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Investment Stewards: Are You a Fiduciary Investor?

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Enough about your advisor. What about you?

My last my last two columns explored issues surrounding your advisor's fiduciary capacity—or lack thereof—and legal responsibility to act in your best interest. Now our attention turns to a variation on that theme: investors who are themselves fiduciaries, undertaking the solemn task of investing to achieve the financial goals of various types of beneficiaries.

This situation arises in a variety of familiar contexts. Perhaps you are the trustee of a family trust benefiting a surviving spouse or other family members. Or, maybe you are the guardian for an elderly person or a child with special needs.

Many readers are likely to own—or work in human resources for—companies sponsoring a retirement plan, such as a 401(k) or profit sharing plan, governed by the fiduciary provisions of the Employee Retirement Income Security Act (ERISA).

Finally, our communities are fortunate to have many charitable funds, foundations and endowments—or eleemosynary organizations—whose board members must prudently invest substantial portfolios for the long-term benefit of special and deserving individuals and organizations.

Serving in such a capacity presents rewarding opportunities and frequently daunting chal-

Summary: Investment Stewards: Are You a Fiduciary Investor?

Whether a trustee of a family trust, a guardian to another individual, a member of a community non-profit board or responsible in some manner for a 401(k), you are a fiduciary. Is your focus on whether a well-thought-out process? If not, you may need to reexamine your responsibilities and how you are approaching them.



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Specific firms mentioned are illustrations only and are not recommendations. Past performance does not guarantee future results.

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lenges. These positions are often volunteer—and sometimes thankless. Trustees, business owners and board members are generally successful members of the community and even may manage their own portfolios. However, they often lack the background and specific training to manage fiduciary investments.

A distinguishing feature of all of these positions is the potential for substantial personal legal liability for the failure to carry out the duties of investing in a prudent and responsible manner—a threat that certainly must be taken seriously in this era of class action litigation.

Procedural Prudence

While there are variations in the specific duties of investment stewards, the different species of fiduciary investors share a number of characteristics: the basic principles—and proper mindset—for avoiding liability are the same. Critically, the focus is not on the outcome of any particular investment decision, but on whether a well-thought-out process was undertaken.

Current standards and practices have evolved over hundreds of years and are presently informed by the latest developments, on parallel tracks, in the disciplines of law and science.

Legal Background

The famous *Harvard College v. Amory* (Mass. 1830) case established the Prudent Man Rule, which admonishes trustees to “observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering probable income, as well as the probable safety of the capital...”

Today’s legal landscape is comprised of three extremely important statutes with which investment stewards should become familiar:

- ERISA, mentioned previously, which governs qualified retirement plans;
- Uniform Prudent Investor Act (UPIA), governing the investment of trust assets in most states; and
- Uniform Prudent Management of Institutional Funds Act (UPMIFA), which governs the investments of foundations, endowments and other charitable organizations.

Better Investing Through Science

In 1990, Professors Harry M. Markowitz and William F. Sharpe were awarded the Nobel Prize in Economics—based on nearly 40 years of research—for their contributions to what has come to be known as Modern Portfolio Theory (MPT). MPT represents a revolution in investment thinking. Prior to Markowitz, investors focused on selecting securities they believed would maximize their return. No particular attention was paid to investment risk.

MPT turns the investor’s attention to portfolios as a whole—recognizing that, by combining higher risk securities into one portfolio with lower risk vehicles, investors can attempt to control risk and achieve a level of return appropriate to their circumstances.

Most Valuable Resource

From a distance, fiduciary investors may find it challenging to sort out and follow the various legal paths listed above. Fiduciary360 (www.fiduciary360.com)—a non-profit dedicated to raising awareness and establishing the Global Fiduciary Standards of Excel-

lence—distills the common themes and constructs a framework for practice.

Fiduciary360 publishes the Self Assessment of Fiduciary Excellence (SAFE) consisting of 22 questions—corresponding to 22 prudent practices—which may be downloaded or completed online for free. The practices are generally divided into four categories:

- **Organize.** avoid conflicts of interest and maintain a written investment policy statement;
- **Formalize.** apply the principles of MPT—time horizon, risk level and appropriate asset allocation;
- **Implement.** disciplined investment manager selection and due diligence; and
- **Monitor.** control expenses and conduct periodic reviews.

Stewardship for Safety...and Success

If you find yourself in the position of an investment steward—or are an advisor to one—adhering to the 22 practices will go a long way toward insulating you from legal liability. The bonus will likely be a more successful long-term investment outcome.