAGE	Commissions for transactions and product sales.	Financially motivated to sell products leading to potentially biased recommendations. No Fiduciary Relationship.
BANK	Sometimes fees. Often times commissions.	Increasing conflicts of interest as banks increasingly pursue product sales and proprietary products. Others may provide Fiduciary Advice.
INSURANCE AGENTS	Typically commissions for insurance and investment product sales.	Products often sold based on commission rates. This often leads to conflicts of interest. ³ Typically no Fiduciary Relationship.
FEE-BASED (HYBRID BROKERAGE)	Combination of commissions and fees.	As the tendency of this group is to focus on asset gathering, there is typically no Fiduciary Relationship.
FEE-ONLY ADVISOR	Fee-only for investment advice. Absolutely no commissions on investment product sales. Transparent costs.	Completely objective. Delivers impartial Fiduciary Advice.

What is Expected of a Fiduciary?

The formal definitions (on page five) describe a fiduciary as a person who stands in a special relationship of trust for another. **The SEC's Office of Compliance Inspections and Examinations further identifies five responsibilities of fiduciaries:**⁷

1. **to put clients' interests first;**
2. **to act with utmost good faith;**
3. **to provide full and fair disclosure of all material facts;**
4. **not to mislead clients; and**
5. **to expose all conflicts of interest to clients.**

The first duty of a fiduciary is to put the investor's interests first. Thus, fiduciaries have a goal of adding value to you through objective, expert counsel. Along that line, every advisor claiming to be a fiduciary typically provides a written statement reflecting his or her fiduciary status and explains what this means. The basis for their advice should be clear and easy to understand. Registered Investment Advisors ("RIAs") are legally bound to a fiduciary standard and are governed by state law and the federal Investment Advisers Act of 1940. Many RIAs assume full authority to manage assets, but every RIA is required by law to act as a fiduciary

In contrast, a federal regulation issued by the U.S. *Securities and Exchange Commission* ("SEC"), called the "Broker-Dealer Rule" (also commonly known as the "Merrill Lynch Rule"), allowed brokers and many bank representatives to provide fee-based accounts *without* serving as a fiduciary. NAPFA and the FPA opposed this exemption because the Merrill Lynch Rule blurred the lines between brokers and fiduciary advisors from a consumer's perspective. In fact, the FPA sued the SEC over this rule and won. In this landmark case, the U.S. Court of Appeals for the DC circuit overturned the SEC rule in early 2007. Now, brokers may no longer sell fee-based brokerage accounts.

Prior to the now defunct Merrill Lynch Rule, most brokers were perceived as salespeople. They executed trades and sold products. During times when this distinction was clearer, it was easier for investors to maintain a "caveat emptor" mindset as they knew they were working with salespeople. More recently, however, broker advertisements conveyed the impression that they were in the "advice" business while they took the legal position that any advice given was purely "incidental" to the sale. As might be expected, this "hair splitting" distinction was confusing to investors who according to various surveys,²⁵ overwhelmingly did not understand that such a distinction existed.

Certainly, brokers do provide "advice," but only in the selection of investments. Their duty is to make only suitable recommendations. **They are not "required" to recommend the most appropriate investment in any given situation. Said differently, they cannot make unsuitable recommendations they know to be inappropriate for you, but they have no duty to seek out the "best" recommendation. Beware—what you and the broker consider inappropriate may be very different.** As a result, *you* will have to evaluate the appropriateness of each and every brokerage transaction or product offered to assure it meets your needs and circumstances. Appendix B further elaborates on the very important differences between brokers and fiduciary advisors.

Figures 3 & 4 illustrate the components of fiduciary advice and competing investment models. When these differences are clearly understood, most investors care very much about the fiduciary status of the person giving them investment direction!

Critical Steps to Finding a Fiduciary Advisor

(SECTION II)

In selecting a trusted “fiduciary” advisor, you are well served to utilize a three-step process to assure your interests are aligned with your advisor’s.

Step One - Review Information from Potential Candidates

First, you must look for qualified advisors. Compare the investment service models described in Figure 4. Confirm that each prospective firm’s marketing material and website clearly states they are Registered Investment Advisors, which means they *must* act in a fiduciary capacity. Review each advisor’s Form ADV Parts I and II—the forms used to register with the SEC.⁸ The forms disclose the advisor’s education, business, and disciplinary history over the past ten years. They also provide detailed information on fees, services, and investment philosophy.

Step Two - Conduct Interviews

Personally interview all potential advisors. During this process inquire about each firm’s:

- Investment process—how it adds value.
- Compensation model—full disclosure of all compensation is critical.
- Team members who will be involved with your account—how long have they been at the firm and how are they compensated?
- Written Investment Policy Statement (“IPS”)—it should describe your time horizon and risk tolerance, your investment objectives, and reasonable return expectations. Clear guidelines for designing an appropriate asset allocation model and selecting securities should also be documented.

Step Three - Be Aware of What You Deserve

Become familiar with the key components of fiduciary advice. This will help you monitor whether or not your advisor truly serves you in a fiduciary capacity. It will also help you spot potential breaches of fiduciary duty, even if a breach is caused by mere oversight. You should fully understand your investment relationship with your advisor. This includes their investment philosophy, the basis of their philosophy, and what steps they take to monitor their investment process. Your advisor should give you a clear idea regarding how often you will meet to review performance and the activities of the individuals assigned to your account.

