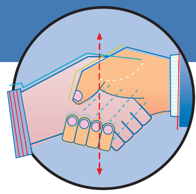

All in the Family

What's driving the apparent growth of multifamily offices?

BY ED MCCARTHY

It's a tempting proposition: Instead of working with dozens, perhaps hundreds, of clients, why not switch to the multifamily office (MFO) model and work with fewer wealthier clients and their families? For example, if your firm currently manages US$300 million divided among 100 clients, imagine how much more time you could devote to each client if you managed the same amount of assets for just 10 clients.

It's impossible to say how many wealth management firms are adding MFO services to their offerings or have made a full transition to the MFO model. Anecdotally, the number seems to be increasing. John Benevides, president of Family Office Exchange in Chicago, says that his organization's membership, which includes single and multifamily office models, has been growing at about 10 percent annually for the past three years. He believes several trends will sustain that growth in the United States and other countries. A key factor is the ongoing turmoil among the large financial institutions that have traditionally offered MFO services; uncertainty about the futures of those institutions is reducing some clients' confidence in their viability.

Growth Prospects

Michael Pompian, CFA, practice director of Private Wealth at Hammond Associates in St. Louis, MO, and the author of *Advising Ultra-Affluent Clients and Family Offices* has found that wealthy families have become more cautious about having all or a portion of their assets managed by one firm or even getting custody services from just one major brokerage firm or bank. "Research shows that wealthy families are moving away from a transaction-oriented business model," he says. "So the idea of an independent firm like ours or others has become appealing to a wealthy family or an ultra-affluent client versus the traditional brokerage model. It's not to say that there aren't top professionals or top-quality products at these big firms, because there are. But the model itself that large firms have had over the years has had some drawbacks for multigenerational families with a high need for independent advice."

At the same time, says Benevides, ultra-high-net-worth clients are demanding more services from their advisers, effectively pulling those advisers toward an MFO model. Another factor is the desire among financial advisers to move up and work with wealthier clients, whom they perceive as more profitable than smaller accounts. FOX's research estimates that there are 12,000 investment advisers, 500 wealth managers, and slightly more than 100 MFOs in the United States. Many investment advisers and wealth managers want to upgrade their services to the next category. "You see more and more of the 12,000 trying to get into the group that's the 500, and more of the group that's the 500 looking to get into the multifamily office side," says Benevides. "In addition to that, if you look at the large financial institutions, many either have or continue to invest in their platforms for providing services to the family offices."

A Vague, Fuzzy Line

The demarcation between wealth management and MFO services is fuzzy. "Family office" has more cachet than "wealth manager," and some firms advertising MFO services are closer to

KEY POINTS

- Ongoing problems at large banks and brokerage firms are causing wealthy families to seek alternative providers of family office services.
- Numerous wealth management firms that want to work with fewer but wealthier clients are also considering or are already offering family office services.
- There is no standard set of services that multifamily offices (MFOs) provide. The service mix is often determined by the founders' backgrounds and the clients' needs.
- Although offering family office services poses no additional regulatory hurdles, investment managers and wealth managers often require additional staff expertise and improved software for managing client relationships.
- Making a gradual transition to the MFO model can reduce the expense and risk of an immediate transition.

the wealth advisory model. According to Benevides, MFOs provide the investment management and integrated advice (i.e., taxes, estate planning, philanthropy, etc.) available from wealth managers but to a much smaller number of clients. MFOs also offer family services, which can include education, family governance work, succession planning, business evaluation, business transition planning and assistance, among others.

David Dodson, CFA, director of Salem Partners Wealth Management in Los Angeles, says the MFO model lacks a clear definition because the services are driven largely by clients' expectations. He believes, however, that the key differentiator between traditional wealth managers and MFOs is a focus on service instead of product. "If you think about your typical asset management firm or your typical registered investment adviser, they're looking to manage the assets of hundreds and hundreds of families and individuals," says Dodson. "I think the MFO model is really service driven. At the very least, our clients expect us to be more than competent on the asset management side of the business. But what they are really looking for are the extra bells and whistles."

The actual definition of "extra bells and whistles" varies with each family. For some families, it means "help with complex tax issues." In one case, Salem Partners helped a family acquire a jet.

