BALLENTINE PARTNERS

Wealth Management

The Business of Wealth Management

Important decisions we made, why we made them, and what it means to you

BALLENTINE PARTNERS | ROY BALLENTINE, ChFC, CFP®

How it all began (back when I knew nothing about wealth management)

When my father died in 1984, my family received a very expensive lesson on the consequences of poor estate planning. This article describes the important decisions Ballentine Partners made in structuring our wealth management practice to help families achieve much better results than my family experienced.

My father moved to Wolfeboro, NH long before it became famous as a summer resort, and he began to accumulate real estate that later proved to be valuable. Despite a sophisticated estate plan that included multiple trusts, partnerships, and corporations, things did not go well. We discovered our family was not well prepared to address family governance, business leadership, or the financial consequences of my father's death. The investment advice we received suffered from serious conflicts of interest, the negative impact of which I did not really understand at the time. My mother and her surviving children all had very different notions of what should happen next.

When the dust began to settle, I reflected upon what had happened and why. We had very capable legal, tax, and investment advisors. Their advice was technically correct. But each advisor was working within his or her own "silo."

But what we desperately needed and did not get was comprehensive, integrated, and objective advice to clearly identify the issues and problems that later became so acute and painful. No advisor was able to provide a strategic plan for our family's wealth. We lacked a team leader who could help us to realize the benefits of collaboration among specialty advisors.

The value of comprehensive, integrated advice

Because we believe that wealthy families need comprehensive, integrated, strategic advice, we have focused on building that capability within our practice. We believe few firms can match our capabilities in this area.

The decision to focus on this area affects every aspect of our practice – how we recruit, train and manage our team; how we staff client engagements; and how we measure our results.

For example, our firm recently took on a new engagement with a family whose balance sheet includes liquid investments, many illiquid closely-held business interests, many trusts, and a large private foundation. For many years prior to our involvement, the family worked with expert advisors from various investment, legal and accounting firms.

Within the first few months of our work, we discovered problems in the estate plan that, had they remained undiscovered, would have cost the family many millions of dollars in completely avoidable estate taxes. Those problems related to the manner in which some of the family's investment assets were being transferred to the family's charitable foundation.

In addition, we discovered problems with the documentation and titling of assets. We also designed and implemented new reporting and recordkeeping systems that improved the quality of information available to the family's decision-makers and their advisors, while simultaneously reducing the family's costs.

One important element of the new system was a cash flow forecasting capability. The family's cash flow was so complicated that all previous attempts to develop a forecasting system had failed. In fact, we identified so many improvement opportunities with one major trust that the family decided to completely overhaul the trust – as part of a long list of on-going projects.

Why had these problems and opportunities eluded the very capable specialty advisors who had been working with the family for so long? Because the family never had an advisor with the broad financial planning skills necessary to identify issues, problems and opportunities across planning areas traditionally dealt with by specialty advisors.

Each specialty advisor was working only within his or her own silo. Rarely does any specialty advisor possess the broad knowledge necessary to understand how decisions made in one area will affect the client in each of the other areas. Ballentine Partners sees the big picture. That is what we mean by comprehensive, integrated advice.

The benefits a family derives from comprehensive, integrated advice are not dependent upon the size of the family's balance sheet. We have seen $10 million family balance sheets with more complexity than some $100 million balance sheets.

Why have most other wealth management firms not followed our lead? Because it is very difficult to deliver comprehensive, integrated wealth management advice. Years of training are required for each new team member. The business of investment management is scalable and becomes more profitable as a firm increases the amount of assets it manages. The business of providing financial planning and wealth management advice is not readily scalable and does not become more profitable as a firm grows. As a result, most wealth management firms focus on investment management.

The value of objective advice and avoiding conflicts of interest

The wealth management business has many potential conflicts of interest. Some of these relate to the sale of investment and insurance products. Others are found in the investment process itself. And, some are found in situations where advice may be slanted to the advisor's advantage.

Unfortunately, objective advice is hard to find in the wealth management business. While many firms claim to give objective advice, few are actually structured to deliver it. Every aspect of our practice is designed to minimize conflicts of interest between ourselves and our clients, and we fully disclose any conflicts to our clients.

Suppose you are considering a large transaction that could be done either with debt financing or by liquidating some securities you own. In most wealth management firms, your advisor will be compensated based on the amount of assets you have under management, and he or she will also receive a substantial loan origination fee if you take out a loan.

The amount of compensation that the advisor will be paid if you take out a loan is likely to be quite substantial. Plus, the advisor will receive more compensation from your assets under management if you take out a loan than if you sell assets to raise cash and avoid taking a loan. This is a clear conflict of interest. It is highly doubtful that you will receive objective advice.

