Could Your Family Benefit from an Independent Chief Investment Officer?

A Whitepaper by Innovest

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EXECUTIVE SUMMARY

Families with assets in excess of $100 million often have multiple investment advisors managing different segments of the family's portfolio. However, having multiple advisors can decrease the likelihood of meeting overall objectives, managing risks, controlling costs, and generating better returns. A family's Chief Financial Officer (CFO) may not be well equipped to manage investment advisors due to insufficient expertise and resources, including time. The most effective solution is to complement the family CFO with an independent family Chief Investment Officer (CIO). A high-quality, independent family CIO:

- Manages and quantifies the family's overall investment objectives, downside risk tolerances, and time horizons based on forward-looking views of the capital markets.
- Develops an investment governance structure, including processes and policies.
- Negotiates managers' fees, especially in an environment of aggressive cross-selling.
- Provides sophisticated and customized performance reporting, including detail on alternative investments, fees, and liquidity.
- Monitors portfolios and managers on an ongoing basis.
- Conducts thorough diligence on investment strategies brought to the family by all advisors, friends and acquaintances and provides unbiased, conflict-free opinions.
- Works with the family to educate the next generation and to review succession planning.
- Considers the family's unique circumstances, including social investing and impact investing considerations.
- Can provide services on either a discretionary or non-discretionary basis. In the institutional world, an CIO often has authority (discretion) to make investment decisions on behalf of the institution.

A firm providing independent CIO services needs to be thoroughly vetted, including its experience and reputation, conflicts of interest, the experience of the team, and the firm's investment due diligence and reporting capabilities. A quality independent CIO can pay for itself through providing services and reducing fees, as well as by making a significant difference for a family's future generations.

INTRODUCTION

It is not uncommon for a family with assets in excess of $100 million to have at least three separate investment advisors managing segments of the family's portfolio. This approach differs from most institutions, such as endowments and foundations, which typically have one consultant who advises on all the managers, products, and strategies in the entire portfolio.

Institutional consultants are similar to a conductor who "manages" all of the instruments in an orchestra. Families who hire multiple "conductors" can decrease the likelihood of meeting overall objectives, controlling costs, and generating better returns.

Family offices often have a Chief Financial Officer (CFO) who is responsible for bookkeeping and accounting, tax, trust management, estate planning, and philanthropy management. In addition, a CFO is often given the responsibility for managing the investment advisors. However, a CFO can be ill-equipped to manage investment advisors due to insufficient resources (including time) and expertise. Consequently, the CFO's process of managing brokers or advisors is often simply repackaging the information provided by the advisors. The problem is that the advisors are often conflicted and have strong incentives to paint the most positive picture, while omitting important information that would be helpful for the family to evaluate. Examples include the amount of fees at all levels and the performance net of all fees. Further, it becomes difficult to see the whole investment picture of the combined portfolio – risks, concentrations, diversification, fees, etc. The result can end up being a horse race between advisors: the advisor that gets the best results over a short period of time stays and the others go. This approach does not work in the long run. The Securities and Exchange Commission (SEC) requires managers to include the disclaimer "past performance is no indication of future performance," because chasing performance simply does not work.

The Independent CIO's Role

The most effective solution is to complement the family CFO with an independent, family Chief Investment Officer (CIO). The purpose and services that a quality, independent CIO should deliver are:

- ✓ Confirm and/or develop the family's overall investment objectives, risk tolerance, time horizons and the role of the investment portfolio(s) within the total family enterprise
- ✓ Develop a governance structure, including policies and process
- ✓ Manage investment advisors and brokers to help you understand your combined asset allocation, quantify and manage downside risk, and identify portfolio concentrations and potential investment opportunities
- ✓ Conduct thorough due diligence on investment strategies brought to the family by advisors, friends and acquaintances
- ✓ Outline and negotiate fees
- ✓ Provide sophisticated, custom performance reporting including detail on alternative investments, especially private equity, as well as the overall liquidity profile and fee analysis
- ✓ Monitor portfolios on an ongoing basis
- ✓ Determine the best approach to educating the next generation and succession planning

✓ Consider unique circumstances, e.g. environmental, social, governance

Overall Investment Objectives, Risk Tolerances, Time Horizons and the Role of Investment Portfolio Within the Total Family Enterprise

The first step in creating an appropriate investment structure is to confirm your investment objectives, risk tolerances, time horizons, spending and the role of the portfolio in your overall family enterprise. Agreement on all these items should be achieved prior to deciding on investment mandates for investment advisors and brokers.

