SPOTLIGHT ON ETHICS

A Modest Proposal for Wealth Managers: Do No Harm

By Scott Welch, CIMA®
A MODEST PROPOSAL FOR WEALTH MANAGERS

First Do No Harm

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In A Modest Proposal, written in 1729, the noted Anglo-Irish satirist Jonathan Swift suggested that the impoverished Irish could ease their economic troubles by selling their children as food. He went so far as to suggest, “A young healthy child well nursed is, at a year old, a most delicious nourishing and wholesome food, whether stewed, roasted, baked, or boiled; and I make no doubt that it will equally serve in a fricassee, or a ragout.”

Today’s market environment can be confusing, because advisors and clients alike are being inundated with issues concerning evolving regulatory, fiduciary, and ethical standards. In addition, there is information overload via a 24/7 news and social media environment. On an unfortunately too-frequent basis the industry media report cases of advisor fraud, malfeasance, or inappropriate sales practices. As a result, many wealth advisors may find themselves impoverished with respect to their clients’ trust.

Consider some of the market events of the past 20–30 years: the market collapse in 1987 following the systemic failure of portfolio insurance; the market chaos of 1997–1998 following the “Asian Contagion” and the collapse of Long-Term Capital Management; the research analysts’ scandal and the bursting of the tech and telecom bubbles in the early 2000s; and the 2008 Great Financial Crisis (GFC)—a nice euphemism for the total collapse of global markets, the destruction of trillions of dollars of personal net worth, the apparent failure of asset allocation and the diversification it preaches, the ostensible failure of a long-practiced buy-and-hold investment philosophy and, perhaps worst of all, the moral failure represented by the repugnant scandals involving Bernie Madoff, Arthur Nadel, Allen Stanford, and others.

This perfect storm of events created a crisis of confidence among investors. Simply put, many investors no longer trusted their wealth management professionals. Instead of addressing the long-term financial objectives of their clients, many advisors found themselves defending against the accusation, “Prove to me you are not Bernie.”

Ten years later, a central bank–fueled bull market may have eased the painful memories of the GFC, but investors and advisors now have to deal with digital advice platforms and the corresponding commoditization of investment advice, as well as confusing industry regulations and language regarding “fiduciary standards,” “advisors versus brokers,” “best interests versus suitability,” “DOL,” and on and on. Now more than ever, earning and maintaining a client’s trust is the key to delivering a differentiated wealth management experience.

How, then, do wealth management professionals go about earning their clients’ trust? Should they adopt a Swiftian solution and fricassee their junior analysts or turn their baby bankers into a “delicious ragout”?

Tempting perhaps but, fortunately, no.

SOLVING THE TRUST PROBLEM

The trust problem we are trying to solve stems from industry-inherent conflicts of interest, such as selling proprietary products or the more insidious agent–fiduciary paradox—the conflict faced by all wealth managers who are

1. hired by their clients as fiduciaries under an assumption that they will always act in the clients’ best interests, but
2. are paid and rewarded as agents by their employers for bringing assets into their firms or selling revenue-generating products and solutions.

One way to minimize the effects of the agent–fiduciary paradox is to engage in what can be referred to as the triangulation of advice. Simply put, this concept suggests that potential conflicts of interest are minimized if

1. financial advice comes from one provider, who is compensated only for that advice (the wealth manager);
2. the investment solution set comes from independent third parties or asset managers (i.e., no proprietary product); and
3. client assets are held by an independent custodian.

Although it is impossible to fully remove all conflicts of interest, the triangulation of advice does more closely align the interests of the clients with those of service providers, because those service providers profit only if they deliver satisfactory and appropriate services and advice.
Another useful framework for addressing the trust issue is presented by industry consultant Charles Green (http://www.trustedadvisor.com), who offers the following “trust formula”:

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\text{Trust} = (\text{Credibility} + \text{Reliability} + \text{Intimacy}) / \text{Self-Interest}
\]

This simple formula nicely captures the agent–fiduciary paradox. The numerator highlights the positive aspects of the wealth manager as a fiduciary provider of advice, and the denominator highlights how trust is diminished by agency conflicts of interest.

A modest proposal that builds on this trust formula calls for wealth advisors to go on a “trust offensive” and adopt as a standard part of their practices a wealth management version of the medical profession’s Hippocratic Oath.

A modern version of the Hippocratic Oath includes the following:\(^5\)

1. I will teach medicine to the sons of my teacher;
2. I will practice and prescribe to the best of my ability for the good of my patients, and to try to avoid harming them;
3. I will never do deliberate harm to anyone for anyone else’s interest;
4. I will avoid violating the morals of my community;
5. I will not cut for stone, even for patients in whom disease is manifest; I will leave this operation to practitioners, specialists in this art;\(^6\) and
6. I will keep the good of the patient as my highest priority.

Implement a quick find-and-replace of the word “patient” with the word “investor” or “client” and this oath serves as a surprisingly powerful start to building and maximizing client trust.

So what might a Wealth Management Hippocratic Oath look like? Here is one suggestion:\(^5\)

1. We will fully educate and inform our clients with respect to what is in their investment portfolios, and why.
2. We will define for our clients precisely what our responsibilities are with respect to our wealth management relationship.
3. We accept full accountability and responsibility for the wealth management advice we provide.
4. We will acknowledge and explain to our clients any agent–fiduciary conflicts we have in serving our clients, and we will explain up front how we will manage that conflict over the life of our relationships.
5. We agree up front to full transparency and full disclosure in all aspects of our client relationships—including how we get paid and any and all conflicts of interest inherent to our relationships.
6. Our clients will know how they are invested and where their assets are held.
7. We will agree with our clients up front about what constitutes a successful relationship, including clearly measurable objectives and metrics for evaluating progress toward those objectives.
8. We will define specifically the service model our clients can expect, including a. the team b. services provided c. deliverables d. fee structure e. communication frequency.
9. We will act morally, ethically, and legally at all times.
10. We will not deliberately act against the wealth management interests of our clients, and we will keep our clients’ wealth management health as a high priority.

A Wealth Management Hippocratic Oath that addresses the collective issues of credibility, reliability, intimacy, and conflict will go a long way in creating a trusting, collaborative relationship between advisor and client.\(^6\)

No wealth advisor can control market performance, and no wealth advisor can control the behavior—moral or otherwise—of other professionals in the industry. But it is imperative that we embed explicitly into our practices the acknowledgment and understanding that the foundations of our clients’ trust must be constantly addressed, upheld, and maintained.

This modest proposal for a Wealth Management Hippocratic Oath will not solve all that ails the industry. But a simple, clear, and comprehensive declaration to our clients that we know there is an issue, that we know we must work constantly to address that issue, and that we pledge to do everything in our power to build and maintain trust is an appropriate—and critical—first step.

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ENDNOTES

4. In other words, I will not attempt to do things beyond my training capability but will instead bring in appropriate specialists.
6. A similar “Code of Professional Responsibility” is available to the public on the website of the Investments & Wealth Institute, of which the author is a member of the board of directors: https://investmentsandwealth.org/ethics-standards/know-the-code.

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