



DE-RISKING ATTORNEY BALANCE SHEETS

A CASE STUDY



ABOUT THE AUTHOR

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ABOUT BANTAM INC.

Bantam Inc. (www.bant.am) is a private investment office for attorneys. We build custom, low-fee portfolios for attorneys with \$10+ million of investible assets. We also consult with clients on an hourly or fixed-fee basis without having to manage their assets.

Few firms can match Bantam's fiduciary commitment due to the simple fact that Bantam is a fiduciary twice over, once as a registered investment advisor and second as a New York State benefit corporation.

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INTRODUCTION

I have worked with hundreds of attorneys as an expert witness in securities litigations. I have also worked with attorneys managing their assets, including attorneys from AmLaw 20 firms, regional firms, and small boutiques.

Despite their different practice areas, firms, and locations, one thing is consistent: they collectively face a number of common risks that arise from being attorneys. In this case study I use the framework of Company Town Risk™ to unpack these exposures and to show how they can be reduced across an attorney's Total Wealth.

DE-RISKING BALANCE SHEETS

Private wealth management should start with de-risking the client's entire balance sheet. In my experience, most advisors give cursory attention to the full balance sheet and instead focus on just one piece of it – the financial assets.

This is a serious mistake.

Bantam's approach begins with an overview of what I call Total Wealth, and includes the client's entire balance sheet as well as their future cash flows. This philosophy reveals hidden risks that would not otherwise be apparent.

The presence of these risks has profound implications for an attorney and her finances. Indeed, when these risks are unearthed, they suggest previously un-contemplated but suddenly obvious investment allocations and financial strategies.

Throughout this analysis, I will use a representative attorney who is an AmLaw 100 firm partner, working and living in Manhattan with a practice focused on corporate transactions in the healthcare sector. However, the issues highlighted apply equally to litigators, lawyers at boutique firms, and plaintiff's attorneys located anywhere in the country.

TOTAL WEALTH

All individuals have four primary types of wealth. These different types of wealth have been well documented in the economic literature and can be referred to collectively as "Total Wealth".

Total Wealth can be divided into four categories:

- > **Human capital:** all the knowledge, skills, training, experience, and social contacts that make up what and who an individual knows. (This can be estimated as the present value of all future earnings.);
- > **Real estate;**
- > **Pensions** and other non-wage cash flows; and,
- > **Financial assets.**

Despite being well known and studied in economics, Total Wealth is frequently ignored by financial advisors, who tend to focus on financial assets. This myopia can lead to disastrous results when an investor's Total Wealth is exposed to one company, industry, or country.

I will examine the risk exposures across an attorney's Total Wealth. For Manhattan AmLaw 100 partners, these risks can be pronounced. Furthermore, they can be exacerbated by opportunities to co-invest with firm clients in direct investments. While these deals are frequently offered at generous terms and are looked at as a perk of working at the firm, they can become self-inflicted wounds.

These common exposures lead to what I call Company Town Risk™.



THE COMPANY TOWN

For much of the 20th Century, you could find “company towns” all across America. These communities typically existed because of one local company that employed virtually everyone in the community and owned almost all the stores and housing.

In such cases, individuals working for the company had virtually all their Total Wealth directly or indirectly exposed to the company. Their income came from a company job, and their human capital consisted primarily of skills the company needed and had trained them for. Their pension was funded by the company, and their house was owned by the company.

These company towns could be exploitive or utopian. As Hardy Green writes in *The Company Town*:¹

A company town seems necessarily to be a place where one business exerts a Big Brother-like grip over the population – controlling or even taking the place of government, collecting rents on company-owned housing, dictating buying habits (possibly at the company store), even administering where people worship and how they may spend their leisure time...

But another model regularly shows up in the United States, recurring across the decades: ideal communities backed by companies that promise to share their bounty with workers and their families. These utopian towns were and are characterized by modern public buildings, libraries and facilities for leisure, education, and cultural enrichment, and comfortable dwellings for managers and workers.

Irrespective of whether the company town was evil or good, if anything happened to the *company*, the workers and residents could have their Total Wealth decimated overnight.

Historically, such decimation was not uncommon. A train trip from New York City up the Hudson River to Albany is at once bucolic and a testament to the gales of creative destruction. Dozens of once thriving mills and factories mark the path northward. These former enterprises supported vibrant company towns, but they, and the communities they spawned, are gone. All that remains are the husks of the old factories, slowly falling in on themselves.

More recently, over the past 16 years I have been involved in securities litigations where investors with high Company Town Risk™ exposures were essentially wiped out when those risks were realized. Those cases involved employees of Kodak, living in Rochester, NY, and, more recently, residents of Puerto Rico.



