

AN INDUSTRY IN TRANSITION
THE FINANCIAL SERVICES INDUSTRY
ADOPTION OF THE FAMILY OFFICE MODEL

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PRELUDE

Over the past few years everyone has written a white paper on the trends in the financial services industry. We hope that readers find that this paper provides a fresh look into what we perceive as a noticeable change in the delivery of financial advice from the old financial planner and investment manager models to the new model of family office services.

Our journey began in 1997 when the California State Legislature passed SB 5089, the Calderon Bill, giving accountants the ability to collect fees and commissions on insurance and investment products. Since many of our referrals depend on accountants, we were concerned about the consequences of this new law. Of course, companies like H. D. Vest and First Global saw this as a boon. The concept of “one-stop shopping” would finally become a reality in California. Over the next couple of years, I attended numerous meetings of the CPA Society, and other industry groups, and met with First Global to discuss its business model, and with my CPA referral sources.

The key was strategic alliances. We, the various financial professionals, would have to form strategic alliances to offer our services and share clients. However, no one seemed to have a particularly good idea of how to make that work. First Global was having trouble convincing accountants that they could also be salespeople. My CPA friends were telling me that they were already too busy. Besides, they knew nothing about investments and didn't want to lose clients should there be a market downturn. The ABA tabled its discussion of Multi-disciplinary Practices (MDP). Only the big financial firms, American Express, AXA Financial, myCFO.com, and some banks seemed to be making any progress in providing “one-stop shopping,” and it was expensive to do so.

Nonetheless, a trend was in place and obvious to the few whom cared to look. We concluded that at some point in the not to distant future the independent specialty financial service provider, regardless of discipline, was going to be threatened. After several false starts, we finally developed the concept of tying the independent advisors together utilizing the Internet to provide a virtual family office. Advisor could offer family office services to their clients while remaining independent, without the need to add expensive in-house services. In February 2000, we established FamilyOfficeNetwork, LLC, website: www.familyofficenetwork.com.

It would be another year before we found a way to provide the unique secure client information-sharing environment necessary to deliver our service. At an industry meeting, we had the opportunity to show our service to industry guru, John Bowen, President CEGroup, and formally of Rinehart, Werber, Bowen and the Asante Group. John was impressed and recommended we write a white paper on the issue. It has taken nearly a year to complete this paper.

In the meantime, several other research pieces have been completed on the trends in the financial services industry. Best known, perhaps, are Mark Hurley's, Undiscovered Managers, papers. The first, September 1999, concluded that over the next 7 to 10 years the financial advisory business would consolidate into a handful of major firms much as the institutional firms had done 20 years earlier. Small firms would find it increasingly difficult to compete and would ultimately perish or eek out minimal incomes. The second paper, September 2000, softened the view a bit adding that certain niche players would also be able to survive. In February 2001, QA3 Financial Corporation published *The Future of the Independent Financial Advisor: Collaborate or Evaporate*. Covariant Corporation published *The Renaissance Advisor – How Independent Financial Advisors can Transform into Wealth Managers*, in May 2001. Both of these papers complemented Hurley's work on the absolute need for financial professionals to change or perish, and added that through strategic alliances, the Internet, and new tools that the independent advisors would be able to survive and prosper.

In late 2001, Schwab published an excellent work, *Strategies for Building a Successful Wealth Management Firm*. The paper focused on the increasing number of wealthy and how advisors need to change to meet their needs. Quoting from the report "The message is clear: This new generation of affluent Americans is seeking advisors who can provide financial solutions that take their entire scenarios into account. In short, they want comprehensive wealth management." To do this, Schwab concludes, advisors will either incur the expense of building an "in-house" solution or they will find new ways to partner, particularly through the Internet.

"Wealth management will play a major role in the financial services industry going forward, and generate a lot of growth for advisors."

***Mark Tibergien,
Moss Adams LLP***

We believe that the other papers, while making significant contributions to the debate, leave out the critical elements of where the trend is headed. Will it be Comprehensive Wealth Management or

Family Office? What is the difference? What can independent advisors do to meet the challenges?
Therefore, we dedicate this work to our fellow independent financial professionals.

About the Author

Peter R. Wheeler is founder of FamilyOfficeNetwork L.L.C. and serves as Managing Director. He has over 37 years of experience in the financial services industry. Pete has been named as one the nation's top 250 financial advisers in Worth magazine's September 2001 issue.

He is one of less than 40 licensed life analysts in the state of California. Pete is a CLU (Chartered Life Underwriter), ChFC (Chartered Financial Consultant), CFP (Certified Financial Planner), and a CIMC (Certified Investment Management Consultant). Pete earned his Bachelors degree in Finance from the University of Arizona in 1968. His extensive background in the financial professions provides him with a unique understanding of the complexity of comprehensive wealth management.

Pete has a history of staying in the forefront of the financial services industry trends. In 1982, he incorporated Wheeler/Frost Associates, Inc., a fee-for-service wealth management company and a Registered Investment Adviser when there were fewer than 4000 RIA's in the United States; today there are more than 20,000. Wheeler/Frost Associates, Inc., currently provides wealth and investment management services to its own clients and the clients of financial planners, accountants, and other professionals. Pete serves as President and Chief Executive Officer of Wheeler/Frost Associates, Inc.. He is responsible for the overall management and operations of the firm and serves on the firm's investment committee. Pete was included in the first group of professionals to receive the ChFC designation. Serving the needs of executives of publicly traded corporations, Pete has a particular expertise in Incentive Stock Options and Non-qualified Stock Options and is the author of "An Executive's Guide: Incentive and Nonqualified Stock Options."

