► Greycourt White Paper

White Paper No. 12 – *Conflicts of Interest: Do They Matter?*

Background

Private investors today have more choices than ever before. The explosive growth in private wealth in the last decade has caught the attention of every major bank, brokerage firm and money management firm in the industry, and the result has been an equally explosive growth in investment products and investment advisors. Although the broad menu of choices is ultimately a desirable outcome, the challenge facing investors is how to distill the available information and create a logical, thoughtful investment program that is ideally suited to their needs.

Discussion

In broad terms, there are two types of firms that an investor can turn to when seeking information on creating an investment program; those that **sell product** and those that **offer advice**.

Firms that sell product, including banks, brokers and money managers all have business models which depend upon the placement of assets into products in which they have an economic interest. These may be in house money management products or they may be fee-sharing arrangements on assets placed with outside firms. In either case, the sponsoring firm has a strong economic incentive to place investors only in the products that they offer – to do otherwise would dilute their own business model. While some of the investment products the firm offers may be well-suited for a given investor, it is virtually assured that no one firm will offer the best product for the investor in every asset class. In short, these firms have an inherent conflict of interest, as their economic incentives are not aligned with the investment needs of the investor.

In contrast to firms that sell product, are those that offer only investment advice. These are independent consulting firms that seek to align their interests with those of the investor by removing the economic incentive to sell product. These firms do not manage money, do not sell product and do not accept or share compensation with other financial service firms. The only form of compensation received by these firms is the fee paid to them by the client. For this fee, the client receives completely objective portfolio design, manger selection and performance assessment. This open structure allows the advisor to select from an unrestricted universe of investment products and recommend truly “best-in-class” solutions to clients.

Institutional investors, including the endowment and pension communities, have long adopted this “open architecture” approach to creating sophisticated portfolios. In recent years private investors have likewise been adopting this approach as they have come to recognize the inherent conflicts of the traditional financial service providers. For investors that have yet to explore these issues, it may be time to ask your current advisor about their own economic incentives and determine just whose interests are being served.

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