When the partners at Kerrigan Kane Wealth Management Group of Wachovia Securities in Kirkland, WA, decided to offer MFO services at their new firm, they saw a market opportunity by providing banking expertise to supplement their investment management and other services. "We decided to converge as a team at a bank, essentially, because we realized that we wanted to have much broader services with the lending aspect of it," says Ian Kerrigan, CFA, associate vice president of investments with McNeil Kerrigan Kane.

The "everyday need" for the firm's clients "is the basics, and they need the lending for large purchases like real estate, airplanes, boats, and things like that," adds Kerrigan, who previously worked with high-net-worth clients as an independent registered investment adviser (RIA) as well as at a major brokerage firm. "I don't think it's a niche. I think it was just uncovered from my perspective. We enlisted a private banker with 25 years of experience, and she has really brought a lot of value to our clients."

Required Resources

The increased breadth and depth of MFO services places greater demands on the advisory firm. John Goodwin, managing member of Filament in Seattle, believes that assembling the personnel to deliver MFO services successfully is a major challenge. It's not just a question of individual talent; staff members must have the collaborative skills to address complex problems within an interdisciplinary service. Some firms hire that expertise. Other advisers complement their core expertise with affiliations and outsourcing.

David Dodson takes the latter approach. He notes that many families already have networks of trusted advisers in place, particularly for taxes and estate planning, and he questions the value of his firm offering potentially redundant services. Other professionals also frequently have specialized skills and experience, Dodson observes, and the flexibility to match that expertise with clients' needs is valuable. "We find that a lot of clients have very specific needs and there are certain law firms that will work better with one family, and another law firm will work better with a different family," he says. "For us to have somebody internally and steer everybody toward, say, an internal estate planner, I don't know that that's ultimately the best level of service that the family could have available to them."

Offering MFO services also involves technological challenges. Collecting the wide range of details necessary to service MFO clients requires a commitment to gather information on a comprehensive, ongoing basis. Client tracking and reporting technology is a critical element at Bristlecone Advisors in Seattle, according to Keith Vernon, CFA, principal of family office services for the firm. Vernon started out as the sole adviser for a single-family office that he started in 1999 for a wealthy entrepreneur. During the ensuing years, the business evolved into an MFO. Because Vernon considers traditional customer relationship software (CRM) inadequate for an MFO, he developed a proprietary information management system, Aristata, that directly facilitated his firm's growth. "In a traditional CRM system that a wealth management firm might have, there might be a list for an insurance policy, for example," he says. "But Aristata not only provides detail about the coverage limits but it tracks the history of that policy in terms of claims, premiums, and coverage amounts. It links that policy to meetings, activities, and tasks around that policy. It's deeper in terms of the information it captures, and then it's broader in terms of how it associates with the insured asset."

A Challenging Proposition

Assuming you can assemble the elements needed to transition to an MFO, it still makes sense to move cautiously at first. Benevides points out that the MFO model does not have the same profit characteristics as investment management, which he describes as much more scale driven. Instead, MFOs are more like a professional services environment. That difference may require a firm to modify its compensation structure when transitioning to the MFO model. Transitioning advisers "come in thinking that they're going to have much greater profit margins, and the profit margins aren't coming in," says Benevides. "Clients are wanting more retainer structures than they are assets-under-management structures."

Transitioning to an MFO is "an expensive proposition," says Pompian. "You can't just suddenly add all those services without having the professionals to deliver them. There's a Catch-22 because if you don't have the clients, you're not necessarily going to hire those resources, and if you don't hire the resources, you're not necessarily going to get the clients. Even if you had the clients and added all those additional services, are the clients willing to pay for them?"

But the transition from an investment management or wealth management firm to an MFO doesn't have to be all-or-nothing. Pompian suggests a slower transition. "In my experience, I have seen some firms successfully add services gradually," he says. "By gradually adding resources and then adding clients, becoming an MFO is a lower-risk proposition."

Ed McCarthy is a freelance financial writer in Pascoag, RI.

RECOMMENDED RESOURCES

Michael Pompian, CFA
Advising Ultra-Affluent Clients and Family Offices
(Wiley Finance, forthcoming May 2009)

"Objectivity and Alignment: New Choices for Families and Advisers"
CFA Institute Conference Proceedings Quarterly
(September 2007)
(www.cfapubs.org)