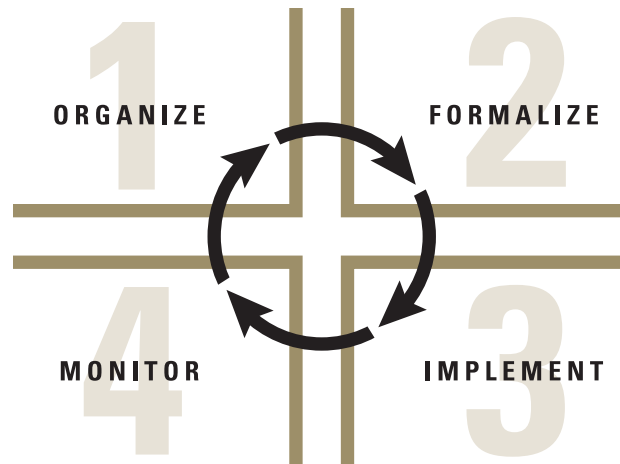
You should also have evidence supporting the advisor’s objectivity such as:

- No compensation tied to product sales.
- No proprietary products.
- Your advisor considers your personal needs as well as all relevant financial issues.
- A broad, comprehensive focus providing advice on a variety of financial issues to ensure objectivity in all parts of the relationship.

Leading fiduciary advisors often base their fiduciary process on standards such as those promulgated by *The Center for Fiduciary Studies*³. These standards allow advisory firms to develop proprietary systems to ensure consistent fulfillment of fiduciary duties. These four steps are outlined in Figure 5. The action items in each step can be used as a checklist to monitor your advisor. For more background, Appendix C highlights legislation that influences and substantiates the standards.

The Four-Step Process Outlined in The Center for Fiduciary Studies' fi360™ Program⁹

Figure 5



Step 1: Organize

- A-1.1 The advisor demonstrates an awareness of fiduciary duties and responsibilities.
- A-1.2 Investments are managed in accordance with applicable laws, trust documents, and written investment policy statement (IPS).
- A-1.3 The roles and responsibilities of all involved parties (fiduciaries and non-fiduciaries) are defined, documented, and acknowledged.
- A-1.4 The investment advisor is not involved in self-dealing.
- A-1.5 Service agreements and contracts are in writing and do not contain provisions that conflict with fiduciary standards of care.
- A-1.6 Assets are within the jurisdiction of appropriate courts and are protected from theft and embezzlement.

Step 2: Formalize

- A-2.1 An investment time horizon has been identified for each client.
- A-2.2 A risk level has been identified for each client.
- A-2.3 An expected, modeled return to meet investment objectives has been identified.
- A-2.4 Selected asset classes are consistent with the identified risk, return, and time horizon.
- A-2.5 Selected asset classes are consistent with implementation and monitoring constraints.
- A-2.6 There is an IPS which contains the detail to define, implement, and monitor the client's investment strategy.
- A-2.7 The IPS defines appropriately structured socially responsible investment (SRI) strategies (where applicable).

Step 4: Monitor

- A-4.1 Periodic reports compare investment performance against an appropriate index, peer group, and IPS objectives.
- A-4.2 Periodic reviews are made of qualitative and/or organizational changes of investment decision-makers.
- A-4.3 Control procedures are in place to periodically review policies for best execution, "soft dollars," and proxy voting.
- A-4.4 Fees for investment management are consistent with agreements and with all applicable laws.
- A-4.5 "Finders' fees" or other forms of compensation that may have been paid for asset placement are appropriately applied, utilized, and documented.
- A-4.6 There is a process to periodically review the organization's effectiveness in meeting its fiduciary responsibilities.

Step 3: Implement

- A-3.1 Each client's investment strategy is implemented in compliance with the required level of prudence.
- A-3.2 The investment advisor and the advisor's fiduciary clients are following applicable "safe harbor" provisions (when elected).
- A-3.3 Investment vehicles are appropriate for the portfolio size.
- A-3.4 A due diligence process is followed in selecting service providers, including the custodian.

ZAG Services Tied to Investment Fiduciary Standards*

Figure 6

SERVICE	ORGANIZE	FORMALIZE	IMPLEMENT	MONITOR
Investment Management	•	•	•	•
Comprehensive Financial Planning	•	•		
Visioning & Life Planning	•	•		
Cash Flow Management		•	•	
Philanthropic Planning	•	•		
Intergenerational Wealth Transfer	•	•		
Tax Planning & Analysis	•	•		
Estate Planning	•	•		
Risk Management		•	•	
Asset Protection	•			
Multi-generational Education	•			
Coordination of Advisory Teams	•	•	•	•
Qualified Plan Advisory Services	•	•	•	•
Family Services		•		
Family Governance Development		•	•	•

* The above table illustrates how the various advisory services offered by ZAG firms closely integrate with the four primary steps of a prudent investment fiduciary process as presented in Figure 5 by fi360™. The last three services are not offered by all ZAG firms.

Key Components of ZAG’s Fiduciary FirstSM Standards¹¹

Figure 7



NOTE: Current version of detailed ZAG Fiduciary FirstSM Standards can be found at www.zeroalphagroup.com/fiduciaryfirst.pdf

The Zero Alpha Group's ZAG Fiduciary FirstSM Standards

(SECTION III)

Although a lot of money in the United States is presumed to be under fiduciary care, the investment industry has done little to define the prudent investment processes necessary for fiduciaries to manage such assets.¹⁰ We believe this is about to change. We are members of the *Zero Alpha Group*. The *Zero Alpha Group, LLC* (“ZAG”) is an international organization of independent and well known wealth management firms.

ZAG member firms collectively manage in excess of \$8 billion in assets. ZAG firms share a common philosophy about investing and client service: a commitment to structured, quantitative, and tax-managed investment strategies while providing independent financial planning solutions to clients. As a group, we have developed a number of proprietary standards & processes to guide you down a path towards optimal wealth management. Fiduciary considerations are at the center of each ZAG firm’s investment process. To assure this, each firm’s proprietary process incorporates ZAG *Fiduciary FirstSM* standards.¹¹

ZAG’s unique *Fiduciary FirstSM* approach utilizes the *Center for Fiduciary Studies* Standards of Fiduciary Conduct¹² as a framework. The process further incorporates the group’s accumulated wisdom gained over decades of experience, our refined best practices, risk management procedures, and well-documented systems. Ongoing investor education, proactive communication, and maintenance of positive client relationships are critical to establishing and supporting an optimal and disciplined ZAG investment strategy.