Wealth Management Firm Revenue Sources Which May Result in Conflicts of Interest (Ballentine Partners Does Not Participate in Any of These)

• Product sales commissions	• Fee sharing agreements [2]
• Brokerage commissions	• Spreads on securities transactions [3]
• Custody fees	• Soft dollar compensation from brokers [4]
• Marketing fees (12(b)-1 fees) [1]	• Internal fees eventually paid by clients [5]
• Placement fees	• Finder's fees
• Fees from proprietary products	• Referral fees
• "Pay-to-play" agreements [2]	• Loan origination and placement fees

(See reference notes on last page.)

A. How is Ballentine Partners compensated?

Ballentine Partners receives compensation only directly from its clients. We were one of the first firms to adopt this completely transparent system. We fully disclose all our compensation to each client. Our firm does not participate in any of the compensation arrangements shown in the above chart.

Whenever the wealth advisor receives compensation from someone other than the client, a conflict of interest arises. The amount of compensation received by the advisor from third parties is usually not disclosed to the client and may be very significant.

B. How are Ballentine Partners' team members compensated?

Ballentine Partners' wealth advisors are compensated with a base salary plus an annual bonus.

We evaluate and reward senior team members based on:

- Adherence to our company's value system (integrity, reliability, competence, teamwork, and looking out for our clients' interests)
- Client satisfaction and retention
- Technical skills
- Communication skills
- Contribution to developing new client relationships

Our advisors' compensation is never affected or influenced by any decision a client makes about a specific recommendation. In many wealth management firms, compensation is heavily influenced by an individual's success in convincing clients to use the firm's proprietary products and cross-selling the firm's (or its affiliates') services to increase revenue. Ballentine Partners has chosen not to allow that type of compensation system in our firm.

C. Where is my money managed?

Many conflicts of interest in the wealth management business relate to the question of where money is managed. Most wealth managers are primarily engaged in gathering client assets on which they can earn income either by charging fees or by selling products rather than providing comprehensive advice. In most cases, they are not even equipped to do so. Also, they have strong financial incentives to persuade clients to use their own products or investment managers, even if those products or managers are inferior.

At Ballentine Partners we:

- Provide our clients with strategic investment advice that covers all investment assets, regardless of where they are located and who is managing them;
- Structure our client service agreements and fee arrangements to emphasize that we are primarily engaged in providing comprehensive advice, particularly with regard to our clients' investments; and
- Base our investment recommendations on the best products and service we can find anywhere in the marketplace.

D. What investment and insurance products do you recommend and why?

Ballentine Partners bases its recommendations for specific investment and insurance products based solely on its research and knowledge of a particular client's needs. In all cases, our recommendations are driven by our desire to find the best solution. This often means the products we recommend either are sold only through direct distribution channels or are offered only by word-of-mouth. This helps to keep costs down. A manager's willingness to share fees with us is never a consideration. We decline all such offers. When we negotiate fees with outside managers, we seek a discount that will apply to every client who wishes to use that manager.

Many wealth management firms claim to have an "open architecture" investment platform, yet they only recommend managers who agree to share a portion of their management fees with the wealth manager. Investment managers who will not share fees are excluded. Some of the best investment managers refuse to participate in fee-sharing agreements. That kind of advice is not objective.

What families need is objective advice. They also need access to investment and insurance products that are the best choices for the family's needs, regardless of who created those products. Ballentine Partners is one of a relatively small number of firms positioned to address this need.

E. Which hat is my advisor wearing today?

Some wealth management firms have tried to address families' desires for objective advice by setting up parallel organizations. One organization presents itself as offering objective advice, and the other is a product sales and brokerage organization.

The same individual client advisor represents both organizations at the same time – even within a single client meeting. During part of the meeting the advisor is supposed to be delivering objective advice, and a few minutes later, the same advisor is convincing the client to purchase an insurance or investment product in which the advisor has a financial interest. When acting in this second mode, the advisor is not required to act in the client's interest or to disclose his or her compensation.

At Ballentine Partners, we wear only one hat – all the time. Our advisors must act in our clients' best interests at all times and must disclose all conflicts of interest.

The value of strategic planning, team leadership and collaboration

A. Strategic planning for family wealth

Many wealthy families lack a strategic plan for their wealth, and they have not adequately defined their wealth management goals.

Helping families to define their goals and develop a strategic plan is clearly the job of a financial planner. That is why Ballentine Partners puts an experienced financial planner in charge of each relationship.

