

Keeping it in the family

At a broad level, wealthy families across the world face surprisingly similar issues when managing their wealth. Generational transfer and succession planning is at the top of the agenda and family offices are now springing up across the world to cater for families' needs. **Will Cain** reports

The US has been a financial services innovator for generations - and now best practice in the family office segment is increasingly being transported across the world. With an estimated 1,000 family office enterprises, the US boasts a thriving market.

Industry practitioners attribute much of the recent development of family offices in emerging markets to the children of wealthy families who are educated in the US and bringing the family office concept back.

This transfer of family office expertise is likely to become more formal in coming years, according to Anna Nichols, managing director of content at Family Office Exchange (FOX).

"I do think we'll see more of that," Nichols says.

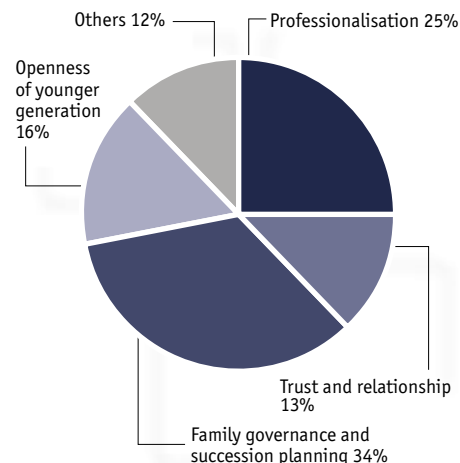
"The US has a lot to offer in family office experience and best practice is already exchanged through organisations like ours with families in countries including Australia, Singapore and Israel.

"As family offices begin to become more popular, particularly in regions like Asia, it is likely we'll see more interest in and exchange of best practice."

FOX, through its role as a resource for best practice among families in countries all

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Asia – motivations for setting up an office



Source: VP Bank

over the world, is already active in this area and Nichols expects activity to be stepped up in the coming years.

Nichols believes US family offices, as they become more global in outlook, will also help speed up this process.

GenSpring Family Offices, as one of the US's largest and most internationally active multi family offices, is likely to be an important part of this process.

"One of the things we see in Asia is a great interest in the education side of things," says Santiago Ulloa, president of GenSpring International.

"In areas like family governance and family dynamics solutions, wealthy Asians are coming to the US and looking for solutions for that."

There is also an interest in the more resource intensive family office operations, where using a shared multi-family office platform like GenSpring can reduce costs. Typically, these are due diligence, asset allocation, accounting and report consolidation purposes.

Asia-Pacific family offices flourish

Terry Farris, head of family office advisory at Singapore-based DBS Private Bank, estimates there are between 25 and 30 true family offices in Asia.

He expects this number to grow significantly in the years ahead as first generation entrepreneurs begin to plan the transfer of wealth to the next generation.

"We are at that evolutionary phase where we have got a lot of generations who have been passing on their businesses to the second generation," says Farris.

"As that process continues, the concept of the family office will start to take hold."

This internationalisation of the US version of the family office concept is also evident in Europe. Consultancy Celent estimates 18 percent of ultra high net worth individuals (UHNWIs) on the continent use family offices. It says there are 750 single family offices with a further 3,700 wealthy families using multi family offices.

Whatever their location, the broad issues facing wealth families are surprisingly simi-



Santiago Ulloa, GenSpring International

lar across the world. The core function of a family office is to manage generational change but this can be a complicated process with many pitfalls.

Success rates for wealthy families, in which wealth is transferred and sustained across generations, are as low as 30 percent according to research by GenSpring – and only 3 percent of these failures are a result of poor estate planning or investment returns.

The research highlights the importance of generational planning not just at an investment level, but on a much holistic basis – and this is the niche where family offices are best able to operate.

Of 25 best practice initiatives for multi-generational families highlighted in the report, none refer to the investment process (see table on facing page). They are based instead around ideas of family cohesiveness, governance, strategic planning, philanthropy, mentoring and trusts and estates. There is a strong emphasis on the transfer not just of a family's wealth, but also of its culture and history.

James Hughes, a lawyer and family wealth specialist quoted in Celent's report, turns the wealth management argument around by saying that "the assets of a family are

its individual members”, emphasising that good family offices are more about managing people than managing money.

Family office vs family business

Generational planning takes on particular importance when wealth is tied up in or managed within a family business. This is especially common in emerging markets, where many wealthy individuals are first generation entrepreneurs, but also remains true to a certain extent in the US.