Research Associate, Shandley K. Phillips is the Director of Information Technology for FamilyOfficeNetwork. Shandley is an Economics graduate from San Diego State University and a professional soccer player with the San Diego Sockers. He has the primary responsibility for the design and maintenance of the FamilyOfficeNetwork website and technology advancements. Recognized for his website expertise, he also has national clients for website design.

Research Assistant, Vishtasp Soroushian, a sophomore at the University of California Berkeley, gave up his winter break to help us complete our research.

RESEARCH METHODOLOGY

Premise

In the 70's, we were insurance agents, stockbrokers, and bankers. In the 80's, we became financial planners. At the end of the 80's, many financial planners transitioned to investment managers. A rising stock market and the appeal of fee-based advice were so strong that mutual fund salesmen appeared in bank lobbies. Major brokerage firms adopted various wrap programs so they too could be in the "advice for a fee" business. By the end of the 90's, though, a new trend was emerging. Companies, like American Express and AXA Financial, were spending millions to offer comprehensive solutions to their clients. Laws were changing and H. D. Vest and First Global were recruiting accountants to offer insurance and investment products directly to their accounting clients. At the same time, advisors started to broaden their practices to provide more comprehensive services for their wealthier clients. Our premise is that the trend toward Comprehensive Wealth Management or Family Office Service is firmly in place.

Resources

We identified many resources, but few were aware of the scope of the trend. We have benefited from work done by Family Office Exchange of Chicago. Additionally, we obtained excellent industry trend information from the www.Advisorbenchmark.com website. The various white papers mentioned elsewhere in this report also provided valuable resources.

Independent Research

Over several months we developed an in-depth questionnaire to find out more about this trend and test our premise. We were able to distribute our survey to about 1000 advisors who represent a broad spectrum of the financial services industry. The survey was augmented with numerous discussions with advisors who had made or were making significant changes to their business models specifically changing to Comprehensive Wealth Management or Family Office models.

Focus

The focus of our analysis was on those in transition, the advisor moving to the more comprehensive model, not the existing traditional family office. We examine how advisors respond to this change and what the future holds for advisors and the industry as this trend continues.

HISTORY

Over 100 years ago, extremely wealthy families such as the Rockefellers sought to reduce the burden of their wealth and provide confidentiality to their personal affairs and wealth management. They hired an attorney or accountant and established the first family offices. Many of these offices exist today. Through the years the services provided evolved providing for virtually all the needs of the family including hiring domestics, pet care, and college admissions. Some dedicated family offices still provide those services. However, today, most focus mainly on the more traditional financial services. Until recently family offices were relatively obscure, reserved for the very wealthy.

In the 1970's most affluent families obtained their financial advice in a disjointed way. The attorney did the wills and trust, the accountant completed the tax return, and the client shopped for insurance and investment contracts from a variety of commissioned salespeople.

By the 80's, the financial planning trend was well established. The International Association for Financial Planning (IAFP) and Certified Financial Planning associations saw their memberships surge as insurance agents, stock brokers, and real estate salespeople rushed to become part of the new industry. There were a few fee-only planners, but most charged a fee for planning and commissions for implementation or did the plan for free in hope of getting the product sales. Much of the planning centered on tax planning and the use of tax shelters to reduce taxable income and provide cash for other investments, insurance, etc.. However, the Tax Reform Act of 1986 brought most of this to a screeching halt. The loss of passive activity deductions and the subsequent collapse of the real estate industry demanded change if advisors were to survive.

“The family office is an old idea that came back into fashion in the 1980's.”

Charlotte Beyer
Private Investors,
New York

The 90's brought an exploding financial market and with it the transition of financial planners into investment or asset managers. Many moved to an asset based fee rather than commissions. The model was so successful that traditional brokerage firms were forced to respond with a variety of wrap programs and SAM's (separate account managers). Initially fees were high and clients were reasonably easy to obtain. Increasing competition has driven fees down, and the multiples clients now expect more than just money management. As a result, a few pioneers started transitioning their practices into comprehensive wealth management firms over the last few years.

Interest in the family office business model as the next logical phase for the financial planner of the 80's and the investment manager of the 90's is growing.

AN INDUSTRY IN TRANSITION

The financial services industry is in the process of great transition and consolidation. The distinct services of accounting, legal, insurance, banking, and investments are rapidly being consolidated into multi-service conglomerates. The merger of Citibank and Travelers Insurance into Citigroup, American Express's purchase of local and regional accounting firms, and the acquisition of Equitable Life Insurance by AXA Financial are only a few examples of the pressure to become a full service financial provider.

"The message is clear: This new generation of affluent Americans is seeking advisors who can provide financial solutions that take their entire scenarios into account. In short, they want comprehensive wealth management."

Schwab

These mega financial institutions recognize that client control is an important way to increase revenue and client retention. According to a study by JPMorgan Fleming Advisor Services, clients offered only one service reported a 39.9% satisfaction rate, while clients offered three or more services reported a 96.6% satisfaction rate. These mega firms can afford to buy clients and buy the services they need to retain them. The local accountant, attorney, financial planner, or insurance agent is often hard pressed to provide an adequate level of diversified services to compete with these mega conglomerates.

At the same time, the independent advisor is caught in a system of client and advisor relationships that is inherently flawed. The client remains at the center of the relationship and information management system. Often, the client's various advisors have no idea who each other are. The client is forced to coordinate the efforts and to act as a liaison between advisors. When asked by the client to help build the team, the typical advisor response is the three-card referral system - "Here are three cards of insurance agents, give them a call and see which one you like." This is not the help clients are looking for.

Consolidation and the ability to deliver on the promise to provide “one stop shopping” for the client’s financial needs will force the independent, single service advisor to change, merge or leave the profession. It will not matter what professional field he or she is in. In order to remain independent, financial professionals must find a way to deliver the same comprehensive services that the conglomerates offer.

