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How Do You Assimilate Within Your Practice The Processes, Technology And Division Of Labor Necessary To Fulfill Your Fiduciary Responsibilities?

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A revolution is afoot. With new marketplace demands raising the bar for advisors wishing to provide high-level counsel to their clients. New tools and technologies have been created that makes it possible for advisors to fulfill their fiduciary responsibilities. The web has democratized access and makes it possible for financial services firms to equip all advisors in their employment with the processes and technology necessary to address and manage the full range of investment and administrative values required by regulatory mandate. The financial services advisory is positioning itself to provide an unprecedented level of investment and administrative counsel.

However, one question remains. Once advisors have access to these tools, how do they effectively assimilate them and the fiduciary standards into their practices? Financial services firms heretofore have deemed the provisioning of these tools to their entire advisory to be price and risk prohibitive. As a result, individual advisors who would like to fulfill their fiduciary obligations have had to assume more personal initiative and risk than they ever have before. With the advent of greater SEC scrutiny and the resulting regulatory requirements, the High Net Worth Asset/Liability Study Initiative ("What Is Advice? High Net Worth Standards Initiative Publishes Asset/Liability Working Document," *Senior Consultant,* March 2004, http://www.SrConsultant.com/Articles/2004-03-What-Is-Advice.pdf) has outlined the tools and counsel required to act in a fiduciary capacity. The goal of this initiative is to foster the development of and access to the tools, resources and documentation necessary for the advisor to fulfill their fiduciary responsibilities. Making the technology tools, resources and documentation available however, does not mean one will know how to use them and effectively incorporate them into their advisory practice. Just because we may know what a golf club is and understand how to swing it, that doesn't make us Jack Nicholas. How we construct and manage an effective and highly profitable advisory services enterprise is easier said than done.

ONCE ADVISORS HAVE ACCESS TO THESE TOOLS, HOW DO THEY EFFECTIVELY ASSIMILATE THEM AND THE FIDUCIARY STANDARDS INTO THEIR PRACTICES?

Family offices face a similar dilemma. Of all advisory practices, the complexity of the family office enterprise represents the height of fiduciary responsibility. The family office's need to operate as a business entity which supports trustee functions, financial controls and prudent investment practices is on the same plane with advisors' growing needs to assist high net worth clients in doing so. Advisors who individually have been accepting these responsibilities for years have been challenged in two primary ways: (1) finding or creating the tools needed to support fiduciary activities and (2) employing a trial-and-error style of implementation for prudent business practices. The result is the aforementioned unwitting adoption of greater risk which leaves them more vulnerable from a business operational and regulatory standpoint than they should be.

But with a little planning, thought and foresight, investment management consultants can not only eliminate these unnecessary risks, but they also can become a resource to high net worth clients – including family offices – needing to do the same. The practice of hiring investment consultants is becoming more and more common for family offices. In our estimation, over 50% of family offices do so today, presenting unprecedented opportunities for investment advisors to provide a more complete solution. Once the technology, resources and documentation are in place, all technical components of the investment process will become commoditized, and thus, your providing a more complete advisory solution will become the new point of differentiation among advisors.

Those advisors who add value by providing customized solutions to their clients' needs will thrive. The commoditization of the investment process by the

adoption of technological tools and standards of fiduciary practice as outlined by the AICPA and the Foundation for Fiduciary Studies (http://www.ffstudies.org) will allow advisors to focus more on their business processes and operations. Such focus will, in turn, introduce a new level of service to high net worth clients.

This article will highlight two opportunities being presented to advisors from the adoption of the High Net Worth Standards Initiative:

1. the opportunity to build sounder, more streamlined business processes, creating more profit for themselves, and
2. the opportunity to assist high net worth clients in adopting sounder, more fully integrated investment practices.

