

# “Fiduciary” umbrella could get bigger

What duty does an investment advisor or stock broker owe his or her clients? The flip answer might be, to paraphrase Will Rogers: “Only recommend stocks that will go up in value. If they go down, don’t recommend them.” But that’s not the real world of investing. Nearly all investments may go down in value in some circumstances.

Currently, there are two legal standards, one for brokers and another for investment advisors. Brokers must take steps to be confident that an investment is suitable for each client. Advisors are bound by fiduciary duty, a higher standard. Advisors must put the interests of their clients ahead of their own. Any possibility of a conflict of interest between the client and advisor must be eliminated or disclosed. As a practical matter, when everything goes well, the standard doesn’t much matter. It’s when there are problems severe enough to trigger lawsuits that applying one standard or another could have consequences.

The Dodd-Frank financial institutions reform legislation of 2010 directed the Securities and Exchange Commission to study this matter. The SEC issued its report on January 22. It said that investors should be “protected uniformly when receiving personalized investment advice or recommendations, regardless of whether they choose to work with an investment adviser or a broker-dealer.” As no one thinks the duty of care owed by investment advisors should be downgraded, that means the more stringent rules of fiduciary duty could someday apply to brokers.

That could mean changes for the business models of some firms. For example, when a firm today underwrites an initial public offering (IPO), the shares may be sold to the firm’s retail clients. In fact, those clients are sometimes eager to be allowed to participate in an IPO. Should the fiduciary rules be applied broadly to brokers, this would no longer be permissible because of the potential conflict of interest.

Because of the significant impact of the rules, the SEC may be expecting some pushback from larger brokerage firms.

Where do trust officers, trust departments and trust companies fit in this universe? The legal concept of “fiduciary duty” was invented for trustees in order to assess the adequacy of their performance. So we well understand all the intricacies of fiduciary duty; this is how we have always operated; it is how we have prospered.

If you find this subject confusing, please bring your questions to us. We will be pleased to tell you more.

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