Photo: The Bannerman Arsenal on the Hudson River from urbanghostsmedia.com



While old mills on the Hudson River may seem anachronistic, the modern economic landscape is replete with company towns. Some of these towns are still tied to one company, but more common is a larger version, tied to one industry or geographic area. Some obvious examples include:

- > Detroit and the automobile industry;
- > San Francisco and the technology industry; and,
- > New York and the finance industry.

As we will see, being significantly exposed to even one Company Town Risk® can be hazardous to your wealth.

COMPANY TOWN RISK™ FOR ATTORNEYS

Without doubt, working for an AmLaw 100 firm while living in Manhattan is a high-tech version of an old mill town. The accoutrements may glitter more, but the risks are the same. This has only been proven by the COVID-19 pandemic and subsequent shuttering of much of Manhattan.

To see how this works I make the following assumptions about the Total Wealth of our representative attorney:

- > **Human Capital:** \$19.2M, which is the present value of her \$2M/year after-tax compensation for the next 10 years, discounted at 0.77 percent (the yield on the 10-year US Treasury bond);
- > **Pensions:** \$5M, comprised of defined benefit and deferred compensation plans at the firm;
- > **Real Estate:** \$5M, the equity value of a \$4M Manhattan apartment and a \$1M Connecticut second home; and,
- > **Financial:** \$10M in liquid investments, allocated 50/50 between stocks and municipal bonds. The stocks are in broadly diversified mutual funds and one private equity fund focused on carveouts from large cap healthcare companies. The municipal bonds are invested evenly between New York State and New York City issuers.

As previously mentioned, most financial advisors would look at our attorney's balance sheet and liquidity position and conclude that she is in a strong position and well diversified.

That would be naïve.

While our attorney has certainly had success accumulating real wealth, she faces a number of insidious Company Town Risks™ which include:

- > Capital Markets;
- > Firm;
- > Healthcare Sector; and,
- > Manhattan.

As I will show, these risks exposures overlap across her Total Wealth.

I will first unpack these risk exposures by Company Town Risk™ type (listed across the top row) and then by Total Wealth asset class (listed down the first column).



COMPANY TOWN RISK™ ACROSS ASSETS

U.S. Capital Markets

ASSET\C.T. RISK	U.S. CAPITAL MARKETS	FIRM	HEALTHCARE SECTOR	MANHATTAN
Human Capital	\$19.2	\$19.2	\$19.2	
Pensions	\$5.0	\$5.0		
Real Estate	\$4.0			\$4.0
Financial	\$5.0		\$0.7	\$2.5
Company Town Risk™	\$33.2	\$24.2	\$19.9	\$6.5

Almost all of our attorney's assets are exposed to U.S. capital markets risk. Her human capital is heavily exposed to the strength of the financial markets. The firm is similarly exposed, as most of its business is transactional. Thus, this risk extends to her firm pension. Most of her real estate is exposed from her apartment, and her equities are directly exposed.

When the markets experience a large disruption, every asset she owns will experience some negative price movement and/or increase in risk.

Firm

ASSET\C.T. RISK	U.S. CAPITAL MARKETS	FIRM	HEALTHCARE SECTOR	MANHATTAN
Human Capital	\$19.2	\$19.2	\$19.2	
Pensions	\$5.0	\$5.0		
Real Estate	\$4.0			\$4.0
Financial	\$5.0		\$0.7	\$2.5
Company Town Risk™	\$33.2	\$24.2	\$19.9	\$6.5

There is a large and direct exposure to the firm through human capital and the pension.

If something were to happen to the firm, she would take a significant hit to her human capital and, potentially, her pension.

Healthcare Sector

ASSET\C.T. RISK	U.S. CAPITAL MARKETS	FIRM	HEALTHCARE SECTOR	MANHATTAN
Human Capital	\$19.2	\$19.2	\$19.2	
Pensions	\$5.0	\$5.0		
Real Estate	\$4.0			\$4.0
Financial	\$5.0		\$0.7	\$2.5
Company Town Risk™	\$33.2	\$24.2	\$19.9	\$6.5

Our attorney specializes in healthcare sector M&A and is thus directly exposed to any events that affect the sector. She is also exposed through the healthcare sector equities she owns in her portfolio.

While the health care sector has been strong, political dynamics could upend the entire space, putting her earnings power at risk.



