TRENT CAPITAL
MANAGEMENT, INC.

Lawsuits arising from the failure to operate within the fiduciary standards required by investment professionals now litter the financial landscape. As well, those who hold oversight responsibility for the best interests of those Trusts housing the retirement funds of employees are equally challenged to maintain this focus. We at Trent Capital take our own Fiduciary obligations seriously, as well as those obligations indicated for the Plan Sponsors of accounts for which we provide retirement plan services and keeping them informed of these. We do act as a Co-Fiduciary on the Plans we manage. To further this end, Bill Thacker is an AIF (Accredited Investment Fiduciary). The AIF is the achievement that signifies the designee has acquired the knowledge to apply Global Fiduciary Standards of Excellence. Failure to subscribe to and follow these Standards usually indicates some restrictive and self-serving element that is a deterrent to honoring the fiduciary responsibility of acting in a client's best interest. It is our hope that some of the information below will further inform those involved in adhering to their required fiduciary standards.

REPRINT FROM: JOURNAL FOR FINANCIAL PLANNING

August 28, 2006

Focus

'Fiduciary': One Word, Many Views

by Jeffrey H. Rattiner, CPA, CFP®

What's all the fuss about being a fiduciary?

Perhaps no term in financial planning elicits a more fiery passion from CFP certificants because planners do not agree on a universal definition of *fiduciary*. Interpretations of the definition and role of a fiduciary run the spectrum of the work we do as financial planners.

"It has always been a hot topic, but now it's hotter because of the Merrill rule <http://www.financial-planning.com/pubs/fpi/20050411101.html> and the enforcement actions by the SEC," says Keith Loveland, J.D., CIDA, and an Accredited Investment Fiduciary Auditor who serves on the Financial Planning Association's Government Relations and Ethics committees. "A lot of planners are thinking about this issue."

In light of such diverse viewpoints, and the many players in the financial services industry who play a significant part in fulfilling this responsibility (whether knowingly or not), the *Journal of Financial Planning* asked FPA members and outside experts about the role of being a fiduciary and how it plays into their practices. Their responses provided opinions that are each as different and controversial as the varying types of practices that exist in our profession.

One thing, however, all our interviewees easily agreed on about being a fiduciary: their clients' interests come first. "This is apropos considering that the CFP Board's *Code of Ethics and Professional Responsibility* requires that all CFP certificants put their clients' interests first," says Ken Roberts, CFP®, EA, of Financial Pathways in Sebastopol, California.

All of our interviewees further agreed that added responsibilities come with the label "fiduciary" and that is why some advisors are reluctant to say they are one. Charles Stanley, CFP®, ChFC, of the Compassionate

Capitalist in Escondido, California, believes that if you are a CFP certificant, then you should hold yourself out as a fiduciary. Compared with a financial services rep who operates at a particular level, or a CFP certificant who acts at a higher level, the fiduciary must operate at an even higher level. Essentially, they are "on" all the time unless it is clear that they are not, says Stanley.
"We should operate at the same level as CPAs, attorneys, or other professionals whereby the public relies on the information distributed by these individuals," says Stanley. "If you want to be a professional, you need to hold yourself out as one. Don't try to be something or somebody you are not."

But as many planners noted, being a fiduciary may be a moot point, at least when it comes to consumers. "Consumers do not really have a grasp when it comes to knowing the importance of their advisors acting in a fiduciary capacity," states Craig Hoogstra, CFP®, AIF®, of McLean Asset Management Corp. in McLean, Virginia. "The public hasn't yet brought this topic up enough in a general working relationship with the planner."