ZAG *Integrative Wealth Management* (IWM) emphasizes the importance of addressing both your personal and financial needs. Your total “wealth” extends beyond financial issues and is also made up of human, intellectual, and social factors. IWM balances your desire to create pools of assets to fulfill various needs with a holistic wealth management approach, focusing on a comprehensive portfolio strategy. The process is constrained by your preferences, tax considerations, cash flow, and liquidity needs. IWM is comprehensive in nature and incorporates your financial plan, estate plan, life plan, vision, and investment strategy.

ZAG’s *Fiduciary FirstSM* standards recognize the far reaching impact of exceptional portfolio management. Effective IWM requires your advisor to commit to a sound and prudent investment process guided by fiduciary standards. Within this framework, the role of a ZAG advisor is to look at a holistic picture of your life and the life of your family, realizing the effect certain investment strategies and decisions may have now and into the future.

Figure 6 lists various services that may be provided by ZAG firms¹³ and the relationship of each service to the four fiduciary steps shown in Figure 5. These various ZAG services complement a prudent fiduciary investment process and serve as the foundational components of sound Integrative Wealth Management. Your benefit: increased simplicity, ease, clarity, confidence, focus, vision, and peace-of-mind. More information can be found on the ZAG website at www.zeroalphagroup.com.

Implications for Investors

(SECTION IV)

While standards provide a yardstick for measuring fiduciary responsibility, the main goal of a fiduciary process is to systemically deliver enhanced value while serving your best interests. There are many benefits of engaging a fiduciary advisor, but not all are immediately apparent. These benefits become clear as you experience the positive results from leveraging an advisor's fiduciary process.

While it is technically feasible for advisors to utilize many different investment approaches, credible academic and industry research point to several core aspects of an advisory relationship that consistently deliver maximum value to you. These core features include:

- A Structured, Quantitative Approach to Investing
- Application of Modern Portfolio Theory (MPT)
- Broad Global Diversification
- Tax-efficient Investing
- A Planning-based Investment Strategy
- A Formalized Investment Policy Statement (IPS)
- Disciplined Rebalancing
- Multi-generational Planning
- Focus on Low Costs
- A Fee-only Investment Relationship
- Avoidance of Proprietary Products

Our ZAG *Fiduciary First*SM standards are based on the belief that a structured approach to investing (i.e. index funds, passive funds, structured investments, asset class funds, and ETFs) is most reliably aligned with serving as a fiduciary advisor. These low-cost, tax-efficient strategies consistently outperform active managers. They eliminate speculative risk, over-reliance on human judgment, and emotional decision making—allowing more consistent returns. To illustrate, Figure 8 shows the long-term advantage of a structured investment approach relative to more expensive, riskier, and tax-inefficient actively managed strategies.

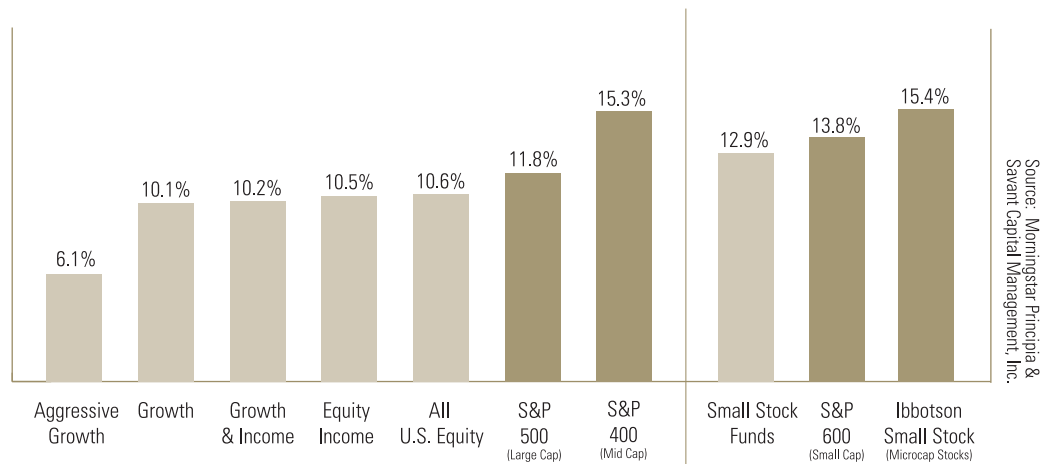
Tenets of MPT and Broad Global Diversification teach us that different types of investments respond differently to various global economic factors.¹⁴ MPT utilizes broad global diversification strategies to reduce portfolio risk and enhance return. While one asset class may under-perform the broad market, another may out-perform the overall market. Figure 9 illustrates the risk and return benefit from effective diversification. Relative to the basic non-diversified strategy on the left, investors who used MPT and Broad Global Diversification (right pie chart) earned higher returns with less risk.

By integrating these and other estate, tax, insurance, and life planning strategies within your investment process, your results will be enhanced and more closely aligned with your personal and investment goals.