Manhattan

ASSET\C.T. RISK	U.S. CAPITAL MARKETS	FIRM	HEALTHCARE SECTOR	MANHATTAN
Human Capital	\$19.2	\$19.2	\$19.2	
Pensions	\$5.0	\$5.0		
Real Estate	\$4.0			\$4.0
Financial	\$5.0		\$0.7	\$2.5
Company Town Risk™	\$33.2	\$24.2	\$19.9	\$6.5

Two direct exposures exist for Manhattan – one from the apartment our attorney lives in, and the other from the New York City municipal bonds she owns. Her firm is also exposed to Manhattan because that's where almost all of its employees work.

If a large disruption hit Manhattan, it would be negative for her and the firm.

ASSET EXPOSURE ACROSS COMPANY TOWN RISK™ FACTORS

Human Capital

ASSET\C.T. RISK	U.S. CAPITAL MARKETS	FIRM	HEALTHCARE SECTOR	MANHATTAN	ASSET RISK
Human Capital	\$19.2	\$19.2	\$19.2		\$57.6
Pensions	\$5.0	\$5.0			\$10.0
Real Estate	\$4.0			\$4.0	\$8.0
Financial	\$5.0		\$0.7	\$2.5	\$8.2
Company Town Risk™	\$33.2	\$24.2	\$19.9	\$6.5	

For our attorney, the largest component of her Total Wealth is human capital. This is true for most AmLaw 100 partners until they get to around five years of retirement. Our attorney's income is highly exposed to the U.S. capital markets in general, the healthcare sector in particular, and is earned at one firm.

Furthermore, if there were a large, disruptive event in the healthcare space, such as the implementation of a single-payer U.S. health insurance program, the transactional work might shift to the bankruptcy group. In such a scenario, the M&A work could spike and then die out.

Of course, the M&A skills from one sector are generally transferable to other sectors, but those other sectors are already well served by entrenched specialists. Our attorney has a lifetime of industry contacts and highly specialized knowledge that could be lost. Her general legal skills are not worth as much without 25 years of contacts and industry knowledge behind them.

Pensions

ASSET\C.T. RISK	U.S. CAPITAL MARKETS	FIRM	HEALTHCARE SECTOR	MANHATTAN	ASSET RISK
Human Capital	\$19.2	\$19.2	\$19.2		\$57.6
Pensions	\$5.0	\$5.0			\$10.0
Real Estate	\$4.0			\$4.0	\$8.0
Financial	\$5.0		\$0.7	\$2.5	\$8.2
Company Town Risk™	\$33.2	\$24.2	\$19.9	\$6.5	

The firm provides our attorney a defined benefit pension plan that comprises her retirement assets.

These cash flows are tied to the health of the firm. They are currently fully funded; however, there remains some risk exposure to the firm as the legal services industry is facing unprecedented changes. I have written about these risks on the Bantam Blog.²



Real Estate

ASSET\C.T. RISK	U.S. CAPITAL MARKETS	FIRM	HEALTHCARE SECTOR	MANHATTAN	ASSET RISK
Human Capital	\$19.2	\$19.2	\$19.2		\$57.6
Pensions	\$5.0	\$5.0			\$10.0
Real Estate	\$4.0			\$4.0	\$8.0
Financial	\$5.0		\$0.7	\$2.5	\$8.2
Company Town Risk™	\$33.2	\$24.2	\$19.9	\$6.5	

Our attorney has an apartment in Manhattan worth \$4 million and a country house in Connecticut worth \$1 million. Both are owned without a mortgage.

The New York City apartment value is correlated to the capital markets. It is also exposed to all the risks of Manhattan, as the COVID-19 pandemic has revealed with declining prices and declining sales.³ Before the pandemic, Hurricane Sandy caused approximately \$10.4B in damage to New York City infrastructure⁴ and approximately \$50.5B in total damage to New York City, Long Island, and New Jersey.⁵ It was a Category 1 hurricane, the least powerful on the five-point scale. If a more powerful hurricane were to hit Manhattan, the damage would be much higher and the impact could be felt at the firm as well.

If Manhattan were to experience a more prolonged interruption in basic services such as power, water, transportation, and telephony/internet, it would have a significant effect on the value of the apartment, as well as the functioning of the firm. Indeed, the firm might be forced to relocate to a contingent office outside of Manhattan, at great expense and business interruption.