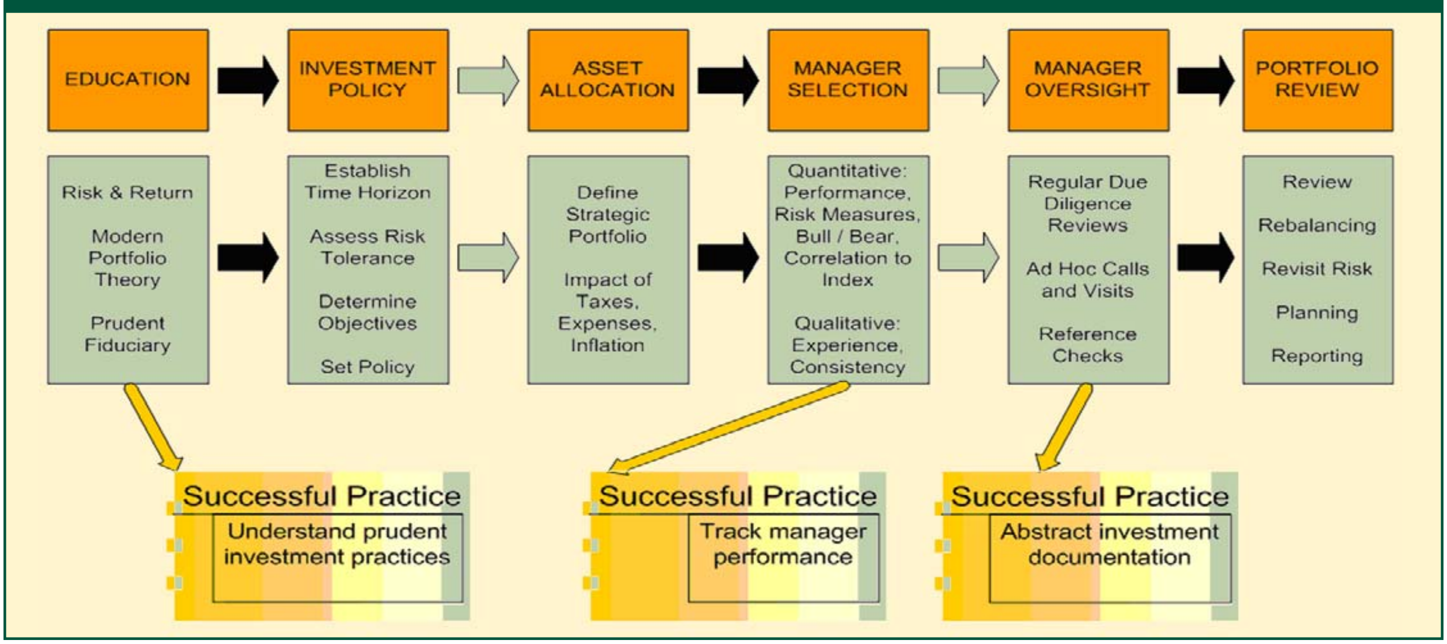
Putting the Standards into Practice

How do you assimilate within your practice, the processes, technology and the division of labor necessary to fulfill your fiduciary obligations? Because of complex considerations that may entail skill sets in technology and other areas with which you may not be familiar, it may make sense to follow your own counsel and engage the assistance of a professional who is well-versed in putting processes, technology and technical resources together into a readily manageable format. Such a standardized format has been developed for the implementation and assimilation of processes, technology and supporting resources. There are three elements and begins with a formalized Business Process Review™ (to see actual Business Process Review example, visit http://www.fametrics.com/pdf%20files/Questionnaire.pdf)[1] which gathers and analyzes information from the answers to a questionnaire that allows your advisory practice to reflect exactly the counsel you wish to offer. This questionnaire covers business and advisory practice issues, policies and procedures, and business strategy. The answers to these questions lead to a customized analysis based on the business objectives of the advisory client, which then leads to customized solutions consistent with the advisors' core competencies. From the evaluation of the answers to this questionnaire, a work flow diagram (Figure 1) is created. Analyses by qualified consultants identify issues that need to be addressed. The consultants then prioritize those issues and recommend solutions. Here's an example of how the process works.

An advisor wishes to cater to ultra high net worth clients primarily in the family office market. The advisor wishes to become an integral part of the family's advisory team in order to more effectively serve their investment needs. The advisor feels that functioning as an outsourced chief investment officer (CIO) for the family will position the advisor to provide more holistic, integrated advice. The advisor has no desire to do bookkeeping, recordkeeping, or even the hand-holding normally considered as part of working with a family office but just wants to serve as the CIO to the family.

As CIO, the advisor must have business processes in place which allow him or her to focus on the more complex needs of this high net worth client. The advisor must have a solid grasp of the family's entire portfolio of assets and must also be assured of receiving from the family the information necessary to fulfill his or her fiduciary responsibilities. There are a series of processes that must be set up within the advisor's practice to successfully fulfill those responsibilities as well as to work effectively as CIO to the family. Therefore, the existing processes of the practice must be evaluated along with the way the practice

Figure 1.
Investment Support Procedures



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functions. The advisor then engages a consultant with expertise in providing the level of customized service that high net worth investors in general tend to demand. The consultant reviews the advisor's business processes and technology capabilities. Current workflow is plotted on a graph and compared to the desired workflow, after which solutions are offered to create a seamless service offering. On the client relationship front, an inherent triangular relationship is formed when the CIO is initially accepted into the fold. Differences as small as a family member wishing to see account positions every Monday morning when the advisor normally only provides them on a monthly basis can sabotage a promising relationship.