Actively Managed U.S. Stock Funds Fail to “Beat the Market”

(Annual Returns Between 1995 and 2006)²³

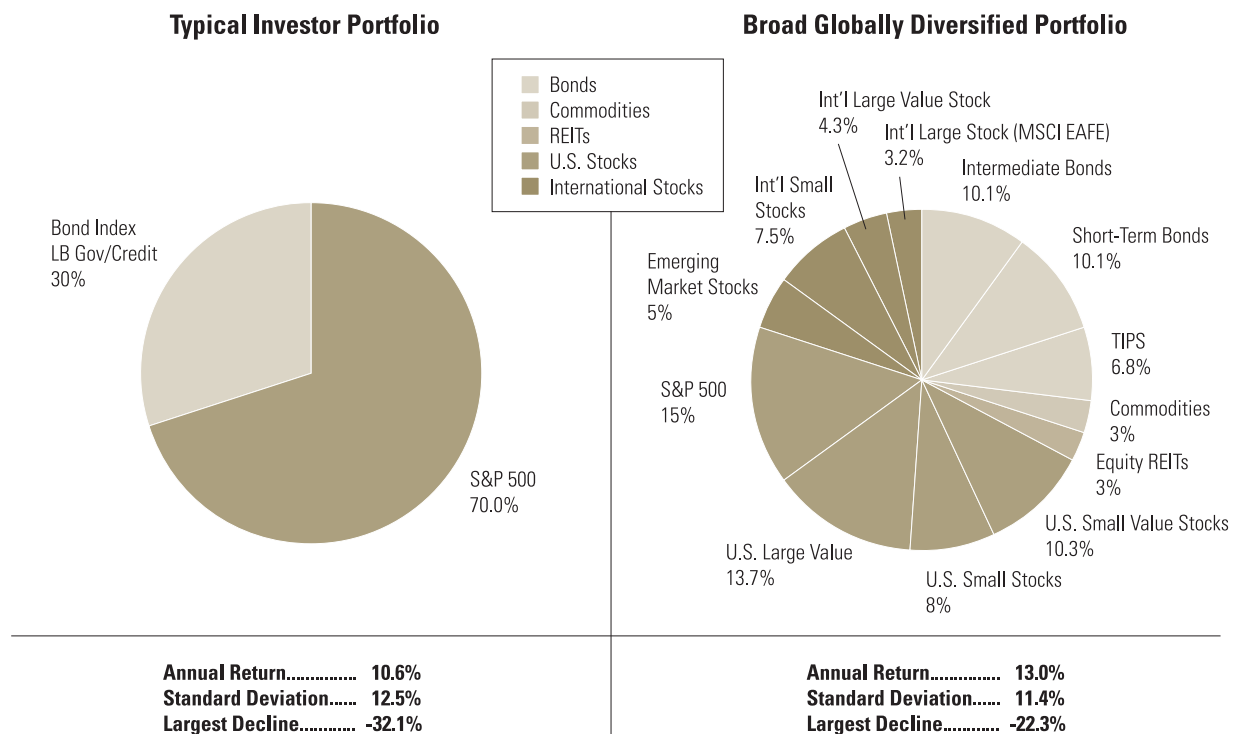
Figure 8



Broad Global Diversification Increases Return & Reduces Risk

(1973-2006)

Figure 9



Our Fiduciary Pledge to You...

We pledge to you, our fiduciary client, a level of service based on integrity and fiduciary responsibility. As we continually renew our pledge of moral excellence, we promise to put your interests first. We will follow a proprietary process grounded in the wisdom we have gained through our experience and constant penchant for learning, resulting in an ever more robust approach to integrative wealth management.

We earn our living by ensuring clients' objectives and goals, both personal and financial, are the top priority. **We fully acknowledge and actively embrace our fiduciary responsibilities, employing prudent investment processes and providing full transparency of fees.** The proprietary process we have developed offers peace-of-mind, multi-generational planning, prudent risk management, and the confidence to enjoy life—supported by the wealth you have created.

This paper describes an industry rife with conflicts of interest—one focused on advancing its own interests over those of the client. Sadly, unless firms corporately embrace the concept of acting as a fiduciary for their clients, violations will most likely continue to occur. Firms and investment professionals, when considering what to recommend for their clients, must change the question from “What can we do that would avoid being egregiously unacceptable in this client situation?” (i.e. how far can we go without “crossing the line”) to “What would be the best thing we can do for the client in this situation.” The two questions are worlds apart.

While most firms are overly focused on commissions and developing “proprietary” products, fiduciary advisors are free to focus on creating processes providing welcome assurance that your needs are objectively met and intentionally placed first.

You should be skeptical of fiduciary references from long-established firms whose compensation models result in potential conflicts of interest which can lead to biased recommendations. You should also be wary of any advisor who is unwilling to clarify his or her fiduciary status, or who displays a reluctance to disclose how their processes fulfill their fiduciary responsibility.

Following the steps outlined in the section entitled, “Critical Steps to Finding a Fiduciary Advisor,” will allow you to leverage the 23 Standards identified by *The Center for Fiduciary Studies*.³ Doing so will equip you with the yardstick necessary to choose a fiduciary advisor and monitor their activities. Your potential benefit: increased simplicity, ease, clarity, confidence, focus, vision, and peace-of-mind.

Appendix

APPENDIX A:

A SHORT HISTORY OF FIDUCIARY RESPONSIBILITY

The original use of fiduciaries as trustees is well founded in English common law. However, it was not until the middle of the 19th century in the United States when the first trust company, US Trust, was formed by enterprising industrialists. This company assisted entrepreneurs in the execution of financial transactions and wealth management. As early US businesses grew, and as greater wealth followed, investors increasingly relied on financial professionals. The establishment of the income tax and the Federal Reserve in 1913 added tremendous complexities and caused businessmen to increasingly rely on trustees and advisors. And as the securities industry grew, trust companies maintained their caretaker position for the assets of institutions and wealthy families.

