Forget All The Misdeeds – Just Trust Us

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Cerulli Associates says that US high net worth clients prefer to hold their money at wirehouses, private banks and trust companies. This includes clients with more than $20 million dollars in that group using the wirehouses, private banks and trust companies.

Since the financial crisis in 2008, the world's 20 largest banks have paid more than $235 billion in fines. One might ask why, after years of misbehavior by many institutions, are wealthy investors still relying on them? One might also ask how the brokerage industry can continue to attract those wealth holders given all the misdeeds and the daily fines and penalties they continue to rack up?

A Lack of Due Diligence

The answer just may be that careful due diligence is not one of the standards America's wealthy are using to evaluate their wealth advisors and custodians. Knowing you own what you think you own would seem to be fundamental and recognizable after the experience of Madoff or Lehman. Madoff's wonderful returns turned to ashes when it was learned that the very assets his investors thought they owned were not owned at all. Custody of assets is fundamental and the custody of a Madoff or a Lehman is purely a sham.

Several years ago, we ran studies of two brokerage houses, each considered a leader in the industry, to evaluate the reporting, auditing and regulatory papers filed by each. One proved just as reliable as a trust company; the other had none of the same protection.

So custody is the start of due diligence. Knowing you have considered all the risks you need to consider requires transparency. When even Fidelity (a family owned company and described by some as the largest "family office" in the world) is accused of sitting on two sides of a table – its own and its customers – and hiding that fact, how can one assume transparency? How many of us actually believe that the big banks are working exclusively in the customer's interest? How many remember the Auction Rate Securities program where banks were apparently emptying their own inventories into their clients' portfolios?

The very process required to ensure due diligence and transparency is a complex process. Even some of the largest single family offices do not do it well. In fact, many family offices follow other family offices in a group-think stampede, assuming that each of the sheep has considered all that needs to be considered about each bank and every other service provider. Family offices fell for Madoff over and over.

Buyer Very Beware

So the protective processes are not in place. The wealth creator, who likely had an entrepreneurial creativity but could execute using deliberate process, looks back after a liquidity event to see the brilliance and intuitive understanding he or she believes easily translatable into wealth management and enhancement.

Here is the question for any of these wealth holders. Where is the process that ensures due diligence when you chose a custodian manager? Is it brand recognition? "I only use the best names" did not protect those relying on Lehman. Is it trust? "I look at him in the eye and decide whether I trust him. Bernie is 100% ok." Only process is protective, and process requires analysis, strategy and formalization before it can be implemented.

The rich people are relying on banks and brokers is not entirely surprising. Within a decade of the financial disasters of 2007, size and reputation seems as comforting as they did before those disasters. Such is the power of institutions with very deep pockets to tell the world every day they really do have the client's best interests in mind.

Once again, buyer beware. Be very wary.