The Four Different Types of Fiduciary Financial Advisors

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The Department of Labor (DOL) fiduciary rule has heightened consumer awareness of the concept of fiduciary duty, but the reality is that being a fiduciary (or not) isn't a singular concept. Conceptually, it's about acting in the interests of the client, and honoring the fiduciary duties of loyalty and care, but not all regulators define (nor enforce) those terms consistently.

This article explores four different types of financial advisor fiduciaries, including registered investment advisors (RIAs) that are Securities and Exchange Commission (SEC) fiduciaries, DOL fiduciaries serving retirement investors, CFP® fiduciaries providing financial planning, and voluntary fiduciaries who decide to step up to honor private or third-party fiduciary standards (see table 1).

One reason for varying fiduciary standards is the fact that different industry channels are regulated by different overseers—each of which defines fiduciary obligations in its own way. RIAs are overseen by the SEC and state regulators, which both have adopted a disclosure- and transparency-oriented approach to fiduciary duty, but only for investment advice and investment management. The DOL fiduciary rule impacts anyone giving advice on retirement accounts (not taxable investment accounts), but it is more stringent in its limitations on conflict of interest. And the CFP Board requires that certificants adhere to a fiduciary duty, but the requirement depends on specifically whether the certificant is doing "financial planning or material elements of financial planning" for a client.

Meanwhile, organizations with a voluntary fiduciary standard for their advisor members—such as the National Association of Personal Financial Advisors (NAPFA) and the XY Planning Network (XYPN)—have their own definitions of when fiduciary duty applies, and which conflicts are and aren't permitted. In addition, RIAs who are struggling to differentiate as fiduciaries—now that DOL fiduciary will apply the rule to more advisors in the future—can look to pursue and opt in to even more stringent versions of voluntary fiduciary rules such as the new registry of the Institute for the Fiduciary Standard or the Center for Financial Excellence (CEFEX) certification.[1]

The bottom line is that there are many different definitions of fiduciary duties, and two advisors who are both "fiduciaries" might have very different fiduciary obligations. And unfortunately, given research showing that consumers struggle to understand even the difference between fiduciary and suitability standards, it's unlikely that many grasp the nuances of the different types of fiduciary duty.

Which means the fact that several different fiduciary rules can apply to financial advisors is leading to a new form of consumer confusion.

REQUIREMENTS TO CALL YOURSELF A FIDUCIARY FINANCIAL ADVISOR

An RIA under the SEC and a broker under DOL can both be fiduciaries, but they're not quite the same kind of fiduciary. In addition, advisors can be subject to different regulators within different channels, each with its own rules. The variability in the fiduciary rules ranges across the requirements to be a

Table 1

FOUR TYPES OF FIDUCIARY FINANCIAL ADVISORS

Fiduciary Type	Fiduciary Scope	Fiduciary Limitations/Requirements
SEC	Investment Advice	Disclose conflicts of interest
DOL	Retirement Advice	Eliminate many conflicts of interest
CFP	Financial Planning	Disclose conflicts of interest
Membership Associations and Voluntary Organizations	Varies by Organization	Varies by organization

fiduciary, the consequences if you fail to live up to being a fiduciary, and even the scope of the activities that the fiduciary requirement covers.

In general, however, we'll see basically four different types of fiduciary financial advisors in the coming years, as discussed below.

AN SEC FIDUCIARY UNDER THE INVESTMENT ADVISERS ACT OF 1940

The first type of fiduciary is an investment adviser who is registered with the SEC or as a state-registered investment adviser. For an RIA, fiduciary duty comes about under Section 206 of the Investment Advisers Act of 1940 (Advisers Act).[2]

Technically, though, the Advisers Act doesn't state that an RIA must be a fiduciary. Instead, it states that advisors cannot engage in any acts that would be fraudulent, deceptive, or manipulative when they hold out to consumers. But in *SEC v. Capital Gains Research Bureau*, a famous 1963 U.S. Supreme Court case, it was determined that the requirement that advisors can't be fraudulent, deceptive, or manipulative when they hold out to consumers effectively means that they have a fiduciary duty to their clients.[3]

In other words, Section 206 of the Advisers Act specifies how advisors can hold themselves out to the public—it's the handbook for how advisors can advertise their services, and a fiduciary duty is attached to it.[4] Therefore, the fiduciary nature of being an investment advisor focuses on being clear and transparent with clients about what you're doing, what you're charging, and any potential conflicts of interest. Anyone who's gone through the RIA registration process has disclosed all outside business activities and potential conflicts of interest in Form ADV to comply with these fiduciary requirements.

