

# Fiduciary Standard of Care—Rekindling the Debate

By: Joseph M. Belth

A lengthy article in *The New York Times* on Sunday, October 12, 2014 may rekindle the debate over which practitioners in the financial services business should be held to a fiduciary standard of care in dealing with clients. The article, entitled "Before the Advice, Check the Adviser," was by Tara Siegel Bernard, a personal finance reporter for the *Times*. The article began on the front page of the mutual funds section of the paper. The article also was published online on October 10.

## The Toffel Case

The article featured Merlin and Elaine Toffel, a retired Illinois couple in their 70s, who "question whether variable annuities they bought, which came with high fees, were completely in their best interest." The article says a teller at their local U.S. Bank branch referred them to the bank's investment brokers, who sold them variable annuities in which they invested more than \$650,000. They obtained the money by selling low-cost Vanguard funds and paying capital gains taxes on the sale. The article said the annuities carried fees of about 4 percent of the amount invested, or more than \$26,000 per year, which would be "enough to buy a new Honda sedan every year," as well as a 7 percent surrender charge if they needed to tap the money. The lack of liquidity caused problems later when Merlin was diagnosed with Alzheimer's and had to move to a skilled nursing facility, and when Elaine consequently wanted to buy an apartment in the same facility. A spokesman for the bank was quoted as saying the annuities were appropriate and the fees were disclosed. The Toffels, assisted by their daughter and son-in-law, eventually received some money without paying the surrender charge.

## Fiduciary and Suitability Standards

A practitioner operating under the fiduciary standard of care must act in the best interest of the client, place the interest of the client above the interest of the practitioner, and avoid conflicts of interest. The fiduciary standard of care applies in such relationships as trustee to trust beneficiary, executor to heir, attorney to client, and conservator to ward.

On the other hand, a practitioner operating under the suitability standard of care must act in a manner consistent with the client's interest. Thus the practitioner must consider such matters as the client's age, financial situation, needs, objectives, tolerance for risk, and time horizon.

Which financial services practitioners operate under the fiduciary standard of care and which operate under the suitability standard of care is a complex question that is beyond the scope of this discussion. Here I observe only that many clients are not aware of the difference between the fiduciary standard of care and the suitability standard of care, that many clients do not understand the significance of the difference, and that many clients are either in the dark or confused about the standard of care under which their practitioners are operating.

## Personal Experiences

The *Times* article reminded me of two personal experiences some years ago. The first occurred when I saw a trade magazine advertisement in which a company offered a series of immediate, nonparticipating, single-premium, deferred life annuities. The annuities were identical in premiums and annuity benefits. However, the annuities differed in agent's commission and surrender charges; that is, the larger the commission, the larger the surrender charges and the smaller the net surrender values. What amazed me was that an insurance company would place agents in such a conflict-of-interest situation. Any of the annuities might be allowed under the suitability standard of care, provided the company was acceptable in terms of financial strength and other relevant characteristics, but only the annuity with the smallest commission and the smallest surrender charges would be allowed under the fiduciary standard of care.

The second personal experience occurred when I walked into the local branch of the large bank where my wife and I had our joint personal checking account to deposit a check for several thousand dollars. I was shocked when the teller asked me what I was planning to do with the money. I suppressed the urge to tell her it was none of her business, and merely inquired about why she asked the question. She said the bank had an investment broker who might be able to suggest a better way to invest the money than what I had in mind. The broker was not in the bank at the time, so I gave the teller my telephone number and asked her to have the

broker call me. When the broker called I asked what kind of investments he had in mind. He said they offer annuities. He did not immediately indicate what kind of annuities he was selling, and I did not ask. I merely said I was not interested.

### **General Observations**

Some financial services practitioners operate under the fiduciary standard of care, but most operate under the suitability standard of care. I believe that all financial services practitioners, including those who sell variable annuities, variable life insurance, and variable universal life insurance should operate under the fiduciary standard of care.

As for insurance agents, I believe that the time has come for those selling traditional term life insurance, traditional cash-value life insurance, universal life insurance, traditional annuities, indexed annuities, so-called fixed index annuities, and indexed universal life insurance to operate under the fiduciary standard of care. In other words, those advising consumers on financial instruments that are as important as life insurance policies and annuity contracts should take the next step beyond the golden rule standard of care that Professor Solomon S. Huebner introduced in the Chartered Life Underwriter professional pledge some 80 years ago.

Some persons in the financial services business support, and many oppose, imposition of the fiduciary standard of care. I would welcome *brief* comments on the subject from readers. I will try to prepare a follow-up to this post identifying key arguments on both sides of the debate. Please send your comments to [jmbelth@gmail.com](mailto:jmbelth@gmail.com) or to me at P.O. Box 245, Ellettsville, IN 47429. Please show your name, your firm's name, your position, your e-mail address, and your regular mailing address. Also, please indicate whether your comments are for attribution or not for attribution; I will abide by your wishes.

Meanwhile, I am offering a complimentary 11-page PDF containing some introductory material from a "Study of Investment Advisers and Broker-Dealers" released in January 2011 by the staff of the Securities and Exchange Commission. Send an e-mail to [jmbelth@gmail.com](mailto:jmbelth@gmail.com) and ask for the SEC package.