But Hoogstra says people are beginning to understand the role of a fiduciary in the retirement area, especially if they have 401(k) plans. "In a 401(k) plan, the participant can see the investment policy statement," says Hoogstra. "These plans are taking an added fiduciary standard of identifying investment managers."
Ken Roberts adds that planners must disclose conflicts of interest and compensation dilemmas. "The perception is that planners should not be engaged in activities that appear to be viewed as inconsistent with the way they must satisfy their clients' interests," he says. One cannot over-emphasize the importance of clarifying the fiduciary issue. "Breach of fiduciary responsibility is the leading cause for arbitration against brokers, and the leading cause for civil and regulatory suits against RIAs [registered investment advisers]," says Don Trone, AIF®, of the Center for Fiduciary Studies in Pittsburgh, Pennsylvania, a leading expert in examining the importance of holding oneself out as a fiduciary. (Editor's note: See our "10 Questions" interview with Don Trone in the February 2005 issue of the *Journal of Financial Planning*.)

Trone adds that fiduciaries must always act with complete and uncompromising fairness, and should never exert any undue influence over clients in such a way that may compromise independence or exert bias toward the client. "Fiduciaries can be held liable for errors in judgment or omissions in their daily activities, including not doing anything, doing too much, or just plain doing the wrong thing, resulting in liability claims arising against that individual," says Trone. "They must be prudent in their thought process and maintain a rational and disciplined approach."

When Are You a Fiduciary?

Our planners have varied viewpoints about when someone should act as a fiduciary. For example, Richard Almeida, CFP®, of Balliett Financial Services in Winter Park, Florida, and a former trust examiner for the Office of the Controller of the Currency, believes that all fee-only planners are already fiduciaries. Charles Stanley goes a step further to say that *all* financial planners should be fiduciaries—that is, the planner should do what's best for the client whenever the planner is working with the client in the investment arena.
Trone provides a five-part definition in answering the question of when a planner might act as a fiduciary in an investment capacity:

- When the planner has discretion over a clients assets
- When the client is dependent on the planner's advice
- When the planner is providing a client with comprehensive and continuous investment advice
- When the planner is providing an ERISA client investment advice, and is receiving a fee
- When the planner is a registered investment advise

Stanley believes that salespeople enter into a fiduciary relationship with unsophisticated investors without ever knowing it. Says Stanley, "If it becomes apparent that a salesperson is building a relationship with a client who heavily relies on the expertise of the salesperson in selecting investments, then at that point the salesperson has crossed the line and must act as a fiduciary."

So how are planners to know they crossed the line? Hoogstra thinks fiduciary status is determined by a "facts and circumstances" test specific to each situation. He says, "In providing the same services to different clients, it is possible for a planner to be a fiduciary in one situation and not in another. The one thing that is crystal clear is that it's hard to pinpoint an all-encompassing definition on the issue."
Some of the planners we interviewed think that using an investment analysis is not enough by itself to make

them a fiduciary. Many times the concept of fiduciary extends to the kind of control the planner has in the client's investment situation, says Stanley. "Did the client rely on the advice dispensed by the planner? How much influence did the planner have in getting the client to act in a certain way?"

Trone says the Securities and Exchange Commission's position is that financial planners are indeed fiduciaries and should therefore have to register. But he argues that "this may not be true, since much of what the planner does involves implementation. Furthermore, it clearly wouldn't apply to the planners involved in creating plans or educating advisors."

Trone quotes from *Gouger v. Bear Stearns* (823 F. Supp. 282, 288): "A broker has a fiduciary duty to the client where the broker knows, or should have known, that trust has been placed with that broker." He goes on to say that "broker/dealer entities providing financial planning services are held to suitability standards, *not* fiduciary standards. ERISA case law defines the highest standard in the industry. As a profession, we should want to see all practitioners operate at the highest standard of care applied to everyone.
"Much has been made about the SEC Ruling in April 2005, which made permanent an exemption for brokers to register with the SEC when investment advice provided by a broker was merely 'co-incidental' to the selling of investment products [the so-called Merrill Lynch rule]. Unfortunately, the public still has not been provided with a bright line indicating the demarcation between broker and advisor."

