FIDUCIARY CONDUCT AND YOUR REPUTATION

What's Trust Worth As An Investment Advisor?

Written by
Blaine Aikin, Executive Chairman Fi360 and CEFEX
AIFA®, CFA, CFP®

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Warren Buffet famously said:

"We can afford to lose money,
even lots of money.
**But we can't afford to lose reputation,
even a shred of reputation.**

A company's (or a person's) reputation is a measure of how others perceive their quality and character. It is the consensus opinion of whether that company can be trusted. A great reputation can take years to acquire and constant attention to protect. It is often a company's most valuable asset, especially if the firm's core business is professional advice. But reputations can be fragile. A company whose reputation takes a hit may never recover.

Every company in every industry either benefits from or is dogged by the reputation it has earned. Investment advisors must be perceived as trustworthy. Without trust, there is no basis for an advisory relationship and the business cannot exist.

This white paper for investment advisors covers four key points. First, reputation is an advisor's most valuable asset. Second, your business success is largely a matter of intentionally building, protecting and promoting your reputation. Third, there are specific factors, grounded in fiduciary principles, that advisors can manage to build a great reputation. Finally, by building a great reputation, you benefit your business, the profession and your clients.

BACKGROUND

The connection between professional reputation and fiduciary conduct

"Fiduciary" is a legal construct that sets high expectations for the conduct of professionals. Practitioners of professions that have strong conduct standards (medicine, law, etc.) are, as a group, highly regarded by society for the special skills they have acquired and the ethical obligations attributed to their profession. These professions are held in high public esteem and practitioners enjoy the presumption of being ethical and competent.

But the reputational advantage of being in a respected profession can mean that misconduct is met with special scorn. The asymmetry of knowledge between professionals and their clients creates inherent vulnerability of the layperson to the actions and advice of the professional. Violations of trust – fiduciary breaches – can lead to the most egregious forms of abuse, the Bernie Madoff scandal being a case in point.

Isolated incidents of professional misconduct largely confine reputational damage to those directly associated with the violator. However, systemic abuse by practitioners and those closely associated with the field inevitably damages the reputation of the profession itself. Thus, fiduciary responsibility is much more than a legal construct. It is inextricably tied to the reputation of a profession and its practitioners.

Unfortunately, the occupation of investment advisor does not meet the attributes generally required to be recognized as a classic profession.[1] Investment advice is commonly considered to be subsumed under the **"financial services industry"** moniker. The distinction between fiduciary advice as a professional endeavor and product distribution as a sales endeavor is neither recognized nor understood by the public.

Without the benefit of public recognition of investment advice as a distinct and respected profession, investment advisors must build their reputation from the ground up. But that task is made even more challenging by the poor public reputation of the financial services industry at large. According to the **2018 Edelman Trust Barometer**[2] the financial services industry is the least respected of all industries included in the survey, a position it has occupied for many years. Barely 50 percent of respondents believe financial services companies can be counted upon to "do the right thing" in their decision-making.

[1] Generally recognized attributes of a profession include: 1. Public service orientation. 2. Code of conduct that requires clients' best interests to be served. 3. Defined body of knowledge (competency standards). 4. Governmental and/or professional sanctioning authority. 5. Pathway to the profession (academic and experience requirements)

[2] 2018 Edelman Trust Barometer https://www.edelman.com/trust-barometer

HOW MUCH IS A REPUTATION WORTH?

Reputation-building isn't easy, but it is worth the effort. A company's reputation affects customers' purchasing decisions and impacts corporate value. Consequently, reputational value has been the subject of considerable study, leading to quantification at the firm level and the development of models that capture the factors influencing value.

Charles Fombrun is a co-founder of Reputation Institute and former professor at New York University Stern School of Business and The Wharton School, who is contributing to the body of knowledge in this area. Fombrun notes that **"our purchasing decisions are governed by two factors:** our perceptions of the features of the products or services we are interested in buying, and our perceptions of the companies that stand behind them." While marketing has typically focused on the features of products and services, it turns out that company reputations are likely to be more important. Citing an interesting example of doctors' prescription behaviors, Fombrun explained that,

> **Research conducted by Reputation Institute in various countries confirms that perceptions of pharmaceutical companies drive physician behavior significantly more than their perceptions of the products those companies are marketing.**[3]

The power of reputation to influence purchasing decisions implies pricing power. Research supports this conclusion. For example, an academic experiment conducted in 2006 compared eBay auction purchases from sellers with established positive reputations versus purchases of the identical products that those same sellers posing as newcomers offered on directly comparable new websites (i.e., the only difference was having no established reputation). The "reputable sellers" earned a price premium of over 8 percent.[4]

Evidence also shows that reputation is a key contributor to corporate value, and often the most important contributor to value. Consulting firm Booz & Company Inc. publishes an annual **"US Reputation Dividend Report"** based upon Reputation Value Analysis to highlight the importance of reputation management and factors that influence reputational value.[5] Recent findings indicate that over **20 percent** of shareholder value (market capitalization) in S&P 500 firms is accounted for by reputation. The contribution varies widely by firm and industry and can exceed **50 percent** of shareholder value.

