Facilitating Excellence in the Management of Wealth

How Will Our Money Be Managed?

21 Questions To Ask Financial Advisors

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Overview

At HighView Financial Group, design, implement and manage tailored investment portfolios for three groups of clients:

Advisors
Investment Advisors, Financial Advisors

Families
Families, Single Family Offices, Multiple Family Offices

Institutions
Foundations, Endowments, Private Pension Plans

In our experience, most clients' definition of "excellence" in the management of their wealth is tied to the concept of "sustainability". In other words, "Don't lose our money!'

Although there are many purposes for wealth, many of which are emotionally linked, the practical purpose of wealth is to be able to fund a set of future liabilities. For a family, such future liabilities are typically lifestyle and legacy needs while for a foundation, such future liabilities are annual funding requirements for charitable giving purposes. In order to provide for such future liabilities, though, it is critical that the wealth that is funding such future liabilities be sustainable!

At HighView Financial Group, it is our belief that sustainable wealth is created through the deployment of comprehensive and objective asset management practices, integrated with goals-based investor profiling and stewarded with a fiduciary mindset. The integration of these principles is illustrated below:

Given the nature of our business, together with our partners' collective experiences in senior leadership positions at various wealth management firms, clients and their professional advisors, such as lawyers and accountants, frequently ask us how they we determine if their money will be responsibly managed to meet their goals?

As a result, the focus of this article is to provide clients and their professional advisors with set of ten questions that will answer this all important question:

"How will my money be managed"?

The Questions

At HighView Financial Group, we believe that Advisors are critical to the future success of the Wealth Management industry as they are the providers of professional advice to investor clients in the prudent structuring and responsible growth of their financial assets.

Before establishing a business relationship with a Financial Advisor, though, there are two broad groups of questions that need to be answered:

Credibility → Are you who you say you are and are you qualified to do it?

Competency → Are you good at what you do and will you help us accomplish our financial goals?

Credibility:

In our experience, the "Credibility" questions are the baseline set of questions that need to be answered and typically include questions such as:

1. **Please describe the history, size, ownership and management structure of your firm?**
2. **Is your firm registered with a securities regulatory body?**
3. **Who are the key investment professionals in your firm?**
4. **What is your industry experience, financial education & professional certification?**
5. **Have you and/or your firm ever received any regulatory and/or professional sanctions?**
6. **Please describe the investment professional and administrative support team who would be managing our wealth?**

Although the answers to these questions are important to **determine whether or not you want to even consider engaging a given Financial Advisor,** they do not help you determine if **they're actually good at what they do.** To accomplish this, reference checks from actual clients are critically important, but equally important, is understanding if a Financial Advisor will be able to help you meet your financial goals given your unique set of investment objectives and risk tolerances. For this, you need to assess a Financial Advisor's professional "*competency*".

Competency:

When assessing a Financial Advisor's competency, many investors focus on historical performance numbers. Although such performance is an important criteria, it should not be the sole focus of a competency-based assessment for two reasons:

a. Portfolio performance is an historical set of values that were produced based upon a combination of factors that were both internal to a firm (ie: people, practices, etc.) and external to a firm (ie: economic, political, etc.) that may not be capable of being replicated in the future.

b. As clients all have a unique set of investment objectives and tolerances for risk, the historical performance of a given "sample portfolio", even if capable of being replicated in the future, will many times not be a suitably structured portfolio for a given client.

As a result, it is our belief that in order to effectively assess an Advisor's professional competency, investors need to assess two key elements of an Advisor and their firm:

Philosophies → **Why** do you do what you do?

This addresses the key questions related to **why** does an Advisor and their firm believe that wealth should be managed the way that they do.

Practices → **How** do you do what you do?

This addresses the key questions related to **how** an Advisor and their firm manage wealth on a daily basis to ensure consistent execution in the diligent pursuit of clients' investment objectives.

Given client need for "sustainability" of wealth, these philosophical and practice assessments should focus on three areas:

- Investor Profiling
- Asset Management
- Stewardship

Investor Profiling:

Effective Investor Profiling is about Advisors identifying the purpose of their clients' money against discrete time horizons.

