Helping clients choose the right investment advisor

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SEARCHING FOR SATISFACTION

The impact of wealth, whether it arrives through the opportunistic sale of an operating business or a much-anticipated trust distribution, brings a wave of responsibility for any wealth owner or beneficiary. When managing and protecting these assets, the savvy wealth owner will come to understand the importance of partnering with the right set of advisors. Regardless of professional background, wealth owners and beneficiaries will need to lean on specialists for investment strategy along with estate, tax and philanthropic planning – all key elements for wealth preservation and optimization.

The one advisory discipline that is omnipresent in this wealth management challenge is that of the investment advisor. The investment advisor is involved in almost every aspect of wealth management and will directly impact the financial success or failure of a family's overall wealth.

Choosing the right investment advisor is no trivial task. And it's important to help current and prospective clients find their way through the process. A wide range of professionals, firms, specialties and industry acronyms becomes dizzying for even the seasoned wealth management professional. Clients find themselves sifting through registered investment advisors (RIAs), stock brokers, chartered financial analyst (CFAs), certified financial planner (CFPs), multi-family office professionals, wealth advisors, investment consultants, private bankers and trust officers.

While many wealth owners focus on an advisor's background and expertise, they must place equal importance on the more abstract aspects of values and operating principles if they expect the advisor to align with the goals, values and principles of the owner, the beneficiary and their family. For many talented wealth owners, many of whom are self-made experts at building widgets or generating customer satisfaction in their own successful businesses, navigating today's labyrinth of advisory roles, firms, products and markets takes them far afield from their comfort zone.

Here is a clear-headed framework of best practices to help clients select the right investment advisor, including qualitative and quantitative considerations, parameters for monitoring advisors and straight-forward guidance for those who must terminate an advisory relationship.

ASSEMBLING THE TEAM

Whether this is the first or fifth selection of an investment advisor, clients must begin by defining who is part of the selection committee, who is at the helm and what process will identify and ultimately determine the family's best choice.

Assembling the selection committee need not be painful. Wealth owners should include those with good business sense, technical skills and an ability to analyze financial data – along with other individuals who can judge personality and cultural fit. Committees can be small, even run by one person or a conglomeration of family members and outside interested parties. The latter often helps assure a broader assessment and unbiased evaluation of advisors. In some cases, experienced families will invite younger generations and/or future beneficiaries to join in the process, thereby enhancing wealth education while introducing younger generations to the selection process. When choosing advisors for a trust, the wealth owner must seek committee members and trustees who understand how fiduciary responsibilities become a guiding priority. Trustees must be mindful to make educated decisions on behalf of current and future beneficiaries.

The person who heads up the selection committee is often the wealth creator or, in the case of a trust, the trustee. One person should likewise serve as committee leader with responsibility for managing the process and keeping participants engaged. Clearly defined criteria must be specified so all participants understand how to evaluate and ultimately make choices. Several industry groups and providers offer helpful checklists as a starting point for such criteria.

DEFINING AND ARTICULATING FAMILY GOALS

Assisting clients in choosing an investment advisor starts with clear definition and articulation of a family's goals. Sharing these questions with clients often saves time and adds clarity later in the process:

- What is the long-term vision of the family, and how does their wealth support that vision?
- What is the purpose of the entity or trust that holds the assets (i.e., current income, growth, preservation of capital, philanthropy, future business/education opportunities, mission-related investing or impacts involving social responsibility, etc.)?

- What type of investment advisor is needed for the situation – a generalist with broad-based expertise or a specialist with a narrower focus?
- Do the values and working principles of the advisor (and the advisor's organization) mesh with those of the family?

DEFINING THE ADVISOR'S ROLE

The marketplace for financial advice is as big as it is complex. You can advise clients that before choosing an investment advisor, they can narrow the playing field by understanding their own goals and developing a working knowledge of the various service providers. Once a family defines its goals, its members should enjoy a clearer view of the role of their advisor.

Here are some key factors that help current and prospective clients define the role played by investment advisors:

- **Discretionary vs. nondiscretionary: Autopilot, pilot or co-pilot?**

  The family must decide their preference for some degree of hands-on or hands-off in how investments are deployed. The Securities Exchange Act of 1934 defines "discretion" based on hiring a person who is "authorized to determine what securities or other property shall be purchased or sold by or for an account," even though the wealth owner or trustee retains responsibility for such investment decisions.

