

Ten Crosscurrents in Family Wealth

By Robert W. Casey and Thomas R. Livergood

EXECUTIVE SUMMARY

When jet streams clash, they create storms of immense power. These crosscurrents cause tremendous disruption, yet can bring in their wake, new and refreshing opportunities. As John F. Kennedy took the Chinese word deriving from *crisis*, he told us that it translates to both *danger* and *opportunity*. The current crises staring wealthy families in the face are those of the financial market turmoil, the prevailing uncertainty about the economic outlook, and important public policy questions. Closer to home, other traditional concerns reflect generational clashes that create crosscurrents of their own. Firms striving to serve, sustain, and profit in partnership with these families are shifting as well, sorting out their own paths in the light of the morning after.

Yet from our perspective, as an organization that counsels families and chronicles the firms that serve them, there are many positive developments to report. It is true that families and firms face dangers, challenges, and uncertainties. On the other hand, they have been empowered by many new developments in the aftermath of these crises. The future offers great promise for those able to grab hold of it. Understanding the crosscurrents in family wealth provides the groundwork for understanding what has just passed and what lies ahead.

Ten Crosscurrents in Family Wealth

1. More Choices for Families
2. Renewed Focus on Family Governance
3. Determination to Nurture Non-Financial Wealth
4. Wanted: Objective, Conflict-Free Advice
5. The Standards of Stewardship
6. Concern about Sustainability of SFOs
7. Turmoil among Traditional Providers
8. Firms Going National Driven by Scale
9. Emergence of Family Wealth on a Global Stage
10. Families Remain Confused

We discuss each of these crosscurrents, then conclude with ten predictions we envision in their aftermath in the next twenty years.

1. MORE CHOICES FOR FAMILIES

Let's step back for a second. Multi-family offices, whatever their location or growth strategy, have been a great leap forward in terms of providing choices for families. Once there were two alternatives: families that could afford the expense could establish their own family offices; those that couldn't took their business to a bank. As the cost of operating a single family office rose, the parameters of that decision narrowed considerably. Enter the multi-family office. Over the past decade, the rise of this new type of firm, typically targeting families with assets to supervise in the range of \$25 million to \$500 million, represented an attractive solution. As a result, multi-family offices have flourished even though they maintain a fairly low profile in the marketplace.

Other flavors of firms have emerged as well, many with even less of a public profile than the multi-family offices. They reflect both the adaptability of the marketplace and the varied needs of families for professional help in managing their wealth. Remember, the multi-family office has three predominant characteristics designed to meet the needs of a particular set of clients: 1) a heavy multigenerational orientation, 2) an extensive menu of family office services, and 3) average family relationships in the \$50 million range.

Families with different needs can find solutions to fit. For example, an enhanced financial planning firm, one offering comprehensive wealth management but no family office services, might be just the ticket for a \$10 million family with no multigenerational issues. Alternatively, an external chief investment firm may be the appropriate provider for a \$300 million single family office that wants to outsource the chief investment officer function. Another flavor is the external family office, which can take on most or all of the duties of a single family office while the family retains control of the family office entity, governance, policymaking, and other functions.

As family needs evolve, and firms evolve to meet them, the range of choices grows ever wider. One of the most interesting developments we see is the bridge building between single family offices and multi-family offices. They

find each other culturally simpatico, and that opens the way for partnering that would not be possible with other parties. Increasingly, multi-family offices are providing outsourcing and consulting services to single family offices. From this, we see emerging hub-and-spoke relationships, with a multi-family office delivering different types of services to a group of single family offices in its orbit. The single family offices get to keep their independence and control of their destiny, while the multi-family offices build operational scale and help cover fixed costs. It's a win-win outcome for the firms and the families involved.

2. RENEWED FOCUS ON FAMILY GOVERNANCE

In many ways, the nature of families and family relationships represents an unchanging aspect of human life. The joys and the strains felt by people coexisting in multigenerational families were chronicled in the earliest literature. New stories have been added through history, and many threads of similarity about kinship string across cultures and across time, from the distant past to the frenetic present of the 21st century.

