



Open Letter To The Department of Labor And SEC: Markets Deserve Clarification On The Duty Of Care

The ongoing debate over the Fiduciary rule has arguably done more to raise awareness than the actual rule itself ever will. Just look at the [increased attention](#) paid to “fiduciary duties”. Sunlight is the best disinfectant, and this scrutiny should naturally help curb many of the conflicted practices that violate the Duty of Loyalty.

The Duty of Care, on the other hand, could use a little more sunlight. Many throughout the industry are still unclear as to how to fulfill the Duty of Care. This uncertainty, at least in part, is behind opposition to the rule.

We welcome the SEC’s request for comment on the fiduciary rule and hope to see both the SEC and DoL work together to refine the fiduciary rule in a way that improves access to high-quality advice for all investors.

The first order of business should be to place a higher priority on defining the “Prudent Man” standard underpinning the Fiduciary Duty of Care.

What Would A Prudent Man Do?

The DOL has been quite vague in its comments about the Duty of Care. The only recent reference we found is in the [most recent FAQ](#), where it cites the [Prudent Man standard](#), which states that a fiduciary will act

“with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”

This hypothetical “prudent man” represents an impossibly vague standard for advisors and investors. Cases such as [GIW Industries, Inc. v Trevor, Stewart, Burton, & Jacobsen Inc.](#) and [Donovan v. Mazzola](#) have brought a little clarity to the concept, but much ambiguity remains.

As financial planning expert Michael Kitces wrote in January of this year, this ambiguity raises the possibility for [damaging class action lawsuits](#) under the current regulation. Defining prudent advice or investment recommendations has never been done before, but if there were ever a time to do it, it is now.

We propose the DoL and SEC start by requiring that all investment recommendations be backed by research that meets the following criteria. How can anyone argue that investment research should not be:

- **Comprehensive.** It should reflect all relevant publicly available information (i.e. all 10-Ks and 10-Qs), including the footnotes and MD&A.
- **Objective.** Investors deserve unbiased research.
- **Transparent.** Investors should be able to see how the analysis was performed and the data behind it.
- **Relevant.** There must be a [tangible, quantifiable connection](#) to investment performance.

The average client would probably be surprised to learn that these criteria are not already required for investment research.

Diligence Matters

Due to increasing complexity and length of annual and quarterly financial reports, meeting these criteria requires a focused effort and, perhaps, significant changes in the way research are created by most firms.

Recent advances in machine learning and cloud computing have opened the door to [technology](#) that can produce the research investors deserve. That said, the proliferation of this technology faces challenges from the very nature of the investment advice business and the endemic conflicts of interests it has with clients.

Consequently, leadership from the SEC and DoL on the prudent man front is just as important to the integrity of the capital markets as it is for the duty of loyalty. Clearer guidelines would help wealth managers and regulators with compliance and reassure investors that they are getting value for their fees. The DoL and SEC have an opportunity to give meaningful clarity to the investment community. We hope they do so.



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Disclosure: David Trainer and Sam McBride receive no compensation to write about any specific stock, sector, style, or theme.

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To fulfill the Duty of Care, research should be:

1. **Comprehensive** - All relevant publicly-available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including footnotes and the management discussion & analysis (MD&A).
2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide [tangible, quantifiable correlation](#) to stock, ETF or mutual fund performance.

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