7. **Please describe the process that you and your firm would use in determining client investment objectives?**

   One of the key regulatory requirements for Advisors to complete with their clients is the Know Your Client (KYC) form, which profiles investor clients in terms of age, income, net worth, past investment experience and their investment objectives in terms such as "Growth", "Income" and "Income/Growth". The goal of such documentation is to provide Advisors with sufficient information on which to construct proposed portfolios for clients.

   In our experience, there have always been two challenges with the KYC approach:

   a. **Insufficient Client Information:**
   The standard KYC questionnaire required by securities regulators is typically four to six questions and takes roughly five to ten minutes to complete with clients. In our view, such information, while important to know, is only an extreme baseline set of information that is needed to help Advisors construct tailored portfolio solutions that satisfy clients' financial goals.

   We believe that the whole process of "Investor Profiling" should begin with understanding a client's financial goals. In other words, what's the "purpose" of the funds to be managed? If done properly, this goals-based discussion is a "conversation" with a client – versus a "question & answer session" – that requires materially more time than that required to complete a KYC form.

   b. **Inadequate Goal Definition:**
   In order to gain a solid understanding of the "purpose" of the client's investable assets, we believe Advisors need to help clients articulate their goals. These needs should be defined in terms of **dollars** and **time horizon**. For example: "Based upon the current cost of university education, together with reasonable forecasts for inflation, I'll need to have $50,000 in 10 years."

   A huge challenge in the wealth management industry today is that far too many "goals" are being pursued in terms of "Relative Performance" or the "Portfolio Strategy" (ie: Income, Growth, Income/Growth). Beating the index by 100 basis points is not a measurement of success in achieving a goal; it's a means of measuring the success of a money manager against the market and is only one factor in a client achieving their goals. Similarly, managing a Growth portfolio is not a goal; it's an investment strategy to help a client meet their goal!

   Clearly defining a client's goals is the only way an Advisor can begin to construct portfolios for clients that are designed to satisfy those goals.

8. **Please describe the process that you and your firm would use in determining client tolerance for varying degrees of investment risk?**

Investing has two sides to it – return and risk. Unfortunately, during bull markets the "return" discussion dominates and risk is not always given its due time for discussion. Before finalizing any portfolio structures with clients, we believe that Advisors should solidly test clients' appetites for risk.

The wealth management industry is famous for the publication of many statistics aimed at capturing risk such as standard deviation, downside capture, Sharpe Ratios, etc., Our experience has confirmed that all of these statistics are meaningless risk indicators to the average private client. Private investors each have their own interpretation of what risk means to them. This personal concept of risk has been formed in the investor's mind through life experiences and by innate personality. So to say that there exists an all-encompassing concept of risk and by extension an all-encompassing risk-management solution is unrealistic. The most important job of an Advisor is to have the client articulate their personal concept of risk. Of course this is easier said than done. Typically, individuals struggle trying to articulate their personal concept of risk because it is a complex and difficult concept that they likely have spent little time thinking about.

One effective tool that we've always used with clients in assessing risk is to test the risk of loss in terms of meeting their goals. This involves "stress testing" based upon ranges of historical events linked to different asset classes, **the risk of loss to both income and capital.** In order to do this effectively, the following needs to be considered:

a. **Review Potential Losses In Terms of Dollars**
Advisors should illustrate potential losses to both income and capital in dollar terms as well as percentages. For instance, if a client has a $200,000 portfolio, and based upon its structure, an Advisor determines that historically the portfolio can anticipate a 30% loss, the client should be asked specifically their tolerance for a loss of $60,000 to $140,000. In our experience, the statement of potential loss in dollars is significantly more meaningful to clients than percentages, as clients often do not make the translation from percentages to dollars.

b. **Review Realistic Loss & Recovery Periods**
Advisors should illustrate potential loss periods to clients. For instance, if a client's portfolio, based upon its structure, has historically had loss periods ranging from six to twelve months, then the Advisor should test the client's ability to truly tolerate this length of down period. This should apply to both capital and income, especially in those situations in which equity securities and high yielding income securities are included in portfolios. Dividend cuts to even "Blue Chip" companies can happen…what is the client's ability to live through such periods?