That said, change is nonetheless much in evidence among today's wealthy families—not in human relationships or emotional makeup but rather in lifestyles, demographics, in knowledge, ready access to vast amounts of information, and in sophistication. Family governance in multigenerational families, for example, is being reshaped by increased life expectancy. A family with three living generations was once the norm. If four generations were in evidence, G4 was probably toddlers and G1, elderly and incapacitated. Now, wealthy families with five living generations are common, and six is not unusual. Remarkably, the number of generations being served ranged up to seven in a recent research study of single family offices by our firm.¹

What implications does this trend have for family governance? A family with three generations can be governed informally, often by dictate of the senior members. A family with six living generations needs a formal governance structure that facilitates participation of all households if it is to deal coherently with the challenges of modern life. Another increasingly common phenomenon is households being geographically scattered across the U.S. or even globally. For them, a formal governance structure is essential if the family is to sustain itself over time and at long distance. And

indeed, our study found that six in ten participating family offices have established a formal governance structure such as a family council or board of directors.

Of course, the Internet and other modern forms of communication help families keep in touch across generations and time zones. They can connect in real time with their cousins or with the most minute details of their household finances and investments. Technology thus helps families get closer and stay closer. And as they have improved their cohesiveness, many families are taking a broader look at their wealth, and especially at their non-financial resources. Increasingly, they realize the need for nurturing all the family's forms of capital. It cannot just be their financial wealth that ties them together and provides the means for their future survival.

3. DETERMINATION TO NURTURE NON-FINANCIAL WEALTH

Other forms of family wealth are much more important than money, many thoughtful observers believe. One of those observers is James E. Hughes Jr., attorney, noted family counselor and a truly wise man. Hughes has written two influential books on the subject of families.² The first, Family Wealth: Keeping It in the Family, sets out his view about the importance of non-financial forms of family capital. Hughes pictures a pyramid with four layers. The bottom, foundational layer consists of the family's spiritual and social capital. It is the strength of these values that forms the base of the family entity. The next layer is represented by the family's human capital, in other words the family members and the sum of their relationships. The third layer is the family's intellectual capital, or each member's knowledge and the family's collective know-how. Finally, the top and smallest layer of the pyramid, the one supported by all the others underneath, represents the family's financial capital.

Within this framework, Hughes contends, the fundamental issues of wealth preservation are not quantitative, not dollars and cents. Rather, they are the qualitative values of human capital, intellectual capital, and spiritual/social capital. These qualitative strengths can be sustained over many generations if the family is determined to do so. "To develop and survive," Hughes writes, "a family, like a tribe, needs to enhance the growth of its members' human and intellectual capital to its highest capacity. Without such

enhancement, the family will not have the human assets required to take advantage of the new opportunities the future will offer and to combat the new threats it will pose.”³

Many wealthy families are embracing the worldview offered by Hughes and employing his suggestions. For example, our firm’s recent research found that two-thirds of participating family offices offer education programs to family members and have been actively expanding those programs in recent years. Among the expanded offerings cited: hiring an educational consultant to custom-design programs, adding programs for 15- to 18-year-olds, offering an educational component on the family website, and preparing personal development plans for individual members of the younger generations. By enhancing their own human and intellectual capital, families are girding themselves for the challenges ahead.

4. WANTED: OBJECTIVE, CONFLICT-FREE ADVICE

What does the best-in-class advice offering for wealthy families look like? First, it is objective and unconflicted in terms of investment advice. To address the problem of conflicted advice, many firms have adopted open architecture investment platforms in recent years. By open architecture, they mean that any investments can be selected for clients, with no preference given to the firm’s own products. Indeed, it has been common to see firms stop offering proprietary products altogether, adopt an open architecture approach, and rely entirely on investments from outside providers, eliminating the potential for conflicts.

