Risk management for the wealthy

By David Breden, Investec Trust Group

Very few areas of investment activity have been immune from loss in the last three years. Whether wealth has been held in traditional investment vehicles such as stocks and shares, or in property or in more adventurous assets, the continual upward spiral in values of the first six or seven years of the century has come to an end and has been replaced by a generalised collapse that has significantly reduced the wealth of many.

It has been hard for those who spent the early years of the millennium accumulating wealth with great success to accept that the assets and investment strategies that served them so well in the past have lost their magic and that a new approach to the changed environment is required. Now that property and financial markets are no longer rising unstoppably, greater consideration must be given to the potential for negative market movements, and to the design of strategies that seek to blend the potential for asset appreciation with defensive strategies that minimise loss in a downturn. Investors who were successful in rising markets because of their willingness to take risks must now take full account of these risks if they are to avoid potential ruin.

A professional trustee is ideally suited to play the role of a risk manager for wealthy families and individuals. The trustee has an obligation to protect and enhance the value of the assets entrusted to his or her care in the interests of all the beneficiaries of the Trust and accordingly, must have a full understanding of its ability to accept risk and suffer loss just as much as he or she needs to appreciate its requirement for income or capital appreciation.

In the new world, the trustee must be as diligent as any investment manager in building robust 'Know Your Customer' frameworks to understand the often conflicting needs of different beneficiaries and merging these interests into a composite strategy that provides appropriate protection and growth opportunity for all parties.

It is a common view in the fiduciary (or wealth management) world that a risk manager is someone whose job is to say 'no' to profitable deals. This is a misconception as the role of the risk manager is to challenge these proposals and identify the possible downside risks so that these can be evaluated and where possible mitigated and managed. Once this exercise has been conducted, the trustee must consider whether the residual risk position can be accepted or is better avoided. Clearly the trustee cannot accept a risk that has the potential to wipe out the client's wealth. He or she enjoys the advantage of being able to evaluate proposals dispassionately, without the personal attachments and prejudices of the client, in order to reach a proper assessment of the potential advantages and disadvantages of an investment decision.

The trustee works in close partnership with a wide range of tried and tested professional advisors who will be able to provide support on legal and tax matters as well as providing information on market performance and trends. The creation of an efficient network of professionals can bring significant benefits to the client, these experts can give the trustee up to the minute legal and fiscal information from a wide range of key jurisdictions. Equally the use of professional asset managers should provide the trustee with views on the prospects and opportunities in relevant markets as well as flagging areas of concern or opportunity that may impact upon or enhance the value of assets held.

The roster of professional advisors will include investment professionals who can be selected on the basis of the Trust's objectives. Their performance will be reviewed by a system that will ensure that they continue to meet the needs of the Trust. Benchmarks will be established that reflect the investment objectives of the Trust and performance compared to these benchmarks in order that under performance can be identified and addressed at an early stage. The soundness of banks where funds are deposited can also be monitored.

All of the information available to the trustee can be collated and reported to the client so that full information is available on the current performance of assets, as well as on threats or opportunities that may impair or enhance future prospects.

The trustee's role is perfectly suited to acting as a family risk manager to the wealthy, providing an independent challenge of proposals and an analysis of market conditions to reduce potential downsides and ensure that threats opportunities are identified and seized or avoided to further the interest of all parties.