What Does Fiduciary Responsibility Mean and Why Does it Matter

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What is the Definition of Fiduciary?

Fiduciary is a common law legal term that has specific requirements under both state and federal regulations. A **Fiduciary**[1] is a person with a legal and ethical duty of loyalty to act solely in the other party's best interests. As a Fiduciary responsible for the good faith management of another person's assets, the fiduciary is expected to manage the assets for the benefit of the beneficiary rather than for their own profit, with all potential conflicts of interest disclosed and mitigated in accordance with a contractual agreement. Examples of common Fiduciaries[2] include Trustees, Financial Advisors and Investment Managers[3], Attorneys[4], Executors, Medical Professionals[5], and Bankers[6].

When Does a Fiduciary Relationship Begin?

The fiduciary relationship begins when one party expects the fiduciary obligation and the other party acknowledges acceptance of their fiduciary liability. Depending upon the type of relationship, this occurs automatically as a matter of contract law or as a matter of commercial regulation in accordance with the Uniform Commercial Code, The Investment Advisors Act of 1940, the OCC Fiduciary standards[7], and the ERISA Act of 1974[8].

A Fiduciary[9] is expected to serve in the client's best interest, act in Utmost Good Faith, act prudently with a professional level of care, skill, and judgement, avoid conflicts of interest, disclose all material facts and conflicts that cannot be mitigated, and provide disclosure regarding the actual investment expenses incurred.

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[1] http://www.investopedia.com/terms/f/fiduciary.asp
[2] http://apps.americanbar.org/abastore/products/books/abstracts/5310344_chap1_abs.pdf
[3] Financial Advisors held to Fiduciary standard through Investment Advisor Act of 1940
[4] http://apps.americanbar.org/abastore/products/books/abstracts/5310344_chap1_abs.pdf
[5] http://journalofethics.ama-assn.org/2011/10/msoc1-1110.html
[6] Bankers held to a Fiduciary Standard through Compliance with Comptroller of Currency 12 USC 92a(a),
[7] Federal Statute 12 USC 92a(a),
[8] http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html
[9] Six Core Fiduciary Duties for Financial Advisors, Institute for the Fiduciary Standard, Knut Rostad, Sept 9, 2013.

Why Does the Fiduciary Relationship Matter?

The engagement of an investment advisor is a confidential and intimate relationship built upon a professional trust. The advisor is expected by the client to provide competent, unbiased, and continuous advice regarding the sound management of the investments with all conflicts of interest properly disclosed and mitigated. If a client engages the services of the professional expecting that the service would be provided with the "fiduciary level of care"; and it is not provided, than ultimately the client is harmed by this breach of trust. Without a fiduciary level of care, the client cannot expect that the advice provided in actually in their ongoing best interest and is no more than a single commercial transaction that may not be fit or suitable for the long-term goal.

Other Types of Commercial Relationships and Duties of Care

Suitability Standard

Every day, we go to stores and professional tradesman and engage in commercial transactions where there is no ongoing fiduciary responsibility to us by the vendor or store. In accordance with the Uniform Commercial Code, we buy products and services to solve specific problems such as home repair, warm clothing in winter, and cleaners for the kitchen. Such products and services are held to a simple legal standard called "fitness for use" or the "suitability standard". Depending upon the retailer or service provider we are able to return these products for a multitude of reasons in accordance with a contractual warranty of service or a legal right under the Uniform Commercial Code due to defect or unsuitability for the intended purpose.

The Suitability standard is a transactional standard where the product, information, or advice has limited liability to being suitable for fulfillment of the goal at the time of the transaction. The financial professional has no ongoing service requirement to monitor or recommend changes based upon the changing needs of the client. The suitability is not evaluated based upon if the product is the best known to achieve the goal; it can be simply one of many chosen for reasons that may not be fully disclosed. Some potential conflicts include bias toward proprietary products, enhanced commissions or revenue from the sale of that specific product, non-cash marketing assistance, or the achievement of particular sales goals.

The challenge for the client is that often the service contract specifically disclaims the fiduciary standard of care and asserts that services are being provided in accordance with a suitability standard. The contract may even further limit your rights to seek remedy in court, but rather just arbitrate the case in accordance with this limited expectation for care.

Non-Negligence Standard

The non-negligence standard is the lowest standard in all commercial trade and in the financial world. This baseline standard of care[10] , especially for insurance agents, expects a degree of skill and knowledge requisite to his or her employment responsibilities, exercise good faith and reasonable skill, care and diligence in the execution of his or her employment responsibilities, possess reasonable knowledge of available polices and terms of coverage in the area in which the insured seeks protection; and either procure the coverage necessary for the client's exposures or advise the client of his or her inability to do so.

Often insurance policies have disclaimers of liability that require the insured to review the policy in detail and inform the insurance company of any errors or concerns. Seldom is there a contract for the services provided that makes the agent actually responsible for the suitability of the purchased insurance product beyond this negligence standard. Despite the long-term trusted relationship and dependence on the insurance agent, they are not held to a Fiduciary standard unless a separate contract specifically requires it or actions cause a court to deem them a Fiduciary (fiduciary breech). A higher level of care is difficult to achieve because most insurance policies are sold based upon commission, with an agent getting bonuses and other services based upon sales production. Further, most insurance agents are "agents of the insurance company" with contractual provisions that limit their service to being in the company's best interest.

[10] *Rider*, 42 *N.J.* at 476-477

Request the Fiduciary Standard of Care

To achieve the level of care that you want, you can specifically request in writing your expectation for the Fiduciary Duty of Care and wait for the written acceptance of that care. The acknowledgement should be written on corporate stationary with the signature of the financial professional and a principal of the firm. They can provide as part of a service contract with any disclosures of potential conflicts of interest. The document should disclose all compensation arrangements that affect the financial professional and the advice they provide to you. Once this is done, you will know that your financial professional is acting in your best interest.

Establishing a Relationship with a Financial Professional

As a client who expects to receive a Fiduciary level of care, you have the right to request information from the potential advisor before you engage their services. Common information that can be requested and reviewed:

1. Acknowledgment of Fiduciary Care with all associated disclosures
2. Background report from regulatory supervisor showing all history of criminal, felonious, and customer complaint history and resolutions.
3. Background report showing results of compliance audits
4. Credential verification from credential organization
5. Fee structure and service contract that specifically references all fees that will be paid by you, all commission revenue and bonuses, and third party revenue including non-cash compensation (marketing and technology subsidies).
6. Professional resume and references (referrals)
7. Investment Philosophy Statement that will be used by the advisor
8. Samples of information and performance reports that will be provided to you as a client including website demo access.
9. Creation of an Investment Policy Statement listing all limitations on discretion and investment choices.
10. Strategy for monitoring and communicating about status of assets