This trend represents a better deal for wealthy families, and has dramatically altered the investment business. “Investors searching for advisors today will find that the open architecture revolution has had a profound effect on the way that even the most traditional financial advisors now do business,” says Gregory Curtis, chairman of Greycourt & Co., a leading advisor to the wealthy. And, he adds, “For investors willing to do their homework and conduct serious diligence on prospective advisors, the open architecture era offers vastly greater choice and many attractive advisory models that possess fewer conflicts of interest than traditional models.”⁴

Second, best-in-class advice is both comprehensive and integrated. Typically, in addition to needing investment advice, the wealthy client will also want guidance from specialized professionals such as an accountant,

attorney and insurance agent for tax, legal and risk management advice. Multiple professionals providing disparate advice may leave the client in a disadvantaged position. The accountant's tax advice might conflict with the attorney's estate plan, which itself might be out of sync with what the insurance agent is suggesting. Stuart E. Lucas describes the problem in his book, Wealth:

“Very few wealth management professionals have enough breadth of skill and experience to operate across multiple disciplines or to anticipate how advice offered by one expert can potentially affect that offered by another,” he says. “The advice of one advisor, should, ideally, complement and reinforce the value of another advisor's input. But the siloed nature of professional fields such as estate and tax law, financial planning, investment management, and banking usually works against this desired outcome.”⁵

To address the need to coordinate advice from disparate experts, the notion of integrated wealth management has evolved for families requiring a multiplicity of services. Typically, a primary advisor will play the role of “quarterback,” taking the lead in handling the client's financial issues and coordinating the activities and advice being supplied by all the other advisors. The quarterback role is the essence of wealth management, and requires an impressive set of skills. As Jean L.P. Brunel describes in his book Integrated Wealth Management, the successful wealth manager is, “1) a strong investor; 2) someone with a solid understanding of tax accounting, as well as financial and estate planning issues; and 3) a trusted advisor who appreciates the specifics of each client's psychology.”⁶

This is a tall order, to be sure, but today's best-in-class wealth management firms are delivering on it, to the benefit of their family clients.

5. THE STANDARDS OF STEWARDSHIP

Two events in recent years have helped spur new interest in the issue of fiduciary stewardship. First was the implosion of Enron Corp., and particularly its 401(k) retirement plan. An imprudently high 58 percent of the plan's assets was invested in Enron company stock; the stock value went to zero and many plan participants were financially devastated. Second was Bernard Madoff's \$65 billion Ponzi scheme. It remains to be seen how many individuals and organizations in positions of fiduciary

responsibility directed money under their care into Madoff's possession, but the number appears to be large. Many will no doubt face serious legal liability.

In response to these events, some thoughtful people in the investment world took steps to spotlight the issues of fiduciary responsibility, and to educate those who serve as financial stewards for others so they can do a better job. Among them were Donald B. Trone and Charles A. Lowenhaupt, who helped establish the Foundation for Fiduciary Studies after the Enron debacle. More than five million people in the U.S. serve as fiduciaries, including investment committees members of retirement plans, foundations, and endowments, as well as trustees of private trusts and investment advisors. To help guide them, the foundation developed Prudent Investment Practices: A Handbook for Fiduciaries, which lays out a series of practices appropriate for those who have responsibility for managing someone else's money. "Fiduciaries have the most important yet misunderstood role in the investment process: to manage the investment practices, without which the other components of the investment plan can neither be defined, implemented, or evaluated," its authors note.⁷

Since the Madoff scandal erupted, Trone and Lowenhaupt have renewed their efforts, this time with exclusive focus on stewardship in the realm of private wealth. Lowenhaupt's firm, Lowenhaupt Global Advisors, early in 2009 proposed a series of guidelines, "Principles of Wealth Management for Private Wealth Holders and Related Parties," that will be developed and augmented with practice standards. In its proposal, the Lowenhaupt firm observed that laws and regulations cannot by themselves protect against investment fraud. "Instead, protection lies in each wealth holder imposing a sound process that remains constant and stable even in perilous times or under dangerous conditions," the firm said. "That protective process must ensure that best practices and fiduciary standards are always in place to insulate wealth from corruption wherever the wealth is located and by whomever it is controlled."⁸

Wealthy families should welcome these principles and put them to immediate use. They cover areas such as governance and succession in a family office, trust, or foundation, and monitoring and compensating its officers; investment policy statements; portfolio diversification; selection of managers; custody of assets; and transparency of expenses. With these

principles in hand, most families will be able to do a better job of watching over the people they entrust to manage their wealth.