This trend is a result of two unique phenomena: the explosion of new wealth and the increased competition to provide services to the wealthy and nearly wealthy driven by new entries into the financial services industry and the removal of restrictions that previously barred cross discipline services; specifically the Bank Modernization Act of 1999, creating multi-disciplinary practice for attorneys, and broadening of the CPA’s services. Former allies in the delivery of financial services now are competitors. Increased technological capabilities allow advisors to deliver on the promise of increased services.

Wealth in America – A New Generation

Clients no longer look for single solution providers. They want dynamic partnerships that focus on accumulating wealth over a lifetime. They want advisors who will help them fulfill lifetime goals, provide for their families, and plan for charitable bequests. This new generation of wealthy has acquired wealth earlier than any other generation, mostly as a result of their own efforts. They are subject to more regulations and have more complex issues of taxation, distribution planning, and charitable giving than their parents could have imagined.

In 1989, there were 800,000 millionaire households in America. Today, there are 3.3 million such households. It is projected that there will be 5.6 million by 2005. In 1998, the number of households with more than \$1 million in liquid net worth increased by 16 %. A 1998 study by Spectrum Group, found that including ill-liquid wealth there were 6.7 million households over \$1 million. The ill-liquid wealth included 14.1 million Americans with stock options. This represented most of the ill-liquid wealth. With the demise of the dot com companies since then and now the loss of Enron, many of these people are probably now former millionaires. It is estimated that 50 % of all high net worth households use three or more financial professionals.

The traditional model for providing financial advice to the high-net-worth client has been the family office. Today's new wealthy, according to a recent study by PricewaterhouseCoopers, are first generation wealthy. They have created their wealth through entrepreneurial efforts or corporate executive benefits such as stock options. They expect their advisors to provide them with a menu of financial services that meet their complex needs. Further, the majority (63%) prefers to work with one advisor who will provide a world-class diverse list of services. The potential for advisors is tremendous.

The New Advisor

With an understanding of the new client as their guide, advisors are quickly reshaping their practices to meet the demand. Rather than selling products, they are becoming solution providers. Large, well-capitalized firms have the resources to quickly provide all the services necessary to meet the needs of a comprehensive wealth management practice. However, will they have the best platform for providing the client centered advice that the wealthy demand?

Private bank relationships, such as JPMorgan, have done an excellent job of serving the very wealthy for generations. We are dealing with the new wealthy now. Many institutional providers will provide services based upon a limited selection of in-house products or through relationship managers who change every couple of years, leaving the client with a sense of abandonment.

“There are 7.1 million US households with a net worth of \$1 million or more.”

1999 Affluent Market
Research Program –
Spectrum Group

The financial advisory industry is currently made up of 11,500 firms. This does not include all of the banks, insurance companies, and CPA's that are entering into the competitive mix. Mark Tibergien, Moss Adams, LLP, estimates that there will be an eightfold increase in RIA's in the next 15 years. “What was once considered a traditional source of referral has now become a competitor for the independent advisor,” said Tibergien. Industry experts point out that advisors who can provide an all-encompassing wealth management package will be well positioned to capture millions of dollars worth of assets in the coming years. However, only 57 % of our survey respondents agreed that clients are looking for a “one-stop” solution. Fifty-four percent said they had already added services

to compete with the full service firms. Some firms (7.8%) have already transitioned to the family office or comprehensive wealth management model, but most have not. For the independent, forward thinking advisor, a golden opportunity presents itself. As Schwab puts it, “As you move to provide an all-encompassing, holistic wealth management approach, you’ll find yourself in the sweet spot of what may likely be the greatest growth opportunity in the history of the financial services industry.” The time for action is now.

WHO ARE THE PLAYERS?

Several business models are competing to meet the financial needs of the semi-affluent and wealthy. Banks, insurance companies, brokerage firms, large accounting firms, and many others are attempting to provide all financial services through “one stop shopping.”

Banks, Brokerage Firms, and Trust Companies

In June 2000, Schwab purchased 147-year-old U.S. Trust for \$3 billion. U.S. Trust’s old-money clientele, with \$90 billion in deposits, is a strange match for the aggressive high profile Schwab. No longer content to be a discount broker, Schwab will use the trust company to spring board into wealth management for the newly wealthy and to provide trust services to the clients of the 6000 independent advisors who custody their clients’ assets with Schwab. However, not all advisors see this as a plus as Schwab continues to push its service umbrella into the advisor’s territory.

Wells Fargo & Company, the banking giant, already had a strong position in banking, trust, and brokerage services when it acquired H. D. Vest, Inc., in July 2001. In 1983, H. D. Vest pioneered the delivery of financial services through the tax professional. Vest is principally responsible for changing the laws in the various states giving accountants the ability to sell insurance and investment products. Most of the firm’s 6000 representatives are either CPA’s or EA’s. This acquisition has provided the representatives with the additional banking services of mortgages and trust services.

“Full-service brokerages are refocusing their efforts toward fee-based services, and are well-positioned to provide the comprehensive services the market segment requires.”

The Cerulli Edge
May 2001

So far, the model appears to be successful with transaction growth of 72%. At the time of acquisition, H. D. Vest had \$16 billion of client assets.

American Express Financial Advisors has over 10,000 agents marketing financial products. It also has the financial backing and marketing strength of its parent, American Express Company. Through American Express, the company reaches over 2 million households. In 2000, the company was in a very aggressive mode of purchasing CPA firms through which it intended to market its financial products. At that time, it was projected that American Express would be the largest CPA firm in the world within three years. Since then, American Express Financial Advisors has had some troubles retaining its agents. Current information on the success of the CPA acquisition program was unavailable.

