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The Voice of the Investment Management Consultant

Does the Advisor's Declaration of Fiduciary Status Require A New Generation of Industry Leadership?

Stephen C. Winks

Virtually every successful advisor in the industry “wants to do the right thing,” but in early October, when the SEC requires advisors to have a Code of Ethics and formally declare their fiduciary status, most advisors will find their ability to do the right thing – to declare their fiduciary status – as a function of the support their firm is willing to provide. Virtually every advisor in the industry today is faced with the prospect of having to compete with and being held accountable to a much higher level of counsel than the NASD-member firms that support us are willing to acknowledge. On October 5, 2004, “doing the right thing” becomes literally synonymous with fulfilling one’s fiduciary obligations to their clients.

The reality of the marketplace is every investor wants unconflicted counsel and an entrusted advisor to address and manage a broad range of investment and administrative values required by regulatory mandate. Certainly, every advisor would like to comply, but if the firms that support us (both independent and full-service) continue to shrink from the acknowledgement of our fiduciary status, then our role and counsel as an advisor is limited to the lowest common denominator of trade execution, when trade execution is fast becoming a commodity. For the well-being of the industry, the investor and the advisor, a new generation of leadership that subscribes to fiduciary responsibility must emerge. SEC Chairman Donaldson has said, “rules alone do not assure ethical behavior, only by instilling an ethical culture can a firm-wide commitment to ‘do the right thing’ be achieved.” The SEC requires a declaration of fiduciary status, and fiduciary responsibility has been defined (see [“High Net Worth Standards Initiative Publishes Asset/Liability Study Working Document,” Senior Consultant](#), March 2004, <http://www.SrConsultant.com/Society/HNW-Working-Index.html>), citing case law, statute, regulatory opinion letters, and best practices; and the

SEC examiners constitute a real enforcement mechanism. The only thing keeping us from addressing and managing the full range of investment and administrative values required in order to fulfill our fiduciary responsibilities is access to the enabling processes and technology.

Today, NASD member brokerage firms do not acknowledge we provide investment advice. Our role is to just make investors aware of investment alternatives; no advice is implied or rendered. It is up to our clients to make investment decisions. In essence, our role and counsel is minimized, and investors are forced to act as their own counsel. As a result, though it is difficult for us to accept as advisors, a *caveat emptor* (“buyer beware”) relationship with the client is established, which is the antithesis of the trust and the fiduciary relationship that we and our clients both desire.

We are not allowed by our supporting firms to create investment policy statements for our clients which are essential to the fulfillment of fiduciary responsibility. We are not assisted in the aggregation of data on all our clients’ holdings to include those custodied outside our firm, making it possible for us to address and manage the full range of investment and

administrative values required by regulatory mandate and necessary to add value. We can’t assure best execution because our firm’s trading desk considers electronically generated V-WAP (volume-weighted average pricing) to be too onerous of a benchmark to which to be held accountable. Yet, with the transparency of the web, nothing short of “doing the right thing” will do. You cannot be timid in offering high level counsel, you must be authoritatively bold and confident, yet we are not empowered with the resources to be either.

It makes no difference to our clients how difficult it may be culturally, structurally or technologically for our supporting NASD member firms to acknowledge

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our fiduciary status. Our clients are becoming increasingly aware that there are highly capable advisors out there, who have declared fiduciary status and are providing unconflicted counsel, who are accountable for addressing and managing the full range of investment and administrative values required by regulatory mandate as cited in case law, statute, regulatory opinion letters and best practices. Not only are our supporting firms not listening to us, they are not listening to the marketplace and the emergence of a much higher level of counsel that would instill the faith and trust of the investor in our counsel.

