

## 10 Tips To Improve Family Office Investing

By Edward Siedle, Founder, Benchmark Financial Services

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Wealthy individuals and family offices have, generally through hard work and sometimes just plain luck, been blessed with financial success. Yet contrary to popular belief, they often are not nearly as successful when it comes to investing their money. When I first began working with the wealthy (as opposed to my pension fund clients) I was surprised to find that they were so prone to make, shall we say, less-than-optimal investment decisions. I presumed that given their extensive capabilities and resources, these investors were relatively astute in investment matters. Not necessarily.

Indeed, a problem I have with the Securities and Exchange Commission’s “sophisticated investor” standard is it presumes that just because an investor

has built a certain net worth, or earned a certain amount, he necessarily knows something about investing in, say, hedge funds. Believe it or not, it is possible to be a highly successful lawyer, real estate developer or Internet entrepreneur and never have invested in the stock market. Wealth and wealth management expertise do not necessarily go hand in hand. Moreover, the wealthy can be sitting ducks in their natural habitats, as I explained in my article “Beware Of Hedge Fund Marketers Flouting Country Club Rules,” which appeared in Forbes Magazine.

That means family offices that are established for the purpose of managing wealth originally earned far from Wall Street must either get savvy about the wealth management business (and its sometimes unsavory practices) or surround themselves with people who are. Otherwise, wealth built over decades or generations can be lost virtually overnight to a “wealth transfer scheme”—and by that I don’t mean an estate plan to transfer wealth to heirs, but a plan designed to transfer hard earned wealth to advisors.

Here are 10 suggestions to radically improve family office investment performance and reduce the risk of becoming a victim of the next Bernie Madoff. For each item that results in either savings or greater expense, I have indicated the projected amount for a hypothetical wealthy individual with \$10 million under management. Of course, family offices (which typically have greater assets) would realize greater potential savings and performance gains. The steps I recommend should improve net investment performance and need not result in any additional investment costs. They may even result in savings.

**1.** Commit to undertaking a true due diligence of the investment firms, as well as individuals, you do business with. Forget about hiring some slick private eye. Investment-related due diligence is unique and specific to the industry. Industry friendly resources, such as FINRA’s BrokerCheck, are of limited value since they understate wrongdoing; regulators are even less helpful. Asking a friend for a recommendation is not an adequate due diligence. The good news is that investment-related due diligence is not particularly expensive. Knowing how to investigate investment managers and what issues to focus upon can keep the cost down. Projected annual cost: \$10,000. This cost may be reduced if an integrity monitor as described below is retained.

**2.** Consider retaining an “integrity monitor” or independent fiduciary to vet and oversee your investment services providers, as well as family office staff. It is common practice for major companies to hire an independent private “inspector general” to oversee their operations and prevent the occurrence or reoccurrence of illegal or unethical business





practices, as well as detect fraud. Indeed, courts and regulators often require that such a monitor be embedded in a company to prevent future wrongdoing as part of a legal settlement of charges the company has engaged in wrongdoing. But why wait until something goes wrong to add this critical layer of independent protection? The cost is minimal. An integrity monitor who is doing his or her job will more than pay for himself. Overseeing an investment program requires expertise in negotiating advisory fees as well as reviewing securities trading and custody arrangements. So make sure the integrity monitor you hire possesses relevant expertise. Annual cost: \$50,000.

**3.** Hire a family office manager who is knowledgeable about your new business, i.e., the business of managing money, and is willing to give strong, objective recommendations. Cultivate an environment where decisions are based upon merit, not politics. Family office managers complain to me that family members often don't heed their warnings. When I review investment portfolios, often the explanation for an absurdly improbable investment I have questioned is "a family member wanted to do it" or "a friend of the family was involved in the deal." There's no point in hiring a knowledgeable family office manager if you're not going to listen to her. The manager should also be adept in family education and growth. The beneficiaries will eventually inherit the responsibility of hiring their own office manager and need to understand the discipline of investing and stewardship of assets. Starting them early on by making them involved in the family office board will help.

**4.** Re-evaluate your participation in any wealth management and family office associations and events promoted as exclusive or invitation-only. In my experience many of these are dangerous marketing-driven venues where any educational component is minimal and has been corrupted by behind-the-scenes financial arrangements. Pay-to-play is the norm. That is, speakers pay promoters for the privilege of pitching their products to you, as well as for assets steered to them. There's a sucker in the room. Guess who? Projected annual savings: \$25,000.