A few considerations:

1. What are the potential uses of the funds? Near term, longer term? What would cause this to change? Should all investments be managed in same manner?
2. If you have a large private or public holding in a specific industry (such as real estate or energy), you may wish to exclude additional investments in these industries from the rest of the portfolio. If you engage in a high-risk business (for example, a start-up), perhaps the remainder of investment portfolio should be invested in a more risk-averse manner.
3. What is the scale of the assets? Would you benefit from keeping investments with one advisor to benefit from economies of scale regarding fees and trading costs?
4. What role will the investments play within the overall family enterprise? How much volatility can be tolerated?

Governance – Policies and Process

The culmination of the knowledge referred to in the above section should be documented in a formal Investment Policy Statement (IPS). The IPS should be reviewed on an annual basis, at a minimum, or whenever your family situation changes. The policy may address the cash flow needs from the portfolio, as well as important governance issues that address the following questions:

1. Who is authorized to make investment decisions? Family, committee, independent CIO?
2. How frequently do formal family or committee meetings take place?
3. Are family members the only decision makers, or are outside trustees involved?

Portfolio Design and Asset Allocation Characteristics

Portfolios that are run by different advisors can have dramatically different risk and return characteristics. It can be helpful to quantify the characteristics of each portfolio to help understand the differences and determine whether each portfolio is constructed to meet the family's objectives. Forward-based capital markets assumptions must be utilized, as historical asset class rates of return can be highly misleading in quantifying characteristics. For instance, historical long-term fixed income returns are much higher than forward-looking expectations because current rates are low relative to history. When equity valuations are high as well, one could argue that future stock returns would be muted.

Figure 1 illustrates the characteristics of a portfolio (IPS) as well as several potential asset class mixes that could improve the overall risk/return profile of the portfolio.

Figure 1

2023 – Asset Mix Alternatives			
Portfolio Component	**IPS**	**Mix 1**	**Mix 2**
Large Cap (U.S.)	20%	14%	22%
Small/Mid Cap (U.S.)	8%	6%	8%
Int'l Equity (Developed)	12%	11%	17%
Emerging Mkt Equity	6%	4%	6%
Domestic Fixed Inc.	21%	29%	11%
Low Correlated Hedge	15%	12%	12%
Other Real Assets	8%	7%	7%
Private Equity	5%	10%	10%
Private Debt	5%	7%	7%
Totals	100%	100%	100%
Expected Return	**7.03%**	**7.00%**	**7.50%**

2023 – Projected Downside Risk in a 12-month Period			
	IPS	**Mix 1**	**Mix 2**
95th Percentile	(16%)	(12%)	(18%)
99th Percentile	(23%)	(19%)	(26%)
Prob > 0.00%	66%	70%	65%

While return objectives are one important component of portfolio construction, downside risk should also be considered. In Figure 1, the 95th percentile depicts a one-in-20 chance of a loss in a one-year period. In other words, to expect an average annual return of 7.00 percent in Mix 1, you would need to expect that the portfolio could drop by 12.00 percent in a bad market.

Understanding risk is vital and will help a family stay grounded in down markets. Emotions run high when markets fall steeply, leading to investment mistakes. By quantifying downside risk, portfolio construction can be based on what the family can withstand in unpredictable times, and therefore decisions made in downturns become less emotional.

Product Evaluation

When brokers, advisors, friends and acquaintances bring new investment ideas and products to you, are you equipped to determine whether the investment is appropriate for the portfolio given overall investment objectives? Is it a good investment relative to other opportunities? Are fees in-line with the peer group? Is the product structure reasonable?

Brokers or advisors should be able to demonstrate their due diligence process for traditional products being recommended for the family's portfolio. Typically, manager tenure, performance consistency, fees, style drift, risk, and organizational consistency should all be analyzed and explained.

Sometimes a more challenging situation is when families are approached by friends and acquaintances with new investment opportunities. While there may be some comfort investing alongside people you know well, often these strategies have not been fully vetted and, in particular, the role of the strategy within the family's overall portfolio might be uncertain. Furthermore, it can be difficult for a family to decline their friends' recommendations. An independent CIO can conduct full investment due diligence and provide a third-party perspective on these opportunities. The independent CIO can also be the one to help communicate the decision as to whether or not the opportunity makes sense for your family.