It is not irrational that our supporting firms do not want to acknowledge our fiduciary responsibility and its associated fiduciary liability. Without access to the enabling processes and technologies, very few of us are capable of managing in real-time the 240+ investment and administrative values necessary to provide the continuous, comprehensive counsel implied by regulatory mandate. And even if a few of us are, it is not because our firms are capable of supporting us. And even if our firms were capable of supporting us, where does that leave the vast majority of advisors who are not able to fulfill their fiduciary responsibilities? All advisors want to “do the right thing,” even if they are not able. Even if our supporting firms wanted to support fiduciary counsel, culturally there would be resistance from both advisors and senior management to change. Counter-balancing the importance of “doing the right thing” and re-winning the investor’s trust and confidence is the terrible human cost incurred within our supporting firms by streamlining organizational and cost structure around the enabling processes and technologies necessary to empower us to address and manage the full range of investment and administrative values required. The new business model would be highly disruptive and would turn the industry upside down. The advisor would then actually become the value added. The firm that supports the advisor serves as an important enabler to whom value is ascribed only to the extent to which it specifically empowers the advisor to add value. Harvard Business School professor Clayton Christensen observes in this book, *The Innovator’s Dilemma*, “Under the traditional

corporate planning process, it is impossible to justify enormous capital investment in emerging, yet-to-be-profitable business models.” For publicly traded companies, it is “irrational” to abandon an established business model for a new business model with an unproven cost structure, earnings, profit margin and multiple.

Given the pain our supporting firms would incur in reinventing themselves (culturally, structurally and technologically) to empower us to “do the right thing” in fulfilling our fiduciary obligations, is it reasonable for us to assume that our supporting firms would pursue a strategy that would be so highly disruptive to status quo? By our supporting firms (both full-service and independent) insulating themselves from fiduciary liability, they have had to deny

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that we render investment and administrative counsel. It is politically inexpedient and culturally inconceivable within our supporting firms that one would advance the notion that we, as advisors, would act in a fiduciary capacity. Our supporting firms have a cultural blind spot. Even if our supporting firms tried, they simply would be blind to or would not understand what is required to fulfill our fiduciary obligations. It is the old conscious competency argument. How can a firm that is built around denying its advisors provide advice, understand advice, know what is required to deliver it and why it works? You actually have to be consciously competent in order to develop and provide the enabling resources necessary to empower advisors to fulfill their fiduciary responsibilities. The disconnect is there have been brilliant breakthroughs in the enabling processes and technologies that empower us to add value, that have gone unnoticed because our industry’s leading financial services firms

don’t know what to do with these innovations. They don’t know how these innovative breakthroughs work, why they are important, or how they relate to other technologies or understand the specific ties to fiduciary responsibility. There is no question new industry leadership is required to assimilate industry redefining innovation, but that leadership will not come from today’s leading financial services firms but from our most consciously competent practitioners.

The irony is virtually all of the processes and technologies necessary to fulfill our fiduciary obligations either exist or are being developed. In speaking with U.S. senators and congressman who are actively engaged in financial services reform, there is huge interest in the emergence of fiduciary counsel.

The major consumer advocacy groups, the AICPA, and key state and federal regulators are very interested in supporting the industry’s adoption of a standard for fiduciary counsel that can be audited back to case law, statute, regulatory opinion letters and best practices. Leading technologists are excited by the prospect of using these standards to formalize process, procedures, work flow and task, so that much of the disclosure and reporting detail required can be automated, greatly reducing the labor intensity of

fiduciary counsel, bringing high level counsel within the reach of all advisors. Nobel Prize-winning investment theory is converging with advanced systems technology to facilitate a level of real-time investment and administrative counsel that goes far beyond the human capacity to reason. The vision and leadership required for this level of counsel to emerge can only come from our industry’s leading practitioners. This unprecedented level of investment and administrative counsel is within our reach, but only if we, as advisors and early adopters, work to assure it is brought into fruition. It is up to us. The reason why it took 40 years for modern portfolio theory to reach the retail investor is that it is presumed the industry was interested in addressing and managing values like risk, when in actuality, it was focused on product distribution and commission sales. Nothing has changed. As advisors, we must align our interests in a concerted effort to assure the expeditious emergence of the infra-



structure required for all advisors to declare their fiduciary status and fulfill their fiduciary responsibilities. If we wait for this support infrastructure to be provided by the industry, it could take us another 40 years. If we were to make a concerted effort, there is no reason why within the next 24 to 30 months we could not accelerate ready access to the enabling resources necessary for our fulfillment of our fiduciary responsibilities.