6. CONCERN ABOUT SUSTAINABILITY OF SINGLE-FAMILY OFFICES

Single family offices face serious challenges from collapsing investment markets, the dispersion of wealth across newer generations and demands for increased services by family members. As a result, many of them express concern about the sustainability of their organizations and the continued cohesion of the families they serve. Those are among the findings of a recent research study of single family offices by our firm.⁹

Indeed, the study found that family offices consider sustainability to be their biggest challenge. The term sustainability covers a range of concerns—the financial viability of the family office, the family’s sense of commitment and cohesion, and the ability to weather the tricky transition to each new generation of family leadership. These concerns may be exacerbated by tough times, but in a larger sense they are inherent, regardless of economic conditions, in a family enterprise that attempts to sustain itself over multiple generations.

Let’s look at some of the factors that feed this concern. One is the turmoil in the investment markets. Two in three participating family offices said they had reviewed their investment approach as a result of market problems and half of those had made changes in investment policy or practices. One in five acknowledged that their family office lacks sufficient expertise to evaluate today’s investment vehicles and strategies, and more than a quarter said they had assigned the role of chief investment officer to an outside firm or consultant. “Our biggest challenge is maintaining a long-term focus despite the disastrous 2008 investment returns on a global basis,” said one respondent. “We’re looking forward to the resolution of the economic instability stemming from the credit crisis,” said another.

Another key challenge is human capital. A number of participants in our study mentioned the difficulty they face in recruiting and retaining talented staff members. One in seven said their organization had a senior-level staff vacancy, and a quarter of those had hired a recruiting firm to fill the position. Finding an experienced individual to step in as chief executive of

a family office can be an arduous process that takes months. The difficulty in staffing their family offices with high-quality people becomes an impediment to their continued operations.

Costs eventually become an impediment as well. Family offices operate under the same economic and business rules as other wealth advisory firms. They are in a scale business. In other words, economies of scale give larger firms lower unit costs than smaller firms. How much so? Their expense ratios (total expenses divided by assets supervised) provide a gauge. The average expense ratio for the largest family offices (\$1 billion plus in assets) in our study was one-fifth the average for the smallest family offices (under \$100 million.) In effect, the smallest ones spend five times more per unit of output than do the largest. At some point those costs may become too much for many family offices, another factor contributing to the widespread concern about sustainability.

7. TURMOIL AMONG TRADITIONAL PROVIDERS

The last generation has been marked by wave after wave of bank mergers. A typical bank's ownership and name would change every few years, and turnover in relationship managers was equally high. Wealthy families using the local bank as corporate trustee often found that the knowledge and attentiveness to their situation by the bank's trust officers would ratchet down with each merger. Tales abound of families that went from a personal relationship at the local bank to using an 800 number to reach the trust department after it was relocated to a distant city. Mergers among the major brokerage houses had a similar impact on their customers.

This turmoil prompted many families to look around for new options. Other factors also contributed to their interest in making changes. An important one was dissatisfaction with the sales-driven approach often used by traditional providers, which tended to skew their advice in favor of their own products. Gregory Curtis of Greycourt & Co. described the problem succinctly: "I have now been advising wealthy families for almost three decades, long enough to watch substantial fortunes diminish into ordinariness through nothing more than a conflicted advisor's determination to keep family wealth in its own uncompetitive and over-priced investment products."

