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7 Best Practices For Wealth-Managing Fiduciaries

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As the U.S. Department of Labor has tried to issue regulations for financial professionals who give retirement advice, and the U.S. Securities and Exchange Commission has previously taken a similar stance for financial advisers under their jurisdiction, the debate over who in the financial services industry should be required to act as a fiduciary has been getting more intense.

It's a contentious issue to be sure, but whether you are charged with managing someone else's wealth as a trustee, an executor or a financial adviser operating from a fiduciary perspective, having the client's needs come first is always paramount. Here are some thoughtful best practices for any wealth-managing fiduciary.

Suitability: Asset Allocation and Investment Recommendations

Perhaps one of the first aspects that a fiduciary should address is the suitability of the investments they recommend. The adviser should be in a position to understand all aspects of the client's financial situation, including their or the entities' liquidity needs and risk tolerances. That understanding needs to come from more than a brief questionnaire that asks simplistic, open-ended questions like, "How would you feel in a real market meltdown?"

In theory, that inquiry makes sense, but in the real world, the last substantial financial crisis is almost 10 years in the past and the substantial gains from our long-running bull market has clouded the perspective of many investors.

What suitability means to me, as a fiduciary, is asking people the right questions and then coming back to them with a specifically designed investment and asset allocation recommendations that are in their best interests.

Transparency Into Fees and Business Practices

When it comes to acting as a fiduciary, your business practices should be transparent. This approach can potentially be problematic for financial advisers operating as brokers within their practices. Because they are not required to put their client's best interest before their own interests when giving advice, brokers may choose not to disclose their compensation within certain transactions.

Operating as a fiduciary who embraces transparency means full disclosure of all fees, whether they are advisory fees or any other cost associated with portfolio construction and management. Are certain fees absorbed by the adviser team? Are other costs passed through to client portfolios? These are all questions that would be answered before beginning the fiduciary/client investor relationship.

Constructing an Investment Policy

An investment policy statement (IPS) is a crucial tool that fiduciaries use in structuring investment portfolios for clients. The IPS outlines the client's general goals and objectives and describes the strategies the adviser should use to achieve those objectives. And although an IPS may be constructed at the beginning of the adviser/client relationship, it is by no means a "set it and forget it" document, but a living, breathing entity that needs to be updated as the client's situation changes or the market shifts.

A fiduciary wants to give clients the most suitable advice, and having this guideline in place can help keep the adviser focused on what will best meet the client's goals and objectives, and will help determine when it's time to make a change.

Fee Structure

Probably the biggest differentiator between a fiduciary and a broker (either of whom may call themselves "financial advisers"), is how they get paid. A fiduciary adviser is compensated for the advice they give, either on an hourly basis or as a percentage of the assets they manage. It's hard, if not impossible, for someone who earns commissions selling financial products to truly act as a fiduciary. If your income is dependent on what you can sell, there's a real incentive to put your own interest, or those of your employer, ahead of the client. A fiduciary should be on the same side of the table as the client, doing everything they can to preserve and grow the capital that's been entrusted to them.

Sell Advice Not Investments

This goes hand-in-hand with the previous item. Quite simply, fiduciaries who manage wealth should not have a business model that relies on selling investment products. That's not to say there aren't one-off opportunities that come up — this is more about firms that design products to first help their own company's balance sheet instead of their clients'.

Don't Participate in Pay to Play

One of the ways that mutual funds and other asset managers pay brokerage firms for their services is through what are known as "soft dollars." A fund might pay for the research of a brokerage firm by executing trades based on that research through that firm's platform via an arrangement where, for example, if the broker executes $100,000 worth of trades they receive the research for free rather than paying a hard dollar fee of say, $50,000 for it. If that's why the trade is being executed, is that really in the client's interest?

Avoid Conflicts of Interest

The most basic rule is, if an action could be construed as representing a conflict of interest, avoid it like the plague. For example, an independent financial adviser working as a fiduciary may potentially bring in outside money managers to manage an allocation within an investment portfolio, pursuant to the mandate of that manager's specific area of expertise. These outside money managers should have a financial relationship of absolutely zero with the adviser's platform. The fiduciary adviser should continuously be conducting due diligence on the entire universe of money managers within every asset class so that they can make independent decisions on where they will allocate capital — not simply working with a money manager who may or may not have a financial relationship with their firm.

At its core, being a fiduciary means adhering to the golden rule — treat your clients the way you want to be treated. An adviser who subscribes to that philosophical precept is likely to have more satisfied clients and fewer hassles from regulators, making it the epitome of a win-win situation.

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