There are no trade associations that have fiduciary responsibility as a condition of membership, as it is in conflict with growing membership. Other than PowellJohnson, there are no advisor support firms that understand fiduciary responsibility and acknowledge the advisor's fiduciary status. An organization of advisors who are committed to the declaration of their fiduciary status and who have the courage of their convictions is needed to fill our industry's leadership vacuum in ways our supporting firms can't. Imagine, one or two thousand advisors, with a credible market presence of a trillion dollars or so, could literally reshape the course of the financial services industry by simply having the courage of their convictions to "do the right thing." By uniting with consumer advocacy groups, U.S. senators and congressmen, regulators, technical experts, money management executives and technologists who share our interest in the investing public's well-being, an eleemosynary organization could be created to foster the development of the enabling resources necessary for all advisors to fulfill their fiduciary responsibilities. The processes necessary to add value have been defined. Most of the technology exists, and that which doesn't, is in development. The only thing missing is consciously competent leadership which can only come from our industry's leading advisors. As financial advisors, it is within our power to reshape the course of the financial services industry by organizing, managing and successfully completing 12 major initiatives and enlisting the support of like-minded peers to adopt a professional standard for investment and administrative counsel based on fiduciary principles.

There are 12 major initiatives, which with success, we can assure all advisors the ability to declare their fiduciary status. These 12 initiatives will literally change the course of the financial services industry and will instill the faith and trust of the investor in our fiduciary counsel.

1. **Define professional investment and administrative counsel**, citing case law, statute, regulatory opinion letters and best practices for each of the ten major market segments of the individual (mass, retail, high net worth, ultra high net worth) and institutional (defined contribution, defined benefit, foundation and endowment, public funds, profit sharing, Taft Harley) investor

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markets, so that counsel can be managed and audited. This establishes a common level of granularity in best practices by defining process, procedure, work flow and task, so that technologies can be created to automate much of the disclosure and reporting detail associated with fiduciary responsibility. This not only reduces the labor intensity of fiduciary counsel but elevates the role and real-time counsel of the advisor far beyond what would otherwise be humanly possible (see "[What is Advice? High Net Worth Standards Initiative Publishes Asset/Liability Study Working Document](#)," *Senior Consultant*, March

2004, <http://www.SrConsultant.com/Articles/2004-03-What-Is-Advice.pdf>).

2. **Create a collaborative extranet site** which would solicit, by invitation only, the industry's leading technical experts to contribute their best thinking on best practices in addressing and managing the full range of investment and administrative values required by case law, statute and regulatory opinion letters. Emphasis will be on developing process, procedure, work flow and task on the 240+ functions that an advisor must perform in order to fulfill their fiduciary responsibilities. The first three such sites will be up at SrConsultant.com within 60 days and will be focused on best practices in

the foundation and endowment, defined contribution and high net worth market segments, building upon earlier research of our industry's most respected advisors who formulated best practices (see "[Elevating the Advisor's Counsel Beyond the Human Capacity to Reason](#)," *Senior Consultant*, April 2004, <http://www.SrConsultant.com/Society/TechBlueprint/TechBlueprint1.html>).

3. **Build support** from Congress, consumer advocacy groups and regulators for the creation of a universal communication protocol that would facilitate the free flow of client-permissioned information among all custodians. This makes it possible for advisors to provide continuous, comprehensive counsel implied by regulatory mandate and literally makes it possible for advisors to add

value. Only when one can make a recommendation in the context of a client's holdings is it possible to determine if the recommendation improved overall portfolio return, reduced overall portfolio risk or enhanced the tax efficiency, liquidity and cost structure of all the client's holdings as an investment portfolio. This creates much more accurate and reliable investment information, greatly reduces the cost of account aggregation and makes relevant a new generation of real-time, web-based analytical tools that greatly elevates the role and counsel of the advisor (see "[DTCC Fills Technology Leadership Vacuum](#)," *Senior*



Consultant, December 2003, <http://www.SrConsultant.com/Articles/2003-12-DTCC-Tech-Leadership.pdf>).

4. **Advocate and build support for the development and adoption of electronic wizards** to manage as much portfolio detail as possible, particularly in disclosure and reporting, that lends itself to automation. By virtue of an advisor working within the context of a process that automatically manages a high level of portfolio detail, much of the labor intensity of fulfilling our fiduciary responsibility has been mitigated. Working with SrConsultant.com and the Center for Fiduciary Studies, ActiFi has created a series of self-evaluation tools which will help us understand what area of our counsel might need more attention in the fulfillment of our fiduciary responsibilities. This is the precursor to using wizards to actually manage elements of our counsel. There are at least 240 elements of our counsel that are required in order to fulfill our fiduciary responsibility. ActiFi will be rolling out the first series of wizards later this fall.

