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Keys to the Kingdom

Four leaders in the wealth advisory profession discuss the family office model.

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By Bruce W. Fraser

It was the English philosopher and statesman Sir Francis Bacon who said riches are for spending. The most recent Capgemini "World Wealth Report" claims there are 85,400 individuals worldwide with a net worth in excess of $30 million. To service these ultra-affluent individuals and counsel them on spending wisely, the wealth management industry has developed the "family office" concept.

Family offices provide an array of services covering investment advice and money management, philanthropy, financial and tax planning, wealth transfer, due diligence, and increasingly, lifestyle services. It is a segment of the wealth management industry that is growing rapidly; by most accounts, there are between 3,000 and 4,000 family office operations serving the ultra-wealthy in the U.S. alone.

How are family offices organized and run? How do they serve their clients? Can aspiring wealth managers enter this coveted niche? For answers to these and other relevant questions, Wealth Manager asked contributing writer Bruce W. Fraser to moderate a discussion with four experts (see "Participants," end of the article) on family office planning.

***Wealth Manager*: What constitutes a family office? Are there different types of family offices?**

Grove: Based on research with over 650 family offices, we identified three different types of family office structures: The classic single-family office (SFO) is one wealthy family that handles all their affairs internally. Multi-family offices (MFOs) cater to more than one family—maybe five or six, and sometimes upwards of 35 to 40—that have pooled their assets. Usually, it's to get economies of scale in terms of pricing and access to different types of investments. Sometimes it's because they have shared values and goals with respect to long-term financial plans. The third type of structure is the commercial family office (CFO). That is essentially a wealth management firm or other type of financial services organization that has created a platform to provide family office types of services to families with considerably less overall private assets.

Pearl: There is a significant difference between what should constitute family offices and how that term is used in wealth management today. The tradition and original starting point was the single-family office. It was almost like the moat around the family castle. It was designed to provide complete control and confidentiality and ensure that the family's best interests were always being served through 100 percent dedicated staff. All services were provided internally. Today, unfortunately, firms of all types are using the term "family office" to describe their offerings, which makes it difficult for families to determine what services are actually provided. For some firms, this is simply putting a new label on the standard banking and wealth management offerings.

***Wealth Manager*: What is the threshold figure for establishing a family office?**

Grove: For many years, the number that was floated around for the single-family office was $100 million. But our research indicates the number is a moving target. What we found is that the average net worth of families with single-family offices was $600 million, which means the hurdle is getting much, much higher. And for the multi-family office, it was closer to $115 million.

***Wealth Manager*: What is the threshold for commercial family offices?**

Grove: The average family working with a commercial family office has a net worth of about $53 million.

***Wealth Manager*: What are the differences that set family office services apart from a wealth management business?**

Bavelas: One really big difference is the complexity and comprehensive nature of the services provided, not only in a single-family unit, but across multiple family units within the same family.

Pearl: The key differences are, first, a level of customization that enables a specific investment program for each family, based on their needs. Secondly, an understanding of and the capabilities required to help families preserve and build wealth across multiple generations. Thirdly, services that go far beyond asset allocation and manager selection, that include the creation of custom investment vehicles. I would argue that the fourth would be 100 percent objectivity, so that the choices made on the family's behalf are unquestionably appropriate for the family, not the result of a favorable commission situation for the advisor.

Bavelas: The objective of wealth management companies is to manage money, and a lot of the money happens to be in wealthy families that have family offices. So an evolution is underway in which some of the established wealth management practices have enhanced their offerings to better position themselves to get the money management assignment.

***Wealth Manager*: What are the typical profile and needs of your family office clients?**

Grove: I'm currently working with a handful of single-family offices with assets in the $500 million to $600 million range. All of them have experienced some kind of trigger event that has caused them to evaluate their current structure. Most offices are formed in response to a pressing need, but with the passage of time and the addition of new family members, needs will change. Many families want to know how other families deal with administrative issues. Or … how involved they are in tax planning. What types of lifestyle services should they bring in-house, versus handle on an ad hoc basis? What types of financial education programs have proven effective? How the budgeting process can be less painful for all the family members involved? So it's very much the process of facilitating decision-making for them.