The consultant guides the advisor through a series of "handshakes" necessary to forge the type of relationship that the advisor will need with the family members, thereby offering them the depth of service they seek.[2] The advisor is now operating optimally within his or her own practice and can offer the family office a customized CIO relationship.

This type of customization is not limited to family office clients. Practically any investor with significant wealth will feel entitled to service – defined in his or her terms, not the advisor's. Providing such service does not have to derail an advisory practice from an efficiency standpoint nor does it require an advisor to provide services he or she does not wish to offer.

Implementation Built on Industry Best Practices

Sound business processes are based on best practices and industry standards. It's not enough simply to have the tools in place to make those processes more efficient. Advisors must know how to use those tools properly and how to combine them in a way that produces the most efficient and effective running practice possible.

How many advisors actually know how to write an investment policy statement? With the new tools and fiduciary standards, how many advisors really know how to use them to transform their practices into saleable businesses?

Like family offices, the most successful advisory practices operate like businesses. The business processes required to serve high net worth clients and fiduciaries are more complex than even most sophisticated investment management consultants may realize. These differences begin with the definition of the term "high net worth." On the financial services side, this term has been most commonly interpreted to mean clients with investable assets of between $1 million and $5 million. However, the high net worth market that is vastly underserved today lies in the $5 million to $50 million range. This "middle market" of investors has more complex needs than investors with smaller assets. The $l million to $5 million market will largely be adequately served with the newly commoditized tools, but the needs of the middle market high net worth mirror those of the ultra affluent rather than the traditional brokerage client. Trusts, estate planning, broad-based tax planning and even psychological factors all play a role in clients with larger assets.

WITH THE NEW TOOLS AND FIDUCIARY STANDARDS, HOW MANY ADVISORS REALLY KNOW HOW TO USE THEM TO TRANSFORM THEIR PRACTICES INTO SALEABLE BUSINESSES?

Fiduciary concerns are more poignant within the middle and ultra high net worth markets; therefore, consultants wishing to address these markets must adapt the consulting process to its needs and must fully equip themselves in these advanced business processes. The technology initiative laid out in the High Net Worth Standards Working Document (http://www.SrConsultant.com/Society/HNW-Working-Index.html) will lay the foundation needed for advisors to begin addressing the middle market. Expanding and integrating business processes to better address this market's needs is the next step.

In order to ensure smooth integration of these expanded business processes into the consultant's practice, a Business Process Review™ is advisable. This review generally covers the following functions when reviewing investment support:

- Research and New Ideas – Evaluation of resources and scope and quality of research.
- Establishing a Macro View. – Includes a forward looking view of the markets, opportunities and risks.
- Knowing Your Client – Includes knowledge of family dynamics, various family member attitudes about money and personal vision that may affect investment policy.
- Inventory of the Current Portfolio – Includes all portfolio assets, their ownership structures and how these factors integrate to affect the overall portfolio.
- Performance Review for Managers and Accounts – Within the scope of the overall allocation and in view of complete portfolio of assets, both financial and non-financial.
    - Comparing Current Accounts to the Model or Customized Benchmark – Includes historical risk adjusted performance.
    - Reviewing Wealth Projection Scenarios – Includes tax optimization, retirement planning, estate planning, event planning, inflation and expenses, and how those relate to the overall wealth picture.
    - Documenting or Updating Investment Policy Statements – Necessary updates as life events and stages change and regular review on an annual basis.
    - New Manager Set-Up – The scope and depth of the due diligence process
- Manager Review and Recommendation – The process for recommendation.
- Termination of Manager – The process and discipline of termination.
- Rebalancing of Portfolio – Must be in line with macro investment policy statement (IPS) as well as with the IPS for each account.
- Liquidity Management – Cash management and availability are extremely important to high net worth investors.
- Gathering Monthly Returns – Complicated by the data aggregation constraints and number of accounts, and affected by regular income taxes, the AMT and measuring manager alpha across multiple managers.
- On-Going Due Diligence – The due diligence process multiplied by the number of accounts and managers involved.
- Portfolio Reviews – Must be comprehensive

and integrated with all factors to be considered in achieving objectives.

- Account Reviews for Clients and Trustees – Must concentrate on fiduciary responsibilities and other fiduciary duties.
- Performance Attribution – Not only for individual accounts but for the portfolio of accounts as a whole.

The business process components listed above encompass much more than the commoditization of the basic tools and fiduciary documentation can offer. Middle market and ultra high net worth clients often have multiple accounts with different ownership structures and separate policy statements underneath the overall umbrella IPS. This level of clientele demands integration of investment advice across these various accounts, across a plethora of tax considerations and ownership structures, and across multiple account objectives.