  In simple terms, giving an advisor discretion means specific decision-making authority has been delegated to the investment advisor. This authority allows the advisor to decide and implement specific investment choices on behalf of the family or trustee without prior approval of each decision once an investment strategy or policy statement has been approved.

  In a non-discretionary arrangement, the wealth owner essentially sits shotgun with the investment advisor. The advisor works closely with the wealth owner to determine the appropriate investment strategy, presents investment recommendations and seeks the owner's approval prior to implementing a recommendation. This often increases the wealth owner's level of engagement and time needed.

In any decision regarding discretion, the wealth owner must balance the desire for hands-off delegation against the desire for hands-on control of the investment process.

- **Advice vs. products: Product-driven solution or advice only?**

  Wealth owners should also understand the differences between a product-driven investment program or an advice-only model. To address this dynamic, you may explain that in an advice-only model, the investment advisor offers advice with an open architecture model designed to be free of proprietary loyalty to any given product set. This approach can be less susceptible to product-driven conflicts of interest and frequently allows for clearer disclosure of fees. This model also can allow a robust selection of asset managers covering a breadth of traditional and non-traditional asset classes, a dedicated manager research and monitoring process and performance measurement and reporting tools that allow for comparisons with appropriate asset class benchmarks.

  You can also help clients understand that a product-driven program often offers similar services, with one significant difference. These firms frequently have proprietary investment products (e.g., mutual funds or a portfolio manager who picks stocks and bonds) as part of their advisory offering. While the firm often has intimate knowledge of its product set, the closer tie between advice and product can create potential for conflicts along with opaque layers of fees. This model may provide the only way to access certain investment products or services, but wealth owners must be mindful of whose best interests are being served.

- **Big vs. boutique brands**

  Clients should also know that providers can be sorted by the size, quality and familiarity of their brands. Choices range from large, recognizable investment banks to the niche brands of private banks or independent boutiques. Other providers work within larger corporate banks or corporate trust companies. Apart from corporate entities, families can chose an independent fiduciary, wealth management firm or privately owned, multi-family office that offers services specifically designed for high-net worth families.

- **Bundled vs. independent trustee services**

  Clients must also decide who will administer their trust. Wealth owners who choose not to act as their own trustee, or those who would rather not place a family member

or disinterested third party in this position, frequently rely on a corporate fiduciary or trustee. The private client arms of many banks have developed bundled trust services to help manage trusts for their clients. For owners who do not possess adequate investment expertise, a certain scale of wealth or necessary technical infrastructure, delegating investment responsibilities to a trust bank may allow for better performance, service and reduced complexity.[1]

One of the major hurdles of the bundled service model is transparency and perceptions of conflicts of interest. Any bank that manages a wealth owner's investments, custodies those assets and serves in a fiduciary capacity has a potential for conflicts. For the wealth owner, the issue rests on whether the bank's interests are fully aligned with those of the wealth owner and whether a clear and complete understanding of fees is provided to the owner's satisfaction.

There are benefits to the bundled service approach. In his 2006 book, Wealth, Stuart Lucas emphasizes two benefits of a corporate trustee that go beyond the basic bundled service model. First, these organizations have virtually infinite lives. They don't die unexpectedly, disappear for days at a time or give sudden notice that they are retiring. A relationship with a corporate trustee may offer an added sense of stability, which may translate to better sleep at night for the wealth owner. The other benefit is the corporate trustee's ability to say "no" to beneficiaries in a businesslike manner less encumbered by family emotions.

Some wealth owners prefer to assign trustee services to an independent provider in order to keep this aspect of fiduciary responsibility entirely separate from the other aspects of wealth management. The absence of internal products and investment management services reduces potential conflicts. This also allows the trustee to focus solely on the task at hand – interpreting trust documents and administering assets in accordance with the wishes of the grantor and the related trust documents.

Deciding which types of firms to investigate should be dictated by the family's goals and the role the advisor will play in achieving those goals. Clearly, the wealth owner's preferred level of engagement and willingness to be involved also play a vital part in this decision.

