

What makes a fiduciary?

REFORM OF THE FIDUCIARY RULE FOR US INVESTMENT ADVISORS PROMPTS **JOSEPH KELLOGG** TO CONSIDER WHAT IS INTENDED BY THE TERM 'FIDUCIARY'

Recent headlines in the US reflect the federal political struggle to reform the definition of who is a fiduciary in the world of investment advisors.

A reform first attempted by the current administration in 2010, the US Department of Labor earlier this year issued a notice of proposed rulemaking aiming to impose a stricter fiduciary standard on retirement advisors who give financial advice.¹ Financial service providers and their industry representatives have resisted this imposition. Powerful industry support even generated Bills in the House of Representatives and the Senate that would defund any efforts by the Department of Labor to enforce a stricter fiduciary standard. The Securities Industry and Financial Markets Association (SIFMA) has proposed a standard of 'best interests of the customer', where material conflicts of interest could be waived if the customer is informed.² We'll have to wait and see how it plays out.

FIDUCIARY PHILOSOPHY

With all this fuss about fiduciary standards, I would like to review what is intended when someone is called a fiduciary, and what the implications of being a fiduciary are in terms of how one is supposed to act. In STEP, we are all professionals in relations of trust, but does being a fiduciary mean the same thing for an investment advisor as it does for a lawyer or an accountant? Does it mean the same thing for a trustee, protector and director? All of the relationships involve a person in a position of vulnerability who takes a risk and puts reliance, confidence, good faith and trust in another person to provide services.

Starting in the English and Welsh court of equity, the Court of Chancery, the fiduciary was held to a certain standard of conduct that was legally enforceable by the beneficiary. The fiduciary's duty to protect the interests of the beneficiary developed in a very strict manner because the Court of Chancery was charged by the Crown with protecting the vulnerable. The fiduciary's role and accompanying duties were distinct from those of contracting parties that advanced out of the common-law courts, but both parties' duties were pulled together by the *Judicature Act 1873*, merging the court of equity with the common-law courts.

After hundreds of years of cases in the Court of Chancery, the main obligation of the fiduciary to

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the beneficiary was distilled into a lofty mandate to act in the sole interest of the beneficiary only, and to have no conflicts with the fiduciary's personal interests or conflicts with other fiduciary duties. Of course, professional fiduciaries are not in the business for their health, so the 'no-profit rule' permits the exception that the fiduciary may profit as long as the beneficiary is informed and consents.

If the exception to the no-profit rule is understood to allow the fiduciary to actively pursue conflicting interests, as long as the beneficiary is informed and consents, then beneficiaries are at a disadvantage in a legal relationship that was originally intended to protect the vulnerable. Today, we enter into numerous professional relationships that require us to sign off multiple pages of overwhelming information. The availability of professional services tremendously increases the quality of our lives and what we can achieve in any given day. However, if we fully scrutinised and understood the risks of the terms of agreement of every professional relationship we entered into, we would not sleep much or need the professional services anyway.

In some professional relationships, it makes sense that the service provider should be allowed to maximise profit with fewer restrictions, encouraging more professionals to participate and engaging more creative minds. There are other professional relationships where it makes sense to limit the pursuit of profit-making opportunities arising in the context of the service relationship, thus encouraging more beneficiaries to engage with the professional services and promote a culture of trust.

In a fiduciary relationship, those entrusted should conduct themselves such that they actively avoid situations where a conflict of interest with the beneficiary can arise. This is an important distinction that TEPs should understand. In the US, we will have to wait and see what standard of conduct the Department of Labor imposes on retirement advisors. If the standard is only informed consent, then it shouldn't be called a 'fiduciary standard'.³

1 www.dol.gov/ebsa/newsroom/fsconflictsinterest.html

2 www.sifma.org/issues/savings-and-retirement/dol-fiduciary-standard/overview

3 The Institute for the Fiduciary Standard is a good resource for more information on promotion of the fiduciary standard: www.thefiduciaryinstitute.org/in-the-news