Private Wealth Management

A wealth manager, asset manager, multi-family office or private bank intending to service the wealthy should first and foremost begin with empathy. Too often the agent seems to be looking at themselves when they talk about what they can do for their clients.

Empathy is very important. The rationale is simple, how can one be trusted to consider what the client has not considered if one has not considered what the client has considered?

It is no wonder that the industry's self prognosis is not optimistic. The wrong approach can only be repeated so many times after which, one's sophisticated client being as sophisticated as their agent believes they are is bound to adapt. It is no wonder also that the industry is in decline. In many ways the family office is the high net worth's defence against the corporate onslaught.

The wealthy are not homogenous and they each have their own particular needs. While bespoke solutions are sought and service providers strive to provide them, there are general principles.

The wealthy are not interested in short term gains. They may appear to be for recreational reasons but in the end they want purchasing power preservation plus a spread, compounding over the long term.

They worry about their future just like everybody else. Human beings adjust to being rich and the rich may not feel as rich as one thinks they feel.

They worry about loss. Some clients are happy to take a guaranteed finite defined loss (a cost) over the chance of gain with the associated chance of unquantified loss. They may just want safekeeping and banking services. They understand the concept of diversification of custody in addition and as opposed to diversification of investments. In these uncertain times, bank failures cannot be ruled out.

Often they are, understandably, suspicious of the motives of those who come to service and advise. But here the issue is complicated. They are naturally suspicious of services and advice which are provided for free, and yet are unwilling to pay for advice, from poor prior experience, of unpaid advice and services. And around and around it goes.

Relationships are all important for the wealthy. Staff turnover is not only damaging to the building of lasting relationships they are also a metric of failure. As an industry, staff turnover in wealth management is remarkably high. A consequence is that long duration or gestation strategies or products are purposely and successfully under-represented, despite the importance of long term strategy. Instead, product providers complain that investors are not long term enough in their outlook precisely with regard to their daily, weekly or monthly liquidity products. Staff retention is closely related to staff compensation which is in turn closely related to agency behaviour. Ideally, staff should eat their own cooking, as demonstrated by the chefs who cut the fugu (the poisonous but delicious puffer fish.)

The wealthy are not responsible for their agent’s budgets. Organizations run to quarterly sales targets and financial results. This is a wonderful way to run a business facing the wealthy, a wonderfully poor way of representing the client properly. Front line relationship managers may, if they are good, understand this and keep a relationship at risk of losing a trade. It is simply irrational to do the trade and lose the relationship. Unfortunately not everyone in an organization, particularly large, complex ones with interdependent stakeholders and constituents, understand this simple principle. Clients aren't always active. Sometimes when the going gets tough clients understandably reduce their risk. Sometimes, when the going is easy, they may likewise reduce their activity. To earn their keep, advisors need to provide investments which are robust under various environments, which means turning to alternative investments which obtain their returns from sources other than passive, directional exposure. And even then, sometimes, the right advice is to reduce risk and do less. Advising a client appropriately builds trust and will likely get you fired.

The corporate connection:

Many rich families have strong relationships with the banks originating from their business activities. This relationship is beyond the scope of this discussion, but the information asymmetry is less acute in that relationship. The entrepreneur knows their own business far better than they do an accumulator or a CDO Squared. They engage the bank as equals or partners.

Any executive must see the obvious synergies of managing both private wealth needs as well as corporate ones. This is sometimes if not often the raison d'etre of a private bank.

Here truly is a synergy and a strength if it is properly executed. The agent must engage the client as an equal, a strategy that may involve providing training, at the behest of the client, potentially to both current and future generations.

The outmoded merchant bank model is suddenly relevant, aligning principal and agent objectives. Basel 3 is a potential impediment, of course, as it is to so many parts of banking. In fact, the implications of Basel 3 have already driven some of the more cynical banks into the co-opting of client capital to provide the regulatory and equity capital to quasi-principal trades which place the bank in a senior position with recourse and not a small proportion of the profits. Such perversions will eventually alienate further the principal from agent.

The better way is to foster co-investment in a transparent and clear way, where regulation only governs disclosure and is otherwise neither prescriptive nor intrusive.

For Agents:

* understand the client.

* represent the client first.

* align the interests of the firm with the client.

* be transparent about fees, expenses and economics of the relationship.

* keep the relationship, lose the trade.

* be prepared to educate the client.

* the client is the ultimate payer.

For Clients:

* pay for independent advice.

* conduct due diligence on your advisers.

* ensure alignment of interest between your advisers and your own objectives.

* be transparent about your objectives and clear in your instruction. Require your agent to be similarly clear and transparent.

* trust but verify.