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# FIDUCIARY STANDARDS FOR INVESTMENT ADVISORS

*Attorneys for Family Held Enterprises*

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# FIDUCIARY INVESTMENT ADVISORS

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Investment product sales and fiduciary advice are distinct, important, services offered to investors and trustees. The materials that follow strive to distinguish the two in an industry that increasingly seeks to conflate and confuse them:

- What does a fiduciary advisor look like?
- Why might an investor select one?
- How can an investor identify one?
- Where are the rules?
- What are the best practices?

What does a **fiduciary investment advisor** look like?

# WHO'S THE FOOD "FIDUCIARY?"



# WHO'S THE FOOD "FIDUCIARY?"



Supermarket Manager



Cheesemaker



Registered Dietician



Baker

# WHO'S THE INVESTMENT FIDUCIARY?

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# WHO'S THE INVESTMENT FIDUCIARY?



Broker / Dealer



Trader



Registered  
Investment Advisor











Investment  
Banker

Why would an investor want a  
*fiduciary*  
investment advisor?



# TRUST IN INSTITUTIONS

The financial services industry has firmly established its place at the bottom of the Edelman Trust Barometer

Industry	2012	2013	2014	2015	2016	5 yr.Trend
 Technology	76	73	75	73	74%	▼ 2
 Food & Beverage	63	63	64	63	64%	▲ 1
 Consumer Packaged Goods	57	60	61	60	61%	▲ 4
 Telecommunications	58	60	61	59	60%	▲ 2
 Automotive	62	65	69	66	60%	▼ 2
 Energy	53	57	57	56	58%	▲ 5
 Pharmaceutical	54	54	55	54	53%	▼ 1
 Financial Service	43	47	48	48	51%	▲ 8

Source: 2016 Edelman Trust Barometer



**Senator Susan Collins (R-ME):** “Could you give me a yes or no to whether you consider yourself to have a duty to act in the best interests of your clients?”

**Daniel Sparks of Goldman Sachs:** “I believe that we have a duty to serve our clients well.”

“...we estimate the aggregate annual cost of conflicted advice is about \$17 billion each year.”

The Effects of Conflicted Investment Advice On Retirement Savings

February 2015

White House

“Non-fiduciaries may give imprudent and disloyal advice; steer plans and IRA owners to investments based on their own, rather than their customers’ financial interests; and act on conflicts of interest in ways that would be prohibited if the same persons were fiduciaries.”

Conflict of Interest Rule - Retirement Investment Advice

April 2016

Department of Labor

How can an investor **identify** a  
fiduciary investment advisor?

# CAN ANY ADVISOR CLAIM TO BE ONE?

## Some firms offer “Fiduciary-like promises...”

“A healthy relationship with your Financial Advisor should make you feel that your best interests are the top priority, no matter what is happening in the market and no matter the size of your portfolio..”



“Acting in good faith and taking pride in getting things just right. The personal commitment each of us makes to go the extra mile for our customers and put their interests before our own is a big part of what has always made [Firm B] a special place to work and do business.”

# UNTIL THE RUBBER HITS THE ROAD...

## ...but decline Fiduciary liability.

“The law establishes that a broker does not owe a fiduciary duty to a customer with respect to a nondiscretionary account..”



“Claimants first claim fails because [Firm B] did not owe [the investors] any fiduciary duty.”



# FINDING FIDUCIARY ADVISORS

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Methods for identifying fiduciary investment advisors are limited and inconclusive. Shared values and personal references remain the most reliable ways to discern a fiduciary advisor. Other tools include:

## Form of registration

- Broker/Dealer – fiduciary liability in specific circumstances
- Registered Investment Advisor – fiduciary w/disclosed exceptions

Form ADV for RIA's (e.g. 18-60 pp, no criminal, regulatory, civil actions)

- Disclosure of other business activities, compensation arrangements, ownership, conflicts of interest, etc.

Brokercheck for Broker/Dealers (e.g. 731 pp, 366 regulatory, 55 arb, etc.)

- Complaints/misconduct (if any)

Follow the \$\$\$ and check disclosures

## How are advisors paid?

- Advisors whose only income derives from fees charged transparently to clients are more likely to act as fiduciaries
- While other sources of income may be earned, mitigated and disclosed, they introduce the potential for substantial conflicts of interest



# CONFLICTS AND DISCLOSURE

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- Non-fiduciary advisors engage in contractual relationships, assuming equally competent parties; they limit their liability through disclosure of conflicts and mutual agreement
- Fiduciary law assumes a vulnerable party (e.g. doctor/patient); the bar for limiting liability by disclosing conflicts is higher<sup>1</sup>
  - Notice of the conflict must be given
  - Clients must be capable of independent judgement
  - Clients must receive full information
  - Client consent must be clear and specific
- While no advisor is conflict-free, fewer conflicts, rather than more disclosure are key to a fiduciary relationship

<sup>1</sup>"Fiduciary Law", Tamar Frankel, Oxford University Press 2001 pp. 200-207

# OVER-RELIANCE ON DISCLOSURE

- The SEC verifies disclosure of conflicts as a way of ensuring an advisor is meeting their fiduciary obligations.
- While disclosure of conflicts is practical and necessary, it falls far short of ensuring the requirements of utmost good faith and reasonable care are met.