I also work with wealth management firms in the process of migrating to a family office platform. Most have the right philosophy in place around offering comprehensive consultative personal service, but need help fine-tuning the culture and expanding the platform appropriately to really compete.

Pearl: The typical single-family office we serve has assets in excess of $300 million, and some are in the 10-figure range. Many clients are second generation who recognize the need to take an active role in the stewardship of the family resources they have inherited or come to control. They know the statistics —that most family wealth is dispersed and depleted by the third generation —and are determined to take proactive steps to preserve the family legacy and the funds that go with it.

Their needs are limitless. Because my firm works with the areas unrelated to financial investments, I can't comment on needs. But examples of "soft services" include advising on and management of everything from art and jewelry, aviation, summer camps and private staff. There is a trend toward medical and psychiatric care management for seniors and adult children. We have other clients who are well below these asset levels, who do not have a family office.

***Wealth Manager*: Philanthropic issues or charitable giving is a big trend nowadays. How do you counsel family office clients in this area?**

Bavelas: Hannah (Grove) made a good point: The things that get addressed first are the burning issues, those most urgent. In this regard, we help a lot of families assess the proper way to finance transactions that get outsourced. These can be anything from dealing with a large liquidity event, to selling or buying a property or an operating company. On the philanthropic side, we're helping them to establish and manage a foundation, decide how to give away money, and perhaps involve the next generation in the spirit of philanthropy. We're often in a situation where we're turning on the yellow light and suggesting that if you feel compelled to make a contribution or establish a foundation, let's make sure you consider all the economics involved.

Pearl: Families in this category are subjected to relentless requests to donate. We're helping the client identify what's important to them and where they want to focus.

***Wealth Manager*: What role does technology play in running a family office?**

Bavelas: It continues to be a challenge because the disparity of assets needs to be tracked and reconciled in terms of performance and the risk associated with them. Technology helps lessen the challenge to consolidate all this information into a single report for the family.

Schreiber: I agree with Arthur (Bavelas) on the importance of technology. We were a wealth management firm that evolved into a family office to provide a higher level of services to a handful of clients that were in the $25 million to $50 million asset range. We integrate everything into a workflow technology platform employees can use to provide the comprehensive advice and customized services wealthy families need to get the job done. Technology creates efficiency so families aren't paying exorbitant fees and losing the ability to grow assets.

Grove: The biggest change I've noted is the use of technology for security, which is becoming a bigger concern for the families, especially as their wealth escalates. Many feel like targets, and they are trying to protect their family members, protect their identity, and protect their data. What we are seeing is security specialists and consultants using a range of technology to encrypt data and communications and set up structures that will allow the family members to protect their identities.

***Wealth Manager*: So, obviously, identity theft is a very real concern?**

Grove: I don't know how real the issue is, but I would say people with this type of wealth often border on the paranoid.

***Wealth Manager*: How does an advisor to a family office decide what services to provide and how to be compensated? Is it hourly, retainer, fees based on assets under management or a combination?**

Grove: My recommendation to advisors is to start with their core competency and use that as their anchor service, relying heavily on a network of other experts to provide the things they cannot. Much also depends on who their clients are and what they want, because not all family offices want a broader scope of services.

Another big hurdle for advisors as they try to develop a family office platform is moving away from the constraints of being fee-only or commission-based. It's practically impossible to offer the full range of family office services. We are finding that more successful family office practitioners have left that mindset behind, and are compensated in different ways: hourly fees for some services, project-based fees for others services, and commissions on certain products.

Schreiber: We use a combination of assets under management fees, retainers, and also hourly fees for project work. This really goes to what Arthur was saying about disintermediation forcing more transparency relating to the cost of various services. The trend is to try to un-bundle advisory and management services from the cost of providing money management so wealthy families can better understand the real cost for services provided.

***Wealth Manager*: Can all of you put dollar figures around your services and charges?**

Bavelas: I think everybody on the panel charges similarly in some ways, usually project fees, money management fees and success fees, depending on the nature of the assignment.