Note, however, that the SEC rules don't prevent or stop advisors from engaging in a lot of those conflicts of interest; they simply require that all of them be disclosed and communicated transparently so that it's not deceptive, fraudulent, or manipulative. This means you can have RIAs that have related businesses offering insurance, real estate transactions, etc.

I highlighted this on my blog *Nerd's Eye View* in 2015 when CNBC featured a list of the top fee-only RIAs, and nine of the top 10 had related businesses receiving insurance commissions.[5] Those businesses and commissions had to be disclosed, and we identified those "fee-only" firms actually still getting commissions precisely because everything was explained in their ADVs. From the SEC's perspective, the advisors disclosed those activities, so it was okay. But it revealed that the firms weren't actually fee-only fiduciaries—they were fiduciaries that also had related non-fiduciary (and commission-based) businesses.

Technically, it's even possible for an RIA to get commissions as an RIA.[6] It's not common, but there's nothing that outright forbids SEC fiduciaries from getting commissions. It's just that the most common form of investment-related commission results from selling a securities product, which goes through a broker-dealer and isn't under SEC standards. But nothing in the SEC rules for fiduciaries explicitly states that an RIA can't have commissions.

Notably, though, the scope of the Advisers Act covers just investment advice, investment management, and the compensation advisors receive for providing investment advice and investment management. It doesn't cover the sale of securities products, insurance products, financial planning, tax advice, estate planning advice, or retirement advice. Thus, the SEC's version of fiduciary duty is fairly limited in scope and focus, at least for the typical comprehensive financial planner. Its focus is on not being misleading in advertising, making it a transparency disclosure-oriented fiduciary standard with application limited to the conflicts of interest around the investment advice.

A DOL FIDUCIARY FOR RETIREMENT INVESTORS

Now we will contrast the SEC fiduciary with a DOL fiduciary, governed by the DOL fiduciary rule, which is different.[7]

First and foremost, the scope is different. SEC fiduciary rules apply only to investment advice delivered as an RIA—either SEC registered or state registered. DOL fiduciary rules apply any time investment advice is given in an advice relationship to a retirement investor.

A "retirement investor" could be a 401(k) plan administrator, a plan participant (someone investing in the 401(k) plan), or an individual retirement account (IRA) owner—but the advice given must be tied to a retirement account. For example, if someone works as a financial advisor with a client who has a taxable brokerage account and an IRA, the advisor is only a DOL fiduciary for the IRA and not for the other account. The brokerage account might be subject to the SEC fiduciary rule if the advisor is an independent advisor rep of an RIA, or it might not if the advisor works for a broker-dealer.

This highlights the limitations around the DOL fiduciary rule regarding scope. However, the manner in which DOL applies its fiduciary rule shows it to be more stringent than that of the SEC in actual application.

SEC fiduciaries can have a relatively wide swath of conflicts, as long as they're disclosed in the ADV. But DOL fiduciaries are prohibited from many of those conflicts. DOL fiduciary rules limit advisor compensation if it would create undue influence. DOL fiduciary rules raise fiduciary concerns any time there's variable compensation. DOL fiduciary rules consider the quality of the advice and whether it meets a best-interest standard as well as the reasonableness of the compensation—in addition to an SEC-style requirement not to make misleading statements.

Thus, the DOL fiduciary rule is much more limiting to advisors (and arguably more protective to consumers). For instance, an advisor who has discretion cannot have variable compensation across a portfolio under DOL fiduciary, which is a big difference from SEC requirements, which require only that the variable compensation be disclosed.[8] Likewise, RIAs who have discretion for managing stocks and bonds are allowed to charge more for the stocks than the bonds under the SEC fiduciary rules, but forbidden to do so by the DOL fiduciary rules when the advisor has discretion.

The key point to recognize is that the DOL fiduciary rules prohibit some types of transactions presumed to be "too conflicted," and the SEC allows many of them while simply requiring that they be disclosed in Form ADV. But these fiduciary rules apply in different situations. DOL pertains to retirement accounts (not taxable investment accounts), but it also applies to other types of investments in retirement accounts including annuities, which the SEC fiduciary rule doesn't cover at all.

DOING FINANCIAL PLANNING AS A CFP FIDUCIARY

A third type of fiduciary rule can apply to someone who is serving as a fiduciary under the CFP Board's Practice Standards.[9]

This fiduciary rule is different yet again. First, it applies only to CFP certificants, not to anyone else who holds out as a financial advisor. More significantly, it applies only within the scope of financial planning: The CFP certificant must be providing financial planning or "material elements of financial planning" to be deemed a CFP fiduciary.