In the 1920s, '30s and '40s, the economy underwent a series of economic shocks that included two worldwide wars and a global depression. This led to the establishment of the social security system which, for many, was their only financial "savings" plan. After World War II, the economy grew rapidly, labor unions prospered and tax rates increased through the 1950's and 60's. As a result, employers established retirement funds—this time in the form of defined benefit pension plans—to reward faithful employees. But investment abuses grew along with the funds, resulting in the Welfare and Pension Disclosure Act of 1958 and the Labor-Management Reporting and Discipline Act the very next year. Abuses continued, causing politicians to pass ERISA (Employee Retirement Income Securities Act) in 1974. This forced employers, and fiduciaries such as trustees and other advisors, to disclose adequate information to plan participants and establish standards of conduct for plan sponsors (corporate employers). It provided for full disclosure and ensured all qualifying participants would receive benefits.¹⁶

The focus on abuses continues today. On May 31, 2007, the Certified Financial Planner™ (CFP) Board revised its practice standards. The new ethics standards now require CFP designees to serve their clients as fiduciaries. CFPs must now put clients'

interests first, act as a fiduciary and disclose the scope of their engagement and their compensation when engaging in planning activities. Recent scandals have also inspired new legislation in the form of the Pension Protection Act of 2006, the most extensive overhaul of prescribed practice standards for anyone advising qualified retirement plan participants.

APPENDIX B:

BROKER VS. FIDUCIARY ADVISOR

How does the fiduciary status (or lack thereof) of your investment provider affect you? The answer is simple: non-fiduciary advisors are neither legally nor morally bound to put you and your family's best interests first. Furthermore, their recommendations are not guided by fiduciary standards. How can you then determine whether the recommendations they offer are in your best interest or theirs? As you recognize the real differences in business models, philosophy, culture and even the basic legal differences between fiduciary and non-fiduciary firms, it becomes obvious why you should care!

Fee-only fiduciary advisors are not paid more to recommend one product over another. Furthermore, while the brokerage model shifts the burden of proof (related to determining investment merit) to you, a fiduciary advisor assumes this responsibility on your behalf. You can rest assured that your portfolio is designed to help you reach your goals and objectives. Brokerage firm recommendations cannot be relied upon to do the same.

Remember, in the brokerage model, the broker provides no advice other than initial investment selection. He or she is paid commissions to sell investment products. Furthermore, brokers have no duty to monitor or manage the recommendations they make. That is your job. The broker hands that responsibility to you because he or she does not serve you as a fiduciary. Today, investors have ready access to investment products and discount trade execution—the transaction services of the original brokerage model have been commoditized by technology.

Appendix

In contrast, the SEC mandates that fiduciary advisors address and manage a broad range of investment and administrative values to help you achieve your goals and objectives. In other words, brokers sell products you can get anywhere while fiduciaries, guided by your risk tolerance and realistic performance expectations, provide advice to help you achieve your goals.

The confusion sets in as follows: The Investment Advisers Act of 1940 provides exemptions for certain industry or professional groups from having to register as investment advisors. Two conditions must be met. If the advice offered is ‘solely incidental’ to brokerage services and if the firm receives no ‘special compensation’ for the advice, the firm may be exempt from registration. Many traditional brokerage firms have given their employees fuzzy titles such as ‘Financial Advisor’ or ‘Financial Consultants,’ and allowed them to earn ‘fees.’ Although these are initial earmarks of fiduciaries, most brokerage firms have no desire to be formally labeled ‘fiduciaries’ and avoid registration of their employees by saying the employees do not have discretion over investor accounts. Thus, by skirting the issue, brokerages have been able to blur the respective services and activities of investment advisors and broker-dealers against an uneven regulatory environment with disparate standards.

Until the SEC lost a recent lawsuit (regarding the Merrill Lynch Rule referenced earlier), some brokerage firms maintained the appearance of being an “investment advisor” by charging fees as well as commissions. Even so, their true compensation often varied based on the particular product or investment vehicle sold within the managed account. As such, high expense funds and investments with hidden fees were commonplace in fee-based brokerage accounts. Differing levels of compensation inherently bias brokers to favor particular products. Another common abuse involves selling annuities to investors within an IRA or 403(b) account. Though not illegal, this offers no additional tax benefits; yet investors get saddled with high annuity costs and related surrender charges often lasting 7-10 years.

These are just two examples of common fiduciary breaches under the commission and the fee-based brokerage models, which were becoming increasingly frequent prior to the overturning of the SEC Merrill Lynch Rule. Fuzzy titles along with flashy and creative advertising campaigns mislead investors into thinking that brokers offer objective, sound “advice.” This often distorts the true legal relationship and the fact brokerage firms are sales organizations. Their compensation models make true objectivity practically impossible. Hopefully, with the recent changes in the industry, these distinctions will once again be more easily determined by investors who can then make appropriate and informed choices regarding investment providers.

APPENDIX C: LAWS AND STANDARDS

Today’s fiduciary standards are based primarily on four federal laws, the Employee Retirement Income Security Act (ERISA),¹⁷ the Uniform Prudent Investors Act (UPIA),¹⁸ the Management of Public Employee Retirement Systems Act (MPERS),¹⁹ and the Pension Protection Act of 2006 (PPA).²⁴ These laws serve as the foundation for the four steps and 23 practices identified by *The Center for Fiduciary Studies*.³ The fiduciary handbook published by fi360^{TM9} cites seven practices common to the three laws.²⁰ Fiduciaries must exhibit fiduciary skills, knowledge, and responsibility in order to earn and retain the trust of their advisory clients.

These fiduciary standards also form the basis for ZAG’s proprietary *Fiduciary First*SM standards.