Asset Management:

Effective Asset Management is about Advisors constructing portfolios that meet clients' needs, investment objectives and risk tolerances.

9. Once a client's investment objectives and risk tolerances are determined, please describe the process that your firm uses for creating client portfolios?

With the Investor Profiling process now complete, Advisors need to craft portfolio structures that align against both client goals, all the while balanced against their risk tolerances and desires to outperform.

The end result should be a tailored portfolio that has been created through the following range of potential construction levels:

Asset Class
What asset classes will be included in the portfolio (ie: equity, fixed income, real estate, cash, etc.)?

Geography
From what geographic regions will the ultimate securities be accessed (ie: Canada, US, International, etc.)?

Investment Markets
What investment markets will be accessed (ie: public, private)?

Investment Strategies
What investment strategies will be used in the portfolio (ie: long only, long-short strategies, active, passive, etc.)?

Overlay Strategies
Will any strategies need to be employed that overlay the portfolio (ie: currency hedges, tax mitigation, etc.)?

Investment Mandates
What investment mandates will comprise the portfolio (ie: Canadian equity, US mid-cap, Canadian Laddered Bond, Canadian Corporate Bond, etc.)?

Investment Managers
What investment managers (including the Advisor where applicable) will be employed to satisfy the investment mandates?

Investment Securities
What are the current Investment Securities that will be used within the portfolio by each Investment Manager?

It is worth noting that multiple goals will typically require multiple portfolios. In other words, each goal will typically have its own portfolio.

Finally, to properly communicate the benefits and risks of a recommended investment program, an Investment Advisor should also be able to illustrate the behavioural attributes of the proposed portfolio both in percentage and absolute dollar terms. This process will ensure that the management of client expectations are adequately addressed.

10. What role do the various investment securities used in client portfolios perform in terms of risk and return?

In our experience, the management of risk, not return, is the primary determinant in structuring a portfolio Risk and Return are directly correlated. The following are HighView beliefs in terms of Risk and Return:

Risk

» Risks can only be managed if they are identified and understood

» Understanding risks involves assessing their probability and magnitude

» Risk of loss must be considered in terms of both income and capital

» The risk of losing money is far more important to clients than the risk of underperforming an index

» Loss avoidance is the primary risk metric to consider in designing an absolute return oriented portfolio.

» Excessive concentration exposes a portfolio to imprudent levels of risk

Returns

» Returns cannot be managed as they are a by-product of portfolio structure and process

» Returns must be considered in terms of both income and capital.

» Excessive diversification can be very dilutive to long-term investment results.

» Clients should have a bias toward absolute returns

» Net (after cost) returns are what really matter to clients.

11. Do you use customized Investment Policy Statements for each client?

Charles Ellis, in his book entitled, "Investment Policy: How To Win The Loser's Game", states the purpose of Investment Policy:

"The high purpose of investment policy, and of the systematic process prerequisite to it, is to establish useful guidelines for investment managers that are genuinely appropriate to the realities both of the client's objectives and the realities of the investments and markets."

Ellis goes on to describe Investment Policy as, "the explicit linkage between the client's long-term investment objectives and the daily work of the investment manager."

Although the content of Investment Policy Statements (IPS) can vary, we have always viewed the core elements required in order to design a portfolio solution are as follows[2]:

Investment Objectives
The purpose of the portfolio in order to meet a financial goal.

Risk Tolerances
Ability to tolerate risk in terms of both capital and income loss

Liquidity
The definition of any short-term need for liquid funds

Taxation
Any tax issues that must be addressed in the management of the portfolio

Legal
Any legal or regulatory issues that must be addressed in the management of the portfolio (ie: trust restrictions)

Unique Preferences
Any unique client preferences that must be addressed in the management of the portfolio (ie: exclusion of specific securities/sectors)

One of the challenges in the private wealth management industry is that many investment policy statements do not sufficiently capture these design details. Many IPS documents are "templated" and not sufficiently tailored to each client's unique circumstances. Instead, they are really marketing materials that outline a firm's investment beliefs and capabilities with an indication as to how they would propose structuring a client's portfolio. As a result, there is no linkage between "client need" and "client portfolio structure". Although this marketing information is important to clients, in our view, it doesn't belong in an IPS – the purpose of which is to capture client investment objectives, risk tolerances and portfolio constraints.