[3]The Real Value of Reputation by Charles J. Fombrun and Jonathan Low https://www.iabc.com/wp-content/uploads/2014/10/The-Real-Value-of-Reputation.pdf

[4]THE VALUE OF REPUTATION ON EBAY: A CONTROLLED EXPERIMENT by Paul Resnick , Richard Zeckhauser, John Swanson, and Kate Lockwood https://sites.hks.harvard.edu/fs/rzeckhau/PostcardsFinalPrePub.pdf

[5]The 2017 US Reputation Dividend Report http://reputationdividend.com/files/9415/0048/5298/US_2017_Reputation_Dividend_Report.pdf

WHAT ARE THE LEVERS TO PULL TO ENHANCE REPUTATIONAL VALUE?

As previously discussed, trustworthiness is essentially synonymous with the professional advisor's reputation. Therefore, factors that influence the perception of trustworthiness are drivers of reputational value.

"The Trusted Advisor", a book by David Maister, Charles Green and Robert Gaiford, provides an actionable model of the drivers of trust known as the **THE TRUST EQUATION**.[6]

TRUSTWORTHINESS

=

CREDIBILITY

+

RELIABILITY

+

INTIMACY

÷

SELF-ORIENTATION

The factors of this equation are described on the following page.

[6]"The Trusted Advisor", a book by David Maister, Charles Green, and Robert Gaiford

CREDIBILITY

Demonstrated or verified competence and quality

RELIABILITY

Demonstrated diligence in the performance of responsibilities and fulfillment of commitments

INTIMACY

Strength of the professional relationship

SELF-ORIENTATION

Ability and propensity of the advice-provider to subordinate the advice-recipient's interests to the interests of the advice provider

Note that the four factors in this model of trustworthiness relate to the two fundamental fiduciary duties of care and loyalty. Credibility and Reliability are associated with care; Intimacy and Self-orientation relate to loyalty.

The equation treats Credibility, Reliability and Intimacy as additive positive influences on trustworthiness. Self-orientation is a detractor. Dividing the sum of positive factors by a Self-orientation score dramatically decreases trustworthiness.

The authors caution that

> "The equation should be treated as a framework for looking at the topic, and not as a scientific calculation.

They illustrate an example using a 1 to 10 scale for each of the four factors but invite the reader to apply any scale that might seem more appropriate.

Our view at Fi360 is that the Self-orientation scale should be narrow, perhaps even binary (either a 1 or 2). As a detractor and denominator, a 1 would indicate that trustworthiness is not diminished by self-serving conduct. The advisor avoids conflicts of interest when possible and managing unavoidable conflicts in a manner that serves clients best interests. A 2 serves to halve the collective value of the positive factors because the advisor subordinates (or is perceived to subordinate) clients' interests to the advisor's own interests. A binary scale imposes a heavy penalty for self-serving conduct and reflects the reality that clients either believe you place their interests first or they don't, and as soon as they don't, they are highly likely to leave.

As mentioned in the **Background** of this paper, recognized professions like law and medicine have strong sanctioning authorities (government regulators or self-regulatory organizations) to govern the conduct of practitioners. This increases the willingness of advice-recipients to trust advice-providers and knowingly make themselves vulnerable to the influence of the professional. The lack of a strong, consistent and enforced fiduciary standard to hold practitioners accountable in the field of financial advice places added pressure on practitioners to demonstrate evidence of their trustworthiness. The public reputation of the financial services industry is a drag on the reputation of financial advisors.

PULLING THE LEVERS

What financial advisors can do to build a great brand

Based upon

THE TRUST EQUATION

and fiduciary principles, we offer suggestions about what you can do to build a great brand by taking action to enhance:

CREDIBILITY

RELIABILITY

&

CLIENT-CENTRIC BEHAVIORS

CREDIBILITY

Credibility involves demonstrated or verified competence, quality and professionalism in your daily interactions. Credibility with clients and prospective clients is essential and the focus of our discussion here, but interactions with others – colleagues, members of the media, friends, family and members of the public – are also important. A great reputation is built on the totality of how you are perceived in both work-related and non-business interactions. None of the factors involved in establishing an excellent reputation are situational.