Pension plans, endowments, even middle-class investors using fee-only

financial planners were all demanding and getting objective, high-quality advice, Curtis noted in a 2003 white paper. “That leaves only one large group of investors still depending mainly on compromised advisors: wealthy families,” Curtis observed. “In one sense, this phenomenon is easy to understand. Families often have legacy relationships with conflicted financial firms that are difficult to break, emotionally if not legally. In addition, at least until recently, wealthy families tended to be relatively isolated. The mass media had no interest in discussing issues of importance to only a few Americans (even though they controlled massive wealth), and privacy issues often prevented families from networking effectively.”¹⁰

Happily, we’ve seen meaningful change in the years since Curtis wrote those words. The marketplace has responded to the needs of wealthy families, and they in turn, have become more aware of their options.

8. FIRMS GOING NATIONAL DRIVEN BY SCALE

The family wealth business has traditionally been local in nature. Firms had one office and served clients close to home. Few but the largest operated regionally or in multiple states. As mentioned, banks that were subsumed by giants in the merger waves found themselves losing family wealth clients, but mostly to other competitors that remained local in nature. True, a small number of brand-name institutions have long competed nationally in this space; but many of those brands have been tarnished in recent years, and they are losing market share across the board.

Today, in a departure, we see a small but growing number of firms, mostly multi-family offices, spreading their geographic footprints to become regional or even national in scope. Some are expanding organically, others by merger. In several cases they are separately branded multi-family offices, part of larger institutions, but operating with their own staffs and service delivery models. What is the common thread among these upstarts? Their competitive advantage is built on the new client-centric advice model—objective, comprehensive, and integrated. They are taking it national, getting a positive response, and in the process offering new choices to families across the country.

9. EMERGENCE OF FAMILY WEALTH ON A GLOBAL STAGE

The U.S. and Western Europe no longer have the world to themselves when it comes to family wealth. The growth of private businesses in Asia, Latin America, the Middle East, and Eastern Europe has helped add many families to the ranks of the world's wealthiest. For example, the *2009 World Wealth Report* of Capgemini and Merrill Lynch Global Wealth Management estimated the number of households worldwide with \$30 million or more in investable assets at 78,000. Of those, 39 percent were U.S. based and 23 percent European, while 18 percent were from Asia and 13 percent from Latin America.¹¹

All evidence points to rapid growth of family offices, as well as multi-family offices, and expansion of their numbers in Asia, Latin America, and the Middle East, though no authoritative global statistics are available. In our experience, families behind these activities are interested in global best-in-class solutions, and require sophisticated cross-border capabilities. Typically, such families operate on a regional, if not global scale, are transitioning control to the second generation, and are still actively running their wealth-generating enterprises.

One recent cross-border study conducted by four leading business schools found some minor differences between single family offices by region. Some of these differences had to do with governance, involvement in family operating companies, or frequency in reporting investment results to family members. But overall, the similarities trumped the differences, said the authors of the study, "Single Family Offices: Private Wealth Management in the Family Context."¹²

"Common assumptions notwithstanding, we found no clear indication that geography influences single family office configuration," the authors said. "There is a popular view that single family offices in the U.S are generally more sophisticated than their European counterparts, and that those in the U.K. are more advanced than single family offices elsewhere in Europe. However, we found no evidence for this belief: *in fact, in our analysis several aspects pointed to an industry where configuration of the single family office is very global* (emphasis added)."

10. FAMILIES REMAIN CONFUSED

Family wealth management has evolved remarkably over the past decade.

Yet a surprising amount of uncertainty and misinformation persists. Families selecting providers are confused. Exactly what is meant, they are likely to ask, by the term wealth management? What is a multi-family office? Is a big brand name reassuring, or a contrary indicator? How do you evaluate service offerings that appear similar on the surface but quickly become different when you look under the hood? They see vastly different value propositions marketed under the same rubric. Can they all be bona fide?

Unfortunately, there is scant guidance available to dispel this uncertainty. We believe this is one of our industry's chief challenges in the years ahead. We believe this is the family wealth industry's chief challenge in the years ahead. It has significant implications ranging from too few private families being served, to an under-achieved market share by family office providers, and a general lack of understanding and trust on the part of families, their advisors, and the media.