12. What are the due diligence processes that you and your firm conduct on investment securities prior to inclusion in client portfolios as well as on an ongoing basis?

We believe that Advisory Firms should have a sound set of research & due diligence capabilities (whether internally or externally sourced) for the investment securities used in client portfolios. For most Advisory Firms (depending upon their regulatory status), this will be equity/fixed income research, mutual fund research and/or institutional money managers.

[2] Adapted from "Managing Investment Portfolios: A Dynamic Process", John Maginn & Donald Tuttle.

Given that all investment opportunities have a "people" component to them – whether it's a direct business that is being invested in or an investment manager that is being engaged to make those investments on behalf of an investor client – HighView believes that such research, and the research providers, should have the following attributes:

Experience → Relevant experience with an established track record of competent research

Objective → Free from conflict in all research recommendations

Transparent → Open in all dealings with investor clients and full disclosure if conflicts do occur

Quantitative → Rigorous quantitative assessment of various financial metrics of an investment opportunity

Qualitative → Rigorous qualitative assessment of the persons involved with a given investment opportunity

13. Once a client portfolio has been implemented, what are you daily practices for ensuring that their portfolios adhere to the terms and conditions agreed upon in their Investment Policy Statement?

Once implemented, Advisors have an obligation to ensure that client's investment objectives are being pursued. This requires a strict adherence to each client's Investment Policy Statement.

At HighView Financial Group, we believe that in order to make a prudent assessment of how a client portfolio is being managed, it should be reviewed against its portfolio construction metrics such as asset allocation, security quality, diversification of holdings by individual securities and/or industry allocation, as well as an overall assessment as to historical portfolio returns against the account objectives.

Once a series of Client Portfolio Reviews have been completed, it's inevitable that various portfolio violations – asset mix, security quality, diversification - will be identified. As a result, we believe that every investment firm should give careful consideration as to their "follow-up" procedures in order to ensure that the client portfolio violations are rectified within a reasonable, and prudent, period of time. Alternatively, if an Advisor believes that such portfolio violations are in the best interest of the client, an updated, and signed, Investment Policy Statement must be obtained from the client.

14. Please describe your client portfolio review & reporting processes?

To ensure that a client remains engaged in the ongoing asset management process, it is critical that there exists a set of processes and practices for reporting on and reviewing the investment results of their portfolios and ensuring that the existing portfolio structure continues to be aligned with a client's investment objectives and risk tolerances.

Goals Review

Regular Portfolio Reporting is a core requirement of the overall portfolio management process. Such reporting should go well-beyond the traditional "position & transaction" reporting and provide clients with an indication of how their investment portfolio is performing against their unique set of investment objectives. Although this reporting could certainly include "relative performance" metrics, it should speak to the quantifiable investment goals of each client. Charles Ellis, in his book entitled "Investment Policy: How To Win The Loser's Game" states, "Performance measurement services do not report results. They report statistics." In other words, portfolio results can only be measured against the success (or failure) of meeting clients' investment goals.

Portfolio Review

Beyond the regular Portfolio Reporting that is provided to clients, we believe that Advisors should adhere to a process of regular, proactive client contact for the purposes of updating clients with respect to both the structure and performance of their portfolios against their investment objectives. Although at times such reviews may focus on individual securities in the portfolio, they should attempt to keep clients oriented towards the "bigger picture" of the structure of their portfolio (ie: asset class, geographical allocations, investment mandates and investment managers) all measured against each client's unique set of investment objectives and risk tolerances. Such reviews are critical to providing clients with the ongoing comfort and confidence that their wealth is being managed to the highest standard of care.

Although there is no "right answer" as to frequency of client contact, at a minimum, we have always endorsed a process of proactive quarterly contact with clients (usually by phone), with one quarter per year being used as an opportunity for an in-depth, face-to-face review of client goals and circumstances.