Insurance Companies

AXA Financial, the French financial services giant purchased Equitable Life Insurance, in 1998. It planned to spend \$700,000,000 over three years to retool Equitable's 7500 insurance agents into independent financial planners. AXA intended to capture the \$50,000 to \$100,000 marketplace and grow with them. It also planned to promote strategic alliances with CPA firms through its agents. So far, the transition has not gone well. For the first half of 2001, AXA's US revenues were off 9.2%. By August, five of the top AXA executives had left the company and many more were slated to depart before year-end. (Investment News, August 20, 2001)

Attorneys

On November 1, 2001, the ABA's new rules allowing attorneys to have ancillary operation agreements or strategic alliances with other certified professionals and to have financial interests in firms in which they may refer clients went into effect. However, little action has happened since. Arizona, Colorado, and Utah may soon put forth proposals before their supreme courts to allow attorneys to partner or share fees. There is no significant effort in other states. The key issue is whether lawyers can remain unbiased and independent, when financially involved with non-lawyers. This used to be the question asked of accountants.

Accountants

CPA's have always been positioned to be the client's trusted financial advisor, but they have only

recently started to assume the role. According to the AICPA, about 90,000 of its 336,000 members practice financial planning at some level. Only 6300 accountants hold the CFP designation and just 3200 accountants have become PFS's and a mere 8214 accountants belong to the personal financial planning section. A survey done for the AICPA in the spring of 2000 found that 34% of its members in public practice were offering investment advice. Many believe this number will grow substantially in the next few years.

As companies that specialize in assisting the "CPA to investment advisor transition" such as H. D.

"Exclusive relationships can be the death knell of credibility."

Bruce R. Wright
The Wright Company

Vest, First Global, and American Express increase their penetration of the market, more CPA's will be compelled to offer similar services to compete within their own industry. However, there may be some backlash on this. Already the Enron debacle is calling for laws that would require CPA's to remain independent

and free of conflicts of interest. Many of the CPA's now entering the financial planning and investment advisory business are doing so in part to capture revenue sources they see as being lost to salesmen. Do they become salesmen themselves as they partner with commissioned based brokerage operations to provide their financial services? Do they really have the time and expertise to be best in the field tax advisors and investment managers? What happens to their client service when a major market calamity happens in the final rush to meet tax-filing deadlines? Additionally, it seems from the interviews that we have conducted, that the CPA is coming to the table late. They are modeling their offering after the current financial planning and investment management models, not the new model of comprehensive wealth management or family office. Many are not aware that the profession they seek to emulate is moving to a new model.

New Models

MyCFO.com has merged the benefits of the Internet with high-level family offices. MyCFO initially intended to deliver its services via the Internet. With the backing of Northern Trust and Kleiner Perkins, MyCFO has spent \$200 million on its platform and says it has automated 90% of the advisory process. However, a superior Internet presence was not enough. MyCFO has established full service offices in major metropolitan areas and staffed them with top estate planning and tax experts from PricewaterhouseCoopers, Deloitte Touche, etc.. "We hired the best people in their areas

of expertise so that we could become the first place an affluent individual or family can get everything done holistically.” said Art Shaw. With a target client net worth of \$50 million or more, MyCFO has done a good job of achieving its objectives. From the fall of 1999 till the end of 2000, MyCFO grew from 46 clients with \$8

In the fall of 1999, start up MyCFO.com had 46 clients with \$8 billion in assets. MyCFO had 310 clients and \$44.3 billion under management by the end of 2000. The average client relationship exceeded \$100 million.

billion to 310 clients with \$44.3 billion. (On Wall Street, August 2001) This is an important number to keep in mind. Many advisors, particularly attorneys, believe that wealthy clients have their advisors in-place and will not make a change. MyCFO has demonstrated that wealthy clients are very willing to make a change if they can be relieved of the responsibility of managing things themselves. As a warning, the On Wall Street article points out that MyCFO intends to downstream its services into the \$1 to \$10 million market place in 2002. The article ominously concludes “Will myCFO become your clients’ CFO? Stay tuned.”

Quantum Alliance 3 (QA³), in Omaha, is based upon strategic alliances between attorneys, accountants, financial planners and insurance agents using its proprietary broker/dealer and insurance agency. Network sharing is contingent upon using the broker/dealer.

“The issue isn’t whether or not advisors will lose clients; it’s whether or not they will make any money.”

Mark Hurley
Undiscovered Managers

Private Family netWorks in King of Prussia provides web-based access to client documents, through a client specific website that is controlled by the family and Private Family netWorks.

Advisors are granted free access to the site, but do not control their data. Clients pay a front-end fee of \$15,000 to \$24,000 and a monthly fee of about \$500.

FamilyOfficeNetwork is based on the premises that clients are best served when their advisors remain independent and practice within their specialty. FamilyOfficeNetwork fosters the strategic alliances necessary for an advisor to out-source the other services his client needs, while maintaining control of the client relationship and a seamless delivery of services. This is accomplished through an Internet based client information-sharing environment providing a virtual family office. Client advisory

teams are unique to each client. Advisors control their data. The advisor pays a fee of \$1,000 per year for access to the Internet-based tools.

Other models are being developed as advisors and financial service firms attempt to gain market share in this “new” industry. All try to provide an array of services to affluent and wealthy clients. As Schwab put it, “Advisors must move beyond ‘business as usual’ and adopt new business models that will help them attract and retain affluent investors’ assets. There is no time to waste. Investment advisors who don’t explore broadening their service offering to wealth management risk being shutout of the game.” Time will tell who the survivors will be. Will it be the 40 to 50 large firms envisioned in the Undiscovered Managers 1999 paper, or will there be a new breed of independent advisor who flourishes in this new environment? Stay tuned!

