BUILDING A FAMILY OFFICE FOR THE FUTURE

Asia's rapidly growing family offices are moving into their next stage of evolution. As the operating environment gets increasingly competitive and complex, the family office of the future will need to become more technologically savvy and focus on offering distinct value propositions, industry experts say. The ones that don't could face extinction.

BY INDIRA VERGIS

Asia's family office industry is still in its infancy, but it's about to undergo some growing pains.

Rising costs—partly driven by more complex regulatory and compliance requirements—and profitability concerns are set to dramatically alter the expectations wealthy families places upon these regional investment operations.

These changes look set to take place at a time of great opportunity. A 2017 Bloomberg report titled 'The Future of Family Offices', estimates there are 3,000 family offices in the US and 1,000 in Europe, while the number of family offices in Asia is estimated at a few hundred. The region houses less than 5% of the world's family offices, the report said, despite the fact Asia is home to one-third of the world's ultra-high-net-worth individuals (HNWIs)—commonly defined as those with net assets of more than $30 million.

Overall, the potential for growth for the broader segment of independent asset managers (IAMs) is undeniable. Industry observers estimate about 5% to 6% of Asia's assets under management are handled by IAMs (of which family offices are one type), versus more than 30% in Europe.

"As wealth matures in Asia, coupled with strong growth in the region, we expect the number of IAMs to increase and gain a larger share of Asia's AUM in line with the trajectory that European countries have taken in the last two decades," said Jason Lai, chief executive officer of Thirdrock Group, an IAM which began as a multi-family office (MFO) in Singapore in 2010.

But to grow their assets, family offices need to convince families they are worth the time, cost and effort. The trouble is investment returns of late have not been that compelling, while the costs of operation are rising. That, combined with the advent of new financial technology and the difficulty of finding good personnel, is causing wealthy families to weigh their options when it comes to putting their money into existing family office outfits.

Organisations that can convince families they can combine fiduciary responsibility and cutting edge investment capabilities stand to prosper. Those that cannot could well fall by the wayside.

30%
Of AUM in Europe is in the hands of IAMs

COST VS. BENEFIT

In the US and Europe, the concept of the family office dates back to the late 1800s. But in Asia, where so much family wealth remains in the hands of the first generation, it's still a relatively new concept.

As a result, there is no archetypical family office structure. Some family offices operate as independent entities with fully-fledged operations, while others are embedded in the family business, with senior executives of the business performing 'family office' functions. Others still operate on behalf of multiple families, and are typically called MFOs or IAMs.

The concept has strong growth potential. IAMs say many rich families have lost confidence in the private banks they entrusted much of their wealth to in the decade since the global financial crisis, in large part because banks often seem to prioritise profit margins over the client's portfolio needs.

"Many wealthy families believe their needs can be served better by building a bespoke team; they might continue to use banks for some services but for the most part, they can pick and choose the best service provider for each need and not rely on a single service provider," said Jessica Cutrera, founding partner of The Capital Company (TCC), an IAM, and a committee member of the Association of Independent Asset Managers Hong Kong.