As noted earlier, while the technology initiative laid out in the High Net Worth Standards Working Document (http://www.SrConsultant.com/Society/HNW-Working-Index.html) will provide the tools that advisors need to develop these processes; implementation of these tools into a seamlessly operating advisory practice is an entirely different challenge. Another business process tool designed to transform existing financial services practices into more profitable businesses is the policy and procedures manual. Such a manual will also support the more complex business processes needed to serve higher level clientele and will be discussed in more depth at a future date. A formal approach to operations and business procedures will enable your advisory practices to operate optimally and is a critical determinant of success.

The Opportunity for Advisors

In all cases of advising high net worth clients, having the necessary tools and standards for documenting fiduciary compliance should be a given not only for advisor practices but also for the clients themselves. Many family offices, much less individual high net worth investors, fall far short of meeting those standards and documenting their processes. In a recent Family Office Metrics survey of 29 family offices, 81% of respondents said they have an IPS for each family member. That means that 19% (1 in 5) do not. More revealing, less than half of the family office respondents updated these IPS's in 2003. The survey showed similar statistics about how often respondents conducted periodic manager reviews and other types of due diligence as a part of their investment support process.[3]

These statistics reveal a plethora of opportunity for high level advisors. Each of these functions is within the realm of the consulting process; and fiduciary responsibilities go hand-in-hand with trust functions, which are a primary concern of high net worth clients. As financial services firms and private banks have embraced trust operations in order to attract high net worth clients and have even purchased their own trust companies, trust advisory opportunities have also opened up to advisors. In the survey on the trustee front, 59% of the respondents held annual reviews with beneficiaries, but 41% did not meet with the beneficiaries for an annual review of the trust.

IN ALL CASES OF ADVISING HIGH NET WORTH CLIENTS, HAVING THE NECESSARY TOOLS AND STANDARDS FOR DOCUMENTING FIDUCIARY COMPLIANCE SHOULD BE A GIVEN NOT ONLY FOR ADVISOR PRACTICES BUT ALSO FOR THE CLIENTS THEMSELVES

The need for advisory involvement on the trust side is critical. Trustee roles and investment vehicles are often fragmented within the family and require the help of qualified advisors. As various trust structures require orchestration much like a symphony in order to function as the family grantor intended,[4] so must a high net worth investor's symphony of investments function. Orchestration of that symphony is the investment advisor's role. That orchestration cannot be conducted effectively if the advisor's practice has not adopted high level business practices and, therefore cannot focus properly on appropriate orchestration of investments.

The best way for advisors to differentiate themselves in light of the new technological tools and fiduciary standards is by the value they offer their clients based on their unique competencies. This means that advisors first must have their own business processes in order. Often, the full scope of advisor competencies and the ability to capitalize on them are beyond the view of human self-assessment and observation. An objective, third party evaluation can be invaluable in the implementation of fiduciary tools and standards, creating economies of scale in business processes and operations, and enhancing service provision to clients. Objective guidance by qualified analysts equipped with accounting, law, operations, technology, administration and management expertise and experience leaves no area of practice management untouched. The institutionalization of proven processes instills confidence that best practices are uniform and are, indeed, best practices. The capture of appropriate data fosters predictive statistical analysis that can enable advisory practices to better plan the road to success, optimizing both advisors' and clients' wealth and effectiveness in the process.

Conclusion

What high net worth investor would not be attracted by an advisor who has adopted proven technology, best practices and business process implementation based on the highest standards set by the AICPA (see AICPA news release at http://www.aicpa.org/info/aicpa_update_36.htm), the Foundation for Fiduciary Studies (http://www.ffstudies.org), the Committee of Sponsoring Organizations of the Treadway Commission (http://www.coso.org), and the Duncan Associates LLP Private Trust Company Model (http://www.jpcdlaw.com)? What advisor would rather spend time piecing together technology tools and standards to ensure documentation of fiduciary fulfillment? The adoption of existing tools and standards by firms for their entire advisories will ensure fiduciary compliance in a literal sense but will not ensure successful implementation and assimilation into advisory practices in and of itself. Guidance for such is available, however, and a blueprint of proven methods for implementation does exist. ■

Notes

1. The Business Process Review is a marked, proprietary tool of Family Office Metrics LLC.
2. Adapted from "The New Family Office: Innovative Strategies for Consulting to the Affluent" by Lisa Gray, *Euromoney/Institutional Investor,* March 2004, p. 96.
3. The entire survey may be seen at http://www.fametrics.com/pdf%20files/Survey%20-%20May%202004.pdf
4. "Master and Commander: Today's Complicated Trust Structures Demand a Firm Hand" by John P.C. Duncan, *Trusts and Estates,* December 2003.

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