WHAT IS A FAMILY OFFICE?

A Family Office Defined

If we are moving towards a model, it might be a good idea if we define it. According to Family Office Exchange, “A family office is the organization that is created, often after the sale of a family business or realization of significant liquidity, to support the financial needs (ranging from strategic asset allocation to record keeping and reporting) for a specific family group.” This defines the historical family office, but does not necessarily reflect the family office of today.

Taking responsibility for providing and/or supervising all aspects of our clients’ financial planning needs enables us to provide you with cost effective, “one stop,” hassle-free personal financial planning and management.

Evensky, Brown & Katz
Website

Evensky, Brown & Katz define their Private Family Office sm by listing their services:

- Evaluate – client goals and objectives, investment issues, risk management, tax issues, estate and gifting, income needs, other financial issues.
- Design – investment plans, risk management plans, tax plans, retirement plans.
- Implement and Monitor – investment policy, implementation, reporting, rebalancing, risk tax and estate reviews, financial counseling, life status reviews.

Bloomberg Wealth Manager in its study of ‘Bloomberg’s Top Wealth Managers’ observed that wealth management is a dynamic, emerging field – one that seems to be rapidly coming of age. It went on to define the firms as providing:

- **A comprehensive scope.** The advisor sees and understands the whole of the client’s financial situation and offers a complete package of services addressing all the client’s financial goals and needs.
- **An intergenerational context.** The high-net-worth client and spouse will die with substantial assets. The advisor helps them develop a plan for the legacy they want to leave to the next generations of family as well as to charity, and then directs implementation of the plan.
- **A central role for the advisor.** The complex issues facing the wealthy client need to be addressed in a coordinated manner. The advisor becomes an overseer, functioning as a quarterback for all the client’s financial affairs.

That seems to come pretty close to what one might think of as Family Office services, or is there a difference between a “Wealth Manager” and a “Family Office?”

“Our clients are increasingly looking for one-stop shopping regarding financial needs.”

Randall White
TriCapital Financial Group

Family Office Exchange currently has a membership of 500 of which 351 are family offices. We estimate that most of these have come from the traditional family office backgrounds, in some cases that office has excess capacity and evolves into a multi-family family office.

However, Cerulli Associates estimates there are 3,000 to 5,000 family offices in the United States and that is on the upswing. Where are all these new family offices coming from?

We believe that most of them are coming from financial service firms transitioning from financial planning and asset management business models. Charlie Haines, Charles D. Haines, LLC, a recognized leader in the transition, says his firm first announced that they were providing family office services in 2000. However, they had really been providing the services for years before that. Charlie’s firm provides a list of “Family Advisory Services”: financial planning, traditional

investments, alternative investments, family legacy consulting, kids and money, philanthropy consulting, foundation management, family business consulting, trust company services, concierge services, physical security services, and tax compliance. Charlie says he's not sure if the family office name really means anything because there are so many different interpretations of it. He prefers "family focused multi-disciplinary practice (MDP) advisory firm." Charlie believes it is essential that the family office have trust capabilities through a controlled trust relationship. The big trust companies, he says, do not make good partners. Whatever he calls it, Haines expects substantial growth because of his firm's comprehensive focus. He already had several clients from the Forbes 400.

Family Office Exchange provides an interesting allocation of family office services: Asset Preservation – 40% including: advice on investment issues, diversification strategies, manager/fund selection, investment reporting. Personal Financial Planning – 20%: create financial plans, analysis of current exposures, cash flow management, insurance reviews, tax planning, retirement planning, etc. Financial Oversight and Compliance – 20%: tax return preparation, trust accounting, family banking, domestic employee payrolls, coordination of legal services, record keeping, etc. Wealth Transfer and Financial Education – 10%: evaluate wealth transfer strategies, implement strategies, estate administration, and family meeting coordination. Finally, Family Philanthropy – 10%: philanthropic support, administration of family foundations, tax compliance, family member involvement in philanthropy. If we are to define a family office by the services it provides, which seems logical, this is a very good list. However, not all family offices or wealth managers provide all the services.

Tom Bray, Legacy Trust Company, moved to a family office model in 1996 after 25 years in the financial services industry. Tom setup his trust company as a more effective way to serve the wealthy client and provide for generational planning. "We used to do a lot of work to help clients develop their wealth, then invite the bank trust department, in providing for our own demise (as the client's advisor). It was crazy to have a multi-family client office without having it in a trust company. So we started a trust company." Bray said. Legacy Trust provides in-house tax preparation, estate planning, investment management, and insurance analysis. "Clients are getting lousy strategic tax services." according to Tom. They have found that the CPA's they work with

have appreciated not having to do the client's personal return leaving them to focus on the corporate work. Legacy Trust charges a standard retainer for most work with the client selecting from a menu of services to be provided. Like most financial service firms turned family office practices, about 20% of Legacy Trust's clients are true family office clients.

Tom Connelly, Keats, Connelly and Associates, Inc., converted to a family office in 1998. Tom said, they "realized that we couldn't do the best job for our clients without considering all areas of the client's financial life." Additionally, Tom said, "Everyone was becoming a fee-only asset allocator. Even if you are good, you will make a mistake sometime. Keats, Connelly wanted to build a business model that would be more sustainable." Tom estimates that one-third of his firms clients are high net worth and utilize the firm's family office services. Keats, Connelly's website includes a long list of family office services that covers most of the services listed by Family Office Exchange. Their family office services are available to clients with a net worth over \$2,000,000.