Laws and Standards Defining Fiduciary Advice

Figure 10²¹

The Laws

Investment Adviser Act of 1940	Uniform Prudent Investor Act (UPIA)	Restatement Law of Trusts 3rd
<p>First fiduciary document – legislated by the Securities & Exchange Commission.</p>	<p>Follows the Prudent Investor Rule, “a legal doctrine providing guidance to investment managers to manage an investment portfolio in a legally satisfactory manner.”</p>	<p>Removed many Common Law investment restrictions on Trustees and made five fundamental alterations to formerly accepted prudent investment criteria.</p>
<ol style="list-style-type: none"> 1. Advisors must not have been convicted of a felony within the last 10 years. 2. There must be no untrue statements on reports filed with the SEC. 3. Advisors must define a Code of Conduct for themselves. 4. Advisors must provide investors with a copy of Form ADV Part II. 	<ol style="list-style-type: none"> 1. Trustees may use risk-return analysis to enhance performance. 2. Allows Trustees to use MPT to reduce volatility and losses. 3. Allows investments in international markets. 4. Allows inclusion of ‘higher risk’ investments when they can reduce overall portfolio risk. 	<ol style="list-style-type: none"> 1. Applied the standard of prudence to the entire portfolio to include all the trust’s assets. 2. Established the trade-off between risk and return as the fiduciary’s central concern. 3. Eliminated restrictions on investment types in achieving objectives of the trust. 4. Incorporated diversification into the definition of prudent investing. 5. Permitted delegation subject to safeguards.
ERISA	Management of Public Employee Retirement Systems Act (MPERS)	Pension Protection Act of 2006
<p>1974 Federal law that set minimum standards for pension plans.</p>	<p>State law governing the establishment of trusts and their management.</p>	<p>The most extensive revision of regulation for pension funds in 30 years.</p>
<ol style="list-style-type: none"> 1. Forced full disclosure to plan participants. 2. Established standards of conduct for plan sponsors ensuring all participants would receive benefits. 3. Requires trustees to place participant’s best interests first. 4. Encourages fiduciaries to adopt written policies. 5. Establishes certain prohibited transactions. 	<ol style="list-style-type: none"> 1. Set universal standards for trust management from state to state. 2. Outlined powers of trustees. 3. Outlined standards for delegation of duties. 4. Outlined definition of a fiduciary. 	<ol style="list-style-type: none"> 1. Advisors must acknowledge fiduciary status in writing. 2. Advisors must disclose in writing any conflicts of interest and all forms of compensation. 3. Fiduciaries must set in writing a set fee level. 4. Advisors must have an ‘advice model’ showing criteria for making recommendations. 5. Plan sponsors may retain a “Fiduciary Advisor” to provide participant level advice.

The Standards

Center for Fiduciary Studies ³	CFP® Board Code of Conduct	Centre for Fiduciary Excellence (CEFEX)
<p>4 Steps and 23 practices based on case law. The steps and practices are outlined in Figure 5.</p>	<p>The guidelines created by the Board of Governors of the Certified Financial Planner™ Board of Standards.</p>	<p>CEFEX is an independent global assessment and certification organization. CEFEX works closely with regulators, self-regulators and the investment community.</p>
<p>Three of the laws, ERISA, the UPIA, and MPERS, serve as the basis from which the standards were developed. The standards, in turn, serve as the basis from which the ZAG Fiduciary First™ standards were developed.</p>	<p>The Code of Conduct is the comprehensive name for the ethical guidelines and professional practices expected of advisors who hold the Certified Financial Planner™ designation. CFP designees must now serve clients in a fiduciary capacity.</p>	<p>A CEFEX fiduciary certification is an independent recognition of a fiduciary’s conformity to ISO standard-like Fiduciary Practices and Criteria. CEFEX promotes global standards of fiduciary excellence for advisors, stewards, and managers.</p>

Five of the six laws provide general guidelines but no specific standards by which fiduciaries can measure and document the fulfillment of their responsibilities, nor do they provide a way by which investors can gauge the quality of advice (the sixth law, the Pension Protection Act provides practice standards for professionals advising qualified plan participants and likewise updates ERISA). The Standards identify fiduciary criteria and best practices and tie them to regulations or legal references. In other words, the Standards provide “muscle and skin” to a legislative “skeleton.”

References, Notes, Sources of Data and Methodology:

