BY JOEL H. FRAMSON, CPA/PFS, CFP

# Fiduciary Facts

## Recent Regs, Court Case Shed Light on Important Topic

**b**reach of fiduciary duty has been an important subject of late because of Department of Labor regulations and a recent court case. This article will explore issues that CPAs must be aware of in their role as trusted professional advisers. There are at least three situations where being aware of the laws and regulations pertaining to fiduciary duty relating to investments are crucial:

1. When you do not act as an investment adviser, but you have clients who are trustees of retirement plans or have established 401(k) plans for their employees.
2. You have your own firm 401(k) or retirement plan, or you are in a fiduciary relationship with your clients with respect to such plans.
3. You either are a registered investment adviser with an investment license under a broker-dealer, or give investment advice to your clients that is not "incidental" to your role as their CPA.

For our purposes, the term fiduciary can be divided into two groups:

- **Investment adviser**: A person responsible for managing comprehensive and continuous investment decisions (wealth managers, financial advisers, trust officers, financial consultants, financial planners and fiduciary advisers).
- **Investment stewards**: A person who has the legal responsibility for managing investment decisions (trustees and investment committee members).

A fiduciary relationship is generally considered to be the highest standard of customer care available under the law. Many different types of professions owe a fiduciary duty to someone; for example, lawyers to their clients and trustees to beneficiaries. For investment advisers, the duty comes not from the SEC, but from common law.

The Investment Advisers Act of 1940 does not use the word "fiduciary" and it

does not appear in the Act. You may wonder why the concept of fiduciary duty came to be applied to advisers. In fact, it was the Supreme Court that recognized congressional intent and held that the Act: "reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship, as well as congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested."

From this legal backdrop, the SEC does mandate that advisers are fiduciaries, and provides this guidance: "As an investment adviser, you are a fiduciary to your advisory clients. This means that you have a fundamental obligation to act in the best interests of your clients and to provide investment advice in your clients' best interests. You owe your clients a duty of undivided loyalty and utmost good faith. You should not engage in any activity in conflict with the interest of any client, and you should take steps reasonably necessary to fulfill your obligations. You must employ reasonable care to avoid misleading clients and you must provide full and fair disclosure of all material facts to your clients and prospective clients."

A fiduciary relationship is generally considered to be **the highest standard** of customer care available under the law.

It's clear that investment advisers regulated under the SEC or individual states have a fiduciary responsibility to their clients. This fiduciary duty is defined by a number of laws and regulations, not the least of which derive from the Uniform Prudent Investor Act and ERISA. Even brokers under certain circumstances have been held by the courts to have a fiduciary duty to their clients.

Perhaps the leading California case on the issue of stockbrokers' fiduciary duty can be found in *Twomey v. Mitchum Jones & Templeton, Inc.* [1968 – 262 Cal.App2d 690 (69 Cal. Rptr. 222)]. This line of cases centered on the close relationship and trust the client placed on the stockbroker. That relationship was deemed to be fiduciary in nature, and the broker was found to be in breach of fiduciary duty.

An adviser, as that trustworthy fiduciary, has five major responsibilities:

1. To put a client's interests first;
2. To act with utmost good faith;
3. To provide full and fair disclosure of all material facts;
4. Not to mislead clients; and
5. To expose all conflicts of interest to clients.

Let's assume that a CPA who has a

fiduciary duty to a client, retirement plan or trust observes that client or entity breaching a fiduciary duty. The CPA would then have a fiduciary obligation to notify the client and could be deemed to have breached his or her fiduciary duty if appropriate action isn't taken.

In a CPA's role as a trusted adviser, a fiduciary relationship may be caused by virtue of that professional relationship, much in the same way the *Twomey* court found that the stockbroker's relationship of trust rose to a fiduciary standard.

A CPA may become a trustee of a client's trust or a trustee of a qualified retirement plan. In the case of a qualified retirement plan, the fiduciary must be aware of actions that might indicate others breached a fiduciary duty, such as:

- Using retirement plan assets to purchase real estate for corporate use;
- Using the assets of a private trust to provide unsecured loans to related parties and entities of the trustee;
- Using a company retirement plan as collateral for a line of credit; and
- Buying artwork or collectibles with retirement plan assets and putting them on display.