In our survey, we found that only 8% of the respondents described their practice as a family office. Yet, when asked how many clients they provided family office services to, 49% responded that they

"We expect it to evolve slowly from existing players as financial firms embrace open architecture and information sharing. This new role is the virtual family office (VFO). This concept focuses on technology and offers HNW clients the highest level of online functionality and service."

The Cerulli Edge
May 2001

provide family office services to one or more clients. The same 49% responded that they had one or more years of experience providing family office services. The majority had between five and twenty years of experience. When asked what would motivate them to add family office services, only 11% said they had no intent of doing so. While not conclusive, we believe that there is a definite trend in place for financial service professionals to provide more family office like services to their clients.

What then is a family office? The traditional view of the obscure financial servant to the extremely wealthy is certainly being challenged. The new participants are providing the variety of services and consulting to the masses of not so wealthy that were only in reach of the wealthy a few years ago.

Today's family office is perhaps best defined as: a multi-family, multi-disciplinary wealth management advisory firm that offers a broad array of financial consulting, advisory, and implementation services provided by both in-house and supervised out-sourced professionals in a seamless single source delivery to the client.

There is really no difference in the terms “comprehensive wealth management” and “family office services.” However, there is a difference in the extent of services offered from firm to firm. The key here is the level of commitment the advisor has to providing the highest level of quality service across a broad array of service offerings.

Strategies for Building a Successful Wealth Management Firm

Advisors who transition to comprehensive wealth management from a more traditional asset management business model must take special care to clearly articulate:

- The full range of their new, complex offerings and how those offerings will benefit clients
- The value clients receive from an advisor that can seamlessly integrate those services and construct a comprehensive, dynamic financial plan based on their ever changing financial needs.

Wealth managers who can effectively communicate such “value added” services are more likely to differentiate themselves from traditional asset managers who offer a more limited range of services, and as a result attract greater numbers of affluent investors.

Schwab Institutional

TECHNOLOGY

It is no accident that the explosion of firms providing family office services and offering them to a broader market is happening now. Without today's technology, the cost of delivering these services would have dictated that they remain exclusively for the wealthy. In the 80s, increased PC power brought the ability to perform advanced asset allocation and reporting functions from the institutional money manager to the independent investment manager. It is now empowering the conversion of financial planners to comprehensive wealth managers.

“In short, advisors need to re-examine the ways in which they do business and ask themselves “What is required of me to remain successful in tomorrow's marketplace?”

Schwab

While all sources agree on the uses of technology, there is some question as to just how much the financial service industry has actually adopted. According to a survey conducted by Corviant Corporation, “The reality of advisors achieving financial portal status is, however, a long way off.” They found that of 200 advisors surveyed only 22 had websites.

Our survey had very different results. Sixty percent of our respondents said that they provide online access to client accounts. Although, much of that was through a third party such as Schwab or TD Waterhouse; not directly by the advisor. Seventy-five percent said they actively use the Internet in their daily business practices and 16 % intended to do so within the next 12 months. Seventy percent have their own websites. The majority, 72 %, did not see the amount of information available to their clients online as a threat to their business.

We asked advisors: “How would you rate your website?” Most thought that their website was client friendly and a good place to provide client information. There was also a fairly strong response to the site being just an online brochure. Few felt that it was a good source of business development.

We found that over 60 % of our respondents spent less than \$10,000 per year on their client and portfolio management software, and 84 % spent under \$20,000. It seems like a very small amount to be spending in this era of technology. Centerpiece had a slight lead over Advent as the preferred portfolio management system, while SunGuard, DbCams, and Portfolio 2000/2001 have a small user base. Advisorbenchmarking.com found similar results with Centerpiece at 31 %, Advent 29 %, Quicken 15 %, and DbCams 10 %. However, Advisorbenchmarking.com found that when sorted by assets under management, larger advisory firms preferred Advent by over 50 %. There was no reason to believe that one system worked better than another for a family office.

Advisors are using a variety of back office and support systems to manage their offices, prepare financial plans, do investment research and selection, and provide custody and trading for their clients’ assets.

Custody

Schwab led the way with over 50% of the advisors, responding to our survey, indicating they use Schwab as their custodian, followed by Fidelity, then T. D. Waterhouse. Advisorbenchmarking.com found similar results. When measured by assets under management, advisors preferred Schwab increasingly as the asset based increased. We found that there was some interest in alternative custody, such as the new advisor owned National Advisors Trust Company. But, there was no evidence that the trend to more comprehensive wealth management was reflected in any change in custodial relationships. A number of advisors are expressing concern about Schwab's entry into wealth management through its ownership of U. S. Trust and the establishment of financial service offices.

Contact Management

Most respondents were using ACT followed by Goldmine and Protracker. Several had custom designed contact management systems. While it was clear that our respondents were effectively utilizing contact management software, there were no distinguishing characteristics between those who identified themselves as primarily a family office and those who were not.

Other Software

For investment decision-making, Principa Pro was a strong leader followed by Ibbotson Portfolio Strategist. For financial planning tools, Financeware lead the field. This is interesting as Financeware's online tools are the first step in online interactive financial planning. Respondents also indicated that they used Quickbooks and Microsoft Money as part of their back office systems. We did not ask if these systems were used for the firm's own accounting needs or to provide tax planning for clients.

It would appear that advisor utilization of the Internet as a business tool is increasing.

Utilization of the Internet Across All Independent Advisors

	<u>January 2001</u>	<u>July 2001</u>
Research Investment Opportunities	80%	84%
Communicating with Clients	74	78
Downloading Custodian Forms	62	72
Downloading Account Information	50	71
Intra-office Communications	42	58
Marketing Brochure	42	51
Marketing to Attract Clients	35	45
Ordering Office Supplies	34	41
Posting Client Statements	31	34

Source: Advisorbenchmarking.com

Advisorbenchmarking.com’s sampling technique involves an ongoing web-based gathering of advisor responses, so the January and July reports could represent very different groups. However, we believe that the numbers are representative of increased utilization by advisors of web-based services. It is interesting to note that posting client statements is at the bottom of the list. While several software programs now provide web posting of account statements and portfolio performance reports, not many advisors have adopted the technology.