[1]Source: Wealth, by Stuart Lucas, page 121.

ASSESSING THE MOST IMPORTANT FACTORS FOR THE FAMILY

Outlining and articulating the key advisory characteristics that are most important to a family is a major step forward in the selection process. You can assist clients through this process with some helpful guidance.

Best practice suggests prioritizing the vital characteristics so client and family stay focused on priorities and relevance of each factor. This prioritization of characteristics can be in the form of a checklist or a scorecard that each member of the committee will complete during the selection process.

While the list and prioritization of qualities vary for every family, some core characteristics stand out as common imperatives every advisor should possess. These include both technical and non-technical qualities, with the softer, non-technical issues often swaying a family's decision to partner with one advisor over another. Technical factors include competence in the markets, shared investment philosophy, ability to access certain investments and, of course, performance results. Non-technical indicators include the more abstract senses of trust, integrity, accountability, transparency, alignment of interests, values consistent with their own, experience working with complex families and an ability to make a personal connection.

The notion of "trust" is probably the most vital characteristic – and one that is often the most difficult to pinpoint since it takes on so many forms. After all, what is an advisory relationship without trust? According to a joint study conducted by the Wharton School and State Street Global Advisors, trust is the foundation of the client-advisor relationship.

The study concluded that trust is demonstrated on three distinct levels:

- Technical competence and expertise
- Ethical conduct and character
- Empathy and maturity

CREATING AND COMPILING AN EVALUATION SCORECARD

Best practices dictate that no selection process is complete without a toolkit to help guide the selection committee. Once a family has done the upfront work of documenting what's most important to them, a set of selection tools allows those priorities to come to life in the decision-making process. A customized evaluation scorecard is a simple, but effective, device that has proven useful for many families and wealth owners. The scorecard can help assess an advisory firm's investment and wealth management services, fees and organizational traits, such as culture, experience, staff retention, stability and succession.

This tool likewise helps maintain the consistency and integrity of the search process because each selection committee member evaluates using the same criteria. Family Office Exchange (FOX), a member association and consultancy focused on serving wealth owners in high-net worth market provides a sample scorecard designed to help selection committees rank and evaluate service providers. The sample can be found in FOX's 2008 study, Selecting the Right Wealth Advisor. (www.familyoffice.com)

You can help clients understand that a good scorecard also offers benefits beyond the immediate evaluation process. It often becomes an education or discussion tool for family members who may be outside of the immediate decision-making process. Categories and scoring from the cards can become a valuable communication tool during and after decisions.

MAKING, COMMUNICATING AND IMPLEMENTING THE DECISION

Once the selection committee has evaluated candidates and analyzed scorecards or other measurement tools, clients should put the decision to a vote. The committee's decision should be followed by a timely and carefully tailored communication to the family in order to convey the final decision and outline a plan for implementation.

Each family's selection committee may have its own procedures for voting and communications, and the process will differ based on family preferences, practicalities or even traditions. However, any such process should summarize the reasons for the search process, the due diligence and evaluation process used by the selection committee and the reasons a particular advisor has been selected or recommended.[2]

MONITORING AND EVALUATING AN INVESTMENT ADVISOR

Imagine it's been a full year since a family engaged its advisor. In reality, the real work has only just begun – and you can continue to be part of the process. With the transition complete and enough time having passed to allow the wealth owner and advisor to deepen their relationship, the next step calls for a regular review and monitoring of the advisor.

[2] Selecting a Wealth Advisor, a study by the Family Office Exchange, 2008

Sharing the following advice will help clients provide a benchmark for this

ongoing evaluation:

- **Look back, then forward**

  Before a review, go back and revisit the selection criteria, purpose for hiring the advisor and agreed-upon objectives. Ask whether the original goals remain consistent with the mandate. Develop and document in writing the metrics by which the advisor will be evaluated in the future. Agree on and communicate these metrics, frequency of reviews and any other factors critical to the relationship's success.

- **Quantitative measures**

  Investors often focus on short-term investment performance when the true metric for success is goal achievement. As such, the best advisors will develop a financial plan for each client and monitor performance against goals stipulated in the plan. With that said, investors certainly should get a clear understanding of how advisors evaluate the performance of the managers they select as well their own investment performance for each client. Wealth owners should ask advisors to provide examples of reports evaluating managers as well as examples of client performance reports. Wealth owners will gain a more accurate understanding of performance measurement and will be able to evaluate the advisor's ability to convey complex information to less experienced family members.