“...investor psychology matters. It is not enough to require more and more disclosure without more carefully considering how the information is used by investors...<sup>1</sup>”

“One enormous flaw is that clients who entrust their money and securities to advisers are hardly ever likely to mistrust their brokers’ advice. The other flaw arising from disclosure is that such disclosure relieves brokers of self-limitations on conflicts of interest, especially when clients agree.<sup>2</sup>”

<sup>1</sup>Paredes, T. (2003). Blinded by the Light: Information Overload and Its Consequences for Securities Regulation, Washington Univ. Law Review V.81 I.2

<sup>2</sup>Frankel, T. (2011). Regulation Of Brokers, Dealers Advisers Financial Planners, Review of Banking & Financial Law, 30

Where are the **rules** for fiduciary advisors?

## 1940 Investment Advisor's Act

- “Investment Advisers are of National Concern<sup>1</sup>”
- Registration, descriptive information, business affiliations, manner of giving advice, bases for compensation, etc.
- Prohibition against fraudulent, deceptive, manipulative acts
- “**Best interest of customer** without regard to the financial or other interest of the broker, dealer or investment adviser...”

<sup>1</sup>Extract from Sec. 201, Investment Advisers Act of 1940

- Even if respondents' advice was “honest,” in the sense that they believed it was sound and did not offer it for the purpose of furthering personal pecuniary objectives, the Commission was entitled to an injunction<sup>1</sup> requiring disclosure.
- Nor is it necessary in a suit against a fiduciary, which Congress recognized the investment adviser to be, to establish all the elements required in a suit against a party to an arm's-length transaction.

<sup>1</sup>Compelling a registered investment adviser to disclose to his clients a practice of purchasing shares of a security for his own account shortly before recommending that security for long-term investment and then immediately selling the shares at a profit upon the rise in the market price following the recommendation.

Note: All text on this page is extracted from the SEC v. Capital Gains Supreme Court Decision, 1963



The 1940 Investment Adviser's Act  
exempts from the definition of  
Investment Adviser:

“any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore.”

# NON-FIDUCIARY ADVICE

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“An important aspect of a broker-dealer’s duty of fair dealing is the suitability obligation, which generally requires a broker-dealer to make recommendations that are consistent with the interests of its customer.

Broker-dealers also are required under certain circumstances, such as when making a recommendation, to disclose material conflicts of interest to their customers, in some cases at the time of the completion of the transaction.”

# POSSIBLE “HARMONIZATION”

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“The Commission may promulgate rules to provide that, with respect to a broker or dealer ... the standard of conduct ... shall be the same as the standard of conduct applicable to an investment adviser under ... the Investment Advisers Act of 1940.”

Dodd-Frank Wall Street Reform and Consumer Protection Act

July 21, 2010

*(2,300 pages, 390 required rule makings)*

# THE SEC ON “HARMONIZATION”

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“Many investors are ... confused by the different standards of care that apply to investment advisers and broker-dealers. That investor confusion has been a source of concern for regulators and Congress.”

“...the Staff recommends the consideration of rulemakings that would apply expressly and uniformly to both broker-dealers and investment advisers, when providing personalized investment advice about securities to retail customers, a fiduciary standard no less stringent than currently applied to investment advisers under Advisers Act.”

SEC study on Investment Advisers and Broker-Dealers  
as required by Section 913 of the

Dodd-Frank Wall Street Reform and Consumer Protection Act, January 2011

# HARMONIZATION QUO VADIS?

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- In April this year, the DOL issued a ruling seeking to grant investors in IRA accounts a fiduciary level of protection
- The SEC continues to explore the possibility of applying a fiduciary standard to broker/dealers advising on taxable accounts, while facing strong push-back from many parties
- For investors and trustees, complexity and confusion reign...

What are the **best practices?**

- The Institute for The Fiduciary Standard published “Best Practices for Financial Advisors” in September 2015 in order to translate the core duties of a Fiduciary investment advisor into a set of practices that are practical, verifiable and communicable to the investing public.
- The core fiduciary duties are:
  - Serve the client’s best interest
  - Act in utmost good faith
  - Act prudently – with the care, skill and judgement of a professional
  - Avoid conflicts of interest
  - Disclose all material facts
  - Control investment expenses



## THE INSTITUTE FOR THE FIDUCIARY STANDARD – 9/30/15

1. Affirm that the fiduciary standard governs at all times
2. Ensure a “reasonable basis” for advice in the best interest of the client
3. Communicate clearly and truthfully
4. Disclose total fees paid by the client or by third parties
5. Avoid conflicts. Disclose all unavoidable conflicts
6. Abstain from principal trading
7. Avoid compensation in association with client transactions
8. Avoid gifts or entertainment that are not minimal/occasional
9. Ensure baseline knowledge, competence and ongoing education
10. Institute an investment policy statement or process
11. Ensure underlying investment expenses are reasonable
12. Affirm adherence to Best Practices

Please share your:

- Questions
- Suggestions
- Experiences



THANK YOU