Financial Planner Expert Witness – Ultra-High Net-Worth Clients and FINRA Arbitration

By Thomas G. Taliaferro, CIMA®, AIF®

F. Scott Fitzgerald: “The rich are different than you and me.”

Ernest Hemingway: “Yes, they have more money”

This apocryphal conversation between two giants of American literature only scratches the surface of the difference between ultra-high-net worth investors and the rest of us. I have had quite extensive dealings with this class of investor (defined as having $30,000,000+ in investable assets) and I’ve discovered that they are indeed different. They tend to be more sophisticated than most investors. They have little interest in policy-driven asset allocation models—with the exception of their involvement with foundation portfolios. They are drawn to complex and sophisticated risk-management strategies and they become very disgruntled when these strategies produce losses, even in the short run. Finally, they are very loyal to advisors who promise less than they deliver and they have little tolerance for excuses or double talk.

As an ultra-high net worth financial planner expert witness with 30 years of experience I can say with confidence that most (but certainly not all) people who have accumulated large wealth are familiar with the basic tenets of capital markets and the general principals of investing. From the moment their wealth demands attention, they’ve been besieged by a phalanx of advisors willing to show them a surefire method of making it grow. Unfortunately, most of these advisors present strategies forged from the philosophy of sell-side investment management—the market is always cheap, there is no such thing as bad news and cash is not an asset class. Wealthy investors are not attracted to the asset-gatherer type of advisor. They are more interested in having an advisor who provides hands-on, innovative and more tactical strategies.

As with any non-standard strategy, financial advice that is at odds with the consensus is subject to being wrong and lonely at the same time. An advisor who implements a standard policy-driven asset allocation model (60% equities, 30% fixed income and 10% alternatives, for instance) is unlikely to be the odd man out when the market crashes. On the other hand, an advisor who is concerned about market valuations and implements a less orthodox tactical allocation can look relatively foolish if the market continues to surge.

The advisor who reiterates the logic of a currently underperforming strategy and sticks to his guns, rather than shifting with the consensus (almost always at the wrong time), gains the undying loyalty of the ultra-high-net-worth investor—assuming the strategy ultimately performs as expected. The advisor who abandons a strategy due to short term aberrant performance is likely to lose the large account and risks receiving a formal complaint. The advisor who has an independent point of view—whether or not it agrees with the consensus—and has the fortitude

to stick with it will enjoy a much more productive relationship with wealthy investors than an advisor who flits from one trendy strategy to another.
Even FINRA has recognized that the ultra-high-net-worth investor is different. In 2012 the regulatory authority implemented a pilot program for large cases—$10,000,000 or more. The program is designed to make the arbitration process more formal and customized. Ultra-high net worth financial planners will be called upon to testify in this forum. This procedure allows a good deal more discretion in the selection of arbitrators, including the appointment of non-FINRA arbitrators. It also allows for much more extensive discovery procedures, even the appointment of a special arbitrator to oversee discovery issues. It makes much more extensive use of depositions and interrogatories and a host of other options that make the arbitration process more like a court proceeding. Ironically, the first case to be decided under the new program was an employee/broker-dealer dispute. It involved a commodity trader who had been terminated and denied payment of earnings and interest. The case was decided in favor of the trader.

The program seems to be underutilized, however. As of June, 2016, there have been only nine cases arbitrated under its guidelines, five of which have been decided by award. The scanty usage of this program may have to do with the fact that both parties must agree to its implementation. There is a move afoot to make the program mandatory in cases involving claims of $20,000,000 or more. I suspect that this broader, more formalized setting for FINRA arbitrations will become the standard due to continued criticism of the current, self-contained and internalized system. Regardless of the format of the proceeding, such disputes can be expected to utilize expert witnesses in financial planning and ultra-high net-worth individuals.

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