The authors of "The Trusted Advisor" called attention to another important aspect of credibility, stating:

"

Credibility isn't just content expertise. It's expertise plus **'presence,'** which refers to how we **look, act, react,** and **talk about our content...** we must find ways not only to be credible, but to give the client the sense that we are credible.

The following are our **TOP THREE** suggestions to build credibility:

01.

Develop content expertise and earn designations to demonstrate content mastery.

A. FIDUCIARY

i. AIF® Designation - Investment fiduciary responsibilities substantiated in law, regulations and best professional practices (prerequisite for AIFA® Designation).

ii. AIFA® Designation - How to conduct fiduciary assessments to help other investment fiduciaries, including institutional clients, navigate their own fiduciary duties and achieve recognition for conformity to fiduciary standards.

B. FINANCIAL PLANNING: CFP®

Most respected and comprehensive financial planning designation.

C. INVESTMENT ANALYSIS AND MANAGEMENT: CFA

Most respected and comprehensive designation for portfolio managers, financial analysts and financial advisors who delve deeply into investments and investment strategies.

D. Consider other specialized designations in areas where you focus your business; research your options and select the most credible designation in the field.

02.

Practice what you learn to retain and deepen your knowledge and embed professional practices in the way you do business with clients.

A. Be a practicing fiduciary, not just a knowledgeable one.

B. Say what you do, do what you say, and make sure your marketing matches both; otherwise your credibility will suffer. For example, if you market yourself as a financial planner, be a CFP® professional and make the financial planning process central to your client relationship model.

C. Specialize your work and develop expertise in areas you are passionate about such as retirement plans/planning, foundations and endowments/charitable giving, impact investing/sustainable and responsible investing, etc.

03.

Develop your professional presence to gain confidence and improve your communication skills

A. Write for trade and other publications; blog; contribute to professional online commentary sites; write white papers or a book; send clients regular correspondence or commentaries

B. Speak at professional events, client functions and public venues

C. Teach in your areas of special expertise to clients, other professionals, as an adjunct faculty member, etc.; teaching forces you to master your material

D. Seek awards for your writing, speaking, teaching and other notable achievements

RELIABILITY

Reliability is best evidenced by the experience of the client working with you. Even so, you can accelerate the process of gaining credit for reliability by encouraging interactions between new and established clients (e.g. through client events). Providing **"new client training"** can also be effective if you can showcase well-established protocols for client interactions and have set service standards that are distinctive and highly reliable. Careful profiling at the outset of each new client relationship that includes listening closely for insights about client interests may make it possible to anticipate what information or service you can provide proactively.

Technology can also play a huge role in improving reliability and your reputation. **"The Business Value of Trust"**, a white paper from Cognizant (a technology consulting firm) provides survey results and useful insights about the relationship between trust and technology. Interestingly, this paper includes a modified version of the The Trust Equation that multiplies the Credibility, Reliability and Intimacy factors rather than adds them. There is no explanation for the change, but a possible explanation could be that the factors are likely to reinforce one another, effectively compounding their impacts. The paper asserts that "The future will soon belong to companies that build their products and services around the trust equation and place it at the core of their brand."[7]

The following are our **TOP THREE** suggestions to build reliability:

[7]"The Business Value of Trust", a White Paper from technology consulting firm Cognizant, May 2016 https://www.cognizant.com/whitepapers/the-business-value-of-trust-codex1951.pdf

01.

Leverage technology to ensure consistent and flawless execution of core business functions and delivery of client services. Showcase your best technology to clients.

A. Explore technology available to you through your firm or professional affiliations and take full advantage of those capabilities that are most helpful.

B. Keep current on the latest technology available in the marketplace and consider technology investments to improve your efficiency, effectiveness, and reputation.

C. Consider Fi360’s Fiduciary Focus Toolkit™ to help regiment and manage your core fiduciary responsibilities.

02.

Earn CEFEX® certification for your firm and for your institutional clients (retirement plans, foundations and endowments, etc.).

A. The process of preparing institutional clients for certification increases client engagement (builds intimacy) and enhances credibility.

B. Certification ensures that fiduciary processes (that are tied directly to reputation) are in place and consistently applied (i.e. are reliable).

C. The CEFEX mark signifies that the firm is worthy of clients' trust and confidence.

CEFEX is an Fi360 company that promotes fiduciary excellence by assessing and verifying conformity to high standards of conduct that are substantiated in law, regulations and best professional practices.