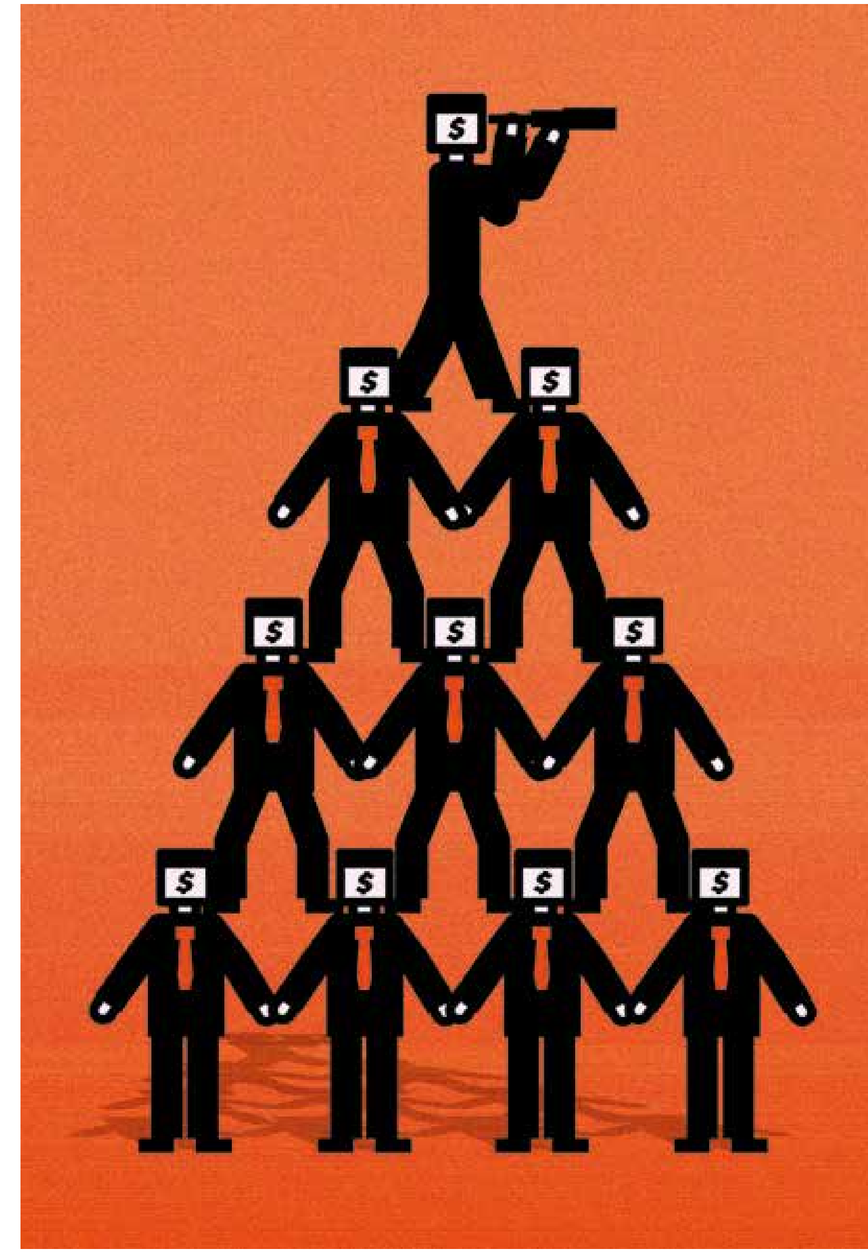
But building a bespoke wealth services team isn't cheap. "You need five people at the very least to set up a family office—a chief investment officer, a research expert, a couple of asset specialists and someone who can act as the interface between the office and the family," said Pathik Gupta, head of wealth management for Asia Pacific, at Scorpio Partnership.

He estimates that a family needs to have at least $1 billion in investable assets to justify setting up a dedicated office team. In addition, annual operating costs can be up to 15 basis points, or $1.5 million a year for a family with this minimum level of wealth.

CEO SALARIES
A big component of single family costs

Region	Average family office CEO salary in 2015
North America	$371,000
Europe	$303,000
Emerging Markets	$236,000
Asia Pacific	$276,000

Source: Global Family Office Report 2016 by UBS and Campden



What's more, Cutrera says many families lack the time to manage a bespoke team. "There is also limited talent in this space; families want people whom they know and trust, which could mean engaging another family, instead of going to the market and simply hiring a group of people," she added.

MFOs or IAMs offer an elegant solution. These institutions already have professional employees, while they combine the assets from several families to help meet the costs of operation.

They offer another advantage too: they can better meet an increasingly onerous regulatory burden of investing.

Recent international regulatory initiatives such as the Foreign Account Tax Compliance Act (Fatca) of the US and the Organisation for Economic Cooperation and Development (OECD) Common Reporting Standards have ratcheted up compliance costs for wealth managers, even as they inject more complexity to the role of client advisers. Increasingly, family offices need to possess adequate KYC (know your customer) and asset and liability management processes when onboarding clients and making offshore investments.

"CONSOLIDATION WILL BE ONE WAY FOR ENTITIES TO DEAL WITH REGULATORY CHALLENGES. ONE OF THE EASIER WAYS TO SUPPORT INCREASING COMPLIANCE FUNCTIONS IS TO MERGE OR PARTNER WITH ANOTHER FIRM"
Jessica Cutrera, The Capital Company

"The cost of these risks is especially high for HNWI businesses because of the breadth of their product offerings and the sensitive nature of their client base," Thirdrock's Lai said.

"We expect to see a growing regulatory focus on issues around consumer protection, conflict of interest, outsourcing and cybersecurity. While the full regulatory impact is still not clear, what is certain is that the regulatory burden on wealth management firms is getting even more complex."

VISIBILITY ISSUES

But while it makes sense for wealthy families to team up their investment operations, it's not all plain sailing ahead. Industry insiders say one of the biggest problems MFOs face is the lack of visibility on the entire portfolios of their clients.

Wealthy Asian individuals tend to prefer distributing their wealth across multiple wealth organisations, be they banks or MFOs. As a result, the multi-family office typically manages just a portion of the family's assets, which makes risk management all the more difficult, according to Scorpio Partnership's Gupta.