Alternative Investments. With alternative investments, the process should be even more in-depth. Risks and returns are often less market-driven and more product specific.

Background checks, onsite visits, structure analysis and reference checks are crucial. How and why are returns generated?

Proprietary Products. There may be times when a broker or advisor's proprietary products are of high quality. Often, however, they are not. The compensation structure at many firms varies and may encourage advisors to recommend their own company's products. Special scrutiny of these products is essential.

Case Study: Selling Ideas

Situation: A family office worked with multiple advisors and brokers. The family was skeptical about conflicts of interests and needed an independent CIO to take control of the asset allocation, product evaluation, and consideration of new products and managers.

Additionally, the brokers/advisors were "selling ideas" to the family office that were laden with high fees and commissions. For instance, one manager wanted to "sell access" to a manager for a three percent entry fee!

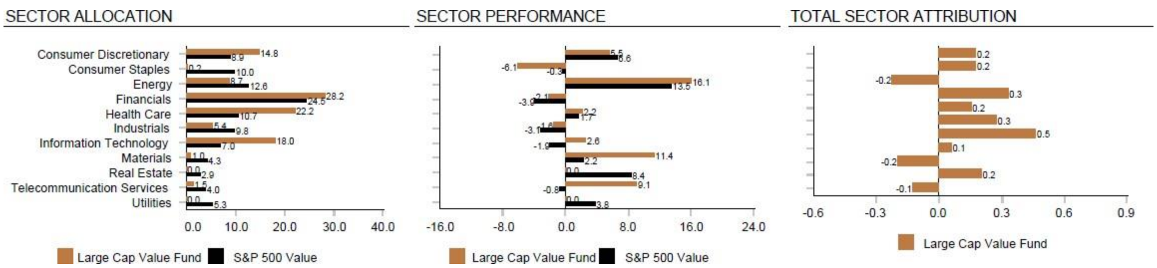
Independent CIO Solution: Each broker/manager submitted their best ideas to the family and CIO, and then the best products were selected based on the family office's needs. They now use the best products from each broker/advisor at reduced fees.

An independent, conflict-free family CIO that does not offer proprietary products is ideal for conducting this diligence. The CIO can help you determine whether the recommended products represent the best-of-breed within the asset class.

Attribution analysis can also help explain how the manager's performance was generated and whether the investment process is sound and repeatable. Institutional investors rely on this information to help make decisions about managers and overall asset allocation. The analysis in ***Figure 2*** provides an example of an attribution analysis that can be performed on investment strategies over short- and long-term time periods.