5. **Advocate and build congressional, regulatory, and consumer advocacy support for the democratization of advisor access to investment policy capability.** Investment policy statements with legal opinions that confirm compliance to the appropriate regulatory authority make our compliance with our fiduciary responsibilities more manageable. Every element of investment policy should have a well-documented audit trail going back to statute, case law, regulatory opinion letters or client directive to assure our fiduciary status. Investment policy manages and minimizes fiduciary liability and makes it possible for NASD member firms to acknowledge our fiduciary status by being able to effectively manage fiduciary liability.

6. **Advocate and facilitate the development of gating technology** which ties investment policy and all the investment and administrative values cited in investment policy to portfolio management technology (sub-accounting, trade and order routing and reporting) so all trades which take a portfo-

lio outside of compliance with investment policy will be electronically suppressed and managed by exception. This empowers the financial advisor to manage a very large number of custom investment portfolios in compliance with each individual investor's unique requirements as defined by custom benchmarks established within the investment policy. This makes investment policy an important portfolio management tool (see "[BullRun Financial Makes a Multi-Generational Leap in Portfolio Construction Technology](http://www.SrConsultant.com/Articles/2002-05-Bullrun-Financial.pdf)," *Senior Consultant*, May 2002, <http://www.SrConsultant.com/Articles/2002-05-Bullrun-Financial.pdf>).

7. **Advocate and facilitate the utilization and adoption of advanced post-modern port-**

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[HTTP://WWW.SRCONSULTANT.COM/REGISTER/REGFORM.HTML](http://www.srconsultant.com/register/regform.html)

folio theory investment tools. It is possible to tell a client in real-time how and why a portfolio is performing, citing the specific values and metrics most important to the client as established in investment policy. A default overlay management mechanism can even be established that follows a pre-approved, rules-based investment methodology so that the advisor looks good relative to the client's custom benchmark, even when they are not able to be as vigilant as possible. This removes the fear that advisors may not be capable of adding value in providing high level counsel. The overlay management function can be outsourced or actually run and managed in-house by supporting NASD member firms (see "[Overlay Management: The Whole Product Solution](http://www.SrConsultant.com/Articles/2002-11-Overlay-Management.pdf)," *Senior Consultant*, December 2002, [http://www.SrConsultant.com/](http://www.SrConsultant.com/Articles/2002-11-Overlay-Management.pdf)

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8. **Advocate an industry definition of best execution** that resolves the cultural conflict between commission sales (as a profit center) and fee-based counsel, viewing it as a cost center (see "[The Third Rail of the Financial Services Industry: Trade Execution, Best Execution, and Beyond](http://www.SrConsultant.com/Articles/2004-07-Third-Rail.pdf)," *Senior Consultant*, July 2004, <http://www.SrConsultant.com/Articles/2004-07-Third-Rail.pdf>).

9. **Advocate, identify and develop outsourced postmodern portfolio theory investment methodologies** that alleviate the concern that advisors are not particularly adept at portfolio construction. This places the advisor on the same level of investment counsel as the industry's leading private banks (see "[Investment Methodology, the Holy Grail of Consulting](http://www.SrConsultant.com/Articles/2001-09-HolyGrail.pdf)," *Senior Consultant*, September/October 2001, <http://www.SrConsultant.com/Articles/2001-09-HolyGrail.pdf>).

10. **Develop a series of business models at various asset levels that require varying technology, staffing and capital commitments**, so advisors better understand the management dynamics of building an advisory services business. This interjects a practice management discipline that greatly enhances operating efficiencies and career opportunities for supporting staff functions, while providing an understanding of how practices evolve to a higher level of counsel and larger asset base. Outsourced technical resources that provide expertise and assistance – such as the Center for 401(k) Due Diligence for 401(k)'s and Champion Partners for foundations – will be delineated, so high level counsel for every market segment is cost-effective and within the reach of all (see "[How Are Top Advisors Growing Their Business In A Difficult Market?](http://www.SrConsultant.com/Articles/2003-04-Top-Advisors-Grow.pdf)" *Senior Consultant*, April 2003, <http://www.SrConsultant.com/Articles/2003-04-Top-Advisors-Grow.pdf>).

