Chapter 21

How to Identify True Fiduciaries

As we've established, it is difficult to pin down the definition of *fiduciary*. It is possible to think about the term from a purely legal standpoint or to use an impersonal dictionary definition, but, to me (and to many of my colleagues), that isn't enough. The most trustworthy fiduciaries are those who not only comply with the law but also adhere to a strict code of ethics, which is often embedded in a fiduciary oath (see chapter 22 for more).

Keeping this information in mind, let's take the discussion one step further and talk about how you, as a consumer and potential investor, can leverage your knowledge about fiduciaries to identify financial advisors who do or do not hold themselves to a strict moral and ethical standard.

Professional versus Lay Fiduciaries

First of all, it's imperative to note that just about anyone can be considered a fiduciary. James Watkins, CEO of InvestSense, notes that legal precedence demonstrates that "a fiduciary relationship exists when one person is under a duty to act for or to give advice for the benefit of another upon matters within the scope of their relationship. . . . It may be based upon a professional, business, or personal relationship."*

To complicate matters, there are two main categories of fiduciaries: professional fiduciaries and lay fiduciaries. A professional fiduciary provides fiduciary services for a living, while a lay fiduciary generally

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* Watkins, interview by author, April 15, 2022.

operates outside the financial industry and usually has little training in financial services. An example of a lay fiduciary might be a co-executor of a will or a member of a nonprofit's board (see financial advisor Kate McBride's excellent article* about nonprofit lay fiduciaries, if you'd like to learn more). Incredibly, about 17.5 million people in the US can be classified as lay fiduciaries, while only about four hundred thousand people are considered professional fiduciaries.†

If you happen to work with a lay fiduciary, don't expect the same standard of care and expertise that you would get with a professional fiduciary. Guerdon Ely, financial advisor and founder of Ely Prudent Portfolios, explains the difference between the two, stating, "A lay fiduciary, which is also referred to as an amateur, is expected to comply with the same standard of prudence as a professional. However, the expectation of the reasonableness with which they exercise their duties is lower than that of professional fiduciary."‡

Fortunately, it's not usually too difficult to tell the difference between a professional and a lay fiduciary. A professional fiduciary will likely work at a financial institution and will have completed advanced training in financial services. It's a good idea to take note of an individual's education, certifications, and accreditations. A professional fiduciary might have certifications/designations such as Accredited Investment Fiduciary® (AIF®), Accredited Investment Fiduciary Analyst® (AIFA®), or Certified Financial Planner® (CFP®), among others.

Once you've determined someone is, indeed, a professional fiduciary, the real digging begins. How do you determine who *really* follows fiduciary best practices and who does not always act in the best interest of the consumer?

Fiduciary Standards

All professional fiduciaries are held to a minimum standard when it comes to client care. The US federal government requires fiduciaries to act in their clients' best interests and to put client interests before

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* McBride, "Did You Know That There's More Than One Type of Fiduciary?"

† InvestmentNews, "Ever Hear of a 'Lay Fiduciary'? There Are 17.5 Million of Them."

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

their own. This legal requirement is open to interpretation, and some fiduciaries have chosen to interpret its meaning loosely.

In an effort to tighten regulations around fiduciaries, the Department of Labor attempted to expand the definition of an "investment advice fiduciary" in the mid-2010s. The revised definition "elevated all financial professionals who work with retirement plans or provide retirement planning advice to the level of a fiduciary, bound legally and ethically to meet the standards of that status."*

The expanded definition put brokers, insurance agents, and other product providers who earn a commission for financial services in a panic. The new rules would have likely disrupted their rewards-based compensation systems. So, they fought, and, ultimately, they won. After several delays and court battles, the fiduciary rule was vacated in June 2018.

