Markets Need a Single, Official Definition of "Fiduciary"

What is a fiduciary?

Investors, advisors, and regulators have spent years arguing over who should be classified as a fiduciary, but few ask what that fiduciary status means. Everyone seems to assume that there is an official and commonly understood definition. In reality, there are several fuzzy and sometimes contradictory definitions of the term applied by different people and organizations.

These differing definitions only add to the uncertainty and anxiety surrounding the debate over the Fiduciary Rule. Regulators need to put forward a unified definition of the fiduciary duty so that investors and advisors can have a fully informed debate on the matter.

Further, Morgan Stanley's (MS) recent exit from the protocol for broker recruiting shows that competition is heating up in the wealth management space. Battle lines are being drawn, and all market participants will benefit from knowing exactly where the lines are drawn for fulfilling fiduciary duties.

Differing Definitions

A recent article from Sellwood Consulting does a good job of explaining the various definitions of "fiduciary:"

- The common law definition of a fiduciary is one who has the obligation to act for another with "total trust, good faith, and honesty."
- The Employee Retirement Income Security Act (the definition used by the Department of Labor) defines a fiduciary as one who acts solely in the interest of the beneficiaries of a plan, acts with "care, skill, prudence, and diligence," diversifies the investments of the plan, and adheres to any documents governing the plan.
- The Securities and Exchange Commission (SEC) says that a fiduciary "must eliminate, or at least disclose, all conflicts of interest."

What's worse, some regulators now seem to have abandoned any attempt to define the word "fiduciary" at all. Nevada's recent fiduciary rule gives no definition of fiduciary duty and allows the state's securities administrator wide latitude in determining what violates fiduciary duty.

This patchwork of definitions creates potential for confusion and misunderstanding in the advisor/client relationship. What happens when the investor expects "total trust, good faith, and honesty" while the advisor only believes they need to disclose any conflicts?

Just as important, none of these definitions speaks to the advisor's capability to act in the best interest of clients. Even if an advisor fulfills the Duty of Loyalty, investors also needs to be confident in the advisor's ability to fulfill the Duty of Care by putting them in appropriate investments.

What Makes a Fiduciary?

In the past, we've put forward guidelines for research that fulfills the fiduciary Duty of Care. These guidelines have been shared by thought leaders such as wealthmanagement.com, MarketWatch, Michael Kitces and Kim O'Brien, CEO of Americans for Annuity Protection.

However, these standards can also apply to all aspects of the advisor/client relationship. To be a true fiduciary, an advisor should seek to be:

- **Comprehensive**: Consider all relevant data about the client (age, income, tax situation, financial goals, etc.) and all publicly available data on potential investments (e.g. 10-Ks and 10-Qs), including the footnotes and MD&A.
- **Objective**: Clients deserve an unbiased advisor, and both clients and advisors deserve unbiased research (i.e. not conflicted sell-side research.)

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- **Transparent**: Client should be able to see all the aspects of the investment process, including the analysis performed and the data behind it.
- **Relevant**: Investments should have a clear connection to a client's financial goals, and the research behind investments should have a tangible, quantifiable connection to stock or fund performance.

Can anyone really argue that advisors should not be held to these criteria? Certainly, most investors believe they deserve this level of care from their advisor, and many probably assume their advisors are already required to meets criteria as high as the ones above.

What's more, advisors and firms increasingly need to deliver this level of service if they want to continue the profit growth that drove recent earnings beats for Morgan Stanley (MS) and UBS (UBS). The market will naturally move towards the standards above, but regulators can expedite this process and earn more credibility by taking a leadership position in the process.

The SEC and DOL should work together to promote a fiduciary standard of loyalty and care for advisors that meets the criteria above. By clearly defining the fiduciary relationship, regulators can reduce uncertainty and restore public trust.

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Disclosure: David Trainer and Sam McBride receive no compensation to write about any specific stock, sector, style, or theme.

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To fulfill the Duty of Care, research should be:

1. **Comprehensive** - All relevant publicly-available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including footnotes and the management discussion & analysis (MD&A).
2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide tangible, quantifiable correlation to stock, ETF or mutual fund performance.

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