Standards aim to create a long-term solution to wealth mismanagement

By Katie Barker

Don Trone and Charles Lowenhaupt, founders of a new set of Standards for private wealth holders the world over, explain what they hope to achieve

According to Charles Lowenhaupt, chairman of Lowenhaupt Global Advisors: "The problem with 2008 was not that the markets went down, investors are used to markets going down, the problem was loss of trust. And if you don't trust financial service providers, you have to micromanage them."

Unfortunately trust is not a commodity that can be bought back easily. Madoff had an impact beyond the staggering financial losses, he destroyed the wealthy's trust in their funds, their managers and their investment portfolios.

It was in this climate that Lowenhaupt and Don Trone, president and founder of the Foundation for Fiduciary Studies, began discussing how wealthy families and individuals could move forward again with confidence.

Lowenhaput began by identifying a set of principles he believed to be basic and intrinsic to proper wealth management. "There are certain fundamental principles that every wealth holder should be observing. They are not aspirational, they are fundamental, such as the separation of custody and management, the diversification of managers, the need for independent accounting and a basic understanding of how compensation is designed," he explains.

The process of identifying the principles began in December 2008, just after the Madoff fraud was exposed. The aim was to help families, family offices, private trusts and foundations minimise the risk of being caught out by financial mismanagement in the future.

Trone began to develop a set of Standards from the first draft of the principles by which private wealth managers could abide. Unlike public companies, which are required to follow certain guidelines and are held to account over them, private wealth managers have no universal Standards against which they can benchmark progress or assess risk.

"There are a number of best practices defined for wealth holders, and everyone who looks at them would say yes we hope to get to that point where we can follow many of these best practices, but there were no formal Standards," says Lowenhaupt.

When developing the Standards Trone was conscious of creating something that was flexible enough to be applied globally. "They are only going to have credibility and applicability if they can be adopted by anyone responsible for the management of investment decisions. They have to be written with a level of flexibility that provides decision-makers the opportunity to take different paths to get to the same destination," he explains.

Cultural considerations were particularly important for Trone. "We take for granted the plethora of products we have available

in North America and Europe. We fail to appreciate the challenges facing a wealth holder in China or India who may not be able to implement the same process that we're advocating. If we fail to consider the global community we are not going to get global adoption," he says.

The Standards were launched in September through a newly established body: the Institute for Wealth Management Standards. The IWMS is an independent, non-profit organisation designed to take the Standards to an international audience. Between the launch in September and 15 December 2009 the IWMS is holding a consultation period and is hoping family offices, trusted advisors and wealth holders will comment on the Standards.

"Once we get through the comment period the next steps will be to incorporate the comments and then immediately begin to develop the revised Standards into training and certification programmes," explains Trone.

In developing the Standards, Lowenhaupt and Trone hope to give wealth holders a framework in four key areas: governance, risk management, investment management and oversight and monitoring.

A key feature of the Standards is the creation of a new role, the Standards director, who may be from within or outside the family office and would oversee their implementation and continuation. "The Standards director may be the family office executive, it may be the lawyer or the accountant or someone completely external, and thereafter it will be their job to make sure the Standards are implemented and monitored. For many it will be the family office executive and much of the role will be exactly what they do now but in a way that is more disciplined," explains Lowenhaupt.

One of the things both founders

Charles A Lowenhaupt is the founder of Lowenhaupt Global Advisors

hope the Standards will encourage private wealth managers to do is keep a closer eye on their investment portfolios. Standards six and seven focus specifically on investment portfolios and how they should be monitored. Six charges the Standards director with the responsibility of defining investment policy, including the criteria for monitoring performance, and seven advocates setting up a process for regular monitoring of investments to ensure they are performing to their defined goals and objectives.

Although neither Trone nor Lowenhaupt are claiming the losses of 2008 could have been avoided completely, Trone believes following a structured investment policy did mitigate the losses suffered. "The corporations and individuals who were following prudent investment practices fared considerably better than those who were not. It is not uncommon to hear that those who were not following prudent investment practices lost as much as 40% of their portfolio, whereas those who did may have lost less than 20%," he says.

"We see that superior investment performance comes from developing a sound investment practice and ensuring it is continuously followed. Ad hoc changes tends to do more damage than any other activity," he continues.