Investment Policy Review

At least once per year, we believe that Advisors should be reviewing the key elements of each client's Investment Policy Statement (IPS): Investment Objectives, Risk Tolerances and Constraints. The purpose of such a discussion is to ensure that changes in clients' lives have not inadvertently caused a change in how an Advisor would recommend the structuring of a given client's portfolio. If such an IPS validation process does not happen on a regular basis, it's highly possible that there could become a mismatch between "Client Need" and "Portfolio Structure", which in adverse capital market conditions, can cause needless stress in the Advisor-Client relationship.

In the situations where changes to portfolio structure are required, it is important that these changes be captured in revisions to the client's Investment Policy Statement.

For instance, if an Advisor is informed by their client that their anticipated date for retirement has been shortened by five years, this may require a change in portfolio structure that would result in changes to the client's Investment Policy Statement.

Similarly, in certain market conditions – such as severe bear markets – some Advisors and their clients may be uncomfortable with the structure of their portfolio and agree that their Advisor should change their portfolio structure (ie: increase my allocation to bonds).

Any changes to a client's goals or situation that translates into a change in their portfolio structure requires that their IPS be revised, and signed by both the client and the Advisor. This is the only way to ensure that both parties to the Investment Policy Agreement remain committed to it!

Stewardship:

Effective Stewardship is about thinking and acting like a fiduciary in the oversight of the wealth that has been entrusted to Advisors and their firms.

15. **What are your firm's beliefs in the management of client wealth?**

As we have travelled the world in search of top investment managers, we have been fortunate to meet many world class money management firms. A striking similarity across all of the "top tier" firms was their ability to articulate their philosophical beliefs. These are the beliefs that drive all the behaviours and practices of these organizations and ensure that their brand experience is consistent and strong.

Once a solid philosophical foundation has been established, successful wealth management firms then develop a focused strategy for their business that captures the unique opportunities in the marketplace but which is also carefully aligned against the specialized knowledge, skills and abilities of their firm and their people.

16. **Please describe the structural and operational practices of the oversight body in your firm that ensures our wealth is being managed in a prudent manner and in accordance with my investment objectives, risk tolerances and portfolio constraints.**

We believe that stewards are those individuals who have been entrusted with the oversight of wealth for the benefit of others. Effective stewardship is about defining and living a set of fiduciary based governance philosophies for the oversight of wealth to ensure that it is prudently managed with a goals-based approach and to the highest standard of care. When the competencies of an individual steward are not sufficient to address all of the needs of a client, a multi-disciplinary group of professionals should be assembled, based upon expertise, to address those needs. Such a group would be referred to as a "Stewardship Council".

A steward, or stewardship council, should organize themselves to ensure that the following attributes are well-defined:

- A **Mandate** that clearly addresses its purpose so that it is well-understood by all stakeholders.
- A **Structure** that addresses the roles required. The roles for each governing body will vary depending upon its purpose.

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[3] Governance and Compliance are not the same thing. While Compliance is "doing things right", Governance is about "doing the right things".

- A carefully selected set of qualified steward **Participants** to satisfy each of the roles of the governing body. The people should fit the role, not the reverse!
- Governance[3] **Standards** that define the practices, processes and responsibilities of the governing body in the fiduciary oversight of wealth. This includes all Books & Records that are to be professionally maintained on a timely basis and made available to all stakeholders.

Practices must be adopted that require the creation, and periodic review, of a customized Investment Policy Statement for each client portfolio that captures the:

- Investment Need
- Economic Requirement For Return
- Capacity to assume varying degrees of risk
- Expectations for return and desire to outperform
- Portfolio Management Constraints

17. How does your firm manage the potential conflicts of interest that can exist amongst custody, investment accounting and investment management?

The division of three professional duties in the management of wealth is critical to mitigating potential conflicts of interest and, therefore, potential loss to clients:

- **Investment Management →** The selection of investment securities
- **Investment Accounting →** The valuation of investment securities
- **Custody of Assets →** The physical ownership of the securities, on behalf of the client, of the investment securities.

