The Colony Group

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CAN AN ADVISOR BE A FIDUCIARY TO STAKEHOLDERS AND CLIENTS?

It's interesting to watch how corporate boards have been dealing with the seeming conflict between their fiduciary obligations to shareholders and the mounting pressure to consider the interests of other "stakeholders," such as employees, customers, business partners, local communities, governments, and even the planet. Making matters more complex, some of the strongest advocates for stakeholder consideration are *shareholders themselves*, especially shareholders who are focused on ESG (environmental, social, and governance) factors. This potential for conflict has an interesting analogue in the investment advisory world. Specifically, investment advisors have a fiduciary obligation to prioritize the interests of a single stakeholder, clients. Yet, investment advisors also may feel compelled to adopt a broader stakeholder model, and they may even feel pressure to do so from the very clients to whom they owe a fiduciary duty. Can an investment advisor be a stakeholder company while also discharging its fiduciary obligation to clients? In this article, I will argue that the answer is "yes."

Understanding the fiduciary standard

While neither Congress nor the SEC has offered a specific legal definition of the fiduciary standard applied to investment advisors, the SEC did offer some helpful comments in a 2018 release, in which it stated that an advisor's fiduciary duty:

> comprises a duty of care and a duty of loyalty. … This means the adviser must, at all times, serve the best interest of its clients and not subordinate its client's interest to its own.

The SEC went on to clarify the duty of care:

> The duty of care includes, among other things: (i) the duty to act and to provide advice that is in the best interest of the client, (ii) the duty to seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades, and (iii) the duty to provide advice and monitoring over the course of the relationship.

And on the duty of loyalty, the SEC stated:

> The duty of loyalty requires an investment adviser to put its client's interests first. An investment adviser must not favor its own interests over those of a client or unfairly favor one client over another. In seeking to meet its duty of loyalty, an adviser must make full and fair disclosure to its clients of all material facts relating to the advisory relationship. In addition, an adviser must seek to avoid conflicts of interest with its clients, and, at a minimum, make full and fair disclosure of all material conflicts of interest that could affect the advisory relationship.

This language might seem clear to the casual reader, but astute advisory companies recognize the need to be vigilant in applying the fiduciary standard. Its application is not always obvious. By way of example, I previously have written about the conflicts that firms seem to have when they agree to merge with or be acquired by another firm. They are required to prioritize the interests of clients, and yet, I'm forced to wonder what happens when a company receives two offers – one from a company that is far better for clients but is willing to pay less and one from a company that is far worse for clients but is willing to pay more.

The fiduciary duty and advisors as stakeholder companies

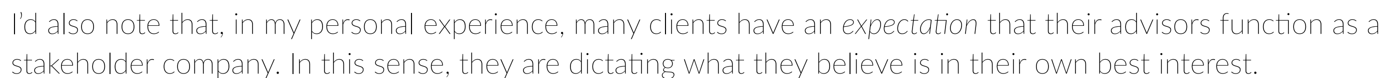
The topic of advisors as stakeholder companies is yet another example of when the application of the fiduciary standard is less obvious. It needs to be addressed by starting with a fundamental question: is there really a conflict in the first place if an investment advisor becomes a stakeholder company? I'd argue that, in most cases, there is no conflict. To the contrary, being a stakeholder company is probably imperative for most advisors looking to discharge their fiduciary duty to clients.

Hiring and engaging a diverse, empowered group of people and treating them well is good for employees, but it's also good for clients. Indeed, it's in the best interest of clients, as clients will be best served not by a homogenous group of disengaged employees who regularly need to be replaced but by a group of employees with diverse expertise and perspectives and who feel sufficiently valued and respected to stay at the company for extended periods of time.

Likewise, being strong financially serves shareholders, but it also serves clients. Long-term, sustainable profitability (as opposed to short-sighted decisions designed to make money at the expense of others) is the key to investing in and retaining the best people, technology, space, research, and other resources – all in the service of clients.

A similar line of reasoning applies to industry stakeholders. Advisory firms who believe that their "independence" means they need no one else in order to serve their clients do a disservice to their clients. Forward-thinking, client-focused advisors understand the need to collaborate fairly and respectfully with custodians, technology companies, research providers, third-party managers and service providers, consultants, and yes – regulators too. Only with a strong ecosystem around it can an advisory company provide its clients with everything they need, and not just what the advisor happens to have available internally.

Then there are the broader stakeholders, including the communities in which advisors operate and the planet itself. Can an advisor serve those stakeholders while still upholding its obligations to clients? A corollary to that question is whether they even have a choice. Clients, too, operate within those communities and the world generally. We can make all the money in the world for our clients, but they and their children will benefit from and enjoy it far more if the places they live and play in are safe, clean, fair, equitable, and sustainable.



I'd also note that, in my personal experience, many clients have an *expectation* that their advisors function as a stakeholder company. In this sense, they are dictating what they believe is in their own best interest.

But none of this is to say that advisors need not be vigilant as they think about serving stakeholders other than their clients. It's clear that an advisor *cannot* prioritize the interests of other stakeholders, including shareholders and employees, *over* clients to whom the fiduciary obligation is owed. That rule needs to pervade all decision-making, and advisors who choose to be stakeholder companies do need to be mindful of potential violations. Assuming they do, they may just find themselves better positioned to meet not only their commitments to clients but also the ideals and principles on which they were likely founded.

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