- 1 Abuses to which many firms have neither admitted nor denied guilt, yet agreed to pay millions in fines, include:
 - Lack of independence in research provided by internal analysts
 - Late trading and market timing abuses by mutual funds
 - Kick-backs by mutual funds to financial institutions who sell them
 - Inflated stock prices
 - “Spinning” of initial public stock offerings
 - Back dating executive options compensation
 - So-called “contingent” commissions in the insurance industry
 - Selling high cost annuities in qualified accounts
 - 12(b)-1 fees financial institutions earn from mutual fund products
 - Banks acting as fiduciaries, yet using proprietary products and collecting 12(b)-1 fees
 - The variety of mutual fund sales charges including “A,” “B,” “C,” and “D” shares
- 2 The Sarbanes Oxley Act of 2002 and an SEC ruling in June of 2004 have been the main legislative responses thus far. The SEC ruling primarily mandated the independence of the majority of seats on mutual funds’ Boards of Directors.
- 3 The Center for Fiduciary Studies is a research and training center focused solely on the subject of investment fiduciary responsibility, providing training programs and professional designations based on investment fiduciary standards of care: The center awards the Accredited Investment Fiduciary® (AIF®) and Accredited Investment Fiduciary Analyst™ (AIFA®) to individuals that complete its training program and passes an accompanying exam.
- 4 In Missouri, and many other states, brokers are considered fiduciaries, although the scope of their fiduciary duties is very limited (e.g., Vogel v. AG Edwards; Roth v. Roth; Leuzinger v. Merrill Lynch). Many registered investment advisors are likewise dually registered as broker-dealers and may engage in transactional (commission) activity not subject to fiduciary requirements associated with being an SEC registered investment advisor. Finally, there are a limited number of registered representatives of broker-dealers whose firms allow them to assume a legal relationship of fiduciary responsibility.
- 5 Some registered investment advisors are dually registered as NASD representatives (brokers) or as insurance agents (agents). Such registered investment advisors may earn commissions (even while acting as a fiduciary advisor and while earning commissions for selling a product) in the capacities of a broker or an agent. This may be consistent with a fiduciary relationship provided that proper disclosures are made and the product (i.e. life insurance or investment products) is the most appropriate solution for the client given their individualized needs and circumstances.
- 6 On May 31, 2007, the CFP Board revised its practice standards. The new ethics standards now require CFP designees to serve their clients as fiduciaries. CFPs must now put clients’ interests first, act as a fiduciary and disclose the scope of their engagement and their compensation when engaging in planning activities.
- 7 “Fiduciary Duty: Return to First Principles,” by Lori A. Richards, Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission, <http://www.sec.gov/news/speech/spch022706lar.htm>
- 8 At this time, only Part I of an advisor’s Form ADV is available electronically for viewing on the SEC website, <http://www.sec.gov/answers/formadv.htm>. Investment advisors are required to furnish you a copy of their ADV Part II.
- 9 The mission of f360™ is to promote a culture of fiduciary responsibility and improve the decision making process of investment fiduciaries. f360™ coordinates the resources for the following entities: Foundation for Fiduciary Studies; Center for Fiduciary Studies; and Fiduciary Analytics. f360™ is also a founding member of CEFEX, an independent assessment and certification organization, operating on a global basis. CEFEX works with the investment and fiduciary communities to provide comprehensive assessments that measure risk and trustworthiness of investment fiduciaries.
- 10 “Prudent Practices for Investment Advisors,” The Center for Fiduciary Studies, p. 9.
- 11 ZAG Fiduciary First™ standards, <http://www.zeroalphagroup.com/fiduciaryfirst.pdf>
- 12 The Four Steps and 23 Fiduciary Standards developed by the Center for Fiduciary Studies in its booklet, “Prudent Practices for Investment Advisors.”
- 13 Actual services provided to specific clients of ZAG firms vary by firm and by individual client engagement. Specific services provided to any particular ZAG firm client depends on the scope of the engagement as documented in the client’s written contract. For example, in many instances, a client may retain a ZAG firm only to provide investment management. In such instances the ZAG advisor may not provide financial planning, integrated wealth management, or any other related services.
- 14 “The New Fiduciary Standard,” by Tim Hatton, CFP, CIMA, AIF, p. 26, Bloomberg Press, Princeton, NJ 2005.
- 15 See sources of data and methodology below for substantiation of risk and return calculations.
- 16 “History of EBSA and ERISA,” US Department of Labor, Washington, CD. <http://www.dol.gov/ebsa/aboutebsa/history.html>
- 17 “Employee Retirement Income Security Act—ERISA,” US Department of Labor, <http://www.dol.gov/dol/topic/health-plans/erisa.htm>
- 18 Uniform Prudent Investor Act drafted by the National Conference of Commissioners on Uniform State Laws, July 29-August 5, 1994.
- 19 Uniform Management of Public Employee Retiree Systems Act, <http://www.nastra.org/resources/umpersa.pdf>
- 20 The seven practices common to the three laws include:
 - Know applicable standards, laws, and trust provisions
 - Diversify client assets to his or her specific risk/return profile
 - Prepare an investment policy statement
 - Use “prudent experts” (money managers) and document due diligence
 - Control and account for investment expenses
 - Monitor the activities of “prudent experts”
 - Avoid conflicts of interest and prohibited transactions
- 21 Information regarding the Investment Advisers Act of 1940, the CFP Board, and the Pension Protection Act are sourced in part from “Fiduciary Fire Index,” by Bob Veres, www.financial-planning.com, November 1, 2006.
- 22 Comment by Ross Fowler, Australasian licensee for f360™.
- 23 Twelve year period used due to availability of survivor-bias free data, since 1995.
- 24 Pension Protection Act of 2006 (PPA), <http://www.dol.gov/ebsa/pensionreform.html>
- 25 Regulation of Stockbrokers and Financial Advisors: What American Investors Understand, Think is Right, <http://www.zeroalphagroup.com/news/cfzagsurvey102704.cfm>