If the CPA is a Registered Investment Adviser, the fiduciary duty is applicable. If not an RIA, the CPA needs to be cautious because fiduciary status may be conferred based on facts and circumstances. For example, giving investment advice that's deemed not incidental to the practice of accountancy could cause the CPA to be deemed giving investment advice, which would result in fiduciary status.

Similarly, CPAs who hold themselves out as financial planners, CPA retirement planners or financial advisers, a client's trust and reliance for significant advice from the CPA could give rise to a fiduciary relationship. Marketing services as a "trusted adviser" may establish the criteria necessary for fiduciary status (see *H&R Block* case).

In Release IA 1092, the SEC said: "The staff believes that a person who provides advice, or issues or promulgates reports or analyses, which concern securities, but which do not relate to specific securities, generally is an investment adviser under Sec. 202(a)(11)."

Under this rule, such advice as preparing an asset allocation and discussing that allocation with clients may be deemed to be giving investment advice.

## Fiduciary Duty and the DOL

At the time this article was written, the Department of Labor released its long awaiting ruling, informally called the Fiduciary Rule (the Rule). Keep in mind that the rules and regulations of the SEC will be different from DOL's Rule. Thus investment advisers will need to assimilate both rules. The Rule applies to 401(k) plans.

The Rule focuses on how investment advisers are paid. In contention is the perception that some advisers were taking advantage of employees who were not investment-savvy. In some cases, advisers would recommend inappropriate investments that produced higher fees to the adviser.

The DOL has introduced a higher sense of obligation, meaning that investment advisers must focus on what is best for a plan participant. If a retirement plan has less than $50 million in assets, investment advisers must sign a Best Interest Contract Exemption, which states that they will act in the best interest of the plan and its participants, and be compensated by a flat rate or percentage of assets no matter what investment is picked.

To address an issue where an adviser assists a plan participant to roll over assets from an employer-sponsored plan to a 401(k), the Rule introduces the concept of "level to level compensation." A special exemption is being given to firms or advisers that only receive a level fee. Level-fee fiduciaries receive the same compensation, regardless of the particular investments the client makes, whether based on a fixed percentage of assets under management or a fixed dollar fee.

## Other Court Case

While not related to the DOL Rule, fiduciaries also should be aware of a Supreme Court Case settled in 2015, *Tibble v. Edison International*. This was a case alleging breach of fiduciary duty in an ERISA plan. At issue was whether the trustees/fiduciaries of a 401(k) plan breached their duty to monitor the investments being offered to employees of Edison. Secondly, it was alleged that the trustees of the plan only offered a retail class of mutual funds with higher fees than was obtainable if the plan used institutional class funds.

Referring to the AICPA-edited handbook "Prudent Practices for Investment Stewards," the issues in this case may have violated practices that include:

- **Practice S-4.2**: Periodic reviews are made of qualitative and/or organizational changes of investment managers and other service providers; and
- **Practice S-4.4**: Periodic reviews are conducted to ensure that investment-related fees, compensation, and expenses are fair and reasonable.

## Conclusion

Fiduciary duties are a critical component of the responsibilities of financial advisers. Without proper education and a solid understanding of who is a fiduciary, and what those duties entail, CPAs could be taking on the risk of a breach of fiduciary duty without even being aware of those duties.

While the length of this article does not make possible a deeper dive into the specific prudent practices that a fiduciary should be aware of, it should at least introduce the subject and encourage CPAs to learn more.

**Joel H. Framson, CPA/PFS, CFP** is president at Silver Oak Wealth Advisors and a member of the CalCPA Personal Financial Planning Committee. You can reach him at jframson@silveroakwa.com.

### want more?

### Prudent Fiduciary Practice Handbooks

Joel Framson was engaged by the Foundation for Fiduciary Studies to participate in, and become one of the editors for, a project culminating in a number of AICPA handbooks that serve as a foundation for prudent investment fiduciary practices: "Prudent Practices for Investment Advisors" and "Prudent Practices for Investment Stewards." Both of these publications may be obtained from FI360 (www.fi360.com), and are included as practice aids on the AICPA PFP Division website (www.aicpa.org/PFP).