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Advising Ultra-Affluent Clients and Family Offices

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To all professional advisers
who make a difference in the lives of their clients

Contents

Foreword

The global financial system is suffering from historic stress and the cracks are showing. This period of time will be marked as the tipping point for the wealth management industry even though the actual trend has been quietly forming for years.

At the center of the trend is a reevaluation of trust and a desire on the part of clients to understand the essential nature of their financial service providers—and to specifically understand the provider's core competencies and how they fit into the client's overall wealth management program. In addition to this new awareness of the business models of financial service providers, is recognition of the interplay between trust, incentives, and economic behavior.

I have worked with ultra-affluent clients and family offices for many years, first as an adviser for the last seven years as the Managing Partner of a private association of family offices, and recently as the founder of a technology platform for wealth management content. Through these experiences, I have had the great luxury of seeing a sort-of collective consciousness of ultra-affluent families and their advisors. Family offices in particular, due to their unique makeup—essentially serving as private investment holding companies—are often leading indicators of future trends. Due to their financial resources, access to top advisers, and ability to take action quickly, family offices can lead the way towards activities that become more broadly adopted by clients and financial service providers at all levels of the wealth spectrum.

And one of the most powerful trends underway within the family office and ultra-affluent market is the separation of advice from recordkeeping and investment products. In the standard approach, clients are offered a bundled solution whereby their wealth manager (or private bank, broker, investment adviser, etc.) offers consolidated recordkeeping and custody, advice, and proprietary investment products—or in some cases, investment products from outside partners where revenue sharing is common.

Now the wealthiest clients obtain advice from independent advisers and consultants who help assemble best-in-class investment products from a global spectrum of providers, and then aggregate and track results through dedicated master custodians. Thus, successful advisors to ultra-affluent families not only need demonstrated domain expertise, but a transparent business model, and a willingness and ability to cooperate with multiple external advisers and providers.

Advising Ultra-Affluent Clients and Family Offices is the first comprehensive guidebook that succinctly lays out the separate components or building blocks for structuring a sophisticated wealth management solution. But just as important as assembling the right financial components, is understanding the human side of the equation. This is why Michael Pompian provides such a unique perspective in *Advising Ultra-Affluent Clients and Family Offices*. Michael is the rare financial writer who is at once a wealth management practitioner at the top of the industry he writes about, as well as a researcher and writer on human economic behavior. The subject of his first book, *Behavioral Finance and Wealth Management*, is evidence of Michael's deep understanding of the human factors that greatly influence financial outcomes.

Essentially all ultra-affluent clients are trying to ensure three things: long term growth of capital with limited volatility, predictable cash flows from interest, dividends, rents, royalties, and capital gains, and minimal friction from taxes, fees, and losses. The wealth holder also wants to understand what they own, how they are doing, and what they should be doing in the future—essentially requiring a balance sheet, income statements, and strategic plan—they also want this information and advice *integrated and in real time*. So planning, investing, and measuring become a continuous process. This is very hard to do. Michael Pompian articulates a clear and insightful roadmap which outlines the process, components, and human factors needed to create a sustainable world-class wealth management program—both advisers and wealth owners would be wise follow Michael's lead.

Stephen Martiros
Managing Partner, CCC Alliance
Founder, Summitas

Preface

Despite the downdraft in the markets that began in 2008, an explosion in wealth has occurred in the last 25 years. Many ultra-affluent individuals and family offices need significant help preserving and growing their wealth. Entrepreneurs are often very good at creating wealth, but they are often not as skillful or interested in managing their wealth. Moreover, much of the wealth in the world will change hands over the next 25 years from more experienced family members to newer generations that may not be as focused on wealth management as those generations that created it. Thus, there is a significant opportunity to advise ultra-affluent clients (UACs) and family offices now and well into the future. I have a personal stake in this: I am an adviser to UACs and family offices myself, having been in the financial advisory business going on two decades.

I review in this book key topics that are crucial to building the skills necessary to effectively advising UACs, especially soft issues such as family dynamics, philanthropy, and family governance. What advisers to this client segment need to realize is that these soft issues are taking an equal and sometimes greater place in some cases than investments in the work that advisers do with their clients. This is especially true with third- and fourth-generation family members; at this stage, investing in human capital (i.e., investing in the development and wellbeing of family members) is often more critical to the long-term health of the family than making great financial investments. Wealth preservation across multiple generations is a question, therefore, of productive human behavior. If proper development of family members is not done, wealthy families can succumb to the dreaded "shirtsleeves to shirtsleeves in three generations" curse. At the same time, and especially in the current environment, advisers to UACs also need to have solid investment knowledge, and there are a number of chapters dedicated to investments such as real assets, hedge funds, and private equity that UACs are broadly investing in.

There are four parts to the book. Part One begins with an introduction to advising UACs. This includes a discussion of what is considered ultra-affluent and understanding the mindset of UACs—their attitudes, aspirations, and investor behavior. In Part Two, I discuss investment strategies for UAC, which covers best practices of the top investment organizations and a review of many of the alternative investments that UACs invest in. Part Three delves in to key aspects of advising multigenerational families, including selecting an adviser, considerations for creating a family office, and selecting an investment vehicle structure. Part Four covers special topics in advising UACs that include wealth transfer, family governance, equity risk management, asset protection, creating a philanthropic strategy, and developing a multigenerational asset allocation strategy. A common theme running throughout the book is the idea that UAC advisors need not be expert in all areas of wealth management. You simply cannot do it all yourself. Bringing in experts to help you in critical areas, as I have done in many places in this book, is critical for success once you have uncovered an issue that goes beyond your level of knowledge or area of expertise.

You will notice that there is little in the book about taxes. Although taxes are a critical subject when it comes to advising UACs, there are entire books devoted to this subject that advisers should read and keep handy. I recommend Doug Rogers's book, *Tax-Aware Investment Management: The Essential Guide,* published by Bloomberg. Another subject not covered in the book is transitioning from a business-oriented family to a financial family. On this subject, I recommend a piece published by Family Office Exchange in Chicago titled *Managing Family Wealth Separately from the Family Business.* Please feel free to email me with any comments or questions: mpompian@haifc.com.

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I would like to acknowledge all the people who made this book possible. The list is long, so I hope to not leave anyone out. First, I thank my clients, whom I have the pleasure and responsibility to serve every day. They have been the source of the thinking behind many parts of this volume, and without the experience I have gained in serving them, it would not have been possible to write the book. Second, I would like to thank all my colleagues at Hammond Associates who help me to serve our private wealth clients and especially those who helped review the book. The firm contributed greatly with investment research and keen topical insights; there are simply too many people to thank at the firm to single anyone out. I also thank all of the investment managers with whom we work. Special thanks to Hedge Fund Research, Campden Research in London, and Pertrac for their invaluable help in providing data and researching investment themes for the book.

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In addition, there are people at numerous firms across the country who have helped elevate the investment consulting industry as a whole and challenged me to be a better advisor. These firms include Cambridge Associates, Greycourt, CTC Consulting, and many more. I thank members of the New York Society of Security Analysts (NYSSA) and the CFA Institute who have been invaluable friends and colleagues in my career. I also thank conference organizers such as NMS Management, Financial Research Associates (FRA), and Opal, who have worked to provide venues for idea exchanges in the ultra-affluent and family office space.

Last but not least, I thank my family for supporting me in my endeavors; much of what I do day in and day out is with them in mind.