RELIABILITY

03.

Become active and pursue leadership positions in professional associations and in organizations in your target market. Leaders are presumed to be committed to their cause and reliable sources of advice and guidance. Be sure to remember that you must be active and effective in the organizations you serve to have these activities enhance your reputation. Joining an organization and conspicuously failing to make positive contributions detracts from your reputation.

CLIENT-CENTRIC BEHAVIORS

Client-centric behaviors address the "Intimacy" and "Self-orientation" factors in The Trust Equation. You will recall that intimacy speaks to the strength of the professional relationship. It entails the legal and moral obligations the professional advisor owes to clients.

Self-orientation relates to the ability and propensity of the advisor to subordinate clients' interests to the advisor's own interests. Self-orientation exists when conflicts of interest are not avoided or are not mitigated in a manner that places clients' best interests first. Self-orientation is manifested when clients perceive the advisor's conduct to be uncaring toward them and their interests or concerns, and instead excessively focused on what the advisor finds important or of interest.

The following are our **TOP THREE** suggestions to promote client-centric behaviors (i.e., increase intimacy and reduce self-orientation):

01.

Personalize your advice and treat client information as sacred. There are legal and emotional dimensions to the need for advice to be personalized.

A. From the advisor's perspective, personalization is a fiduciary obligation. To serve a client's best interests you must understand material facts and circumstances about the client and the situation that have a bearing upon the advice you render. Under the DOL fiduciary rule, serving a client's best interest specifically requires advice to be prudent, consistent with the duty of loyalty and personalized.

B. From the client's perspective, seeking financial advice is personal and emotional. It requires the client to divulge information that is private and privileged. According to the Cognizant study referenced earlier, survey respondents consider their financial information to be the most valuable information about them and the information they are least willing to share.

C. You should strive to develop the bedside manner of the family doctor of your dreams and put in place top notch tools and techniques to respect and protect the privacy of client data.

02.

Become personally and institutionally aware of potential conflicts of interest and manage them properly by avoiding conflicts or managing them in a manner that serves clients' best interests.

A. Embed fiduciary principles and practices in your firm's culture and operations.

B. Follow what the DOL fiduciary rule refers to as Impartial Conduct Standards, which require serving the client's best interest, assuring reasonable compensation for advice, and avoiding misleading statements.

03.

Proactively seek to better understand clients and client psychology in general, and your target market in particular.

A. Explore research in behavioral science and behavioral finance, much of which is being captured in books written to be accessible and provide practical guidance to advisors.[8]

B. Consider getting professional help from a public relations firm to map and implement a strategy to reach and engage with clients. PR professionals are all about brand-building. If you do the things suggested in this white paper, you will have a great foundation for a PR strategy. Credibility, reliability and a client-centric business model are pillars of a great reputation and brand.

[8]For example, see the work of Dan Ariely, including his books "Dollars and Sense" and "The (Honest) Truth About Dishonesty"; www.danariely.com

THE GREATER GOOD

Cascading benefits from advisors who earn great reputations

Advisors who work on building their reputation in the manner described in this paper are engaging in a form of impact investing. They do well and they are doing good.

Building your reputation for trustworthiness is, first and foremost, client-centric by design. The act is firmly grounded in fiduciary principles – it seeks to achieve fiduciary excellence. Serving clients' best interests is paramount and they are the biggest beneficiaries of all.

Advisors win big too. As we have seen, a great reputation attracts business, increases the value of the company and enhances pricing power. Additionally, although we didn't address this directly, being an advisor with a great reputation is an immensely satisfying endeavor.

The profession of financial advice also benefits. The reputation of a profession is defined in large part by the collective reputations – trustworthiness – of practitioners. The more advisors who adhere to high professional standards and are recognized for doing so, the closer financial advice moves toward being recognized by the public as a true and valued profession.

Fi360'S MISSION

is to help financial intermediaries use prudent fiduciary practices to profitably gather, grow and protect investors' assets. Our training, designations, software and data support financial professionals' efforts to deliver better investor outcomes, and can positively influence their reputations as a result. CEFEX certification verifies that an organization conforms to high standards of conduct and adheres to fiduciary principles that are worthy of investors' trust and confidence.

Creating and maintaining a good reputation requires individual commitment. We're proud to have supported tens of thousands of financial professionals' personal investments in themselves, and their profession, through implementation of prudent fiduciary practices.

Fi360

Editing: Ben Aikin, AIF®, VP of Learning & Development • Design: Bill Cordisco, Creative