Keith Loveland, whose firm, Loveland Consulting in Minneapolis, Minnesota, works with financial planning firms to ensure that they are "goof proof" when it comes to fiduciary issues, also cites the "facts and circumstances" test. "If a person is acting as a comprehensive financial planner, they are in fact a fiduciary," he says. "Planners who do other venues, such as teaching, would be excluded by the Investment Act of 1940. The financial planner who is performing estate planning services as an attorney would have a fiduciary obligation. The CPA who provides tax projections would have the AICPA determine whether he or she is a fiduciary. For the planner providing life insurance illustrations, being considered a fiduciary would be dependent on state law."

In assessing whether a planner has fiduciary responsibility, financial planners should start out with *Prudent Investment Practices: A Handbook for Investment Fiduciaries*, published by Trone's Center for Fiduciary Studies. (For a more detailed look at these investment practices, see Stuart Ober's article in this issue, "Fiduciary Responsibility: Liability and Consequences.") Loveland says planners also can get more information about being a fiduciary by looking at the National Association of Securities Dealer's Web site, www.nasd.com, at *Claim of Fiduciary Duty on arbitration statistics*. Loveland states that unsuitability and holding people to higher standards, due to Enron and other scandals are high on that list. Bruce Ruud, CFP®, CEBS, CMFC, CFPS, of Bruce Ruud and Associates in New Braunfels, Texas, says the planner's role as a fiduciary differs between functions performed under securities law and ERISA. Ruud, a former regulatory director for five states under the Employee Benefit Security Administration for the U.S. Department of Labor, which was responsible for the enforcement of fiduciary relations of ERISA for 30 years, sees it this way: "Under securities law, you put the interests of your clients first and don't consider your own compensation. Under ERISA, the fiduciary concept is more troubling. The planner takes on liability for the fiduciary and co-fiduciary under Section 405 of ERISA. As co-fiduciary, you are responsible for others' work. When you are researching mutual funds through software programs, you're looking at those mutual funds. With pension plans, you need to ask people what services they plan to offer and whether they accept fiduciary responsibility."

While planners differ in their definition and application of the fiduciary label, few go as far as Don Trone, who argues that financial planning poses unique fiduciary issues and who calls for fiduciary standards in *each* area of specialization of financial planning. "In addition to having standards solely for investment advisors, there should be standards for the other disciplines within financial planning," contends Trone. "Standards for insurance, retirement, income taxes, and estate taxes are other general categories where advisors should follow fiduciary guidelines."

Struggling with the Issue

Clearly from the definitions stated above, our respondents have struggled with this issue simply because many of them interpret the definition to fit the type of practice they have. If the system held everyone accountable in the same manner, then planners throughout the industry might be more satisfied with the responsibilities of a fiduciary.

You can hear the passion from planners when discussing the role stockbrokers and annuity salespeople play in client involvement and where planners feel that non-planning groups in general don't adhere to the same standards they do. Charles Stanley, for example, gets irked by salespeople who use a dinner estate planning seminar to supposedly educate prospects and wind up recommending only annuities as the ultimate solutions. He sees very unsuitable annuity sales taking place.

Ken Roberts agrees: "The American public should not receive conflicted advice from any group within the financial services industry. That group of people should always put clients' interests first." "Education is a way to raise the bar and educate all parties involved about the role of a fiduciary so misunderstandings are minimized or perhaps do not occur," says Michael Kickham, CFP®, of Porter Kickham Inc. in Chesterfield, Missouri.

Almeida says that if education raises the bar, then full disclosure is a must to ensure that everything is put on the table for clients to evaluate and make well-informed decisions. "Until regulatory agencies make mandatory full disclosure of gains, trading commissions, and payments from third parties, it will affect a planner's objectivity," says Almeida. "Having full disclosure is the only way that clients will be able to weigh appropriate decisions."

