

Fiduciary Focus: We Ain't Got No Fiduciary Duties

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W. Scott Simon | 03-17-04 | 

In the 1948 Humphrey Bogart film, *The Treasure of the Sierra Madre*, the character Gold Hat (played by Alfonso Bedoya for you movie trivia buffs) delivered some of the more memorable lines in motion picture history when he sneered: "Badges? We ain't got no badges. We don't need no badges. I don't have to show you any stinking badges!"

There have been endless variations in these lines over the years. In this month's column, to help illustrate a point in a far different context I'll add my own: "Fiduciary duties? We ain't got no fiduciary duties. We don't need no fiduciary duties. I don't have to show you any stinking fiduciary duties!"

When I provide consulting and expert witness services in matters concerning prudent fiduciary investing, I'm always a bit amazed when some person or entity pleads that they aren't a fiduciary. I always wonder: Do they hear what they are *really saying*?

A good example of the disconnect between what is said and what is really being said in this context involves the pleadings filed recently in a United States district court in Arizona by a large, nationally known financial-advisory firm. The firm is accused of what may amount to a classic "bait and switch" technique: It provides financial plans to potential clients--free, of course--that (for some strange reason) always seem to recommend the firm's expensive proprietary investment products.

Here is the firm's written defense to this practice: "[Written disclosures to clients who receive financial plans] are more than enough to constitute 'storm warnings' that the financial plans may not be 'objective' or 'unbiased' [against proprietary products] as supposedly represented."

Here is what this "weasel lawyer-speak" defense (I'm a lawyer so I can use this Latin phrase) is *really saying*: "Even though we tell you that we're being objective in our financial plans, you should be smart enough to realize that we really

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aren't being objective in recommending the sale of high cost proprietary products. And if you are too dumb to understand that and are harmed as a result, then it's too bad."

This defense, breath-taking in its gall, is the very antithesis of what it means to be a fiduciary: *putting the interests of your client-beneficiary ahead of your own.*

Indeed, enhancing the protection of beneficiaries was the fundamental underlying goal of the great reforms made in trust investment law in the 1990s. This financial advisory firm, managing billions of dollars of other people's money, seems to be doing all it can to frustrate this goal when it advances such a defense. Does anyone at the firm hear what it is really saying?

I have tried to show you in this column on fiduciary investment issues what a fiduciary *is*. Those who plead non-fiduciary status tell us what a fiduciary *is not*. In doing so, here is what they are *really saying*.

I Ain't Got No Fiduciary Duty to Put My Clients' Interests Ahead of My Own

Are you kidding? Hello! Why shouldn't I sell as many outrageously expensive proprietary products to my (unsuspecting) clients as I can? Isn't that what putting my own interests ahead of my clients' is all about? Hey, the only fiduciary duty I have is to *me*.

I Ain't Got No Fiduciary Duty of Loyalty

I'm not required to invest and manage portfolio assets solely in the interests of my clients--or even partially in their interests. Just so I never forget this, I memorized some commentary from the Uniform Prudent Investor Act: "A fiduciary cannot be prudent in the conduct of investment functions if the fiduciary is sacrificing the interests of the beneficiaries." Yeah, that's me!

I Ain't Got No Fiduciary Duty to Consider the Purposes, Terms, Distribution Requirements, and Other Circumstances of a Portfolio

Boy, that sure sounds like a lot of work! But whatever--I'm not required to do any of this stuff simply because I don't have to invest and manage assets "as a prudent investor would." Fiduciaries that actually go to the trouble to do all this work should get a life.

I Ain't Got No Fiduciary Duty to Determine Investment Objectives

Listen, the only investment objective I'm concerned with is fattening my wallet. Who cares about my clients' investment objectives?

I Ain't Got No Fiduciary Duty of Care

I'm not required to exercise reasonable effort and diligence in making and monitoring investments, with attention to my clients' objectives. Hey, I already told you that the only investment objective I'm concerned with is fattening my wallet. Aren't you listening?

