



Open Letter to the SEC: Markets Need a Unified Fiduciary Standard

What is a fiduciary?

According to SEC chairman Jay Clayton, nobody knows. Mr. Clayton [spoke at the annual Financial Industry Regulatory Authority](#) (FINRA) conference on Tuesday and said:

"There's been a lot of buzzwords — like fiduciary. Fiduciary can mean a lot of different things in a lot of different contexts. I wanted to make sure we level-set on that."

Clayton used the ambiguity of the term as justification for omitting the word "fiduciary" from the [SEC's Best Interest proposal for brokers](#). At the same FINRA event, [he said](#):

"I thought calling them both fiduciary [advisor and broker standards] and then defining them would not make it clear that the relationship models were different."

It's hard to make sense of Clayton's arguments given that the SEC has the ability (or even responsibility) to resolve the ambiguity around the term fiduciary by offering a clear and concise definition. Further, the distinctions between a "Fiduciary" standard and a "Best Interest" standard are by no means clear to the average investor.

Ambiguity Creates Uncertainty

Clayton is right that the word fiduciary can mean different things to different people. 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.
- Prior to the recent rule, the [SEC](#) stated that a fiduciary "must eliminate, or at least disclose, all conflicts of interest."

Compounding the confusion, some regulators now seem to have abandoned any attempt to define the word "fiduciary" at all. Nevada's [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 legal loopholes 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?

The SEC's [proposed interpretation of fiduciary duty](#) is a step in the right direction, but it fails to address important points about what's needed to fulfill the [Duty of Care](#). The SEC is uniquely positioned to put forward a clear, authoritative definition of fiduciary duty, and we think now is the perfect time to do so.

Best Interest Vs. Fiduciary

The biggest controversy in regards to the SEC's proposed regulation is the continued dual-standard, where brokers are held to a best interest standard while advisors must be fiduciaries. As noted above, the SEC says it preserved this distinction to make it clear to consumers the difference between brokers and advisors.

It's hard for us to follow this logic. By any definition, a fiduciary standard requires acting in the client's best interest. In fact, the very first sentence of the SEC's [proposed interpretation of fiduciary duty](#) states:



*“An investment adviser is a fiduciary, and as such is held to the highest standard of conduct and must act in the **best interest** of its client.”*

It seems unlikely that the average investor, who does not spend their spare time obsessively reading proposed SEC regulations, would perceive a meaningful difference between a fiduciary standard and a best interest standard.

The SEC had an opportunity to send a clear message to investors and financial professionals about the expectations for anyone who gives investment advice. Instead, it has further muddied the waters by claiming that brokers will be required to act in the best interest of clients without defining what that means.

A Clear Definition of Fiduciary Duty

So, what should Fiduciary Duty encompass? We don't believe the SEC needs to be overly descriptive. Rather than a long set of rules, it should focus on guidelines that clearly state the expectations involved in the advisor/client relationship.

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](#), and [Michael Kitces](#).

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](#).)
- **Transparent:** Client should be able to see all the aspects of the investment process, including the analysis and the data behind investment recommendations.
- **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 professionals who give investment advice – both brokers and advisors – should not be held to these criteria? Certainly, most investors believe they deserve this level of care, and many probably assume their brokers/advisors are already required to meet the criteria above.

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

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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.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

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