Almeida's practice has a heavy emphasis on education funding advice. He says consumers sometimes don't want to pay the hourly fee for his advice and instead they go straight to a broker, where what they're paying the broker is obscured in the transaction costs. Fiduciary-minded planners also struggle with the issue of assessing return versus risk, not just risk itself. Risk versus return becomes an important element in the struggle of planners to take advantage of opportunities without sacrificing too much risk exposure. Kickham says that under the Uniform Prudent Investors Act, the tradeoff between risk and reward is the central job of a fiduciary. Then the act speaks to the loyalty and the ability of the client to achieve the stated objectives, so in essence there is no risk/return trade-off. Kickham says it's contradictory in nature, yet he's a big fan of the act. "Many people are heavily at risk and are not aware of it," says Kickham. He disagrees with the whole concept of risk tolerance. His clients aren't trying to fund general wealth accumulation objectives. They are coming in with specific objectives, such as saving enough money for retirement and education.

When Issues Arise

Sometimes the fiduciary waters become murky. Craig Hoogstra recalls that during his first stint as a financial planner he ran into a prospect who had all of his money with the bank that lent him the moneys necessary to build various car dealerships around town. The client would never, ever, pull his money from the bank because of that relationship. Hoogstra says that most clients don't know what their true rates of return are in their portfolios. Most of them see the increase in their account statements and have a false sense of security because much of that money is coming from additional deposits into the account, not earnings.

Those we spoke with for this article agreed that a prudent investment process—not performance—is what matters most. Picking ultra-safe investments or cautioning the client against engaging in any activities deemed risky may not be enough if a sound process is missing. "Performing your tasks in a logical and methodical format helps standardize the process and ensures that the same thought process went into delivering investment planning advice," says Hoogstra. "But it's not good enough for the procedures to be correct if it is factually deficient. Essentially you are no better off now than you were beforehand. This will be difficult if your process is to find the next Peter Lynch."

Fiduciary and suitability go hand-in-hand in many situations. Making the appropriate investment recommendations to clients based on their personal parameters, such as risk tolerance, time horizon, liquidity, marketability, tax consequences, and diversification, are essential for any client's portfolio. But is that enough? asks Michael Kickham. He concurs with Trone's earlier comments about broker/dealers needing to be held to fiduciary standards, and stresses the importance for advisors to rise above the suitability standard. "If we don't go toward being a fiduciary, then we are stuck at suitability standards." That's why he's not high on the risk tolerance questionnaire. "It emphasizes suitability versus fiduciary discussion."

To Kickham, "*Fiduciary* deals with faith. The suitability standard depends on a client's blood sugar level." Suitability profiles people; he welcomes getting away from that profiling approach. "A fiduciary's role involves a funding objective unless it clearly states otherwise. Suitability standards focus on liquidity of principal. Dying does not necessitate liquidity of principal. That's an indication of less need for liquidity."

Kickham says he goes against the grain when it comes to elderly people and liquidity. He tells retirees never to touch principal, if possible. "Elderly people need the least liquidity of all. Long-term care and prescription drugs can blow apart the budget of a 75-year-old. The reason is that the 75-year-old has a very clear handle on the budget. They are trained not to spend principal. They need liquidity to the extent of income, not principal."

What needs to be done to ensure that everyone in the financial services industry is approaching the fiduciary relationship in an acceptable way? A uniform approach highlighting information in a similar manner by all parties is a good start, say most of our respondents. But can too much information not lead to a good thing? Charles Stanley says prospectuses were easier to read 15 years ago. "Then, the prospectuses were thinner and more to the point," he observes. "Now they have so many disclosures and they are significantly larger than in years past, which makes them harder to read." He says it should be clear to clients where advisors stand on whether or not they are giving advice.

Facts and Circumstances Affect Litigation

The end result of improper workings under the fiduciary issue is that proper planning is best for everyone involved. The facts and circumstances test, as discussed by Stanley and Hoogstra, will be applied to each situation. Incorrect determination of when planners are fiduciaries can lead to ongoing litigation.