We make financial planning an integral part of the wealth management process. Every major financial decision is examined though a financial planning lens to understand how the decision will impact the family's ability to meet its wealth management goals. Often, the best wealth planning opportunities are found by analyzing the interactions between investment strategy, tax planning, family wealth transfer planning and charitable giving. An experienced and knowledgeable financial planner is uniquely positioned to identify these opportunities.

Over the years, we have learned family wealth is best protected when a family receives both sound investment advice and sound financial planning advice in a tightly integrated manner. In fact, in many cases, the added value of sound financial planning advice may far exceed the value of sound investment advice. For example, we frequently design and create trusts that are intended to help young adult family members develop their financial skills.

One of our clients described the benefits as "priceless." Good investment results are important, but the development of the human potential of each family member is far more important.

Our approach stands in sharp contrast to most other firms. Most firms put a "relationship manager" whose job is to cross-sell as many products and services as possible in charge of each engagement. The financial planning experts are called in only when the relationship manager thinks they are needed. Many of our clients came to us after realizing the "relationship manager" model of wealth management was not meeting their needs.

B. Preparing the next generation

The dissipation of family wealth is such a universal problem that most cultures have a proverb similar to: "From shirtsleeves to shirtsleeves in three generations." In many cases, the wealth will be dissipated within two generations. Ironically, parents spend large sums on advice on how to preserve and grow family assets without devoting adequate resources to financial skill development in the next generation. The success of any wealth preservation plan ultimately depends upon successor generations' thoughtfulness and ability to provide effective stewardship of wealth.

We believe family members should embrace the concept that successful wealth management is a multi-generational endeavor. Years ago, our firm made a commitment to invest in training our advisors for the work they do with parents and children to help family members develop their financial skills and become responsible stewards of wealth. As a result, we have enjoyed a long and fruitful collaboration with Dr. James Grubman, one of the country's leading wealth psychologists.

Most wealth management firms have no specific plan to address the "shirtsleeves to shirtsleeves…" problem. A few firms have sponsored "money camp" programs and other events intended to promote financial literacy. But Ballentine Partners goes beyond that. In addition to sponsoring events, we engage directly with the families we serve. We believe direct involvement through coaching, teaching, and individual counseling sessions will be the most effective way to teach financial skills.

C. Team leadership and collaboration

Successful design, implementation and management of a plan to protect and grow family wealth requires teamwork and collaboration by the family's key specialty advisors. In addition to picking expert specialty advisors for each major planning area (tax planning, estate planning, insurance, etc.), make sure you have a financial planning expert as the overall team leader.

It is important to have a team leader to help all of your advisors do their best work, drawing upon their individual expertise, integrating it all in an optimal strategy for the family, and leading the implementation of the strategy.

The financial planning expert should be as free from conflicts of interest as possible, provide full disclosure about compensation and conflicts of interest, and put the client's interests first at all times. That is the commitment that Ballentine Partners has made to our clients.

Key questions to help you protect and grow your family's wealth

- Is your family receiving objective advice?
- Does your family receive full disclosure of all of your wealth management costs?
- Does your family have clearly stated wealth management goals?
- Does your family have a well-defined strategy for wealth management?
- Does your family have a plan for preparing the next generation to be effective stewards of the family's wealth?
- Is your family receiving comprehensive advice – is each major recommendation carefully analyzed from a financial planning perspective?
- Does your family's team of advisors have an effective team leader?
- Does your family experience the benefits of teamwork among your key advisors?

Notes

1. 12(b)-1 fees are paid as percentage of assets under management (typically 0.25%-0.50% annually) for as long as the client holds the investment. Many mutual funds pay the selling firm a 12(b)-1 fee.
2. Pay-to-play and fee sharing arrangements are common when a wealth management firm recommends an outside manager. The outside managers are often required to share their management fees with the recommending firm. Some firms use the term "open architecture" to describe this arrangement. However, the architecture may be open only to outside managers who are willing to pay for referrals. Ultimately, it is the clients who pays.
3. The spread is the difference between the bid price and the ask price for any security. For some securities, such as municipal bonds, the spread is relatively large.
4. Soft dollars are valuable products and services that brokers provide to wealth managers in exchange for brokerage business that the manager directs to the brokerage firm. Ultimately, these products and services are paid for by clients in the form of higher brokerage commissions than would have been incurred had the soft dollar payments not occurred.
5. Examples: Appraisal fees, loan original fees, or real estate brokerage fees that are charged to an investment firm's proprietary products for work done by another subsidiary of the investment firm. There is no assurance that the amounts paid reflect the market rate for such services. The amounts paid are usually not disclosed to investors.

About Roy C. Ballentine, ChFC, CFP®

Roy is the Executive Chairman and Founder of the firm. Roy dedicates his time to thought leadership, strategic oversight of client engagements, and coaching and training our team members.

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