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Fostering Trust Between Client And Fiduciary

By **Stuart Riemer** (March 23, 2018, 12:16 PM EDT)

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The bedrock of any honorable personal or professional relationship is trust. This is particularly true when we're talking about a professional relationship between a fiduciary, such as an attorney or a financial advisor, and a client. Unfortunately, trust in and amongst the U.S. population is pretty much at an all-time low. The 2018 Edelman Trust Barometer currently reports that the public's inability to easily identify the truth has destroyed their faith in media, government leaders and business.

Faced with this prevalent attitude, how does an attorney, financial advisor or CPA develop the level of trust that cultivates an environment where their clients are comfortable authorizing discretion over their hard-earned investable assets? It's certainly not an area where I would suggest taking a leap of faith.

What is an Investment Policy Statement?

One way to help establish the requisite trust that an advisor will take fiduciary care with your assets is to create an investment policy statement (IPS). This document represents an agreement between an investor and a wealth manager that outlines an investment framework for the manager to implement as they invest the assets they've been entrusted with. It's a document that can require significant forethought and collaboration between the client and the investment fiduciary.

Let's look at how this works in practice using an example from the fixed income portion of a typical investment portfolio. Initially the IPS tells the money manager what kinds of bonds he or she can buy, including specifics on acceptable credit rating, duration, and maturity for the position. This would be considered "pre-trade" compliance with the IPS. "Post-trade" the manager should continuously rely on the IPS as he or she monitors the portfolio to ensure that the bond remains in compliance with the parameters set forth at the outset. If, for example, the credit changes and the bond no longer fits within the guidelines of the IPS, the manager should have two options. The first is to simply sell the bond, since he or she has the discretion to do so, or if that doesn't seem the best course of action, after consultation with the client the IPS can be modified to reflect the change in circumstances.

The beauty of the investment policy statement is that it provides a level of assurance to the client regarding exactly how the manager will invest their money and outlines for the manager exactly what kind of risk and investments the client can tolerate. A fiduciary wants to give clients the most suitable advice and having these guidelines in place, can help keep the advisor focused on what will best meet the client's goals and objectives, and will help determine when it's time to make a change.

Asset Allocation Guidelines

Among the information contained in the IPS can also be overall asset allocation guidelines for the investment portfolio. These guidelines attempt to balance risk and reward by considering each client's unique goals along with their risk tolerance and investment timeline.

For example the IPS might set asset allocation guidelines that call for the portfolio to always contain between 20% and 40% fixed income and between 30% and 70% equities, with the remainder in cash or cash equivalents. Within those general parameters, it would also consider subsets of those asset classes such as U.S. large cap equities, emerging markets or municipal bonds and where they would fit. By adhering to the procedures outlined in the policy statement, the wealth manager can exercise discretion and still remain in compliance, both pre- and post-trade.

Clear Communication on Process

In drawing up the IPS the fiduciary will be able to explain the process used for investment manager selection, the difference between active and passive management as well as their overriding investment philosophy and how they approach changes in the investment market.

And although an investment policy statement is best drawn up at the onset of a fiduciary relationship, it's not carved in stone, but rather as a living, breathing document that evolves according to fluctuations in the market and the client's life changes. At the same time, it shouldn't be revised too often because that can disrupt the long-term plan.

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The IPS helps lay the foundation for a relationship built on trust, but ideally it's only one component of a holistic financial planning and wealth management program. The way for the fiduciary to build upon that initial trust is to be completely transparent and maintaining regular lines of communication with the clients.

Moving Forward

In my own practice, we rely on what we call the 12/4/2 model. That means every client is entitled to 12 monthly performance reports, four quarterly portfolio review calls and two in-person meetings each year. The reports demonstrate that the wealth manager is adhering to the IPS and reflect any discretionary changes that have been made to keep the portfolio compliant. Then, in the quarterly calls and face-to-face meetings, the manager and the client will discuss any life changes the client is experiencing and determine whether the IPS and portfolio should be updated to reflect them.

Having an investment policy statement can reassure the client that their assets will be safe despite the fiduciary wealth manager having discretion over the portfolio. This allows the manager to react nimbly when the market shifts suddenly because they already know what the client wants them to do in such a situation.

When properly constructed and adhered to faithfully, an investment policy statement can protect both the client and the adviser, and goes a long way toward fostering a relationship built on mutual trust and respect.

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