"In arbitration hearings, the facts and circumstances defense seems to be the norm," adds Hoogstra. "Essentially, for a knowledgeable consumer, it is reasonable for a client to know that the contingent sales charge is running at 17 1/2 percent and that it will take 17 years to go away."

Another lawsuit Stanley is familiar with involves an annuity salesperson who invested a substantial amount of client assets in an annuity. The client had cerebral palsy and did not understand the ramifications of what he was doing or getting involved with. Under most circumstances, the salesperson would not be a fiduciary, but because his client had significant health issues, the facts and circumstances changed that situation and made the salesperson a fiduciary, says Stanley. The lawsuit requested that the brokerage firm reverse the transaction and return all the money, including the surrender charges, to the client. The brokerage company has not obliged and now the lawsuit is dragging on. Stanley has since learned that the broker is involved in a similar suit.

Bruce Ruud says attorneys will sue everybody who they think is a fiduciary under ERISA. "You have to show the court you are not a fiduciary. Therefore, the fee the advisor charges for being a fiduciary should be significant due to the liability involved. And since investments will eventually go south, this will be an issue that eventually arises." Ruud says there's a growing need and desire for retirement plans to seek independent advice. "You have to walk very carefully to avoid the minefield of ERISA liability."

Fiduciaries of the Future

Since the professionals interviewed for this article agree that all the players in the industry are abiding by different sets of fiduciary standards, how can it be cleaned up? Says Craig Hoogstra, "If we played by the same rules, then consumers would know what to expect. Full disclosure needs to be demanded and expected. After all, education tends to lead to the best policies, but so does standardization. If the information that consumers saw was all uniform, it would go a long way toward managing client expectations and set the stage for what's yet to come."

In an attempt to help standardize the industry, points out Ken Roberts, planners should use more accessible terms and concepts that consumers will understand. "Many consumers are misinformed and go to their banks to buy annuity products, thinking they are FDIC insured."

Planners need to take the high road when potential conflicts of interest can arise, adds Roberts. He gives an example where a planner must decide whether to recommend to a client that they take out 20 percent of their money currently under management to help fund another objective. "That is 20 percent less of a management fee that the planner is receiving from that client," says Roberts, but it is the right choice for that client.

Hoogstra says what planners need to do is to empower the public to demand certain things as a condition to work with brokers, investment advisors, and other professionals who oversee client assets. "There's nothing there to protect people from giving you certain information, which is why we need standard disclosures," he says. "Clients should ask any professional wanting to work with them the total compensation earned by the advisor. If the advisor gives a client hassles about disclosing that information, then the client should take his or her business elsewhere. The client should ask the advisor if he or she is a fiduciary. If the answer is no, the client has a right to find out why to determine if that is a critical issue in building a future relationship. Perhaps having the advisor complete a questionnaire asking them to provide answers to the issues discussed above would be a good first step to ensure that advisors are taking their roles seriously and that they maintain the client's interests ahead of all else."

Ruud says planners need to spell out clearly in their investment advisory agreement or their engagement letter that they are not taking any responsibility for employer securities selection if they are not being retained. Otherwise, they will worry about co-fiduciary responsibility.

Where does fiduciary responsibility end? What is the ongoing commitment to the client? "Much of that will be spelled out in the engagement letter and investment policy statement," says Ruud. But how much checking is really going on? Hoogstra brings up an interesting point: "Has any advisor ever gone back to see if their clients' existing investments that were chosen as part of their portfolio performed better than an index or exchange-traded fund performed during that same period? Since passive investing is the default standard, advisors tend to gravitate toward that approach."

Hoogstra says we need to go back to each client's portfolio and test it. "Managers who have worked for the fund during the last five years and who are in first or second place in return need to be monitored. If the manager falls below a certain threshold, because of style slippage or for other reasons, then the process must call for the termination of those managers. Just because Morningstar has ranked funds four or five stars doesn't automatically give us the green light to select these funds. Morningstar should be used as the starting point in the analysis and selection of mutual funds."

