By **Patricia M. Soldano**

Make Way for a New Generation

Stay in step with evolving and changing needs

A comprehensive, full-service family office serves a myriad of needs, from investment management to education and governance, accounting and taxes, estate planning and philanthropic management, as well as other services. Staying in step with how these needs evolve and change (and change is on the way) is vital to the success of today's family office.

It's Complicated

The family office must retain critical mass to recruit the talent and deliver the services that today's high-net-worth (HNW) families demand. Issues and solutions have become more complicated. Tax regulations and compliance, along with technology and communication, have grown in complexity, requiring a more sophisticated service delivery model, with a high level of talented professionals. In addition, the "Next Gen," also known as "millennials" (those born between 1982 and 2004), bring a different perspective to the equation, and, with the generational shift of wealth, potentially a lot of assets.

In multi-generational families, there's a stronger demand for governance and education. Families want their children to be financially educated—for good reason. These children, the millennials, are expected to inherit $59 trillion from their Baby Boomer parents. This technologically advanced Next Gen will challenge the delivery of services, methods of communication and investment decision making. Understanding how to engage and retain this generation will be imperative. Building their trust will be paramount.

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Building Trust

The family office business is all about trust. Traditionally, trust was built through person-to-person meetings, handshakes and conferences held under the light of a power point presentation. Millennials may need a different communication method. Understanding how best to communicate with this generation, which lives by its smart phone, may take time. Research has shown the millennials do indeed like face-to-face meetings and value connections. But, don't expect them to keep up with their email inbox, let alone listen to a voice mail. The millennials think and operate differently, and so they're going to invest and communicate differently.

A 2015 Family Office Exchange report, "Engaging the Client of the Future," explored many of the issues associated with millennials:

> This group is extraordinarily busy and inundated with information. As a result, it can be hard to get and keep their attention. This generation is also forward looking. Millennials don't want to talk about past performance. Their focus is on the present and, to a slightly lesser extent, the future.[1]

Communication preferences, along with constant innovation, not only pose a challenge for the family office, but also create a learning curve. This generation may be unaware that some forms of communication, that is, texting or online access, may not be allowed or may be limited due to regulatory restrictions. The family office needs to take the time to agree on the best, most efficient ways to meet and communicate with millennials.

The New Values

Just as the millennials have their preferred forms of communication, so, too, may they have different values. The millennials see the world through a different lens.

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They see their focus on what's important and how they want the world to be for them and for their children, as different from their parents' focus. The millennials are going to have a lot of money—and different reasons for how and when that money is invested.

Millennials don't want to invest just for a rate of return. They want to know specifically the impact of their investment and the positive change it will create. While it's true that family offices often invest through their values, this will be much more prominent with the millennials. Impact investing and socially responsible investing will experience an influx of money. A Merrill Lynch Private Bank and Investment Group survey reported that 29 percent of millennial investors believe values-based investing is an important factor in choosing a wealth management firm.[2]

Although too new to the scene to draw any conclusions, robo investing may impact the SFO of the future.

Regulation Play

Today, family offices—and all wealth management firms—face more regulation. The regulations have become much more comprehensive, complex and difficult, especially with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Wealth managers find that compliance is consuming more of their time and talent. This can affect single-family offices (SFOs) as well, if they don't fall under the exemption.

Under Dodd-Frank, an SFO may have to become a registered investment advisor and be regulated by the Securities and Exchange Commission, which is expensive and complicated. The 2008 financial crisis has made regulation so much more onerous, not only for family offices, but also for all wealth advisors.

Within the framework of Dodd-Frank, online services have also changed, setting up new technological challenges for both families and advisors. These challenges intersect with how the family offices and wealth managers deliver services. It's possible the services won't be as personalized and customized—a point of pride for family offices and wealth managers—because of the regulations to which they must adhere. We're still going to talk and communicate, but government regulations have infiltrated the relationship.

For example, the government requires families to receive written statements from their investment managers, even though the family office also receives their statements. This well-meaning safeguard of third-party checks and balances results in piles of mail. "Why," the family wants to know, despite copious explanations, "am I receiving all this mail when I have a family office in place?" The regulations make it harder for the family office to be this very customized, personalized service.

Direct Investing

After the 2008 financial crisis, families determined that they wanted more control over their investments and sought longer term time horizons. This quest for control has led to an increase in the demand for direct investments by family offices. According to a JP Morgan and GIIN 2014 report, in 2014, ultra-HNW investors and family offices contributed 13 percent of funds raised by impact investing fund managers even though they control only 5 percent of assets under management (AUM) in the United States.[3]

According to this same report, direct impact investments into companies represent 78 percent of AUM, compared to indirect investments, which account for 17 percent.[4]

And, where does the robo advisor come in? The crash of 2008 became a watershed for this online algorithm-based portfolio management service. Tech-savvy millennials, who value entrepreneurship and innovation, may find this attractive. Although too new to the scene to draw any conclusions, robo investing may impact the SFO of the future.

Succession Success

Many SFOs were formed in the early 1990s, and many of those family office executives are facing succession or retirement. Many of those family offices aren't prepared for this change. There may be a void in those positions.

Family members will be seeking replacements, which

could change the business model of the SFO. SFOs could determine that they should disband, decide to join a multi-family office (MFO) or co-opt with other SFOs to form an organizational buying unit.

This ties back to the generational shift of wealth that's also transpiring. Many of these SFO executives were "dad's guy." Now, the younger generation will inherit the money, and the patriarch's family office executive will retire. What's going to happen to the SFO?

Will the children take their money and set up their own SFO? Join an MFO? These are scenarios that need to be considered. The sustainability of the SFO will be challenged with this generational shift of assets and the succession of the family office executives.

Follow the Money

One final thought on trends within the family office industry is the change in how the money moves. It used to be a world of investment brokers. A family went to an investment firm and found their advisor. When he moved firms, the family went with him. The money followed the investment advisor. This loyalty to the advisor is less common today than it was in the past. Money has become more difficult to move due to regulations and compliance, and families no longer want to be vulnerable to one person. If that person leaves the firm, the family isn't as wedded to him.

Endnotes

1. "Engaging the Client of the Future," Family Office Exchange, 2015, *www.familyoffice.com/knowledge-center/engaging-client-future*.
2. "Millennials and Money," Merrill Lynch Wealth Management, 2015, *www.pbig.ml.com/pwa/pages/millennials-and-money.aspx*.
3. "Eyes on the Horizon: The Impact Investor Survey," J.P. Morgan, GIIN, 2015, *www.thegiin.org/assets/documents/pub/2015.04%20Eyes%20on%20the%20Horizon.pdf*.
4. *Ibid*.

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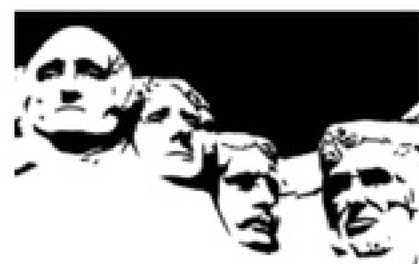

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