Grove: I agree with Arthur, but also believe your fees should reflect the value you provide. For instance, if you are able to help a family save $40 million in taxes, that's certainly worth more than helping them save $4 million in taxes and, as a result, the fee should be larger. Most families would readily agree with that logic.

Pearl: We've built an advisory firm around providing those services through an objective, open-architecture business model. All of our revenue comes from client fees; the client can choose an hourly or monthly retainer fee, depending on their preference. Our hourly fees range between $300 and $600, depending on the type of services and the values we add.

***Wealth Manager*: Is there an overlap between the services provided by wealth management firms and a family office? If so, where does it occur?**

Schreiber: If you characterize a wealth management firm offering as managing money, then there is obviously overlap with the family office, which provides this service whether they manage money in-house or outsource. Many higher-end wealth management firms also provide consultative services, comprehensive planning, tax advice, charitable giving and everything else that goes into helping manage a family's entire financial situation. But family offices provide a more dynamic level of customized services to the entire family across generations, which most wealth management firms do not.

Bavelas: It's been suggested wealth management is typically defined as assessing and advising on money issues and getting paid to manage money. Managing money has been one of the primary objectives of family offices; everything else gets outsourced. So from a family office perspective we want to care for money as it relates to family members. You could argue that multi-family offices are more characteristic of a wealth management firm than a single family office as the fees and charges get further dis-intermediated. So I think there is and will continue to be crossover.

***Wealth Manager*: How does the family office operate in terms of what services are offered and managed in-house and outsourced?**

Grove: Most family officers do some degree of investment management in-house, but more and more are outsourcing elements of that. For instance, 67 percent of our survey respondents said they select and monitor investment managers. In essence, they are really acting as consultants and not portfolio managers.

Broadly speaking, there is more investing being done in-house than there is administration or advanced planning or lifestyle services, and so it is those areas that tend to get outsourced more. But I think that's changing with time, and it certainly differs by family, depending on the issues most critical to them.

Pearl: The criteria for families outsourcing should be the frequency of occurrence and the level of expertise required. For many families, financial investing is "core" and directed internally, but the non-investment services—from estate planning to philanthropy to lifestyle— are outsourced because they are relatively infrequent and require a level of expertise that is generally beyond a single person. Sophisticated families understand it is important to obtain the very best advice available, and that in-house experts have limitations.

***Wealth Manager*: You've all mentioned the outsourcing trend. Is there a danger you can also outsource the client relationship?**

Grove: Whenever there are multiple service providers there is always some tension around who owns and controls the client, and who has the most trusted relationship. One of the biggest skills the family office practitioner needs is the ability to coordinate and manage all the providers without being contentious to the client.

Bavelas: It's a very good question. One of the checks and balances is bringing people in who focus on a specific area and will do the task and once it's done, they exit. It's not always apparent, but bringing in people who focus on a specific area not only increases the level of skillful execution of that particular task, often it will demonstrate enhanced value to the client.

Pearl: On the lifestyle side, we found that it actually enhances and deepens the relationship with the client because it allows the advisor to have a completely different dialogue. The client is appreciative if the adviso r brings to the table someone who can help solve their lifestyle problem.

***Wealth Manager*: How does a wealth management firm move towards becoming a family office? Is it the next logical step in running an advisory business or an altogether different way of running a business?**

Grove: A wealth manager can work with a family office even if they only have one service to provide because offices are looking for specific areas of expertise to supplement their own. But if they truly want to build a family office practice, the first step is to broaden the platform of services they offer. More often than not, that means moving into the advanced planning space so they are capable of providing advice and cou nsel on things like philanthropic planning, asset protection, wealth enhancement, wealth transfer, and then moving into lifestyle services, which is becoming a more important component today.

Schreiber: I agree 100 percent with Hannah. Basically, we had c ore competencies on the investment and the advanced planning side, and we partnered with others regarding lifestyle, tax and legal issues. So if you are going to create a family office infrastructure, you should carefully plan what services you provide in-house and those you outsource because cost is a big factor.