According to Nichols at FOX, many families recognise the legal, personal and business risks of leaving wealth within their family businesses but all too often leave the issue on the back burner.

Nichols says separation between personal and business wealth is best practice for wealthy families and FOX goes as far as saying that it is essential for effective management and planning for the management of wealth over subsequent generations (see page 10 box-out).

Nichols recommends wealthy business owners begin a gradual shift of control away from the operating company to make the process less onerous and overwhelming. The FOX report outlines a three-step process to the independent management of family wealth.

It starts with an entirely business-managed scenario, moves to an intermediate step where a formal department within the business manages the family’s wealth and eventually leads to full separation.

As Nichols admits, “old habits die hard”

for wealthy families – and for many it needs a major catalyst to kick-start the migration process: a privacy breach, sale of the business, an IPO or leadership transition.

Many are happy to have their wealth managed by trusted individuals they have worked with for years. They also see their business’s finance department as a more efficient and less costly alternative to setting up another entity with an extra layer of overheads, for example a single family office.

Wealth separation barriers in Asia

These habits die even harder for wealthy business owners in the Asia-Pacific region, where wealth managers regularly lament the inability of wealth owners to separate personal and business wealth and the complications it can create.

The vast majority of Asia’s HNWI’s are first generation wealth creators, benefiting from the current economic exuberance within the region.

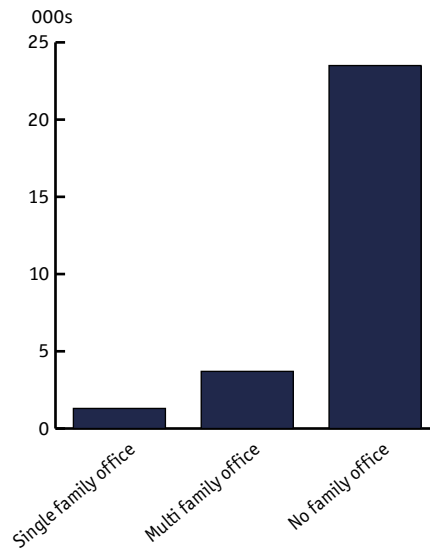
Rohit Sarin, co-founder and managing partner at Mumbai, India-based multi-family office Client Associates, says there are plenty of reasons for business owners to keep wealth within their businesses in Asia. These go beyond cost considerations and habit.

Sarin argues than in Asia it is often difficult for business owners to get a better return on their capital than redeploying it into their own fast-growing organisations.

“Of course, the thinking is that you keep ploughing back major parts of your wealth back into your family business,” he says.

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Family office penetration remains low in Europe despite a high UHNW base (number of UHNWIs)



Source: Merrill Lynch CapGemini World Wealth Report

“That also stems from the socio-economic values of Indian families. A lot of business families have large family structures and the businesses are usually jointly owned. The business continues to be an overall holding platform for their wealth.

“Wealth holders are starting to understand the value of other avenues and asset classes but while this understanding is growing it is still not very deep.

“From that point of view, it makes sense that business wealth holders are still allocating more of their assets to the asset class that they understand the most – and in most cases that remains their own business.”

The one-bank model solution?

Farris at DBS Private Bank, says the best way to solve this problem is to offer a so-called one-bank solution which can serve a client’s corporate and personal wealth needs, also offered by wealth big hitters including Credit Suisse, UBS and HSBC.

The model is able to cater for both sides of family wealth when the business is growing. It can also offer risk diversification through a family’s personal portfolio from heavily concentrated positions in a family business, for example businesses heavily influenced by changes in the price of commodities.

The one-bank model is then well positioned to advise on the migration of family wealth to independent management when generational transfer is on the horizon.

“I would say there are 25-30 true family offices here in Asia and they are multi-generational families,” Farris adds.

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Softer skills – 25 best practices of multi-generational families

Family Cohesiveness	Governance
Family history and culture	Family governance
Family mission statement	Family meetings
Shared values	Family policies
Teamwork and communication	Conflict resolution
Family member well-being	Succession planning
Strategic Planning	Philanthropy
Understanding of economics	Support for philanthropy
Wealth objectives	Shared philanthropy
Planning for major life events	Strategic philanthropy
Mentoring	Trusts and Estates
Financial education	Communicating intentions
Parenting skills	Grantor and beneficiary mentoring
Support for entrepreneurship	Selection of trustees and advisers
Family support network	Trustee and beneficiary relationships
Money smarts	

Source: GenSpring

▶ “My team is working with these multi-generational families and helping them to look at moving into family offices,” says Ferris.