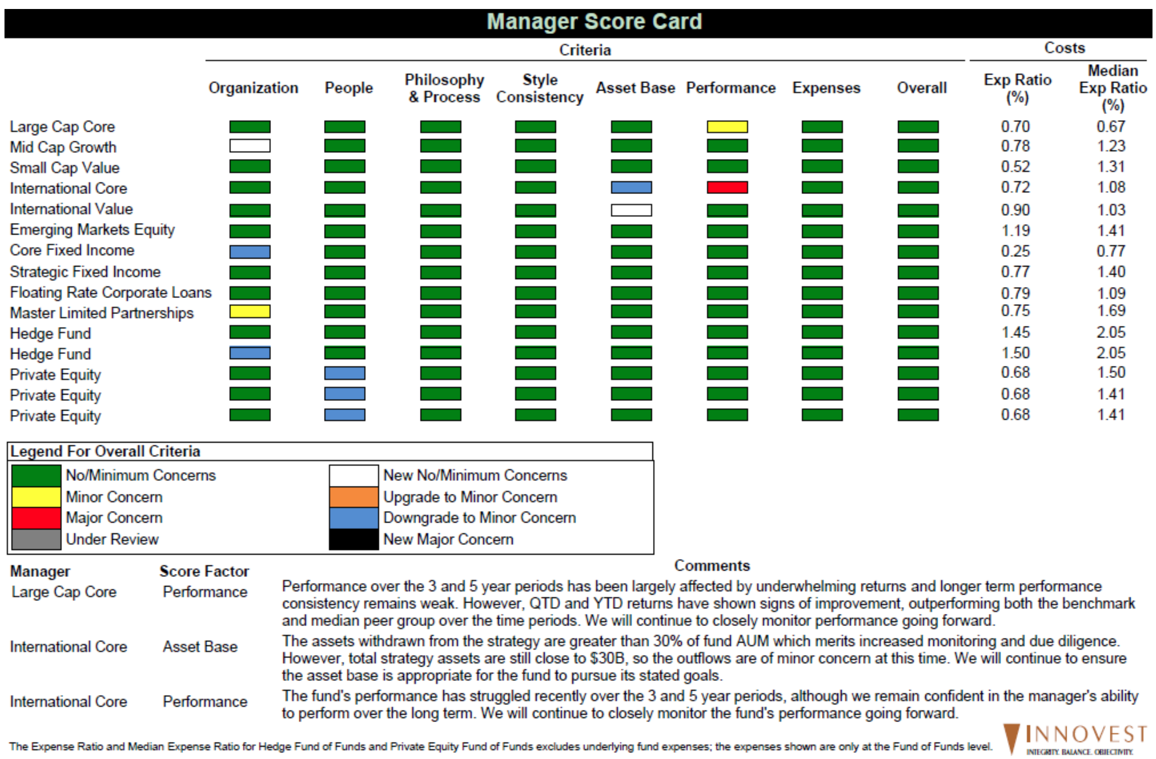
Figure 2

Large Cap Value Fund



Product Due Diligence. As managers inherently present their products in the best light, it is essential to obtain an objective opinion as to the progress and success of products, managers and the total portfolio relative to goals. Extensive qualitative and quantitative criteria should be used in the selection and monitoring of managers. ***Figure 3*** illustrates a sample rating system in which products are given a yellow or red rating indicating there are minor concerns, or major concerns regarding that manager with an accompanying explanation.

Figure 3



Case Study: LJM Growth and Preservation Fund – A Morningstar Five-Star Rated Fund

Situation: An investor asked their advisor about whether LJM Growth and Preservation Fund could be a potential investment solution. LJM had generated a consistent track record of high single-digit returns from its inception in 2006 through mid-year 2017. Moreover, whenever the fund had modest negative periods, it snapped back time after time.

Independent CIO Solution: After extensive due diligence, including a site visit, it was recommended to not invest in the fund. LJM was a classic volatility strategy, using futures and options to essentially bet on the direction and magnitude of the stock market. The strategy itself was not much different than other volatility strategies – it just had more success – for a limited time.

In the matter of a couple days in mid-February 2018, the fund fell approximately 85 percent in value and began liquidating all assets.

Analysis of Concentrated Stock Positions

Many families have significant, concentrated positions in low-basis securities. It is typically beneficial from a risk/return standpoint to sell these securities and diversify the portfolio. However, the benefits from diversification need to be weighed against the tax consequences. Careful analysis by an independent party is required to determine an appropriate strategy for these positions, with careful analysis given to hedging techniques, diversification benefits, tax implications, gifting considerations, and other factors. Fees on specialized strategies can be significant, and an independent family CIO can help to drive down fees by bidding out the proposed solution to various third parties.

Case Study: Taking a Variable Pre-Paid Forward Contract Out to Bid

Situation: A family had a large concentrated stock portfolio and needed diversification, liquidity and downside protection. An outright sale would have resulted in a huge tax bill. The family's Wall Street firm proposed a variable forward contract to hedge the position and create liquidity. However, pricing was not transparent.

Independent CIO Solution: Although the hedging strategy was a solid idea, transparent pricing and competition was created through competitive bidding from several banks. In the end, the family received significant liquidity for diversification, received cash flow from dividends, protected stock price on downside and saved more than $900,000 in fees and commissions.

Performance Evaluation

Performance results should be evaluated at both the total portfolio level and manager/strategy level, including comparisons versus appropriate benchmarks.

All investments with their corresponding benchmarks should be reflected in a table to provide an apple-to-apples comparison. Benchmarks should be clearly stated in the Investment Policy Statement. Ideally the independent CIO's portfolio accounting software should link to each custodian to receive daily downloads to ensure accuracy. The sample in ***Figure 4*** depicts a simple, but comprehensive, table of returns.