In other words, being a CFP doesn't make you a fiduciary, it's about what you are doing for the client.[10] For instance, you can be a CFP non-fiduciary order-taker just executing client orders. That's different from the SEC's version (where just being an RIA makes you a fiduciary), but similar to DOL (because once you're giving advice, the fiduciary rule will apply).

The key point to recognize is that the DOL fiduciary rules prohibit some types of transactions presumed to be "too conflicted," and the SEC allows many of them while simply requiring that they be disclosed in Form ADV.

The CFP fiduciary standard is also much broader in scope and coverage. To be a CFP fiduciary, you must be doing financial planning, but once you are, it applies to all financial planning activities, including subsequent recommendations. Thus, the CFP fiduciary rule is arguably the broadest fiduciary rule in scope, because it applies to your retirement advice, tax advice, insurance advice, investment advice, and everything else under that financial planning umbrella, whereas the DOL fiduciary rules are limited to retirement accounts and the SEC fiduciary rules are limited to investment advice and investment management.

On the flip side, although the scope of the CFP fiduciary rule is the broadest, it's also the least enforceable. Because the CFP Board is not a regulator, it doesn't have the legal right to investigate, compel witnesses, and subpoena documents. It can ask you for information about a client complaint, and if you don't comply it can take away your marks, but that's it. Consumers generally can't sue a financial advisor for breach of CFP conduct the way they can sue for a fiduciary breach under the SEC or DOL, because the CFP certificant doesn't sign a separate fiduciary contract with the client. All the CFP Board can do is privately admonish you, publicly admonish you, suspend your marks, or revoke your marks. This means that, at the end of the day, even CFPs who commit drastic breaches of the CFP fiduciary standard can keep going as financial advisors—just without "CFP" after their names.

VOLUNTARY FIDUCIARY STANDARDS—INVESTMENTS & WEALTH INSTITUTE, NAPFA, CEFEX, AND THE INSTITUTE FOR THE FIDUCIARY STANDARD

A fourth type of fiduciary standard is one that applies to those who voluntarily state that they're going to act as one and comply with a particular voluntary set of standards.

For example, those who take the fiduciary pledge under NAPFA[11] or groups such as XY Planning Network,[12] organizations that require members to pledge to operate as a fiduciary with clients, commit to be voluntary fiduciaries. Similarly, Investments & Wealth Institute members commit to the Investments & Wealth Institute *Code of Professional Responsibility*, which includes in its core values objectivity and the expectation that an Institute professional will provide advice in the client's best interests.[13]

Note that some of these organizations may have their own definitions of appropriate fiduciary behavior and their own limitations on conflicts of interest. For instance, NAPFA and XYPN are both fee-only organizations, and their version of fiduciary requires advisors to accept no commissions, whereas the SEC does not bar commissions (they are rare but not forbidden), the DOL fiduciary rule allows commissions (they are scrutinized but not banned), and the CFP fiduciary standard allows commissions as well. Investments & Wealth Institute's *Code of Professional Responsibility* similarly requires that all compensation—including commissions—be disclosed, but does not necessarily limit such conflicts of interest.

Another example of a self-imposed fiduciary standard is the Institute for the Fiduciary Standard's new registry, which is being positioned as the most stringent of fiduciary standards.[14] This means that it imposes the most consumer-protectionary requirements that advisors completely avoid conflicts of interest, rather than merely disclosing them and then moving on. Similarly, some advisors are getting voluntarily certified as a CEFEX fiduciary, which also boasts one of the more stringent self-imposed fiduciary standards and requires an annual fiduciary audit.[15]

Notably these are still purely voluntary standards. You declare you will follow them, and if you fail to do so, the worst-case scenario most likely is just that you get kicked out of the organization. A few require that you, as a member voluntarily committed to fiduciary standards, must sign fiduciary contracts with your clients, which opens you to being sued by a client for a fiduciary breach, because you opted yourself into a fiduciary contract with them. This is a big difference from CFP fiduciary rules, which don't require CFP certificants to explicitly create fiduciary contracts with every client. That may change, however, pending the CFP Board's update of its own Standards of Conduct.[16]

SUMMARY

The bottom line is simply to recognize that there are different types of fiduciary financial advisors out there. Just saying you're a fiduciary doesn't clarify for clients what your obligations are or are not, nor does it clarify what you're allowed to do or not. Fiduciary obligations can vary. Even the scope of what advice is subject to fiduciary duty (or not) may vary. Simply saying you're a fiduciary financial advisor does not necessarily mean you're a fiduciary regarding all the ways you may engage with clients.