I Ain't Got No Fiduciary Duty of Skill

Yeah, I'm aware that the Uniform Prudent Investor Act states that those possessing skill greater than that of an individual of ordinary intelligence are required to make use of that skill. Actually, I *am* skillful. In fact, one of my greatest skills is to finesse mutual fund breakpoints in my clients' accounts--without letting them know of course--to maximize my commissions.

I Ain't Got No Fiduciary Duty of Caution

I'm not required to invest with a view either to the safety of a portfolio's capital or to secure a reasonable return for it. I can invest in any fly-by-night investment product I want--and believe you me, I do!

I Ain't Got No Fiduciary Duty to Make Rational Tradeoffs Between Risk and Return

The only risk I care about is the risk of not being paid. And the only return I care about is that of the latest, hottest investment product that will do the most to maximize my income. By the way, what the (bleep) is a "tradeoff?"

I Ain't Got No Fiduciary Duty to Assess Risk

I'm not required to analyze and make conscious (or unconscious) decisions concerning the levels of risk appropriate to the purposes, distribution requirements, and other circumstances of a portfolio. All I know is that it's a lot easier to just *ignore the existence of risk*--hey, maybe that's what they mean by an "unconscious" investment decision.

I Ain't Got No Fiduciary Duty to Assess Expected Return

Just tell me this: what is the latest, hottest investment product that will maximize my income? If I think I can make a bundle, I'm there. Even when I don't think I can, *I don't care* because it's my clients' money--and I get paid anyway.

I Ain't Got No Fiduciary Duty to Determine Risk Tolerance

Since I ignore the existence of risk, why should I have to determine risk tolerance? Are you trying to complicate my life? Huh?

I Ain't Got No Fiduciary Duty to Determine Investment Time Horizon

Hey, the only time horizon that I'm concerned with is the time it takes for the fat checks that I earn for placing my clients in spread-loaded, high expense mutual funds to reach my mailbox.

I Ain't Got No Fiduciary Duty to Diversify

I don't have to diversify portfolios broadly--or in any other way. Instead, I like to concentrate my clients' accounts so that they can make a killing. Even when that results in a big loss (which--don't tell anybody this--happens most of the time), I couldn't care less. It's not my money.

I Ain't Got No Fiduciary Duty to Invest in a Portfolio Context

Yeah, I've read about Harry Markowitz, Modern Portfolio Theory, portfolio context, yada, yada, yada. Since I'm not a fiduciary, I don't have to understand that stuff much less use it to actually help my clients. Hey, I just pick the (most recent) highest returning stocks and mutual funds from a pre-approved list and sell 'em to my clients. My picks are made on a stand-alone basis so don't bother me with that "portfolio context" stuff.

I Ain't Got No Fiduciary Duty to Incur only Appropriate and Reasonable Costs

This is where I have the most fun in not having to comply with stupid fiduciary duties. For example, I just love to hear my clients that sponsor 401(k) plans rave about the "free" record-keeping and administration services they get.

When my 401(k) clients say "free," I hear "revenue-sharing." And, baby, when I hear "revenue-sharing" my heart sings because that means high, well hidden and undisclosed costs. By the way, don't tell anyone this--especially my 401(k) clients--but in the 401(k) business *nothing's free*. Well, that's not quite true: The cheese in the mousetrap is *always free*.

I'm happy that my 401(k) clients think they're getting "free" services. It means that I've done what I do best: Keep 'em in the dark. That lets me revenue-share to my heart's content without my clients knowing anything about it. Isn't life grand?

W. Scott Simon is an expert on the Uniform Prudent Investor Act and the Restatement 3rd of Trusts (Prudent Investor Rule). He is the author of two books, one of which, *The Prudent Investor Act: A Guide to Understanding* is the definitive work on modern prudent fiduciary investing.

Simon provides services as a consultant and expert witness on fiduciary issues in litigation and arbitrations. He is a member of the State Bar of California, a Certified Financial Planner® and an Accredited Investment Fiduciary Auditor™. Simon's certification as an AIFA™ qualifies him to conduct independent fiduciary reviews for those concerned about their responsibilities investing the assets of endowments and foundations, ERISA retirement plans, private family trusts, public employee retirement plans as well as high net worth individuals.

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