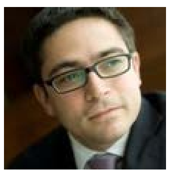
Financial Governance: How can Families Institutionalise their Investment Approach?



Grégoire Imfeld, Geneva, February 2013

For most families, wealth was created from not much, by an entrepreneur. Over time, its value sometimes becomes significant. Asia's wealth resurgence has recently been the stage for prosperous businesses that have generated significant financial wealth. Financial wealth is new for many and money has become both a status and a measure of success in Asia, sometimes replacing more traditional values. Financial and commercial affairs represent two of the most important components making up the wealth of families. There is often a misconception that financial wealth will create growth. Both types of assets behave differently though, and have their own characteristics. Whilst wealth creation initially originates from commercial assets, wealth preservation is generally granted through financial assets. As a result of such different characteristics, they should have different governance structures.

I have too many bankers ...

In the family governance concept however, family councils and/or boards must be created, covering both areas of corporate governance and financial governance. The former is often well put into practice, whilst the latter less so. In that regard, advisers often hear the following kind of observations: "My financial affairs are unattended. I have too many bankers and I have no time to assess or answer the many investments solicitations I receive. Nor can I evaluate the true quality of my financial performance". This comment is too often heard from the mouths of busy and successful entrepreneurs, still heavily involved in their business. This illustrates that successful family businesses that create large amounts of cash find themselves with the new profession of wealth manager, but with limited time and sometimes interest, to dedicate to it.

Those who are inebriated by their business success will tend to manage their wealth with the same risk appetite and expect the same returns to flow naturally in the financial world. This is a common mistake and some have paid a costly price before understanding that public market

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investing is one of the most competitive businesses across all industries and that their one-stock control-it-all approach is different to a multi-stock portfolio. The 2008 crisis has been forgotten too quickly. And new fortunes have been created since the crisis, fortunes that have never endured true market turmoil and that will probably have to learn it the hard way.

Installing structures for financial governance

The elaboration of a successful financial governance structure assumes that the family governance architecture is established and sound. Setting a family strategy (also commonly referred to as a Constitution or Legacy) which defines values and objectives, similar to a family business plan, is important. Despite the increased trend for "sea turtles" to come back from their foreign education, such documents are yet to become mainstream today.

Once created, such a document provides the basis for the elaboration of an investment policy which should adequately translate the family objectives into financial objectives. Family objectives depend on where the family stands in the wealth cycle, that is, whether it is creating or preserving its wealth. One key advantage a wealthy family has is that its financial objectives can be set on several generations. Thus, financial turmoil and periods of increased market volatility can then be better endured. This unique characteristic also shapes the choice of asset classes.

Regrettably, financial investments are considered independently from both the business and the global wealth and are managed without a unified family objective or view on global risk exposures. One possible reasons for this is that it requires information to be centralised, a notion heavily countered by the belief in many Asian regions that the fewer are aware of the wealth, the safer it is. This makes measuring real risk exposure a challenge. This global overview is important however, as it lays out fundamental information to create the guidelines that will then steer the family investment committee. It also offers the opportunity to truly understand the family's culture and dynamics while providing time for interaction among family members. Most importantly, the platform should also unite the family around financial expectations and consequently should result in the most appropriate, sustainable tailored solution.

Asian way to manage financial wealth

Asian families have tended to rely on universal banks with a one-stop shop approach, including financing, IPO, wealth planning, wealth management and asset management. Many have been shopping in the mall of finance rather than seeking out boutique-minded establishments which tend to offer independent advice. On the basis of diversification, families generally have more than one universal asset manager and private banker. The role of the family investment committee varies from an institutional approach to a private banking approach. The former rests on a delegation principle which consequently requires a strong investment committee, while the latter offers more flexibility and customisation, with a more controlling responsibility.

With an investment policy created and agreed upon, implementation can begin, from the RFP (request for proposals) to beauty contests, right through to the development of reporting tools. Once investments have been made, the monitoring of the various managers for risk and adherence to the investment guideline as well as supervision and market reviews become the core activities of the family's investment committee. A fine-tuned financial governance set-up should manage it efficiently.

As the wealth cycle evolves, the importance of, and dependence on, financial wealth increases. In a region where wealth is growing exponentially and seems unstoppable, this future dependence is not yet fully appreciated. Creating an adequate platform at the inception of wealth creation is paramount to the success of both meeting the financial objectives and ensuring a smooth transition to the next generations. It prepares them for their future and their inevitable responsibilities in the realm of financial asset management and provides for a truly, long-term fiduciary relation to develop with external advisors.

Financial assets can be very complicated but sometimes made to look more complex than they really are. A golden rule is to keep it as simple as possible. Although one could debate whether the institutional approach is the most suitable, one thing is certain: for some families, a

proper financial governance may be what they are seeking, sometimes desperately, sometimes without being able to name it, and sometimes even unknowingly.

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