

The SEC's Misguided Concept of Fiduciary

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The SEC staff thinks that fiduciary care is irrelevant. It has no more value to consumers investing retirement funds than it does when they buy clothes.

The March 30 SEC staff opinion left no plausible or meaningful way for advisors to tell investors the truth about their fiduciary status on the SEC form CRS.

That opinion was stunning. It ignored the 59 years of law and practice since the Supreme Court held in 1963 the fiduciary standard is the bedrock of the Investment Advisers Act of 1940. The SEC acknowledged this history in its June 2019 guidance for investment advisors.



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The staff opinion, instead, focused on a “consistent articulation” of legal obligations using the SEC’s “prescribed statement.” This is why, in the SEC’s staff view, the terms “fiduciary” or “fiduciary duty” may be “extraneous,” “unresponsive” or represent “exaggerated or unsubstantiated claims.” “Fiduciary” is a distraction and would “make it harder for investors to focus on the key information.”

Key information matters. A registered rep sells products for a commission in a commercial relationship. An advisor delivers professional advice for a fee in a fiduciary relationship.

A medical doctor is a fiduciary; a retail sales clerk is not. What is the difference to the customer?

The customer in a retail shop can see and try on different clothes and how a red dress fits in the mirror. She can compare prices and quality and judge for herself.

She can consider what the salesperson says. Yet, no matter the salesperson’s praise, she can decide if the red dress looks and feels right and is worth the price. She can make an informed decision.

In contrast, a patient can’t judge the quality of the doctor’s recommendation. The patient lacks expertise. The patient must trust that the doctor is expert and a fiduciary.

This is a centuries-old truth that tells why fiduciary relationships matter. Who would have thought, for example, that a patient who is a doctor in a different specialty cannot judge her doctor’s advice, because she is not an expert in this specialty, and must rely on her fiduciary status? Ditto for lawyers seeking counsel in an area outside their expertise.

No client can judge the recommendation of a broker unless he has the expertise, experience and information about the broker’s incentives and conflicts of interest.

That is why doctors, lawyers, teachers (with respect to the grades) and parents are all fiduciaries. We rely on their advice for a functioning and prosperous society. We cannot be constantly fearful we are being cheated.

These are basics on why fiduciary relationships matter and how common retail purchases and professional advice differ. They remind us why society, markets and the economy depend on a vibrant fiduciary standard to thrive. We must be able to *trust*.

Stating or even suggesting that fiduciary status is “extraneous” is perplexing. Minimizing or degrading investment advisors’ fiduciary status is incomprehensible. Not telling investors the simple truth about their investment advisor’s fiduciary status is on the wrong side of history, the Supreme Court and a prosperous society.

Some suggest that because investors cannot define fiduciary, its absence on form CRS doesn’t matter.

But the RAND report implied brokers can’t define fiduciary either. Yet, the SEC’s own research says investors favor fiduciary advice attributes.

Investors overwhelmingly prefer that their broker or advisor receive all compensation from clients; that “best interest” means their account will be monitored, product recommendations will be “the lowest cost products all other things being equal,” and that third-party payments will be disclosed.

Minimizing the omission of fiduciary on CRS misses a larger point. The larger point is that disclosure can be written so investors understand it. The research suggests so. So just omitting the disclosure shifts responsibility for effective disclosure from the SEC to investors. This is wrong. This same logic applied to medical doctors would mean a specialist in internal medicine would never list his specialty if patients would not understand it.

The problem is not that investors can’t define fiduciary; it’s that disclosures fail to describe what fiduciary means in plain language to investors. This failure was clear in early testing of CRS language.

Fiduciary duties are key to the nation’s prosperity. Fiduciaries avoid conflicts and use expert knowledge to benefit their clients. Their duties of care and loyalty are stringent. Those duties must always be nurtured, explained and enforced.

The differences between fiduciary advice and product sales are great and hard to appreciate. Examples help. Finding the right red dress doesn’t require fiduciary duties. Investment advice, the capital markets and a prosperous society do.

Let’s tell investors the truth: Advisors are legal fiduciaries.

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