Another risk is that of cybersecurity. In 2018 Atlanta was subject to a cyberattack that crippled the city government's ability to function. This attack lasted at least five days and required the use of handwritten notes, physically delivered, to continue government functions.⁶ This attack took the Atlanta government back to 1970s-era technology. If New York City were to be hit by such an attack, the consequences could be more significant and directly related to the capital markets. To put this in perspective, in 1980, New York City tax revenue was \$7B; in 2016, it was \$54B.⁷

Financial Assets

ASSET\C.T. RISK	U.S. CAPITAL MARKETS	FIRM	HEALTHCARE SECTOR	MANHATTAN	ASSET RISK
Human Capital	\$19.2	\$19.2	\$19.2		\$57.6
Pensions	\$5.0	\$5.0			\$10.0
Real Estate	\$4.0			\$4.0	\$8.0
Financial	\$5.0		\$0.7	\$2.5	\$8.2
Company Town Risk™	\$33.2	\$24.2	\$19.9	\$6.5	

Our attorney's liquid assets are moderately invested with a 50/50 allocation between broadly diversified blue-chip stocks and high-quality municipal bonds. The municipal bonds are all New York bonds, split equally between city and state issuers.

She also has an investment in a private equity fund from a firm she represents. The fund is focused on spinoffs of smaller divisions from large pharmaceutical companies. The fund is in its third year with \$500,000 invested and another \$500,000 in capital commitments due, most likely over the next two years.

The public equities are essentially in the S&P 500, which has an approximate 14 percent weighting in the healthcare sector. This exposure equates to about seven percent of her financial assets, or roughly \$700,000.

If the U.S. healthcare sector were to be significantly disrupted, our attorney's private equity fund and healthcare stocks would almost certainly decline in the short run and possibly on a permanent basis. While taken in isolation, these would be survivable. However, this scenario could coincide with our attorney losing her job. That would greatly reduce her human capital at exactly the time when she needed her financial assets to be non-correlated.



The municipal bond portfolio is 50 percent invested in New York City-issued bonds. If a significant adverse event were to befall Manhattan, these bonds would decline in value and the city (and related bond issuers) would likely face credit downgrades. At the same time, her apartment would likely decline in value as well.

This analysis of Total Wealth shows how our representative attorney's assets are replete with Company Town Risks[®] that are not obvious from a traditional financial asset focus.

REDUCING COMPANY TOWN RISK[™]

I have found that almost all attorneys are heavily exposed to Company Town Risks[™] irrespective of the type of law they practice, their firm, or geographic location.

Many Company Town Risks cannot be eliminated; however, some can be reduced. Here I will explore how our representative AmLaw 100 partner could reduce her exposures using methods that are available to most investors.

The key to eliminating Company Town Risks[™] (and the most practical path) is to treat an investor's financial assets as a *completion* portfolio. This means the assessment of Company Town Risks[™] is done first and the allocation of financial investments is done last. This method allows the financial assets, which are the easiest to adjust, to be invested away from the risks that are impractical to adjust and/or non-diversifiable.

Human Capital

Human capital is typically the most difficult to diversify, especially as an investor becomes older. Efforts to diversify human capital tend to have high costs, such as reducing the time available to work in order to re-tool, which reduces the present value of the individual's existing human capital. In addition, as an investor becomes older, their number of working years is necessarily reduced.

Pension

Our attorney could take an in-service distribution from the firm, provided the firm's plan allows for it and she is at the "normal retirement age," both of which will vary by firm. The trend appears to be for earlier mandatory retirements of AmLaw 100 partners, so this is possible at earlier ages.

For the purposes of my example, I am assuming our representative partner can take an in-service distribution for the full amount of her pension's cash value.

Real Estate

Most people are unwilling to move merely to diversify their real estate exposures. Additionally, those exposures would most likely exist to some degree wherever our lawyer lived because her house would likely have to be within commuting distance of Manhattan. Home prices in Westchester and other areas within easy commute of Manhattan are highly correlated to those in New York City. This makes real estate a Company Town Risk[™] that is hard to diversify.

In the post-COVID-19 world, remote work has become the norm. However, this has led to increased time at the second home, not a sale of the primary residence. At least not yet.

Financial

The financial assets are the easiest to adjust and diversify away from the other exposures. As we will see, our attorney could significantly reduce her risk with some simple changes to her investment allocations.

First, the equity allocation could be skewed towards international securities, which will diversify our attorney away from the U.S. capital markets. However, if international markets are out of favor, domestic markets could be used as long as the exposure to the health care sector was eliminated. This can be easily accomplished with the use of sector ETFs in place of broad-based indices such as the S&P 500.



Second, with the human capital exposure to the healthcare industry and the additional private equity fund investment, there should be no other investments in healthcare stocks or bonds, or healthcare-focused private equity funds.