Where does regulation such as the recent SEC ruling fit into all this? "The SEC ruling requires more disclosure language and that brokerage-based accounts are different from advisory accounts," says Hoogstra. He says it creates a bright line between the distinction of what investment advisors and brokers can do for their clients. "Since the brokerage industry has relayed the message that clients should wholeheartedly trust brokers, over time this ruling will continue to remain blurry in the eyes of the consumer."

Don Trone adds that the SEC ruling could add another layer of unnecessary bureaucracy, perhaps the addition of another government agency that applies the fiduciary concept to investment consultants that would include both investment advisors and financial planners.

What About Compensation?

Brokers can follow the rules per the National Association of Securities Dealers and still not be considered fiduciaries. As such, potential problems will continue to exist.

"What will be changing is that conflicts of interests are always present whenever money changes hands," says Roberts. He says brokers have their commissions built into the price of the security, while fee-only advisors charge a separate fee that can be measured and evaluated by the client. "This enables the client to determine what services the fee-only advisor can charge," he says.

"All third-party compensation arrangements should be disclosed," says Almeida. "It doesn't matter whether you are fee or commission. Full disclosure is the only thing that matters."

Says Keith Loveland, "Compensation has nothing to do with whether you are a fiduciary. The SEC IA 1092 Ruling, which set the test for who would qualify as financial planners, states that compensation is not relevant in that assessment."

Hoogstra provides interesting analogies on advisors' fees. Suppose you have had a hacking cough for several weeks and it appears to be getting worse. You go see two equally competent physicians. The first charges $350 an hour whether you are well or sick. The second does not charge you for testing, diagnosis, or prescribing medication. But if medication is needed, the physician earns 10 percent of the cost of the over-the-counter medicine, 20 percent of the medicine prescribed, or 50 percent of recommended surgery. Which physician would you feel most comfortable seeing? Essentially, the more serious the problem, the more money the physician makes.

Or suppose the doctor tells you that, based on your test results, you need a hysterectomy for $5,000. You tell the doctor that your insurance mandates a second opinion before surgery and that you will seek that advice. A few hours later, the doctor calls back and says he consulted with another doctor and they believe that you can now get by with just a D&C. You still tell the physician you are seeking a second opinion and will get back to him soon. The doctor again calls back and says he just consulted with the premier specialist in this field and you can get by with just medication. The moral of the story is that the brighter the light we shine on something, the more it stands out. If we saw and analyzed commission rates, any bad behaviors would disappear.

So what should be made of all this? Clearly, educating ourselves and our clients is a starting point. Then, depending on your specific role in the financial planning process including your compensation arrangements, the perception you display, the disclosure you provide, and the services you engage in and your approach, your definition of fiduciary will vary. More importantly, your role as a fiduciary will be defined for you. Planners need to be alert as to when they will be considered fiduciaries.

Loveland says, "Planners should engage in a self-assessment of their practices to determine whether they are in fact a fiduciary. It will be determined according to the style and type of practice in which they engage."

Ultimately, Charles Stanley wants to raise the bar higher: "If you are a CFP certificant, you should hold yourself out as a fiduciary. If we take the initiative to raise the bar for our profession, the rest of the industry will have no choice but to follow."

Jeffrey H. Rattiner, CPA, CFP®, is president and CEO of Financial Planning Fast Track Inc. of Centennial, Colorado, an accelerated boot camp for financial planners aspiring to satisfy the CFP Board's educational requirements. His most recent book, Getting Started as a Financial Planner*, second edition, by Bloomberg Press, has just been re-released. He can be reached at jeff@jrfinancialgroup.com.*

NOTE: Yellow highlights provided by Trent Capital, Inc.