By **Patricia M. Soldano** & **Chris Walters**

Snapping to Attention

A transformational year

Seen in the rear-view mirror, 2016 stands draped in change:

- In March, President Obama visited Cuba, the first sitting president to do so since 1928.
- The United Kingdom sent shock waves worldwide when its citizens voted in June to exit the European Union.
- In July, the Democratic party endorsed its first female presidential nominee.
- Bob Dylan, the voice of the rock era and its disgruntled generation, won the Nobel Prize in Literature in October.
- November brought to an end a historically divisive presidential campaign that's left both major political parties reassessing their messages.

"The times," the Nobel winner wrote, "they are a-changin," and the wealth management and family office industry hasn't been immune.

In fact, it's safe to say the industry's boundaries have been redefined on all sides, facing challenges that have never been as front and center as they are now. From the global threats of cybercrime to the emerging influence of the Millennials, the family office and wealth management advisor encounters an ever-changing landscape—a landscape that isn't going to return to a familiar profile.

This past year has demonstrated that the industry is headed into a transformation. And, while this transformation didn't transpire in this past year alone, 2016 snapped the industry to attention.

Cybercrime

Earlier this year, hackers accessed Bangladesh Bank, sending fraudulent orders to the Federal Reserve Bank of New York requesting the transfer of nearly $1 billion. Eventually thwarted, the cyberbreach exposed, once again, the extent and continued sophistication of cybercrime.

Keeping a tight lock on clients' assets, privacy and security persists as a 24/7 concern. It's reported that 43 percent of the wealthiest of U.S. households have a chance of experiencing identity theft.[1]

According to a *CNN Money* report, more than 317 million new pieces of malware—computer viruses or other malicious software—were created last year. That means nearly one million new threats were released each day.[2]

The wealth management industry must dedicate resources to protect against cyberbreaches and keep their clients informed about how easily breaches can occur. It's a proven imperative that each member of the client family must adhere to the identified best practices regarding cybersecurity—as must the industry itself.

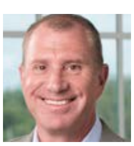
A PwC survey identified best cybersecurity practices by leaders in the digital age, noting that a proactive stance is the best defense. The survey stated: "This necessitates that everyone in the organization—from the board and C-suite to middle management and hourly workers—sees it as their responsibility."[3]

And, no one is more attached to technology than Millennials.

Millennials, Millennials, Millennials

Born after 1980, Millennials make up 27 percent of the U.S. population and stand to inherit $30 trillion from

Patricia M. Soldano is a family office consultant and **Chris Walters** is managing director, both at GenSpring Family Offices in Costa Mesa, Calif.



their Baby Boomer parents.[4] Engaging this wildly independent generation continues to present a challenge for the family office and wealth management industry.

Unattached to political organizations—approximately 41 percent are independent, 34 percent Democrat and 22 percent Republican,[5] Millennials take the title "Digital Natives" and rely on social media to connect to each other and the world, posing a communication challenge for the wealth advisor.

Their world view is, simply, different. They're attracted to advisors who help them develop life-long skills, which doesn't intersect easily with a results-oriented advisor.[6]

This past year, we watched as many Millennials raised the roof around Bernie Sanders and bowed to Al Gore, yet they're quick to distrust authority. They're a puzzling generation who aren't going to grow up and grow out of their beliefs. In fact, many Millennials continue to grow more distrusting of news media and more anti-religious.[7] This isn't a trend, it's an evolution.

How Baby Boomer and Gen X advisors work with Millennials going forward will require a culture change in the industry.

Investing: Impact; ESG; Robo

A 2015 Global Impact Investing Network (GIIN) report[8] of ultra-high-net-worth investors showed 13 percent of the funds raised was from family and impact fund managers, despite controlling only 5 percent of the total assets under management in the United States.

This is a quickly expanding destination for investment dollars. According to a GIIN 2016 report, 158 impact investors committed more than $15 billion to impact investments in 2015 and planned to increase their capital commitment in 2016 by 16 percent.[9]

Clients remain very passionate about impact—some willing to receive sub-par returns. We've also seen how an environmental, social and governance (ESG) strategy straddles the demand for performance with the desire to do good—a value vs. value analysis.

Getting ESG into the portfolio allows investors to feel more comfortable knowing that the companies they're investing in have been vetted against ESG criteria. Incorporating this non-financial data in security analysis is, arguably, a more holistic view of the company, and results show that it's adding to risk-adjusted returns.[10]

Barron's recently published a list of the top ESG funds, and the research reveals that the top 50 of the 200 U.S. large cap actively managed funds with the most sustainable portfolios beat the S&P's 15.4 percent return in the year ending Sept. 30, 2016.[11]

Communication with clients has continued to challenge regulations as well, as texting and social media messaging—albeit convenient and popular—may not be compliant.

Having this more broadly defined inclusive strategy for investing in stocks in the bigger portfolio allows the investor to get more laser focused in his foundation, using those investments to be more thematically aligned with moral values, where they can have a greater personal connection.

