# Chapter 20
## Fiduciary: A Difficult Term to Define

If I asked a dozen different people to describe ice cream, I would probably receive similar answers. Most would agree that ice cream is traditionally made of frozen milk or cream, sweetened in some way, and flavored with any number of fruits (strawberry, black cherry, peach) or spices (chocolate, vanilla). If I showed this same group of people a collection of pictures, they could probably effortlessly identify the pictures of ice cream. Even if all the pictures depicted desserts, ice cream would likely be distinct.

What if I tried this same exercise using the term *fiduciary*? What if, instead of asking a dozen random people, I asked a dozen subject-matter experts about the meaning of *fiduciary*? Would I come to a similar consensus, as in the ice cream experiment?

I did, in fact, run this exercise recently with members of a prominent group of investment fiduciaries. This distinguished group is far better qualified to define *fiduciary* than anyone else I can think of. Even so, their answers varied greatly. Some focused on the root of the word *fiduciary* (which stems from the Latin word *fidere*, which means "to trust"), while others focused on the legal obligations of a fiduciary and still others articulated the ethical and moral responsibilities of a fiduciary.

Who's right?

They all are. Each definition made sense in its own right and was justified by facts and precedence. And this is precisely why investors are often befuddled by the term *fiduciary*. There is no single agreed-upon definition. It's possible to think about the term on many different levels and from many different perspectives. Instead of defining *ice cream*, we're suddenly trying to define *American cuisine*. If you said "burgers, fries, and apple pie," you'd be correct; if you said "a wide variety of dishes adapted from countries across the world," you'd also be correct. The same is true of *fiduciary*.

The exercise was not futile, however. As I combed through online definitions of *fiduciary* and read the responses of members of the group of investment fiduciaries, I did find several commonalities and general points of agreement, which I will discuss in this chapter. I believe it's important for consumers to develop an understanding of the key attributes of a fiduciary, in addition to learning about a few different ways of defining *fiduciary*. Armed with this knowledge, investors will be better equipped to find knowledgeable, trustworthy financial advisors who are committed to upholding a fiduciary standard of care. And, on the other side of the coin, they will gain a better understanding of who to avoid and how to identify red flags.

In this chapter, I will focus on defining *fiduciary* from several different angles. In the next chapter, I will discuss how investors can use this definition to guide their search for a trustworthy, prudent financial advisor—someone who will provide excellent fiduciary-based advice.

## Defining Fiduciary

One of the earliest official attempts to define *fiduciary* came in the aftermath of the Great Depression. With the goal of fighting fraud and improving transparency in the financial industry, the US government passed the Securities Act of 1933, followed by the Investment Advisers Act of 1940. The Investment Advisers Act defines the meaning of *fiduciary* as one who has "a duty of loyalty and duty of care, which means that the advisor must put their client's interests above their own."*

Though the roots of the Investment Advisers Act remain strong, the meaning of *fiduciary* has morphed over the decades. It has been redefined by state governments, legal entities, and independent

* Kagan, "Investment Advisers Act of 1940: Definition, Overview."

organizations (some of which are committed to promoting transparency and integrity in the financial arena). However, aspects of the original definition remain intact.

Today, when searching for different definitions of *fiduciary*, you're likely to come across one term over and over again: ***trust***. Merriam-Webster offers the following definitions:

**fiduciary (adjective)**—of, relating to, or involved in a confidence or trust

**fiduciary (noun)**—one that holds a fiduciary relation or acts in a fiduciary capacity[*]

When thinking about *fiduciary* from a legal angle, it's helpful to turn to a legal dictionary, such as the one provided by Farlex, which defines fiduciary as follows (emphasis added):

> "An individual in whom another has placed the utmost **trust** and confidence to manage and protect property or money. The relationship wherein one person has an obligation to act for another's benefit."[†]

Trust was also mentioned in the survey I conducted. CEO of InvestSense James Watkins is an expert on fiduciary law. He says, "A fiduciary is an individual or any entity to whom another individual or entity **entrusts** the management of their affairs. It can be limited to just one issue or a broad range of issues."[‡]

The word *trust* also appears when referring to "trustees." In the state of Minnesota, a fiduciary is legally defined as "an agent, **trustee**, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an instrument."[§]

Some legal definitions of *fiduciary* deviate somewhat from the core tenet of trust. The state of Delaware, where over half of the nation's Fortune 500 companies are incorporated, has a somewhat different definition of *fiduciary* and fiduciary duties. Delaware corporate law

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* Merriam-Webster, "Fiduciary."

† The Free Dictionary by Farlex, "Fiduciary."

‡ Watkins, interview by the author, April 15, 2022.