He took families with around $500 million to $1 billion in investable assets as an example. "Ideally, an MFO should be managing $300 million to $500 million [of these assets]…to be able to create a highly specific value proposition that fulfils the family's objectives. Yet many of them—including some of the bigger names—have clients that bring in $150 million to $200 million. That gives an MFO just 20% to 30% visibility of a family's entire portfolio."

A lack of visibility on the entire portfolio means the wealth adviser isn't able to manage the portfolio risk in a holistic manner.

In turn, that leads to some MFOs relying on the risk management frameworks of private banks, which remain the typical custodians of wealth assets even when their investment services aren't being used.

However, this isn't necessarily a good solution. "Even the private bank might not have full visibility on their clients' portfolios," noted Gupta.

CONSOLIDATION CRUNCH

Perhaps more pressingly, family offices have been struggling to offer impressive returns.

UBS and Campden Wealth Research's Global Family Office Report 2016, which was released in November of that year, estimated that Asia-Pacific family office portfolios had returned an average 3.9% year-to-date. That's after a flat 2015 when portfolio values were unchanged.

A combination of higher costs and relatively low returns could well pave the way for consolidation in this segment over the next few years.

"Consolidation will be one way for entities to deal with regulatory challenges. One of the easier ways to support increasing compliance functions is to merge or partner with another firm to share those resources," said TCC's Cutrera.

Reports are already trickling in of cash-strapped IAMs looking for buyers. A report on *AsianInvestor*'s website in late July noted that several EAMs (external asset managers) were said to be seeking buyers. Private banks are seen as the most likely acquirers, but that raises concerns about what it will mean for EAM clients.

So who are the most vulnerable? Nadav Lehavy, managing director at Sandaire, an international, family-owned MFO with a regional office in Singapore, argues the first victims will likely be entities that act simply as gatekeepers to multiple banking relationships.

Claudia Zeisberger, senior affiliate professor of decision sciences and entrepreneurship and family enterprise at INSEAD, who is sceptical about the mission of MFOs, argues family offices which take on too many families might struggle to do justice to their individual and often very "personal" mandates.

"When there are too many masters to please, you typically converge to the lowest common denominator," she said.

NOT IMPRESSIVE ENOUGH

2015 estimated benchmark performance of global composite portfolio, by region and % return

Region	% return
North America	0.3
Europe	0.6
Emerging Markets	-0.6
Asia Pacific	0

Source: Global Family Office Report 2016 by UBS and Campden

GROWTH POTENTIAL

Number of family offices

US
3,000

ASIA
100+

EUROPE
1,000

Source: Future of Family Offices 2017 report by Bloomberg

TECH TRANSFORMATION

One way in which family offices might be able to serve multiple masters is by embracing technological innovation. For instance, family offices could offer clients holistic investment advice if they could use digital solutions to consolidate their portfolios and statements.

However, this won't be easy or cheap. "This requires intensive investment in technology, which smaller outfits may find challenging to do," Thirdrock's Lai said, adding that "MFOs/SFOs need to have sufficient scale and a certain level of AUM".

Nevertheless, he believes it is essential to survival. "Existing wealth managers who are unable to maintain investments in digitalisation may, at best, lose profitability and market share, and at worst face extinction or be swallowed up by larger or more digitally mature players."

Lai's emphasis on the importance of technology is bolstered by a demographic shift in the region. Over the next 10 years 59% of Asia Pacific family offices expect a generational transition; this rises to 75% over 15 years, according to the UBS and Campden report.

"The rich are getting younger and in order to work with decision-makers, it's important to understand that their profile is different from the patriarch-driven style of functioning," said Shirley Crystal Chua, founder and CEO of Golden Equator Wealth, a Singapore-based MFO.

She notes younger generations of wealthy people are comfortable using technology to access various financial services, and says family offices need to recognise and adapt to these changes by adjusting their offerings and service delivery models.

Thirdrock's Lai believes the wealth management workforce of the future will most likely include digital talent including engineers and computer scientists, as the lines between fintech and investment firms begins to blur.

"Global asset managers might partner with independent wealth managers to expand their distribution capabilities, while IAMs might internalise product development and partner with leading robo-advisers to enhance their business models," he predicted.

Urs Brutsch, managing partner and founder of HP Wealth Management, an IAM that also offers MFO services, says successful MFOs of the future will be valued for their ability to access illiquid investment areas.

"Clients will need to be convinced of your special capabilities, among which access to private investments will be very important. Clients are done with private equity funds unless they are granted co-investment rights and are increasingly eyeing direct investments in companies, where they know exactly where their money is going."

Size, tech savvy and illiquid investment know-how; tomorrow's Asia family offices are set to look very different from those operating today.