CONCLUSION

The North American theatre in family wealth faces a number of challenges today. Yet we see enormous opportunities. Understanding them helps us prepare for tomorrow. So, as we gaze into that proverbial crystal ball, here's what we foresee unfolding in the next twenty years:

Ten Predictions for Family Wealth

1. Families Move From Confusion to Understanding
2. Family Governance is More Practiced
3. NextGen Remains an Enigma
4. Deceit Remains, Fueled by Human Greed
5. Commissions Become Extinct As Institutions Finally Get It
6. While Objective Advice Becomes the Norm, Best Advice Still Wins
7. Savvy Competitors Learn to Become Collaborators
8. Cycle Repeats of Consolidation & Spins-Offs
9. Professional Designation & Career Track in Family Wealth
10. Globalization Is Commonplace, Efficiencies Are Not

As you can see, we do not envision utopia in the future world of family wealth, but we certainly predict improvements for the benefit of private families and the firms that serve them.

FOOTNOTES

- (1) The Family Wealth Alliance's Inaugural Single Family Office Study, 2009.
- (2) James E. Hughes Jr., Family Wealth: Keeping It in the Family, Bloomberg Press, 2004.
- (3) James E. Hughes Jr., Family: The Compact among Generations, Bloomberg Press, 2007.
- (4) Gregory Curtis, "Open Architecture as a Disruptive Business Model," White Paper No. 38, Greycourt & Co., 2006.
- (5) Stuart E. Lucas, Wealth, Wharton School Publishing, 2006.
- (6) Jean L.P. Brunel, Integrated Wealth Management, Euromoney Books, 2006.
- (7) Foundation for Fiduciary Studies, Prudent Investment Practices: A Handbook for Fiduciaries, 2003.
- (8) Lowenhaupt Global Advisors, "Principles of Wealth Management for Private Wealth Holders & Related Parties," 2009.
- (9) Family Wealth Alliance.
- (10) Gregory Curtis, "A Modest Proposal: Let's End the Conflicts of Interest in the Wealth Advisory Business," White Paper No. 21, Greycourt & Co., 2003.
- (11) Capgemini and Merrill Lynch Global Wealth Management, 2009 World Wealth Report, 2009.
- (12) Wharton Global Family Alliance (Wharton School, IESE Business School, SDA Bocconi, and Singapore Management University), "Single Family Offices: Private Wealth Management in the Family Context," 2008.

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Robert W. Casey is senior managing director for research for The Family Wealth Alliance. He leads the Alliance's research activities and is involved in a number of consulting assignments for the firm. Bob has been a consultant for financial institutions, investment firms, publishers, and other organizations interested in the area of wealth management. A long-time observer of the financial advisory industry, he was founding editor of Bloomberg Wealth Manager magazine. He is former managing editor

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Tom has been quoted in *Business Week*, *Financial Times*, *New York Magazine*, *New York Times*, *The Wall Street Journal*, *the Washington Post* and numerous other trade, popular print, broadcast, and online media. He has been published in *Worth*, *CCH* and *Families in Business* magazines, and interviewed live on Fox News Network, WGN Radio, and Voice of America.

He has spoken at Campden's European and Asia Pacific Family Office Conferences in London and Hong Kong, respectively, and has twice been a panelist at the Milken Institute's Annual Global Conference in Beverly Hills. Tom was the opening session speaker at the 2008 IIR Family Office Forum and has recently spoken at the IMCA National Conference, the Schwab IMPACT Conference, and for three years was the lead-off faculty member for the Chubb Advanced School. In addition, he has spoken at the annual meetings and special gatherings by invitation from organizations such as Ashbridge, Hub, Marsh, Pitcairn, and State Street as well as the Alpha Group.

Prior to founding The Alliance in 2003, Tom was with Family Office Exchange during the early 2000s, The Harris Private Bank during the 1990s, and CIGNA Financial Services during the 1980s. Among many volunteer positions, he served on the founding national board of the 30,000-member Financial Planning Association (FPA) during its merger of two predecessor organizations. A double graduate of Bradley University, he holds the BA degree in Liberal Arts (1977) and the MBA in Finance (1979).

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