According to David Loeper, president of Financeware.com “... advisors who under-invest in

“Clicks and bricks will be the winning strategy as customers value the relationship continuity, convenience, and trust they enjoy with their traditional bricks-and-mortar institutions.”

E-Finance Industry Analysis
JPMorgan Securities, July 27,
2000

technology, end up spending a lot in staff costs, client acquisition and servicing costs.” Tiburon Strategic Advisors found that larger advisors are actually less profitable than smaller ones. According to Chip Roame, managing principal, the average profit margin for all advisory firms is 34%, but for the larger advisors their margin actually falls to 26% ...”. The study concludes that larger firms are not investing enough in technology and are over investing in people.

As advisors continue to expand their services to become comprehensive wealth managers or family offices, they must devote ever-greater resources to the expanding list of services they are providing their clients. If they are to maintain profit margins and provide maximum personal service, they must increasingly rely upon technology.

A report by Accenture, the former Arthur Anderson consulting group, provides some insight into how the rest of the business world is coping with technology growth and customer service. “Clearly the world is now too complex, changing too fast, and far too competitive for any firm to do all of the functions within their business on their own,” said K. Blake Darcy, CEO of CSFBdirect. “Value wins out overall, and the only way you can provide that value on a consistent basis is to be cost effective by using outsourcing and partnerships.” Another Accenture report states that given the option “. . . most executives will avoid the disruption of seismic change in their organizations in favor of sustained and aggressive incremental change. In today’s volatile business environment, executives are called on to change their operating models much more frequently than ever before.”

Isn’t that exactly where the financial professional finds himself today? Schwab thinks so. In it’s industry report, *Strategies for Building a Successful Wealth Management Firm* (Fall 2001), it states: “In short, advisors need to re-examine the ways in which they do business and ask themselves, ‘What is required of me to remain successful in tomorrow’s marketplace?’”

Is it worth it? According to Schwab: “Industry analysts point out that advisors who can provide an all-encompassing wealth management package will be well-positioned to capture millions of dollars worth of assets in the coming years.” Like Accenture, Schwab recommends outsourcing “The key is determining which services are best offered through in-house resources and which should be offered through partnerships with other professionals.” Industry analysts also recommend outsourcing. PricewaterhouseCoopers argues, “Offering valued advice is no longer about offering the best products in-house. Instead, it is about forming alliances and cooperation in order to build the best offering.”

Technology will enhance the client relationship, but it will never replace the personal relationship and trust between a client and advisor.

“Increasingly,” says Schwab “advisors employ technology such as the Internet and customer relationship management (CRM) software in an effort to coordinate the various functions of team members.” The problem is there is not much technology currently available to facilitate the management of the outsourcing process. Our survey respondents provided a long list of services they outsourced, most notably legal and property casualty insurance. However, when asked how they handled outsourcing, the traditional means of phone, fax, mail, and email were the methods of choice. If advisors are employing technology as Schwab says they are, it was not reflected in our survey.

Speaking at the June 2000, Undiscovered Managers Wealth Management Symposium, Nick Georges, Senior Vice President Schwab Institutional Sales, predicted that by 2005:

- Advisory firms will focus on what matters while leveraging partners and strategic alliances.
- Back office functions will go away.
- They will outsource expertise:
 - Comprehensive planning, financial, estate, tax
 - Performance reporting
 - Information Technology

Georges concluded, “This will allow firms to compete with dominant competitors.” Are you positioning your firm to survive much less compete? If advisors are to meet the challenges of increased service, they must find a way to increase the effective use of technology in managing the total process of comprehensive wealth management not just provide better financial planning and asset allocation tools. They must be able to provide a seamless delivery of advice and service regardless of whether the service is actually provided by an in-house expert or an outsource expert. This will be especially true for the smaller advisor who by choice or necessity does not build the diverse in-house support system that is the trademark of the large institutional provider. Through technology, they must be able to communicate readily with the client and the client’s other advisors, having all necessary information at their fingertips. They must, in fact, achieve the virtual family office.

Transforming an organization starts with vision and aggressive leadership.

THE FUTURE

The financial services industry no longer consists of financial planners, stockbrokers, and insurance agents. Today's financial services industry includes bankers, accountants, trust services, and attorneys. For now, some of the players think they can continue to provide one or two services and survive. But that is changing. Mark Hurley's projection of only 40 to 50 big firms surviving in ten years may be a bit off, but no serious observer of the industry can disagree with the need for the survivors to make fundamental changes to how they do business and to do so soon if they hope to survive.

Clients are demanding more service and would prefer a one-stop solution. MyCFO has demonstrated that very wealthy individuals will make a change in their advisor relationships if they can get the service and convenience they desire elsewhere. Continuing to gain new business from affluent investors will be one of the toughest challenges that investment advisors will face in the future. The next toughest may be retaining their existing clients as they are enticed away by comprehensive wealth managers. Why should a client run from one advisor to the next coordinating efforts when a competitor will take care of it all, probably at a lower overall price?

Clients will turn to their trusted advisor, financial planner, CPA, or estate-planning attorney to quarterback their financial affairs. If their advisors cannot provide these services, they will find an advisor who can. Firms will be forced to compete. This will require heavy investments in technology and out-sourcing. The survivors will look like multi-user family offices for the semi-affluent and wealthy.