“If they want to do that, what kind of structures do they need? We can bring in our trust people and look at putting those structures in place. We also look at what governance.”

For wealthy families in the emerging markets of Latin America there is a slightly different emphasis, according to Ulloa at GenSpring.

Political instability in some of the region’s economies has at various points in history caused confiscation of assets from wealthy individuals – notably in Cuba, Nicaragua and Venezuela.

It means UHNWIs in these countries want a greater degree of geographical diversification of their funds.

“Latin American UHNWIs usually have a very big operating business but they also try to reserve some of their funds in other countries,” Ulloa says.

Another driver behind this diversification trend is the rocketing asset valuations across the continent, notably in Argentina and Brazil.

Ulloa says wealthy individuals are on one hand exercising their increased buying power by investing in assets in markets like the US and on the other attempting to protect themselves from possible corrections in

■ GLOBAL ULTRA HIGH NET WORTH

UHNW prefer developed markets, but China’s UHNW population is rising fast

Number of UHNW households		
1 (1)	US	2,692
2 (2)	Germany	839
3 (3)	Saudi Arabia	826
4 (4)	UK	738
5 (5)	Russia	561
6 (6)	Italy	494
7 (7)	Canada	425
8 (13)	China	393
9 (8)	France	377
10 (9)	Switzerland	352
11 (10)	Turkey	341
12 (11)	Austria	297
13 (12)	Netherlands	278
14 (14)	Australia	231
15 (15)	Hong Kong	223

Notes: UHNW is defined as households with more than \$100 million. Brackets denote ranking in 2009. Source: Boston Consulting Group

domestic currencies and real estate prices.

“One of the big trends we have seen in the last year is that many people in Brazil are trying to diversify from the Brazilian market,” he says.

“They have been moving money out of

■ UHNWIs TOP SPOTS

Saudi Arabia, Switzerland and Hong Kong are UHNWIs preferred hubs

Proportion of UHNW households by market (One icon equals one UHNWI per 100,000 households)

1 (1)	Saudi Arabia	
2 (2)	Switzerland	
3 (3)	Hong Kong	
4 (5)	Kuwait	
5 (4)	Austria	
6 (6)	Norway	
7 (7)	Qatar	
8 (8)	Denmark	
9 (10)	Singapore	
10 (9)	UAE	
11 (11)	Israel	
12 (12)	Sweden	
13 (13)	Netherlands	
14 (14)	Belgium	
15 (15)	Canada	

Notes: Brackets denote ranking of country in terms of households with more than \$100 million. Source: Boston Consulting Group

Brazil – totally legally, officially and fully declared – but they want to reduce their exposure to the local market.”

Innovation in family offices must continue to match the rapid pace being set by the world’s growing ranks of UHNWIs. ■

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Best practice

Anna Nichols, managing director of content at Family Office Exchange, highlights three key reasons why it is essential families separate personal and business wealth.

- **Demographic trends:** It is estimated there are 22 million family-owned businesses in the US, with between a third to one half of the principal shareholders aged over 55. These retiring baby boom entrepreneurs need to find alternative wealth management solutions because they will eventually not have the option to use their operating company resources to manage their personal finances. They also recognise that managing personal assets inside their business does not provide the expertise or range of services needed to meet their retirement needs or those of future generations.
- **Financial crisis:** A study by wealth advisers Laird Norton Tyee showed 93



percent of business owning families use their operating business as their primary source of income. Nichols says this lack of diversification puts the wealth of future generations at risk, particularly in an environment where

selective diversification across asset classes and geographies is seen as an important means of managing risk. She adds there is a conflict of interest within operating companies, regardless of the financial expertise of internal employees, because of a tendency to reinvest a higher proportion than might be considered ideal into the business.

- **Non-investment risks:** There are security issues when a family’s wealth is managed within an operating business, particularly from personal and privacy risks. By managing wealth within a business, “families not only increase their risks, they forfeit the significant benefits that come from an autonomous family office or external wealth adviser solely committed to the goals of the family”, the report says. ■

Source: Family Office Exchange, *Taking Care of Business*