With government regulations remaining fairly loose, many people who dole out financial advice do not feel obligated to adhere to a fiduciary standard of care (which, in essence, requires them to put their clients' best interest above all else). James Watkins discusses the fiduciary standard of care, saying, "for 'financial advisers,' there is no one standard. A Registered Investment Adviser (RIA) and/or an Investment Adviser Representative (IAR) of an RIA is held to a fiduciary standard. Stockbrokers and other 'financial advisors' will argue that they are held to a much less stringent standard of care than a fiduciary standard."†

Allan Henriques, a CEFEX Analyst, says that stockbrokers and other brokerage firm advisors owe their "highest duty" to their employer or firm and are merely required to provide "suitable advice" to clients. He explains that "the 'suitable' standard would not require the advisor to sell the client an investment product at the lowest available cost."‡

All this is to say: be cautious. You may think you're working with a fiduciary, but that person may be a wolf in sheep's clothing (i.e., a commission-based investment securities broker or insurance agent

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* Peters, "Everything You Need to Know about the DOL Fiduciary Rule."

† Watkins, interview by author, April 15, 2022.

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

who is not legally required to put your interests first). I've talked with investors who think they're working with an investment advisor, only to learn their advisor is, in truth, dually registered as a broker-dealer.

With so many financial advisors motivated by sales and commissions, how can you, the consumer, possibly figure out who is *actually* looking out for your best interests? If you're feeling frustrated, I can't say I blame you. I'm frustrated too! However, there are several tools you can use and precautions you can take to find trustworthy financial advisors who are committed to fiduciary best practices:

1. The AIF® designation

Does your financial advisor have the Accredited Investment Fiduciary® (AIF®) designation? If so, that's another positive signal they are serious about customer care and putting the best interests of their clients above all else. To earn an AIF® designation, financial advisors must complete training, comply with a code of ethics, and pass an examination through Fi360 (an organization affiliated with the Center for Fiduciary Studies).

2. BrokerCheck

As I've discussed in past chapters, a financial advisor could be (and most often is) dually registered as both an Investment Adviser Representative and an investment securities broker. This can be problematic because the individual can act in either capacity. You never know if you're dealing with the broker (who is incentivized by commissions and bonuses) or the investment advisor.

As a rule, I advise against working with anyone who has an active broker license. To find out if a financial advisor is a licensed broker, use FINRA's BrokerCheck tool. Visit the website, type in the name of an individual or organization, and learn more about their licensing and background.

3. Prudent Practices for Investment Advisors *handbook*

When the *Prudent Investment Practices* handbook (now called *Prudent Practices for Investment Advisors*) was introduced in 2003, I was excited. This handbook was cutting-edge at the time, providing information and strategic guidelines to develop a legal, ethical, client-centric fiduciary practice. It was so client-focused, in fact, that the company where I was employed at the time forbade me from sharing the handbook's contents with coworkers, clients, or the general public. They were scared. They saw the handbook as a threat—a way to enlighten clients about some of the company's less savory practices, such as pushing certain products to gain commissions. For me, this was the straw that broke my relationship with that firm.

Today, the *Prudent Practices for Investment Advisors* handbook is still a powerful tool for both advisors and investors. It discusses the role of investment fiduciaries, defines the meaning of fiduciary excellence, and details how to promote a fiduciary culture. I believe this is mandatory reading for anyone who is an investment fiduciary or who is hoping to work with an investment fiduciary. When you're interviewing financial advisors, ask them for their thoughts on the *Prudent Practices for Investment Advisors* handbook. Any trustworthy fiduciary will take your question seriously and articulate their support of the handbook's tenets.

4. CEFEX

The Centre for Fiduciary Excellence, or CEFEX, is an independent assessment and certification organization. If an investment advisory firm is CEFEX certified, it has demonstrated it adheres to fiduciary best practices. CEFEX audits are quite stringent, and firms must meet specific criteria to gain certification. Additionally, these audits take place every year, so firms must be diligent about continuously upholding fiduciary best practices. If a firm is CEFEX certified, that's a good indication it is putting its clients' needs first.

All investors should exercise an abundance of caution when selecting and working with a financial advisor. To ensure your best interests—instead of the financial firm's profits or the financial advisor's compensation—are the priority, do some digging to determine if they are a professional fiduciary *and* uphold fiduciary best practices. Fortunately, many tools exist to assist with the search, and anyone armed with a little background knowledge should be able to identify trustworthy financial advisors who are committed to adhering to a fiduciary standard of care.