Figure 4

Table of Returns								
Monthly Flash Report								
		Performance(%)						
	Estimate/ Final	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
All Cap Equity								
Broad Domestic Equity Manager 1	F	2.90	3.31	2.62	15.90	10.97	13.13	9.31
Russell 3000 Index		2.82	3.21	2.55	15.06	10.72	12.85	9.21
International Equity								
International Equity Manager 1	F	-0.84	0.82	1.06	11.64	6.30	6.20	N/A
MSCI EAFE (Net) Index		-2.25	-0.02	-1.55	7.97	4.33	5.93	2.10
International Equity Manager 2	F	2.88	2.11	4.68	16.75	11.15	10.11	N/A
MSCI EAFE Growth Index (Net)		-0.20	1.30	0.25	9.99	5.91	6.99	2.84
MSCI EAFE (Net) Index		-2.25	-0.02	-1.55	7.97	4.33	5.93	2.10
Emerging Markets								
Emerging Markets Manager 1	F	-3.47	-4.81	-3.09	12.28	6.86	4.66	2.63
MSCI Emerging Markets Index		-3.52	-3.93	-2.52	14.43	6.56	4.89	1.96
Fixed Income								
Client Fund - Fixed Income Manager 1	F	0.74	1.03	0.55	11.02	5.84	N/A	N/A
Blmbg. Barc. U.S. Aggregate Index		0.71	-0.04	-1.50	-0.37	1.39	1.98	3.72
Alternatives Composite		**1.04**	**1.98**	**-0.07**	**5.27**	**6.84**	**4.54**	**N/A**
Alternatives Composite Benchmark		1.51	2.66	1.04	4.69	3.82	4.73	4.79
Hedge Funds								
Client Fund - Multi-Strategy	F	0.74	1.03	0.55	11.02	5.84	N/A	N/A
Hedge Fund 1	E	0.20	0.07	-1.08	0.22	-4.12	-0.64	N/A
HFRI Fund Weighted Composite Index		1.04	1.46	1.41	6.64	3.42	4.26	3.37
Hedge Fund 2	F	-0.70	-0.05	1.82	4.14	2.62	2.89	N/A
HFRI ED: Distressed/Restructuring Index		0.94	1.62	1.88	5.16	3.89	3.56	4.37
Hedge Fund 3	F	2.10	3.81	5.64	11.71	3.94	6.01	N/A
Master Limited Partnerships								
Master Limited Partnership 1	F	0.65	3.61	-2.30	-1.54	0.12	3.35	N/A
Alerian MLP Infrastructure		4.31	12.53	-0.43	-6.89	-8.97	-3.04	6.86
Real Estate								
Real Estate Manager 1	E	0.00	0.00	0.00	9.04	12.36	N/A	N/A
FTSE NAREIT Equity REIT Index		3.95	5.44	-3.21	1.34	4.88	6.97	6.25
Reinsurance								
Reinsurance Manager 1	F	0.11	0.44	1.11	-12.70	0.88	N/A	N/A
Swiss Re Global Cat Bond Index		0.65	1.23	3.02	2.09	4.50	5.24	6.86
Total Fund								
Client Total Fund	E	0.74	1.03	0.55	11.02	5.84	N/A	N/A
Client Fund Custom Benchmark		0.40	0.99	0.17	8.94	5.86	6.98	4.69
Cash & Equivalents								
Cash	F	0.00	0.00	0.00	0.00	0.03	0.12	N/A

Private equity and real estate investment reporting is often inconsistent, especially if the investments are funded through capital calls. These investments should be included in the total return of the combined portfolio, and the internal rate of return should be calculated for each investment. Often, families can overstate their success with private equity, as successes often overshadow poor investments that can drag performance. Accuracy is important to grasp the big picture, and performance can be segmented by sector or strategy (venture, late stage, technology, energy, etc). Please see Figure 5 for a sample of private equity and real estate reporting.