Six common traits of future dominant competitors:

1. Understand their clients.
2. Utilize professional marketing forces.
3. Institutionalize relationships.
4. Provide expanded, extremely sophisticated advice.
5. Technology must become an integral part of their business.
6. Achieve critical mass or obtain capital to fund growth.

Undiscovered Managers
September 1999

No single individual can meet all the needs of today's affluent investor. That is why the institutions are building staffs of specialists to meet the needs of their wealthy clients. The independent advisor must do the same. Without a team of specialists to handle the complexities of wealth management, the advisor will remain a one or two-dimensional specialist, not a wealth manager. The key is to determine which services can best be provided in-house and which should be provided by others. Strategic alliances must be formed.

Smart advisors in all disciplines are already on the move. They are forming strategic alliances, integrating technology, and refining their client message. Clients are demanding more complex investment products, more sophisticated solutions, and at the same time less personal involvement. They want to enjoy their wealth and trust experts to take care of it. The time is now. Financial advisors who don't broaden their services, who don't form strategic alliances, and don't apply technology to bring it all together, will be left behind. Where will you be a few years from now? Will you stand among the winners who have transitioned to comprehensive wealth management and participated in what Schwab described as "the sweet spot of what may likely be the greatest growth opportunity in the history of the financial services industry." Or, will you be among the ones left behind. The choice is yours. The time to act is now.

WHAT IS FamilyOfficeNetwork L.L.C.?

FamilyOfficeNetwork L.L.C. has developed a unique “virtual family office” platform to facilitate and promote collaboration among financial professionals in order to meet the growing client demand for comprehensive wealth management. The family office model has long been recognized as the pinnacle of comprehensive wealth management services for the wealthy. It is the comprehensive multi-generational services that family offices have provided to their wealthy clients that the conglomerate “one stop shopping” firms are emulating. FamilyOfficeNetwork’s virtual family office allows the professional advisor to deliver these same services to his/her best clients.

FamilyOfficeNetwork L.L.C. is a service bureau providing independent financial professionals with the opportunity to create elite advisory teams. FamilyOfficeNetwork L.L.C. does not provide products or services. Its sole purpose is to provide advisors with a more efficient working environment.

FamilyOfficeNetwork is based upon the fundamental premise that advisor’s working relationships are best defined by the participating advisors. Therefore, the advisors in FamilyOfficeNetwork form their own affinity groups. These teams of advisors can be organized by region, city, profession, specialty, and can span across a state the country or even the globe. Each Network shares the common resources and functionality of FamilyOfficeNetwork. However, the local Networks are distinctly separate operating entities. When searching for an advisor for your client, you will only have to sort through those in your Network not a national database. Each Network has a unique web presence to promote the services of its members.

By forming alliances with other highly skilled financial advisors, estate planning attorneys, and accountants; financial professionals will out-service their competition, gain more revenue, earn more client referrals, and enhance their high-net-worth clients' financial well being. Through FamilyOfficeNetwork L.L.C., financial professionals can offer a full range of financial services to their clients without sacrificing the time and resources necessary to form strategic alliances or build the new services in-house. FamilyOfficeNetwork enables clients to enjoy cross-functional services from their existing legal and financial advisors.

The flexibility of our networking model allows any advisor to organize his choice of teams of financial professionals. This allows for the creation of specialized groups for each client.

- FamilyOfficeNetwork offers a secure method for posting financial documents to the web. All documents are encrypted, before being uploaded to the Internet Sharing Environment, through Secure Socket Layer (SSL), the highest level of encryption available.
- Participating professionals can use their existing wealth management software programs in conjunction with FamilyOfficeNetwork and are not required to switch to a new software platform.
- With their username and password, professionals using FamilyOfficeNetwork can access a list of all their clients sharing the benefits of FamilyOfficeNetwork. An advisor can share a single client with another advisor within the advising team for collaboration without sharing his other clients. This gives the advisor the ability to share clients with any advisor that is a FamilyOfficeNetwork member, allowing the advisor to set up specialized teams for each client.
- The information environment gives the advisor rapid access to all the clients' information, saving the advisor valuable time that should be spent advising. Clients will benefit from the added services and the improved working relationships between advisors.
- Other benefits of collaboration on client issues include sharing innovative financial solutions, a check and balance system, increased revenue from existing clients, and a referral relationship that generates new revenue.
- In order to facilitate access and usage, a wide variety of templates are available for data gathering and standardized reporting. By incorporating standardized templates an advisor can quickly find the information needed to serve his or her clients. Additionally, the templates provide only the information necessary for other advisors to do their jobs. Your

whole file is not included on the Internet. This is a particularly important feature for attorneys and client privileged material.

Each Network is led by an advisor who serves as the Network Coordinator. Network Coordinators are financial professionals who desire to lead the organization of an advisory team. They benefit from a profit sharing program as well as the establishment of a team of professionals that simplify business practices, and support each other in comprehensive wealth management.

Only authorized advisors will have access to the client's data. Advisors have the ability to share clients on a client per client, advisor per advisor basis giving them the freedom to establish the appropriate relationships to meet the needs of the client.

While designed as an advisor-sharing environment, it is possible for clients to access specified data using their own unique username and password. This could be particularly beneficial to the attorney or accountant wanting client review on a document draft or a tax return.

FamilyOfficeNetwork L.L.C., is designed for the benefit of the small, independent advisory firm. Accountants, attorneys, financial planners, insurance agents, investment managers, mortgage brokers, pension administrators, and similar financial advisors will be members of each Network. Other providers of services needed by advisor's clients may also be members of the Network and may be given full or temporary access to client records, for instance, bankers and real estate agents. Networks may also include concierge services, which provide a discount to member clients.

At the time of publication, FamilyOfficeNetwork, L.L.C. had Network sites developing across the country.