Third, the New York City bonds should be reallocated to a diversified portfolio of high-quality *national* municipal bonds. While this would slightly reduce their tax-efficiency, it would significantly reduce the Manhattan risk exposure, which is critical. This is an easy flipping of asymmetric risks from the existing low upside, high downside exposure, to a low downside, higher upside exposure.

Many of the New York State bonds will be highly correlated to the fate of New York City. While they are a secondary priority, they could also be reallocated nationally. This could be accomplished without any adverse tax consequences by letting the New York State bonds roll off as they are called or mature, and diversifying the proceeds nationally.

Table 2: Company Town Risk® Comparison⁸

Traditional Financially Diversified Portfolio

ASSET\C.T. RISK	U.S. CAPITAL MARKETS	FIRM	HEALTHCARE SECTOR	MANHATTAN	ASSET RISK
Human Capital	\$19.2	\$19.2	\$19.2		\$57.6
Pensions	\$5.0	\$5.0			\$10.0
Real Estate	\$4.0			\$4.0	\$8.0
Financial	\$5.0		\$0.7	\$2.5	\$8.2
Company Town Risk™	\$33.2	\$24.2	\$19.9	\$6.5	

Total Wealth Diversified Portfolio

ASSET\C.T. RISK	U.S. CAPITAL MARKETS	FIRM	HEALTHCARE SECTOR	MANHATTAN	ASSET RISK
Human Capital	\$19.2	\$19.2	\$19.2		\$57.6
Pensions					—
Real Estate	\$4.0			\$4.0	\$8.0
Financial	\$1.0				\$8.2
Company Town Risk™	\$24.2	\$19.2	\$19.2	\$4.0	
Difference (\$M)	(\$9.0)	(\$5.0)	(\$0.7)	(\$2.5)	
Difference (%)	-27.0%	-21.0%	-4.0%	-38.0%	

As can be seen, these portfolios are significantly different in their exposures to the individual Company Town Risks™. In the case of the Total Wealth Diversified Portfolio, our attorney has significantly reduced her exposure to U.S. capital markets, firm, and Manhattan risks.

Should a negative event affect the U.S. capital markets, the firm, or Manhattan, or all three, her financial assets have been diversified away from them and should be less affected, while her human capital and firm exposures could simultaneously experience significant distress.

CONCLUSION

By looking at our attorney’s balance sheet from a Total Wealth perspective, her large Company Town Risks™ become obvious and can be addressed *proactively*. These exposures would not be obvious from a traditional financial asset perspective. Applying the Total Wealth approach to address Company Town Risks™ often leads to surprising and counterintuitive recommendations which can help significantly de-risk an attorney’s portfolio without compromising returns.

ENDNOTES



- 1 Hardy Green; *The Company Town: The Industrial Edens and Satanic Mills That Shaped the American Economy*; Basic Books; New York; 2010; 3-5.
- 2 Jack Duval; The Bantam Blog; The Firm of Wall and Mart: When you're not betting the company; October 16, 2020. Available at: <https://www.bant.am/blog/the-firm-of-wal-and-mart-when-youre-not-betting-the-company>; Accessed October 20, 2020.
- 3 PropertyShark; NYC Median Sale Price Hits Yearly Low, Sales Drop Below 2,000 Once Again; September 17, 2020. Available at: <https://www.propertyshark.com/Real-Estate-Reports/nyc-real-estate-covid19/>; Accessed October 20, 2020.
- 4 New York City General Obligation Bonds, Fiscal 2018 Series E, Subseries E-5 Official Statement (CUSIP: 64966QAA8); Available at: <https://emma.msrb.org/ES1117337-ER881180-ER1281915.pdf>; Accessed April 15, 2018; 68.
- 5 New York City General Obligation Bonds, Fiscal 2013 Series I and J Official Statement; Dated Date May 24, 2013; Available at: <https://emma.msrb.org/Home/Index>; 5. \$50.4 billion in federal storm-related aid was provided by President Obama.
- 6 Alan Blinder and Nicole Perloth; *A Cyberattack Hobbles Atlanta, and Security Experts Shudder*; The New York Times; March 27, 2018; Available at: <https://www.nytimes.com/2018/03/27/us/cyberattack-atlanta-ransomware.html>; Accessed April 11, 2018.
- 7 Independent Budget Office of the City of New York; Available at: <http://www.ibo.nyc.ny.us/fiscalhistory.html>; Accessed April 11, 2018.
- 8 Note: asset exposures often overlap between Company Town Risk™ and thus are counted more than once.



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*Note: Nothing in this case study should be considered individual investment advice.
If you need investment advice, please contact Bantam CEO Jack Duval.*