Figure 5

Summary of Private Investments								
Fund	**Type**	**Commitment**	**Contributed**	**Distributed**	**Current Value**	**Total Value**	**Total Value/Paid-In**	**Inception-to-Date IRR**
Concentrated Private Equity								
PE 1	Private Equity	-	$965,250	$0	$965,250	$965,250	1 x	0.00%
PE 2	Private Equity	-	$1,417,075	$47,689	$1,410,000	$1,457,689	1.03 x	76.00%
PE 3	Private Equity	-	$350,000	$79,536	$350,000	$429,536	1.23 x	3.30%
Total Concentrated Private Equity	**Private Equity**	**-**	**$2,732,325**	**$127,224**	**$2,725,250**	**$2,852,474**	**1.04 x**	**39.33%**
Concentrated Real Estate								
Real Estate 1	Real Estate	-	$2,244,312	$0	$2,397,764	$2,397,764	1.07 x	1.24%
Real Estate 2	Real Estate	-	$10,690,361	$0	$9,613,086	$9,613,086	0.9 x	-9.28%
Real Estate 3	Real Estate	-	$2,435,152	$0	$2,222,300	$2,222,300	0.91 x	-2.94%
Total Concentrated Real Estate	**-**	**-**	**$18,102,149**	**$127,224**	**$16,958,399**	**$17,085,624**	**0.94 x**	**1.14%**
Personal Property								
Car Collection	Personal	-	$904,678	$6,620	$811,363	$817,983	0.9 x	-1.43%
Total	**Personal**	**-**	**$904,678**	**$6,620**	**$811,363**	**$817,983**	**0.9 x**	**-1.43%**

Case Study Reporting

Situation: An extremely security-conscientious individual had many accounts and multiple custodians. The individual also did his/her own trading and had partnerships set up for various family members. This format created the inability to view the big picture of the combined portfolios, including the overall risk/return profile.

Independent CIO Solution: Custom reporting was implemented which included entering all aspects of the portfolios each month and reflected the ownership of each portfolio within the performance and market values of the individual portfolios. This custom reporting allowed the individual to have a big- picture allocation view, transaction details to simplify tax reporting, custom cash flow that led to catching a miscalculation, and, most importantly, the individual did not compromise his/her security requirements.

Liquidity

During the 2008 downturn, many investors were caught off guard by the lack of liquidity in their portfolios. Capital calls came at an accelerated pace from private equity investments, and margin calls were frequent. Many investors were forced to sell their most liquid investments – often selling equities near the bottom of the market. These problems could have been prevented or mitigated through good recordkeeping and discussing the liquidity characteristics of private equity, hedge funds, real estate funds, structured products and other alternative investments in advance of investing. ***Figure 6*** is a sample liquidity schedule that addresses the aforementioned characteristics and liquidation timeframes. The schedule tracks the percentage of the portfolio that can be liquidated in various timeframes and assists the family with determining if the liquidity profile of the portfolio is consistent with the family's overall objectives and cash needs. As shown, only 65.4 percent of this sample portfolio is liquid within one week, and 94.8 percent of the portfolio can be liquidated within one year.

Figure 6

		Cash Availability								
Asset Class	**Market Value**	**One Week**	**One Month**	**One /Two Quarters**	**Three Quarters**	**One Year**	**Illiquid**	**Contributions**	**Withdrawals**	**Notice**
Broad Domestic Equity										
	$ 15,555,089	$ 15,555,089						Daily	Daily	None
International Equity										
	$ 3,295,408		$ 3,295,408					Monthly	Monthly	10 days
	$ 4,161,282	$ 4,161,282						Daily	Daily	None
	$ 4,231,751	$ 4,231,751						Daily	Daily	None
Emerging Market Equity										
	$ 3,447,130	$ 3,447,130						Daily	Daily	None
Fixed Income										
	$ 4,707,616	$ 4,707,616						Daily	Daily	None
	$ 2,769,149						$ 2,769,149	Monthly	Bi-annually	90 days
	$ 3,955,961			$ 3,955,961				Monthly	Quarterly	90 days
	$ 3,893,488		$ 3,893,488					Monthly	Quarterly	60 days
	$ 4,576,294					$ 4,576,294		Monthly	Annually	90 days
	$ 157,349			$ 157,349				Monthly	Quarterly	45 days
	$ 39,648						$ 39,648	N/A	N/A	N/A
	$ 258,185					$ 258,185		Quarterly	Annually	75 days
Master Limited Partnerships										
	$ 2,280,523	$ 2,280,523						Daily	Daily	None
	$ 3,319,495	$ 3,319,495						Daily	Daily	None
Real Estate* **										
	$ 1,649,377	$ 1,649,377						Daily	Daily	None
	$ 434,392						$ 434,392	N/A	N/A	N/A
Reinsurance										
	$ 2,079,400			$ 2,079,400				Quarterly	Quarterly	One Week
Cash										
	$ 1,159,163	$ 1,159,163						Daily	Daily	None
Total Portfolio	**$ 61,970,700**	**$ 40,511,426**	**$ 7,188,896**	**$ 6,192,710**	**$ -**	**$ 4,834,479**	**$ 3,243,189**			
% of Portfolio		65.4%	11.6%	10.0%	0.0%	7.8%	5.2%			
% of Portfolio Cumulative		65.4%	77.0%	87.0%	87.0%	94.8%	100.0%			