**5.** Now that you're in the business of managing money, commit to learning about the money management business. Learn about fiduciary duties and how people and firms get paid. Recognize that every investment firm is a for-profit enterprise that, despite anything it may say in its glossy marketing materials, likely puts its own interests first. As we saw during the recent financial crisis, some firms created doomed investments that they recommended to clients but bet against. Require anyone you're doing business with to agree in writing that they owe a fiduciary duty to you. Require that their fiduciary practices be audited annually by an independent third party. CEFEX, Centre for Fiduciary Excellence offers this kind of certification. If they won't agree to abide by that higher standard, then walk away. Guidelines developed for professional pension fiduciaries, subject to a legal duty to safeguard participant benefits, can be especially enlightening as to, for example, the importance of following a defined, disciplined process and evaluating performance against established benchmarks. I was surprised to find that prudent practices developed for pension plans are largely unknown to the family office crowd and never addressed at family office conventions. As an asset-owner, you should be even more diligent than a pension fiduciary. After all, it's your money you're safeguarding.



*The CEFEX Mark distinguishes firms which undertake an annual fiduciary audit.*

**6.** To balance the legions of salesmen employed in the industry selling dream scenarios, get counsel from consultants who are knowledgeable in money investment forensics or what can go wrong. You need to hear about the bad and the ugly, as well as the good. If you're not learning about the "dark side," then your education is incomplete. Like it or not, given human nature, some individuals entrusted with other people's money will succumb to temptation at some point in their lives and steal it—sometimes surprisingly late in their careers after decades of faithful service. Madoff, on the other hand, was a scammer from the get-go that took regulators decades to detect. Projected annual cost: \$10,000. Note that this cost may be eliminated if the integrity monitor is retained.

7. Hire an independent party to calculate time-weighted returns on your investments, as opposed to relying upon any broker or private bank involved with recommending them. Due to the inherent conflict of interest, you should never depend exclusively upon the party who recommended or manages the investment for performance information. Projected annual cost: \$15,000. Note that this cost too may be reduced if the integrity monitor is retained.

8. Re-evaluate any arrangements you have with investment firms that purport to offer red carpet services exclusively to the wealthy. My investigations show that private and trust banks targeting the wealthy rarely provide competitive services. Conflict of interest ridden, high cost services with uncompetitive performance or no verifiable performance history are the norm.

9. Focus on fees. The old saying, “you get what you pay for” resonates with many wealthy investors. However, in the money management industry it is rarely true. Remember that a Timex tells better time than a Rolex; a Toyota Corolla is more reliable than a Rolls Royce and a low cost index fund almost always performs better than more costly alternatives. Scrutinize fees but don’t be foolhardy. Never, ever believe that any service will be provided for free. In investment matters, a so-called free or no-fee service almost always means concealed excessive fees. Insist that the fees you pay are unbundled and disclosed. Annual savings \$75,000.

10. Examine whether social or networking considerations have unduly influenced your investment decisions. Beware of investment pitches at your country club; beware of undue reliance upon recommendations of friends; beware of investing with friends. I’m not saying don’t do it. Just make sure that if you do, you’ve done your due diligence.

Wall Street’s solution to any investor problem, such as lack of diversification, underperformance or undue risk, always involves loading additional fees onto the investor. I begin by reviewing the investment products and services clients have been sold to determine whether any are flawed or not worth the price. Better performance at the same or lower cost is the goal and it is a goal that can generally be realized. Knowing what to cut and how to fashion a better replacement product or service is the key.

### **About the author:**

*Edward Siedle has been referred to as “the Sam Spade of Money Management,” “the Financial Watchdog” and “the Pension Detective.” He began his career in law with the SEC’s Division of Investment Management, which regulates money managers and mutual funds; he later served as Legal Counsel and Director of Compliance to Putnam Investments, one of the largest international money management firms. Since 1989, Siedle has founded and managed firms offering specialized services to municipalities, pension funds and money managers.*

*In 1999, Mr. Siedle founded Benchmark Financial Services, Inc., which provides “enhanced integrity” money management, fiduciary consulting and investigative services to institutions, law enforcement, regulators and wealthy individuals. The firm has pioneered the emerging field of forensic investigations of the money management industry and has conducted investigations worldwide involving in excess of \$1 trillion in assets under management.*

*He is nationally recognized as an authority on investment management and securities matters. He has testified before the Senate Banking Committee regarding the mutual fund scandals and the Louisiana State Legislature regarding pension consultant conflicts of interest. He was a testifying expert in various Madoff litigations. Articles about him have appeared in publications including Time, BusinessWeek, Wall Street Journal, The New York Times, Barron’s, Forbes, USA Today, Boston Globe, and Institutional Investor. He widely lectures and has appeared on CNBC, Wall Street Week, and Bloomberg News. He recently appeared in a Bloomberg special on “Hidden 401k Fees” which earned Bloomberg its first Emmy Award. He writes a “Financial Watchdog” column for forbes.com.*

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