

From FAMILY WEALTH REPORT

Families first: An industry lets its clients down

Charles Lowenhaupt - 14 October 2008

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In all the headlines, in all the ink spilled on the present crisis, no one has stated the obvious. The financial-service industry has shamefully failed private wealth holders. Attributes like stability, longevity and dependability have disappeared in a crescendo of mergers and acquisitions and a frenzy of greed as the industry's essential thread comes unraveled.

For private wealth holders and their trusted advisors, this stunning breakdown of the system raises many troubling questions and issues. Where is the perpetuity a patriarch wants for his descendants when **JPMorgan** becomes **Chemical** and **Merrill Lynch** and **U.S. Trust** become **Nations Bank**? Where are the long perspective and the "conservative" approach to preserving wealth when rogue traders and Wall Street manipulators make arbitrage and short profits a bank's *raison d'etre*. Where are the values to teach one's children and grandchildren when **UBS** allegedly uses tax fraud as a marketing strategy? How are clients being nurtured and protected when "cash equivalents" are created through auctions designed to ensure profits for the financiers even as their customers lose out? Should family wealth be "trickle down" from the huge profits built into transactions designed to benefit their financial-service providers?

Hucksters

Private wealth holders are spending sleepless nights wondering about the consequences of the failures of **AIG**, **Lehman** and several commercial banks and the daily changes in the ownership of financial-service companies around the globe. Amid these ruins, it's time for the entire industry to admit that the chaos in the market reflects the design and sale of products profitable in the short-term for the designers and sellers, but incomprehensible to and inappropriate for their customers.

The slickest and smartest "financial advisors" were often hucksters who sold short-term returns without concern for the goals and aspirations of the individuals and families they were supposed to serve. These advisors looked to their own interests without loyalty to their clients while financial-service companies leveraged profits and rewarded executives by disregarding their customers' well being.

Even if we acknowledge the proviso caveat emptor, it's clear that the industry has acted with unusual selfishness and opaqueness. Clients of financial-service giants have difficulty



evaluating how they're charged because of the industry's deliberate design of structures and shells impossible to see through. It's challenging for the most diligent clients, even for wise trusted advisors, to understand how these big financial-service providers are making their money. Too often it's too difficult to determine whether an institution is being compensated (or otherwise motivated) by third parties to sell products that are much better for manufacturers than for end users.

New model

Private wealth holders worldwide are facing a crisis of trust as they look to "preserve" their wealth. To meet this crisis head on, a new service model must arise from these ashes. The first priority of this new model is to ensure that financial-service companies and clients sit on the same side of the table and that their economic interests are clear and aligned.

In other words, the foundation of the new model must be trust -- something now in short supply among customers of the modern financial-service industry. Building trust is a non-negotiable prerequisite for clients and providers to work together productively. With trust borne from the understanding that mutual success is the way forward, clients and providers together need to create a long-term perspective with the premise that wealth and its preservation should reinforce values that can last a century.

The operative words driving this new model should be "care," "loyalty," "comfort" and "nurture" rather than "Monte Carlo," "derivative," "beta" and "performance compensation." Remuneration to financial-service firms and employees should be reasonable but never designed to encourage the use of strategies that aren't aligned with the client's interests or that encourage the employee's loyalty to any party other than the client.

At the same time, clients have to be more diligent in finding out what's going on. To that end simple questions are best. How is the institution compensated? Does this mode of compensation work reasonably for client and provider alike or is it skewed to the benefit of the provider? Can I understand what this investment is and how it works?

The second pillar of the new model must be an understanding of the importance of freedom from the burdens of wealth; a matter of putting money firmly in its place. Wealth holders the world over have an almost universal objective today: they want to use wealth so they can lead fulfilling lives, freely and comfortably. So wealth has to be viewed as a liberator and facilitator of dreams.

Integrity

To achieve this, of course, economic interests must be aligned, and the service model must be transparent and without conflict. In addition, performance measurement must be more insightful than a recitation of simple mathematical return. Measuring a portfolio's success must incorporate the client's goals, values, and purposes and must reflect an understanding of the wealth holder's personal vision and legacy. Complexity, structured solutions, illiquidity, lack of transparency, and focus on quarterly moves are rarely supportive of this kind of performance reporting.

A model of financial service based on trust and service to the wealth holder's vision cannot be legislated or regulated. Instead, the marketplace must demand it. Every private wealth holder should insist on transparency, appropriateness, and the economic alignment of every institution offering a financial product or service. A firm that offers to help clients cheat a government will not hesitate to cheat a client. A company that allows a rogue trader to build outrageous profits sees loyalty to the company as paramount. The avarice reflected in valuation formulae designed to inflate market prices doesn't help customers evaluate portfolios. A shroud of secrecy with respect to portfolio companies doesn't allow for an open view of compensation sources.

America's vast store of private wealth has been built in business and preserved in traditional portfolios of stocks, bonds, real estate and similar assets. "Products" delivered by financial-service companies are designed to make money for the institutions that manufacture them; if the client makes money as well, the thinking goes, that's fine but not necessary. The wisest private wealth holders know this.

Wealthy clients have to recognize that they have been ill served in recent times by the largest financial-service providers. As customers, they must demand loyalty and integrity. In turn, the financial-service industry must recognize that the heart and soul of private wealth management is loyal service to individuals with the goal of helping them live their lives as they want to. -FWR

The illustration for this column is a detail from a Japanese woodblock print in the Charles A. Lowenhaupt Collection.

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