Fee Disclosure

Families often do not understand all the fees that they pay to their brokers, advisors or investment managers. While some structured products, insurance products, and fixed income fees are hard to uncover or understand, a quality, independent CIO can uncover them or provide professional estimates. Fees are a headwind for investors, and full disclosure can be very enlightening. Fees for similar strategies can vary immensely from advisor to advisor, and it is important to determine why and whether extra compensation is being paid to the advisor on certain strategies. ***Figure 7*** is an example of a fee disclosure summary.

Figure 7

Manager	Management Fees	Incentive Fee	*Internal Manager Fees
International Equity	0.82%		
International Equity	0.90%		
Real Estate	2.00%	20% with GP catch-up	
MLP	1.10%	-	
Sample Endowment Fund	0.55%	-	0.73%
Emerging Markets	0.65%	-	
Fixed Income	1.50%	20% with a high watermark	
Fixed Income	2.00%	20% with a high watermark	
Fixed Income	0.75%		0.32%
Fixed Income	No fee for liquidating vehicle		
Fixed Income	2.00%	20% with a high watermark	
Fixed Income	0.50%		
Fixed Income	No fee for liquidating vehicle		
Broad Domestic Equity	0.12%		
Reinsurance	2.42%		
MLP	0.75%		
International Equity	1.00%		
Cash	0.00%		

	Annual Percentage Fee
Manager Fees	0.76%
Internal Manager Fees	0.34%
Total Portfolio Fees	1.18%

*Internal Manager Fees are the additional fees charged by the underlying managers in a Fund of Funds portfolio. These fees are all estimates.

Fee Negotiation and Related Issues

An independent CIO can help with fee negotiations for clients, thereby paying for CIO services multiple times over. Advantages that an independent CIO has over a single-family office are size and clout. Families need to be aware of the pressure that brokers or advisors receive to drive up "client profitability," which is not what the client is making in returns, but the compensation that the broker or advisor is receiving.

The article "Private Banking Meets Cross-Selling for JPMorgan's Wealthy Clients" published in Bloomberg[1] is revealing. According to the article, "How banks cross sell – essentially a 'would you like fries with that' approach – has come under regulatory scrutiny after revelations last year that Wells Fargo employees opened millions of fake accounts in clients' names to reach sales targets. Wells Fargo admitted to a lapse and has changed its incentives. Nonetheless, the scandal brings an old question about banking into sharper focus: When do bank's incentives for employees put the customer second?" The article mentions that JP Morgan's executives have touted their ability to cross-sell: "'Cross-selling is a big deal. And we do an exceptionally good job at cross-selling. We think we're among the best out there,' Chief Executive Officer Jamie Dimon told an investor conference in September 2012, referring to the bank's retail business. Fifteen months later he told another conference: 'We do as much cross-selling as a Wells Fargo.'" As the article identifies, "There's nothing illegal about cross-selling. Every

1 "Private Banking Meets Cross-Selling for JPMorgan's Wealthy Clients." Neil Weinberg. Bloomberg. February 1, 2017.

company wants to sell its own stuff, and JP Morgan, the nation's biggest bank, is no different." It is common for firms to have programs to increase their brokers' or advisors' compensation at the expense of the firm's clients. The prevalent "buyer beware" Wall Street culture can help build a strong case for an independent, family CIO.

Investors should be aware of the following fees:

+ **Manager/Product Fees.** Many of the same investment managers and strategies can be accessed by different firms, often at different costs. There can be overlap between brokers or advisors for the same family, which is an opportunity for negotiation.
+ **Benchmarking managers' fees versus peer groups is important to disclose**. What are underlying managers' fees and how do they compare to the median comparable product? An example of full disclosure of fees is included in the Manager Score Card in ***Figure 3*** on page 7.
+ **Share Class Differences.** Reviewing mutual fund share classes on an ongoing basis is a helpful way to reduce fees. Often, when the least costly share class is not being used, it means that the advisor is receiving additional compensation. ***Figure 8*** is an example of a share class review.