In order to avoid the potential for fraud, HighView strongly believes that each of these duties should be conducted independently and separately unless prohibited by law and/or regulation. It's important to note that in many large investment firms and financial institutions, all three of these functions can be conducted by the overall firm. In this case, it's critical that each client be satisfied with the internal practices of each firm to ensure that within each firm, there is very clearly a division of these duties and that they are not all conducted or controlled by one internal group.

18. What are the monitoring practices for all investment professionals that will be involved in managing my wealth?

In many wealth management firms, a single Advisor (or group of Advisors) are involved in directly managing client assets. In order to ensure that effective safeguards are in place within each Advisory Firm, we believe that clients should understand how their investment professionals are monitored within their firm? In well-organized firms, there are clearly defined supervisory roles and responsibilities that oversee day-to-day activities in client portfolios.

19. How are all of the investment professionals who will be involved in managing my wealth compensated?

We believe that the **basis** of compensation (not the amount) paid to investment professionals, should be fully transparent and understood by each client. For instance, our investment professionals compensated on a salary & bonus basis or a commission/percentage of sales basis. As compensation structures have the potential to drive behaviours, this information is important for clients to understand.

20. What are the Codes of Conduct and/or Professional Standards that you and your firm adhere to?

At HighView Financial Group, we believe that a Code of Conduct and Standards of Professional Practice should be adopted by each stewardship council to ensure that investment related employees and stewards clearly understand the professional conduct that is expected of them in exercising their duties.

Finally, a Conflict of Interest Policy should be adopted by each stewardship council to ensure that conflicts are minimized but when they do occur, that they are clearly identified and managed in a fully transparent manner.

As a result, clients should ask to see such Codes of Conduct and Conflicts of Interest Policies.

21. Please describe how all client fees are calculated and charged?

Although the standard method of client fee calculation within the Canadian wealth management industry is based upon the market value of client assets, it's important that clients clearly understand how such fees are calculated. The following three concepts are important to understand:

Fee Structure:

Most investment firms structure their offerings as a fee-based solution. For instance, some firms offer their services for a flat percentage fee that is based upon the market value of the account while others create a declining tier fee so that as clients invest more assets, their effective percentage fee declines.

Finally, performance fees are sometimes also utilized. It's important to note that some securities regulators place specific restrictions on the use of such performance fees.

Fee Levels:

Once a client has determined a firm's Fee Structure, they'll then need to determine the actual level of client fees. For instance, in a flat percentage fee structure, one firm may choose a 1% fee level while another firm may select a 1.25% fee level.

Fee Frequency:

The frequency at which client fees are charged in the Canadian wealth management industry are typically monthly or quarterly. It's important for clients to understand which one applies to them but the recognize that such fee frequencies can even vary within a given Advisory firm, depending upon their range of investment solutions that are made available to clients.

As well as any additional direct and/or indirect costs, are calculated and when they will be charged. In the case of direct costs, this would include commission rates and administrative fees. In the case of indirect costs, this would include all fees that are embedded within investment vehicles such as mutual funds as well as the spread mark-ups on fixed income instruments such as bonds.

Final Thoughts

As we've reviewed above, we believe that Advisors are critical to the future success of the Wealth Management industry as they are the providers of professional advice to investor clients in the prudent structuring and responsible growth of their financial assets.

Before establishing a business relationship with a Financial Advisor, though, there are two broad groups of questions that need to be answered:

Credibility → Are you who you say you are and are you qualified to do it?

Competency → Are you good at what you do and will you help us accomplish our financial goals?

By asking these important questions, we believe that clients will be extremely well-informed to select an Advisory firm that is not only credible but one that can competently manage their asset in a tailored and prudent manner that helps them meet their investment objectives while simultaneously managing their tolerance to varying degrees of risk.

Contact

HighView is based in Bronte Harbour in Oakville, Ontario. The Town of Oakville is a beautiful community situated on Lake Ontario, just 30 minutes from Downtown Toronto.

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Facilitating Excellence in the Management of Wealth™

HighView Financial Group is comprised of the following Legal Entities:

HighView Wealth Practices Inc.
HighView Asset Management Ltd.

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