§ Minnesota Legislature, *Notice of Breach of Fiduciary Duty*.

necessitates corporate directors adhere to a **duty of care** (acting with prudence and being reasonably informed) and a **duty of loyalty** (putting the corporation's and shareholders' interests before the director's personal interests).[*]

James Watkins defines a fiduciary's duties similarly, saying, "A fiduciary has several duties, the two primary duties being the **duty of loyalty** and the **duty of prudence**."[†]

Allan Henriques,[‡] a CEFEX Analyst, expands the definition of fiduciary duty even further, saying, "Typically, there are three recognized 'fiduciary duties.'" He lists them as **duty of loyalty**, **duty of care** (to act prudently), and **duty to obey** all applicable legal requirements.[§]

These definitions focus on fiduciaries and fiduciary duty from a legal perspective, but it is possible—and beneficial—to look at these terms through a different lens.

## Beyond the Legal Definition

While it is helpful to understand how fiduciary/fiduciary duty is legally defined, these definitions do not necessarily articulate the moral and ethical standards followed by trustworthy fiduciaries. If we expand our definition to consider moral/ethical implications, we introduce a whole new set of terms and expectations. Some of the words that cropped up in my survey were:

- diligence
- continuous improvement
- best interest
- documented processes

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* Bradshaw Law Group, "Duty of Care and Duty of Loyalty Owed by Directors in Delaware."

† Watkins, "Battle of the Best Interests: Why the Financial Services Industry Opposes a True Fiduciary Standard and Genuine Investor Protection."

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§ Henriques, interview by author, June 1, 2022.

- understanding
- [free from] conflicts of interest
- full disclosure

Carlos Panksep, vice president of the Centre for Fiduciary Excellence (CEFEX), said, “In order to best serve an investor, an advisor must have **prudent fiduciary practices** in place and work in a culture of **continuous improvement** supported by **documented processes**.”[*]

Marie Pillai,[†] former chief investment officer and treasurer at General Mills, defined a fiduciary as “one who ALWAYS looks out for **the best interest** of the person/group in helping them satisfy a specific need(s); taking into consideration and **understanding their situation** as fully as possible; **updating the solution** as circumstances evolve, across the arc of time.”[‡]

To me, it is important to include this moral terminology in a standard definition of *fiduciary*. Without it, fiduciaries are held to a lower standard—the bare minimum to be considered legally acceptable.

Groups such as the Committee for the Fiduciary Standard—a cohort of investment professionals and stalwart fiduciaries founded in May 2009—have advocated for a stricter definition of *fiduciary* in the aftermath of the 2008 financial crises. The investment professionals and fiduciary experts in this group want “all investment and financial advice [to] be rendered as fiduciary advice and meet the requirements of the five core fiduciary principles.”[§] Those five principles are as follows:

1. Put the client’s best interests first.

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* Panksep, interview by author, July 6, 2022.

† Marie Pillai is an accomplished financial professional with thirty-plus years of experience. She is the former vice president and chief investment officer and treasurer at General Mills and the former vice president and chief investment officer at Siemens. She serves as a trustee of the Putnam Funds, and is a senior advisor to Hunter Street Partners.

‡ Pillai, interview by author, March 28, 2022.

§ Committee for the Fiduciary Standard, “Committee Names Kathleen M. McBride Chairman.”

2. Act with prudence, that is, with the skill, care, diligence, and good judgment of a professional.
3. Do not mislead clients—provide conspicuous, full, and fair disclosure of all important facts.
4. Avoid conflicts of interest.
5. Fully disclose and fairly manage, in the client's favor, unavoidable conflicts.

Financial advisors and firms that follow these guidelines often adopt a similar fiduciary oath. Kate McBride,* who is the former chair of the Committee for the Fiduciary Standard, emphasizes that the fiduciary oaths developed by the Committee are "available at no cost for anyone who wishes to use them."† My financial firm upholds an oath like the one published by the Committee. In its current form, it reads as follows:

**Our firm is proud to commit to the following five fiduciary principles:**

1. We will always put your best interests first.
2. We will act with prudence—using the skill, care, diligence, and good judgment of a professional.
3. We will provide full disclosure of all important facts.
4. We will avoid conflicts of interest and strive to provide unbiased advice.
5. We will manage any unavoidable conflicts in your favor.

It is important for consumers to not only understand the legal obligations of fiduciaries but also their moral and ethical responsibilities as well. Ideally, anyone who claims to be a professional fiduciary will adopt a fiduciary oath and commit to upholding it. As of the writing of this chapter, however, this is not the case. Therefore, consumers must act with caution and ask the right questions whenever they are thinking about using the services of a so-called fiduciary.

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† McBride, interview by author, March 29, 2022.