Figure 8

Sample Share Class Review		
Funds Available	**Net Expense**	**Availability**
Equity Fund Share Class A	0.86%	Available
Equity Fund Share Class B	0.59%	Available
Equity Fund Share Class C	0.49%	Available
Equity Fund Share Class D	0.83%	Available
Equity Fund Share Class E	0.53%	Available
Equity Fund Share Class F	0.62%	Available
Equity Fund Share Class G	0.49%	Available

+ **Placement Fees.** Brokers or advisors, at times, will present a product to a family but then reveal a one-time "placement fee" of one to four percent. Placement fees are unnecessary, highly negotiable, and are used to increase client costs and advisor compensation. A good independent CIO can be very successful at negotiating them away.
+ **Fees to Hedging Concentrated Equity Positions**. Tremendous value can be added by having several firms bid on the hedging strategies for concentrated equity positions. This competition between brokers can significantly reduce the usually undisclosed fees and compensation spread that the broker is making.
+ **Fees on Structured Products**. Many advisors recommend "structured products" to clients, which can come with very high fees. One former creator of structured products estimated that compensation spreads for the firms that put these products together were around 10 percent. An independent OCIO can help to provide transparency into product fees and determine less expensive ways to get the same exposure.

Education of Next Generation and Succession Planning

Is the next generation of family members involved in the current decision-making process, or if not, at what point will they be involved or taking over? How will responsibilities be divided? Does the next generation understand the family's objectives, and are they educated on the family's investments? These are all very important questions for families to address in advance of succession changes. An independent CIO can help develop a formal education program for next-generation family members that is customized to the family's needs with consideration given to the following:

1. At what point in time should the next generation be educated?
2. How sophisticated is the next generation from an investment perspective?
3. Given this level of sophistication, what would be the right approach to an education program?
4. Should group or individualized education sessions be held?
5. Who should perform the investment education?

Values Investing

Increasingly, and especially as assets are transferred from generation to generation, families are considering factors other than return and risk in their overall investment objectives. For example, environmental, social or governance (ESG) or faith-based considerations may be important to the family when constructing the portfolio. An independent CIO can help to weigh pros and cons of the various ways of implementing these considerations in the portfolio, from negative screening to active allocations to certain areas, such as impact investing.

Case Study Social Investing

Situation: A family foundation sought to be in harmony with their philosophy and mission by not investing in certain companies.

Independent CIO Solution: After research, it was recommended that the family foundation could implement socially-screened managers in the following asset classes: U.S. equity, international developed equity, emerging markets equity and hedge fund of funds. The socially-screened managers now comprise 91 percent of their portfolio

Independent CIO Considerations

Not all firms offering Chief Investment Officer services are alike. Like an evaluation of any firm, consider the following:

+ **The experience and reputation of the firm.** There are many firms new to independent CIO services. Solutions and services can vary dramatically. Conflicts of interest, such as selling investments, lending, and other proprietary products should eliminate a firm from consideration.
+ **The experience of the independent family CIO team.** Seasoned professionals with strong personal reputations are crucial.
+ **Investment expertise.** This is also crucial. Understand the depth and expertise behind the analysis of investment products and the due diligence process.

+ **Technology and reporting capabilities.** There is a huge variance in the quality of portfolio accounting and reporting tools. Understand the download process from custodians and the reporting flexibility. The independent CIO should be able provide nearly any report with a custom design that a family wants and needs.
+ **Fees.** Again, they can vary wildly. You may not always get what you pay for.
+ **Qualitative issues.** Understand the firm's client and employee turnover, ownership structure, long-term firm plan, success and failures, and, importantly, the culture of the firm. As famed business consultant Peter Drucker used to say, "Culture eats strategy for breakfast."
+ **References.** Talk to their clients that have similar circumstances. Look for high-touch and client-driven firms.

There is the adage, "If you've seen one family office, you've seen one family office!" Therefore, the work must be completely custom for each client, and expertise and experience should be deep. A quality, independent CIO can pay for itself in services and fees and make a meaningful difference for generations to come.

ABOUT INNOVEST PORTFOLIO SOLUTIONS

Innovest is a leading provider of investment consulting services and Chief Investment Officer services to families and family offices. Innovest brings the best practices from the institutional investment community and applies them to family investors.