Trone uses an example from the crisis to illustrate his point. "In the last couple of years the propensity was to move towards hedge funds and alternative investments, not because it was the outcome of a sound investment process but because everyone else was doing it. The Standards are designed to stop that ad hoc movement. They are an anchor to keep you steadied in the storm," he says.

Through a defined and objective process for selecting, monitoring and replacing investment managers, as outlined in standard eight, Trone and Lowenhaupt hope to rebuild trust between wealth managers and wealth holders. Further Standards demand transparency and due diligence so wealth holders can objectively determine how their fund managers are faring.

"Trust is the beginning of the process, not the conclusion," explains Lowenhaupt. "The goal is to build stability in private wealth management so we never see this kind of thing again. The Standards allow wealth holders to come together and ensure stability by really endorsing process in family wealth management."

The aims of the Standards reflect the feelings of wealth managers and wealthy families across the world, they all want to prevent unprecedented losses and find a way to spot fraud, but this is much easier in theory than in practice. That is why these Standards are designed to assess processes already in place and act as a catalyst and basis for change; they are not just a set of new ideas.

In terms of practical implementation, both founders hope the Standards can become part of a working family office within a year. "Once the process begins the Standards director will start reading and getting trained in the Standards and within six to nine months should have a business plan ready for the family office to follow. The beauty of the Standards as opposed to just the principles is that there is a step by step process and within a year they become part of the family's DNA," says Lowenhaupt.

Cost is also hugely important for family offices to consider when discussing the implementation of the Standards, and both Lowenhaupt and Trone concede there will be some initial start up costs for training and these will be increased if families look to hire someone external for the Standards director role.

However, the long-term savings should make the initial costs worthwhile. "Your total costs will actually be reduced because I believe the typical family probably has redundant fees and expenses," says Trone. The Standards are designed to streamline processes and so make them more efficient and cost effective.

Trone also acknowledges the Standards will not necessarily work for all family offices. "There are individual families and family offices that have outstanding governance procedures, even superior to what we are suggesting. But that is not the norm, as evidence by the thousands of investors who were taken in by Madoff.

"We're not saying they should be adopted by every family or every family office, but they should certainly be considered by every family and family office," says Trone.

And the initial reaction from families has been positive. "So far people have liked the Standards because they can be easily articulated, the next generation can understand them, there can be conversations around them and then the Standards offer guidance on implementation," explains Lowenhaupt.

"Family offices have been very supportive because it gives them an objective evaluation tool. They can say we will adopt these Standards, we'll get certified and that will remove a lot of the insecurity and lack of trust many of them are feeling right now," he says.

However both Lowenhaupt and Trone can see some potential opposition, particularly from the financial services industry and professional advisors. "Financial services providers will push back on the Standards which call for more objectivity in the selection of investment managers and greater transparency of fees and expenses," says Lowenhaupt. "The Standards allow a foundation for families and family offices to make clear their demands to their service providers and to do that together as a community of customers," he adds.

"Professional advisors, such as accountants and attorneys, may view family governance as being their sole domain and resent the imposition of Standards by wealth holders," explains Trone.

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IWMS

ABOUT THE INSTITUTE FOR WEALTH MANAGEMENT STANDARDS

The IWMS is a non-profit organisation founded by Charles Lowenhaupt, Don Trone and Campden Media.

The aim of the Institute is to create, develop and promote objective standards for wealth holders to encourage good wealth management and protect private wealth holders.

The Standards are currently in a consultation period and the Institute is inviting wealth holders, family offices and trusted advisors to comment via a brief survey to be found at:

www.wealthstandards.org

The Institute hopes to use the feedback to tailor the standards for effective use by wealth holders.

The crisis has caused many to discuss the issues raised by the IWMS and there are other similar sounding initiatives in the ultra high net worth space. However, Trone believes the IWMS is different and ultimately that these Standards can succeed in creating better governance structures for family offices. "The distinction here is that most of the other programmes we see in the industry are designed for the advisor, this initiative is designed for the wealth holder and that is an important distinction. Most wealth management programme initiatives are empowering the advisor to work with the wealth holder. This is the opposite, it empowers the wealth holder and that is what sets these Standards apart," he concludes.

For Lowenhaupt, introducing the IWMS is about freedom from wealth. "It's ultimately about letting the wealth holder lead their life. It's about the capacity to delegate with ascertainable measures, Standards and rules," he says. FO