11. **Develop a client interview, associated questionnaire, investment policy statement and marketing material** which empowers the financial advisor to clearly

and powerfully articulate the full range of values they address and manage. This establishes a training construct that empowers the advisor to address and manage the full range of investment and administrative values required by regulatory mandate.

12. **Develop prototypical job descriptions and an associated training/symposium/conference discipline** for the three key positions in a practice where a division of labor is likely to occur (chief executive officer, chief investment officer, chief administrative officer). Rigorous professional certifications will be granted, acknowledging competency, and a highly skilled, credentialed labor pool will emerge built around proven business models which is essential for the industry to emerge as a profession. Continuing education will not be viewed as a profit center or as a platform for vendors, but as a legitimate means to elevate the effectiveness and productivity of advisory services.

By it becoming economically viable for advisors to have direct access to these innovations and resources in a highly usable form, we will have democratized access and will have greatly elevated the role, the counsel and professional standing of the advisor.

We have been greatly encouraged by consumer advocacy groups, U.S. senators and congressmen who are active in financial services reform and money management executives who see their interests being well-served by advisors acknowledging fiduciary status, to create a new ecumenical advisor organization committed to the creation of the infrastructure necessary for an advisor to fulfill their fiduciary responsibility and declare their fiduciary status. Over the coming weeks, we will be putting together a very active board of directors of leading advisors, industry executives and consumer advocates to organize the Society of Fiduciary Advisors and on October 5th will be formally announcing in Washington, D.C. its formulation. This coincides with the date the SEC will require a Code of Ethics and a declaration of our fiduciary status.

This is a historic moment within the financial services industry. Forty years and many successive generations of innovation have taken us to this point. A few thousand consciously competent advisors with the courage of their convictions to do the right thing will provide a path that will help the industry find its way again. Your legacy will be that you played an active role in pioneering fiduciary counsel and reshaping the course of the financial services industry around fiduciary principles. All advisors, whether they be consultants, planners, brokers, trust officers, portfolio managers, CPA's or estate attorneys, are unified as an ecumenical group with a common goal – the fulfillment of our fiduciary

obligations and the emergence of our investment and administrative counsel as a profession, instilling the highest level of investor trust and confidence. This is only possible if we, as advisors, have the courage of our convictions to do the right thing and expend the time, the effort and the resources to do the often thankless task of providing leadership when it is needed. This is why the membership ranks of the Society of Fiduciary Advisors will be comprised of industry leaders.

Theodore Roosevelt once said, "It is not the critic who counts: not the man who points out how the strong man stumbles or where the doer of deeds could have done better. The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood, who strives valiantly, who errs and comes up short again and again, because there is no effort without error or shortcoming, but who knows the great enthusiasms, the great devotions, who spends himself for a worthy cause; who, at best, knows in the end, the triumph of high achievement, and at the worst, if he fails, at least he fails while daring greatly, so that his place shall never be with those cold and timid souls who knew neither victory or defeat."

We all stand on the shoulders of giants who have preceded us, and it will be upon your shoulders that future generations will stand. Those who came before us have strived valiantly within the limits of their resources and the technology available to incrementally advance by trial-and-error the level of counsel we provide. It is a high honor that our generation of advisors will see the promise of fiduciary counsel to its fruition. Your leadership and support will literally reshape the course of the financial services industry. Everyone has an important role to play. There is no shame in not being able to declare fiduciary status. The shame is in not wanting to. The Society of Fiduciary Advisors is the means by which leading advisors, technical experts, technologists, legislators and consumer advocates will advance innovation and adoption of fiduciary counsel in ways not possible within our supporting firms or with existing trade associations. With 70,000 readers, I cannot personally call each of you, but if you share our passion and aspiration that our counsel would command the highest level of investor trust and confidence, please hit the following link: <http://www.SrConsultant.com/Register/RegForm.html>. If you want to declare fiduciary status, if you want to do the right thing, if you want to be a leading advisor within the industry in the counsel you provide, you are just a [mouse click away](#). ■

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