Some common investment performance calculation methods include:

- `Gross and net-of-fee performance returns for each manager, compared with appropriate indices or benchmarks

- `Aggregate portfolio performance against an appropriate composite benchmark
- Calculation of each manager's alpha (excess performance over the appropriate benchmark)
- Performance attribution analysis that quantifies the relationship between the portfolio's excess returns and the active investment decisions of the manager[3]
- Performance comparison of agreed target asset allocation vs. actual portfolio asset allocation for the period

[3] Performance Measurement, Michael McMillian

http://blogs.cfainstitute.org/investor/tag/performance-measurement

• Qualitative measures

For many wealth owners, the service relationship and client service experience are as important, if not more important, than portfolio performance.These measures tend to be more subjective, requiring the wealth owner to engage the advisor in intimate conversation. These factors may be worth sharing with clients:

- Ease of access to the advisor and service team members. Are they prompt and proactive or untimely and reactive? How many clients are assigned to each advisor, and do they make all family members feel engaged and important?
- Is the service team knowledgeable and in sync about the family, the situation and overall objectives of a service plan?
- Are the deliverables professional, accurate and meeting expectations?
- Does the advisor team take time to explain their deliverables and offer appropriate education for family members?
- Is there a common alignment of interests? Has the advisor succeeded in earning the trust of the wealth owner or others with a vested interest in their services? Has this trust waivered?

- **Balancing family intimacy and a "business" relationship**

  A very close and personal relationship often develops between a family and its advisors. Aspirations, successes, fears and secrets are shared, as the advisor becomes an extension of the family. At times, the relationship can be on the verge of too comfortable, compromising the ability to have a direct and difficult conversation with the advisor. Both wealth owners and their advisors must walk in this undefined gray area, where professional friendship overlaps with business responsibility. Both parties must recognize that this is, first and foremost, a business and advisory relationship – one in which the wealth owner has contracted with the advisor to deliver a service. A close relationship is essential, but maintaining an appropriate professional distance helps ensure the integrity of the relationship so family goals and objectives remain the ultimate priority.

TERMINATION: WHEN TO HOLD, WHEN TO FOLD?

Unfortunately, even the most well thought-out advisor search and decision-making process can take a turn for the worse.

Sometimes the reasons for termination are obvious, while others may be more subtle and subjective for those involved. Be aware and advise that wealth owners, beneficiaries and other parties need to recognize the symptoms that become grounds for ending a relationship. Noteworthy signals of trouble tend to fall into the quantitative and qualitative categories noted earlier, including:

- Is the advisor failing to understand or help achieve the family's goals?
- Is there consistent underperformance or inappropriate risk-taking in the portfolio? Has the advisor's investment philosophy shifted?
- Are key personnel still with the firm? Are there internal dissention or disagreements that may impact their portfolio recommendations?
- Has the overall service level dropped, or has the advisor repeatedly failed to deliver on commitments?

- Is there excessive turnover within the relationship team?
- Are there concerns regarding firm stability, or has the firm made strategic decisions that are inconsistent with the family goals?
- Have family goals and objectives changed, requiring a different type of advisor or relationship?

SUMMARY

Selecting an investment advisor through a responsible and thoughtful process is a demanding and complex undertaking for any family of wealth. Whether you're dealing with a prospective or existing client, you can provide helpful guidance using best practices. Success requires time, resources and focus – all of which stretch beyond comfortable boundaries for many wealth owners. Still, partnering with the right advisor is critical to the success, achievement and well-being of a family.

By taking this process seriously and allocating the appropriate time, wealth owners will go a long way toward finding the right advisor for the long term. Any family leader who embarks on this process should be equally courageous and inquisitive. Encourage clients and family members to ask hard questions. Help them create and use a deliberate process that will keep the family on track while learning from both successes and mistakes along the way. Refer them to facts, expertise, opinions and new ideas…which ultimately lead to the fit that feels right. This mindset, combined with a realistic process for decision-making, will guide a family to the right relationship.

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