Reaping the right rewards

The observation that an increasing number of clients prefers to pay for performance is a sign of growing ignorance about what clients may and may not expect from their wealth manager. By Kees Stoute

In its comprehensive 20th *World Wealth Report*, CapGemini shares an intriguing conclusion: HNWIs are increasingly in favour of a pay-for-performance fee model.

To be more precise, most respondents – 56% more than last year – indicated a preference for this type of fee model.

From a client perspective, it may seem a perfectly understandable desire. Why would you pay a fee for someone who has lost you your money? It doesn't require a professional to lose money; anyone can do that themselves.

DON'T SELL PERFORMANCE

For the wealth management industry, the findings in the CapGemini report are a sad and worrying sign for two key reasons.

First, paying for performance only makes sense if we sell performance. The more we give the impression that our added value is in delivering consistent superior performance, the more sense it makes that clients expect to pay for performance only.

However, wealth managers are not and will never be fortune-tellers; so we can't be in the performance-selling business. Instead, wealth managers should be professionals who apply their extensive knowledge to help wealthy individuals live the life they want to live, and to obtain a sense of comfort with regards to their wealth.

To achieve this, they apply state-of-the-art knowledge and experience.

The fee is paid for applying knowledge and experience, not for correctly predicting which uncertainties will become a certainty.

We don't pay doctors, for example, only if they prescribe us the right medicine.

We pay them for applying state-of-the-art medical knowledge to alleviate our condition. And we know that very often they will have to make judgement calls, and therefore they could be wrong.

Nonetheless we pay. Why? Because we realise that doctors are in a much better position than we are to deal with the uncertainties surrounding our condition.

The same should apply to wealth managers. We should not get rewarded if the markets happen to be in our favour, in the same way that we shouldn't be punished if the markets happen to go south.

The uncertainty of the markets is precisely what justifies involving specialists: they are trained extensively to deal with uncertainties responsibly and professionally, for instance by avoiding the typical traps that come with uncertainty or by ensuring that investments are and remain connected to explicitly-articulated objectives.

Secondly, wealth managers who stand a chance to increase their income by delivering superior performance may be tempted to take additional risks at the expense of their clients.

If the benchmark returns 5%, whilst the wealth manager realises a 10% return, who cares about risks? Isn't it fantastic? Well, think twice!

The return is impressive, but the risks that needed to be taken to achieve this return may have been outrageous.

Why should anyone pay an individual a handsome income, if effectively he or she has been gambling with your money?

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