Unfortunately, we know from the consumer research that most consumers don't even understand the difference between fiduciary and suitability standards, much less SEC versus DOL versus CFP versus voluntary standards. So there is still room for fiduciary advisors to differentiate themselves, but it's also a struggle to do so.[17]

Accordingly, this is why lobbying around the fiduciary standard, and how these rules are defined, really matters. Because these standards are not all the same in terms of consequences for advisors and protections for consumers. Perhaps someday we'll adjust to a more uniform fiduciary standard that applies evenly across all advisors and all circumstances, although that has its challenges as well.[18]

The fundamental point is that not all types of fiduciary financial advisors are the same, and this is likely going to be an issue of contention and confusion in the coming years.

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The original version of this article first appeared on *Nerd's Eye View*, https://www.kitces.com/blog/the-4-different-types-of-financial-advisor-fiduciaries/.

ENDNOTES

1. Founded in 2011, the Institute for the Fiduciary Standard is a research and education institution—a think tank—whose single purpose is to promote the vital importance of the fiduciary standard in investment and financial advice. http://www.thefiduciaryinstitute.org/. CEFEX is the Center for Financial Excellence; CEFEX certified firms adhere to a standard representing the best practices in their industry. The standards include specific criteria that have been substantiated by regulation or written in consultation with leading firms. A successfully completed standards-based assessment results in certification. This is written assurance that the firm meets the requirements of the standard. CEFEX certified firms voluntarily undertake annual audits by independent expert analysts. This continually verifies their adherence to the applicable standard and is supplemental to oversight performed by regulators or financial auditors; see https://www.cefex.org/.
2. 15 U.S. Code § 80b–6, Prohibited Transactions by Investment Advisers, https://www.law.cornell.edu/uscode/text/15/80b-6.
3. See https://www.sec.gov/divisions/investment/ capitalgains1963.pdf.
4. See https://www.law.cornell.edu/uscode/text/15/80b-6.
5. Michael Kitces, 9 Out of Top 10 CNBC 'Fee-Only' Advisory Firms Not Actually Fee-Only? (June 3, 2015), https://www.kitces.com/blog/9-out-of-top-10-cnbc-fee-only-advisory-firms-not-actually-fee-only-according-to-cfp-board-compensation-disclosure-rules/.
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8. This is even an issue for proprietary products in the portfolio (i.e., where they make more if they shift the client into their proprietary product); see Michael Kitces, How DOL Fiduciary Will Disrupt the BlackRock and Schwab Robo-Advisors (May 12, 2016), https://www.kitces.com/blog/schwab-intelligent-portfolio-and-blackrock-futureadvisor-under-dol-level-fee-fiduciary-rules/#disqus_thread.
9. CFP Board, Financial Planning Practice Standards, http://www.cfp.net/for-cfp-professionals/professional-standards-enforcement/standards-of-professional-conductfinancial-planning-practice-standards.
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11. NAPFA, https://www.napfa.org/.
12. XY Planning Network (XYPN), http://www.xyplanningnetwork.com/?__hstc=220917575.0e5a4887f1fa5b3d5e0a63c92efa0d03.1497451273680.1497451273680.1498165283709.2&__hssc=220917575.1.1498165283709&__hsfp=3871031694.
13. See http://www.imca.org/pages/Code-Professional-Responsibility and page 63 of this issue.
14. Institute for the Fiduciary Standard, Best Practices Affirmation Program, http://www.thefiduciaryinstitute.org/best-practices/affirmation-program/.
15. Center for Fiduciary Excellence (CEFEX), https://www.cefex.org/.
16. Michael Kitces, CFP Board Begins the Process of Updating Its Fiduciary Standards of Professional Conduct" (February 8, 2016), https://www.kitces.com/blog/cfp-board-commission-on-standards-to-revise-cfp-standards-of-professional-conduct/.
17. Michael Kitces, If the Fiduciary Fight Wins, Does Your Marketing Plan Lose? (April 29, 2011), https://www.kitces.com/blog/if-the-fiduciary-fight-wins-does-your-marketing-plan-lose/.
18. Michael Kitces, Why I Do Not Believe the SEC Should Create a Uniform Fiduciary Standard for All Brokers and Investment Advisers (March 30, 2015), https://www.kitces.com/blog/why-i-do-not-believe-the-sec-should-create-a-uniform-fiduciary-standard-for-all-brokers-and-investment-advisers/.