When the robo-advisor joined the scene in 2008, allowing the mainstream investor access to portfolio management, it boiled the blood pressure of many advisors, who saw it as a disruptive technology. Despite its less than warm welcome to the industry, Millennials have embraced the platform and advisors have adopted it, providing them with more time for the client. The future of the robo-platform will be how advisors use the technology to redefine their true value with their clients.

Requirements/Regs/Communication

As more families have more generations involved in the family business, there's been an increased demand for family services such as family governance and education. A Family Office Exchange report[12] indicated the first

concern among families of wealth is the education of the next generation. This education has become increasingly more complex as issues have become more complicated within the client family and the family office.

Investors need sophisticated solutions for these complicated issues and how they intersect with regulation and compliance requirements. The high touch services traditionally employed by the family office may become less personalized and/or customized due to regulation and requirements imposed by the Dodd–Frank Wall Street Reform and Consumer Protection Act. These requirements consume more time and expertise, and they're not going away any time soon. By 2017, most firms will need to adhere to fiduciary standards imposed by the Department of Labor.

Communication with clients has continued to challenge regulations as well, as texting and social media messaging—albeit convenient and popular—may not be compliant. And yet, many of today's clients have trended toward fewer face-to-face meetings and more remote communication.

Succession Plans

Nearly half of all financial advisors are over the age of 55. Over the next decade, Boston-based research group, Cerulli Associates, expects nearly 100,000 brokers will retire.[13] This will be a challenge for all wealth management businesses, and, frankly, this past year didn't reveal many solutions.

In the mid-to-late 1980s, the wealth management industry was attractive to the freshly minted MBA student. By the late 1990s, that love affair began to fade. The industry was no longer attracting that student. Furthermore, starting with the Great Recession, the industry at large has been under siege by politicians and activists, and its advisors were vilified. This trend has now become a big issue.

The Changing Business Model

More complicated tax and estate-planning systems, along with complex investment options, will require the wealth management industry to attract, recruit and retain sophisticated talent. The top program request from client families may be governance and education for their next generation, but that can't be delivered without specialized advisors.

The commitment to update technology comes at a cost, as does succession planning for "client-facing" teams and compliance with increased regulations. That said, can the single family office and the wealth management firm retain its high touch ways within the scale these changes require?

Technology, and how it changes communication methods, online services and connectivity, remains a constant challenge.

These changes are bigger than anything the industry has experienced over the past decades. The world is dramatically changing, and the industry needs to focus on it. This isn't just any year in review; this year has been transformational.

Endnotes

1. Experian, "Portrait of a Fraud Victim" (January 2010), *www.experian.com/newsletters/pdf/2010/marketinsightsnapshotportraitofafraud9-9.pdf.* Labeling it "a boundless threat," a 2016 PwC Global Economic Crime Survey (PwC survey) notes "cybercrime continues to escalate—ranking as this year's second most reported economic crime." *See* "Adjusting the Lens on Economic Crime: Preparation Brings Opportunity Back into Focus," PwC Survey, *www.pwc.com/gx/en/services/advisory/consulting/forensics/economic-crime-survey.html.*
2. Virginia Harrison and Jose Pagliery, "Nearly 1 million new malware threats released every day" (April 14, 2015), *http://money.cnn.com/2015/04/14/technology/security/cyber-attack-hacks-security/.*
3. PwC survey, *supra* note 1, at p. 15.
4. CNBC, "Advisors brace for the $30 trillion 'great wealth transfer'"(June 2016), *www.cnbc.com/2016/06/15/the-great-wealth-transfer-has-started.html.*
5. "The Parties on the Eve of the 2016 Election: Two Coalitions, Moving Further Apart," Pew Research Center (September 2016), *http://pewrsr.ch/2coxNzZ.*
6. Family Office Exchange, "Engaging the Client of the Future" (January 2015), *www.familyoffice.com/knowledge-center/engaging-client-future.*
7. "Millennials' views of news media, religious organizations grow more negative," Pew Research Center (January 2016), *http://pewrsr.ch/1OGDQip.*
8. Global Impact Investing Network, "Eyes on the Horizon: The Impact Investor Survey," *https://thegiin.org/knowledge/publication/eyes-on-the-horizon.*
9. Global Impact Investing Network, "Annual Impact Investor Survey," *https://thegiin.org/assets/2016 GIIN Annual Impact Investor Survey_Web.pdf.*
10. "The Top 200 Sustainable Mutual Funds," *Barron's* (October 2016), *www.barrons.com/articles/the-top-200-sustainable-mutual-funds-1475901470?tesla=y).*
11. *Supra* note 10.
12. "Educating Family Members," Family Office Exchange, *www.familyoffice.com/knowledge-center/educating-family-members.*
13. "Number of U.S. financial advisers fell for fifth straight year," *Reuters* (February 2015), *www.reuters.com/article/wealth-cerulli-advisor-headcount-idUSL1N0VL23920150211.*