

Advisor Alignment: The Emerging Choice of Wealthy Families

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It does not take very long for a family that has recently come into significant liquidity to learn what more experienced families have known for a long time: managing family wealth is complex and time-consuming {Figure 1}. It is several businesses rolled into one with the average family having more than 25 different providers¹. At a minimum, successfully managing wealth requires that a handful of activities be done well, including:

- Identifying the best investment managers in the world
- Negotiating the best fees for all products and services
- Monitoring, reporting on and periodically reassessing all investments
- Coordinating and integrating all family, financial and legal matters
- Ensuring that all appropriate regulatory filings are made on a timely basis and recorded
- Communicating with and educating all stakeholders
- Making sure all activities support individual and family objectives and are sustainable²

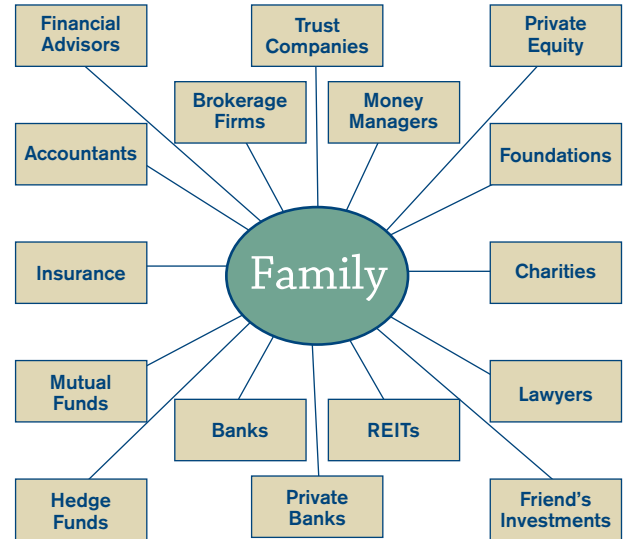


Figure 1

An Altered Landscape

Traditionally, the wealthiest of families established family offices to advise them and work on their behalf to buy and integrate the myriad of different products and services they required. Doing so ensured that all activities would be aligned with their families' interests. However, family offices were a luxury the expense of which few families could afford. Even for some that could afford one, the challenges of hiring, managing, and retaining talented staff made having a family office unappealing. Most families chose to work directly with providers for all of the products and services they and their families required, which were relatively few: a banker, a stock broker, an insurance salesman, an accountant and attorney, and maybe a trust company – each with a straight-forward and relatively transparent array of products and services they manufactured.

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¹ Family Office Exchange Benchmarking Study, October 2006

² For more information on sustainability, please read our white paper entitled "Sustainability: The Springboard for Future Generations"

But over the years families began to see a substantial increase in the amount and complexity of investment options. Regulatory changes led to a complex wave of mergers and acquisitions that dramatically altered the wealth management landscape: banks bought stock brokers, stock brokers bought insurance companies, and insurance companies bought banks. Many providers became financial supermarkets or “one-stop shops” for the sale and distribution of a wide variety of financial products and services to individuals and, increasingly, businesses. The transparency that wealthy families once enjoyed was lost in the process of bundling a wide array of products and services under the guise of advice. The inherent conflicts of interest soon became apparent, most notably the incentive to advise clients toward products and services that yielded the providers more and higher fees. From tainted research to marked-up pricing on securities and from accounting scandals to churning, examples of conflict and fraud are pervasive.

The wealth management landscape has come to be characterized by complexity and conflicts of interest, and presents significant challenges for wealthy families. Families are being forced to play an increasingly active role in the oversight and management of their wealth, a role in which they are at a substantial disadvantage. They are being told that they are getting “holistic” advice though only receiving advice that leads to the purchase of products and services their providers have assembled for sale or distribution. It is impossible for a family to know if they are getting more or less than what they need, or receiving the best ideas and solutions available. And because of the lack of transparency, they will never know how much they

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are actually paying in fees. Though there are many well-intentioned advisors at these firms who suggest that they “protect” their clients from these inherent conflicts, principles can easily get compromised when doing right by the client does not maximize their own compensation or their employer’s profits. At times, even these advisors do not realize the conflicts embedded within the products their employers are encouraging them to recommend. For example, these providers sell “structured products”, like principal protected notes, which have multiple embedded fees within them that make it difficult to evaluate the merits of the solution or understand whether the same result could have been achieved in a more cost effective way. Sadly, even within so called “open architecture” providers, the sales and distribution culture is invariably biased toward selling investment managers that are willing to trade through their own platform or pay them fees or commissions for the distribution of their products. It is unfortunate, but this is the financial services business model.

An alternative option that has emerged in recent years is the *multi-family* family office. It is based on the philosophy of the single family office of hiring people to work directly on the side of families. Multi-family offices provide families with a team of professionals to work on their behalf to buy and integrate the products and services they need directly from manufacturers without the expense and conflict of working through the sales and distribution-oriented financial services providers. But unlike the original family offices, multi-family offices bring the benefits of a family office without the expense and management burdens while providing the additional benefit of shared best practices and learning among families. Multi-family offices do not manufacture, sell or distribute any product. And because families pay these firms for their advice and pay for products and services separately, they always know exactly what they are paying in fees. This transparency ensures that everything is being done in their best interests and in the most efficient and thoughtful way possible.³

Choose Wisely

Recognizing the credibility of this emerging alternative, many providers are including the term 'family office' in their names and literature or claiming to offer 'family office services'. As a result, it has become increasingly difficult for families to distinguish real family offices from providers that sell and distribute product. The only effective way to tell for sure is to follow the money trail by asking for answers to the following questions in writing:

- Is your firm compensated in any way by managers you recommend to your clients or utilize in their portfolios?
- Does your firm do any type of business with the firms you are recommending: trading, custody, investment banking, etc.?
- If your firm negotiates a discount from a manager for volume purposes, do you pass that discount back to your clients or do you keep it for your firm?
- Are people in your firm compensated (directly through commissions or indirectly through bonuses) based on how much of a particular product(s) they sell in a given year?
- Is your firm part of any proprietary asset management organization – directly or indirectly?
- If your firm is affiliated with an investment bank or capital markets group, how often are new product ideas sourced from these areas?
- What dollar-weighted percentage of the investment products used by your clients are proprietary?
- Does anyone other than your clients pay you a fee or give you other non-fee incentives?

GENSPRING FAMILY BILL OF RIGHTS

We do not accept compensation from investment managers.

We are in one business – to be your family office.

All savings and discounts we negotiate are passed entirely on to you.

Our advisors do not sell product and do not receive commissions.

We are not aligned with an asset management organization.

We are not part of an investment bank or capital markets group

We do not sell or distribute proprietary products.

We are paid only by you.

If you get one or more "yes" answers, you are not talking to a family office or other firm that is aligned with your interests. If you choose to hire such a firm anyway, understand that you are in essence accepting the responsibility for examining all advice you are given and becoming versed in, overseeing, and managing all wealth management activities. You are explicitly giving up the benefits of advisor alignment – caveat emptor.

If you get all no answers, again, in writing, then you have found a firm that is interested first in your needs and who is aligned with your interests. Choose wisely.

³ For more information on multi-family offices, please read our white paper entitled "Peace of Mind For Generations: Our Multi-Family Office Solution".

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