***Wealth Manager*: What recommendations would you give advisors and wealth managers looking into offering a family office structure?**

Bavelas: Starting a family office is a serious endeavor, and in many cases unless you have a number of very wealthy clients, with assets over $100 million, it's not terribly profitable for a lot of wealth management firms. But the control issue being what it is, a lot of people want to grow their own services, so they tend to build overhead and infrastructure, and at the end of the day the P & L doesn't look particularly good.

Pearl: Be sure you can provide the services—whether in-house or outsourced—that families expect, at the appropriate quality and timeliness levels. Understand the different needs of families at the $10 million to $30 million, the $100 million to $500 million, and the $500 million-plus levels, because these are very different in all aspects. The increase in complexity as you go up in assets is just extraordinary.

***Wealth Manager*: What are some mistakes you have made in running a family office? How could others avoid them?**

Schreiber: It goes back to Hannah's point about profitability. You can essentially run yourself poor by trying to provide more servicing than you are capable of providing. You have to be careful to provide the right level of service within a client relationship where you can still be profitable; otherwise, you are not going to stay in business.

Bavelas: The mistake that is often made is the unwillingness to say "no." As advisors, we tend to want to have an exceptional experience for our clients, and if you don't possess that certain skill or obtain that skill, it's better not to be in denial about it.

Pearl: When they want promises of things that cannot be guaranteed. For example, assisting in identifying the appropriate colleges for a child doesn't mean that someone can "guarantee" the child will be admitted to the college.

***Wealth Manager*: What will the industry look like 10 years from now, particularly as the number of wealthy people continues to grow? How will it differ from today?**

Bavelas: Ten years is a long way out, but I believe the objectives will be the same for the families: legacy, money management and control. I also believe that control of the accounting of assets will reside in the family of fice as opposed to being outsourced, which is much the case today. The gathering and consolidation of data from global sources will be an important factor and a challenge in servicing family offices in the future.

Schreiber: As families gain more wealth, they are going to demand more and more family-office services. To fill that demand, most organizations are going to try to perfect more custom solutions for family offerings than they offer today. The business will get more competitive because there is mor e opportunity.

Pearl: Expect major consolidation. Firms like Family Wealth Alliance (an Oak Brook, Ill.-based consulting and research firm) are trying to bring standards to the industry so that families can know what they are dealing with. I believe that the number of single-family offices will grow because families will realize that is the only way they can have complete control and discretion; this will happen because some families now with the poorer quality MFOs will be disappointed and opt out. There will be greater recognition of lifestyle management as a discipline, and we will see in-house “lifestyle managers” as well as more outsourced suppliers.

Grove: I’d look at this from two vantage points. Providers are going to feel more pressure to broaden their platform, and they must understand the cost-value equation for each service they offer. We will also see more commercial family offices cropping up over the next five to seven years than we did over the previous five to seven years.

And from the family standpoint, I think there is going to be a greater emphasis on lifestyle services, particularly in allowance management, travel services and security services, especially as families focus on how to protect, defend and control their family wealth.

SIDEBAR
Participants

Hannah Grove - A leading authority on family office planning and sophisticated financial strategies for the ultra-affluent (www.hsgrove.com). She is a veteran of Wall Street with nearly 20 years of practical experience working with wealthy investors and their advisors. Based in the New York metro area, Grove is a columnist, speaker and the author of five books on private wealth.

Natasha Pearl - Owner of fee-based advisor Aston Pearl (www.astonpearl.com), which focuses on advising high-net-worth individuals in the purchase, sale and management of non-financial assets. Prior to starting her New York City-based company in 2001, she spent two years at Sotheby’s as senior VP of world wide relationship marketing.

Arthur Bavelas - CEO of Resource Network LTD (www.resourcenetworkltd.com) New York, N.Y. An internationally-known expert on the needs of the ultra affluent, Bavelas is the author of numerous articles, white papers and books. He most recently co-authored *Fortune’s Fortress: A Primer on Wealth Preservation for Hedge Fund Professionals*.

Don Schreiber - President/CEO of WBI Investments (www.wbadvisory.com), Little Silver, N.J. He is the author of *All About Dividend Investing and Building a World Class Financial Services Business*. Schreiber manages money for his high-net-worth family office clients using high-yielding dividend-paying stocks.

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