SOURCES OF DATA & METHODOLOGY

Short-Term Bonds - U.S. 1 Year Treasury Constant Maturity Appreciation; **Intermediate-Term Bonds** - Lehman Brothers Intermediate Government/Credit Bond Index; **Bond Index** - Lehman Brothers Government/ Credit Bond Index; **TIPS** - 50% Lehman Brothers Intermediate Government/Credit Index and 50% U.S. 1 year Treasury Constant Maturity (1/73 – 2/97), ML U.S. Treasury Linked Data (3/97 - present); **S & P 500 Stocks** - Standard & Poor’s 500 Total Return Index (S&P 500); **U.S. Large Value Stocks** - Fama-French Large Value Index; **U.S. Small Stocks** - Ibbotson Small Company U.S. Small Stock Index; **U.S. Small Value Stocks** - Fama-French Small Value Index; **International Large Stocks** - MSCI EAFE Index; **International Value Stocks** - MSCI EAFE Index (1/73 – 12/74), Fama-French International Large Value Index (1/75 – 6/94), and MSCI EAFE Value Index (after 6/94); **International Small Stocks** - DFA International Small Company Index (1/73 – 9/96), S&P/Citigroup EMI Index (10/96 - present); **Emerging Markets Stocks** - 50% Morgan Stanley Capital International EAFE and 50% DFA International Small Co. Index (1/73 – 12/84), IFC Emerging Markets Composite Index (1/85– 12/88), IFCI Emerging Markets Composite Index (data begins 1/89); **Equity REITs** - FTSE NAREIT Equity REIT Index; **Commodities** - GS Commodity Index; **S & P 400 Stocks** - Standard & Poors 400 Total Return Index (S&P 400); **S & P 600 Stocks** - Standard & Poor’s 600 Total Return Index (S&P 600); **Ibbotson Small Stocks** - Ibbotson Small Company U.S. Small Stock Index; **Aggressive Growth** - Average Survivor Bias-Free Return of Principia Prospectus Objective Aggressive Growth Funds; **Growth** - Average Survivor Bias-Free Return of Principia Prospectus Objective Growth Funds; **Growth & Income** - Average Survivor Bias-Free Return of Principia Prospectus Objective Growth & Income Funds; **Equity Income** - Average Survivor Bias-Free Return of Principia Prospectus Objective Equity Income Funds; **All U.S. Equity** - Average Survivor Bias-Free Return of Principia Prospectus Objective Aggressive Growth, Growth, Growth & Income and Equity Income Funds; **Small Stock Funds** - Average Survivor Bias-Free Return of Principia Prospectus Objective Small Stock Funds. **Survivor Bias-Free Returns:** Savant analysis construction methodology captures and adds back the return of purged funds that typically struggled. For example, had a fund been liquidated or been merged into another fund during July, the dead fund’s returns were added back to the SBF data through June. Said differently, default biased data (typically used by investors and advisors) on the 12/31/06 disk does not include all the funds that were liquidated or were merged into another fund during the ten years between 1/1/1995 and 11/30/06. The analysis uses 12 years of data due to the fact that data prior to 1995 was not available. Portfolio returns, standard deviations and largest declines assumes quarterly rebalancing back to target allocation weights.

Savant is One of the Nation's First CEFEX Certified Advisors and the First CEFEX Certified Investment Steward

Savant has been certified by CEFEX, *Centre for Fiduciary Excellence, LLC*, to the **Fiduciary Practices for Investment Stewards and Investment Advisors**.

CEFEX is a global, independent rating and certification organization that works closely with the investment community and fiduciary industry to provide comprehensive assessments that measure risk and trustworthiness of investment fiduciaries.

In addition to Savant being one of the first advisors to complete the CEFEX Investment Advisor's independent certification process, Savant is also the **first** Investment Steward in the world to have their internal 401(k) plan certified as meeting fiduciary standards of excellence and best practices. Through these two independent assessments, Savant has demonstrated its adherence to the industry's best fiduciary practices as an advisor to individual and institutional clients and as a steward of its own employees' retirement plan assets.

A CEFEX assessment includes both on and off-site confidential reviews of an organization's practices by an independent Accredited Investment Fiduciary Analyst (AIFA®). The process uses the ISO 19011 audit standard, an internationally recognized standard for testing process management systems. The assessment is documented by the AIFA®, and subject to review by the CEFEX



Registration Committee comprised of independent fiduciary experts. The CEFEX standard of excellence for Investment Stewards and Advisors is based on a series of fiduciary practices that seek to increase long-term investment performance by diversifying the portfolio across multiple asset classes and peer groups, evaluating investment management fees and expenses, and selecting or terminating Investment Managers. The annual certification process involves a detailed review of plan documents, policies, and procedures followed by on-site interviews with key personnel.

The **Centre for Fiduciary Excellence, LLC (CEFEX)** (<http://www.cefex.org>) is comprised of four global member organizations: CSA Group (Canada); SAI Global (Australia); Fiduciary 360 (United States); and Rating Capital Partners (Europe). CEFEX also has an association with AFAQ AFNOR International of Paris, France, a global standards development certification and training organization with offices in Germany, UK, Russia, Africa, China, and southeast Asia. CEFEX certification is based on a Standard of Excellence describing fiduciary practices for Investment Managers, Advisors, Fiduciary Advisors, and Stewards (Plan Sponsors, Endowments, Foundations, etc.). The handbook describing the detailed Fiduciary Practices is available at (<http://www.fi360.com>).

To learn more about our CEFEX certification, go to www.savantcapital.com/cefex

Savant Capital Management, Inc.

A LEARNED SCHOLAR: A WISE PERSON

Savant Capital Management, Inc. (<http://www.savantcapital.com>) is an independent, fee-only wealth management firm headquartered in Rockford, IL. Since 1986, Savant has served financially established individuals, trust funds, retirement plans, non-profit organizations, fiduciaries, and families of significant wealth.

Savant stands apart in an industry crowded with conflicts of interest. They accrue no benefit from brokerage services, commissions, or product sales. As a fiduciary, Savant provides impartial advice. Savant clients are neither speculative nor high-risk investors. Rather, each is concerned with preserving capital, growing assets, and avoiding the myriad risks that abound in today's investment environment.

Savant is regularly recognized among the top wealth managers in the United States. *Barron's* has named Savant as one of the "Top 100 Independent Financial Advisers" in the country. Since 2001, Savant has earned a place on *Bloomberg Wealth Manager's* Top Wealth Managers list. Savant has further been recognized as one of the nation's 100 top financial advisors by Robb Report *Worth* magazine each year since 1997. In 2003 and again in 2006, Savant was included in *The Wealth Factor*, a book profiling ten of the most innovative and respected wealth management firms in the nation. Since 2004, Savant has been selected by *Medical Economics* magazine as one of the "Top 150 Financial Advisors for Doctors" in the nation. Savant has also appeared on top advisor lists published by *JK Lasser's* and *The Family Wealth Alliance*.



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