LIGHTHOUSE CANTON

*Creating Value through Innovative Financial Solutions*

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# Life in a post-Pandemic World: A Multi Family Office Perspective

As businesses scramble to adapt and evolve through the unprecedented disruption brought by the Covid-19 pandemic, the Financial Services industry is no exception. Within the Financial Services industry, the External Asset Manager (EAM) and Multi-Family Office (MFO) space is now confronted with greater urgency to evolve in order to remain competitive - not only with the private banks but also within their space. A franchise that was already undergoing disruption prior to the pandemic, EAM/MFOs are now faced with a need to exponentially increase the pace of change and to re-evaluate the business model which (at least in Asia and the Middle East) is still in its infancy. Although the evolution from conventional banking to independent advice is well underway, the Covid-19 pandemic seems to have put wind in those sails. Lighthouse Canton is an investment management firm which also provides financial services to UHNWI and family offices as part of our offering. Based on our experience and observations specific to the EAM/MFO space, we would like to share our thoughts on its evolution. This article attempts to identify (i) the challenges that clients, investment advisors and banks contended with during those eventful weeks in March 2020; (ii) the deficiencies that call for a fundamental change to service delivery models and; (iii) what these mean for the EAM/MFO industry going forward, for participants to stay ahead in the game.

**The Covid-19 Effect**

At a time when the financial markets were witnessing the longest bull run in history, where seemingly nothing could go wrong, the onset of the Coronavirus in Wuhan in December 2019 and its aggressive evolution into a global pandemic applied the brakes on a global economy which was moving on full steam. What quickly followed were rapid nation-wide lockdowns, social distancing norms, and strict quarantines on a global scale as governments world over strived to save lives. The lockdowns disrupted almost everything from global supply chains to international travel, tourism, and hospitality. It did not take financial markets long to factor in the structural damage this could cause to global businesses and the result was one of the deepest and sharpest corrections in global macro-economic indicators from employment to industrial production and national GDP.

Expectedly, markets followed suit.

**Advisory Models put to Test – Independence is Key**

With unprecedented volatility and dislocation in the market, the difference between a "conventional model" and a "fee-driven" model became obvious to clients and institutions alike. A conventional model refers to fees or commission earned by advisors through execution of trades for clients and is typically fraught with conflicts of interest and opacity while a fee-driven model is more transparent in nature as clients are charged a fee based on assets and/or performance instead of purely being dependent on the trading activity or choice of investments. Due to different nature of the two models, those that implement the conventional model would find themselves conflicted between generating revenues based on volume and upholding their fiduciary duty to clients – especially in times of distress. EAM/MFOs that implement a fee-driven model, on the other hand, have the advantage of taking a more independent approach to managing their clients' portfolios as the financial reward is linked to preserving the assets and performance of the portfolios. This enables them to assess client portfolios objectively and decide on the appropriate course of action – rather than the easiest or the fastest. With Lighthouse Canton being an advocate and practitioner of the fee-driven model, we experienced this first-hand in March.

A recent survey conducted by *Hubbis,* which interviewed around one hundred wealth management experts in Asia to assess what they consider to be the next phase for Asia's wealthy investors and how the wealth management community may respond, found that 75% of the participants believed that as providers, they should shift their focus towards discretionary portfolio management, managed accounts and advisory mandates – all of which are, by definition, fee-based models of doing business. This reaffirms the preference for independent and unbiased advice free of any perverse incentives.

The survey also found that clients are migrating towards an independent advisory model given increasing demand for direct or co-investment opportunities. EAM/MFOs, given their bespoke approach and faster turnaround times coupled with their ability to accept relatively smaller and boutique transactions (as compared to bulge bracket banks), find favor with clients over conventional private banking channels.

**Differentiation within the EAM/MFO Space**

Though the events in March reinforced the importance of the evolution of the wealth management industry from a transaction-driven to a more fee driven approach, it is also important to note that not all EAM/MFOs fared similarly during the crisis.

The ability of an EAM/MFO to effectively protect the downside risk of their clients' portfolio in an environment of extreme market volatility is dependent on the availability of appropriate expertise, technology, robust infrastructure, and institutional-quality internal processes to effectively manage the situation at hand. The shortfall of internal processes of some EAM/MFO was evident in March as they grappled to effectively monitor and manage the risk on their client portfolios on the back of indiscriminate selling to cover margin shortfalls (not the best course of action in hindsight given the almost full recovery markets have posted since then). The lockdowns imposed across many countries also laid bare the deficiencies in the EAM/MFOs who had not invested in technology and infrastructure which many view as “cost centers”. However, they overlooked the importance of such investments in ensuring a seamless continuity of the business especially in times of distress. Referencing to a more recent event, some EAM/MFOs can be seen struggling to cope with the limitations imposed by their technology and infrastructure set up to swiftly and effectively implement their Business Continuity Plan (“BCP”) when the lockdown was imposed. This in turn impeded their ability to effectively communicate with clients and to be able to work at a reasonable capacity. Those who had the foresight to invest in building their technology and infrastructure were able to differentiate themselves in their seamless delivery of services to their clients, relying on effective telecommuting.

**The Way Forward could not be Clearer**

The market environment is far from being stable. As far as the economic landscape is concerned, uncertainty and enhanced volatility seem to be the only predictable outcomes for the foreseeable future. However, the future of the EAM/MFO industry could not be clearer than it is today.

While the EAM/MFO models are arguably the next step in the evolutionary process of private banking/wealth management, it also cannot be a win by default for all participants in this space.

In order to be sustainable and to thrive, the following are inevitable implications of the current crisis for the EAM/MFO industry:

- **Breadth of the offering would become critical:** As the industry evolves in this environment fraught with uncertainty, having mere domain expertise (depth) may not remain the only game in town and industry participants will have to develop a much wider offering (breadth) which goes beyond simple portfolio management and investment advisory services. To quote Vikram Mansharamani, lecturer at Harvard University, “breadth of perspective and the ability to connect the proverbial dots is likely to be as important as the depth of expertise and the ability to generate those dots.” What we witnessed during the crisis in addition to the need for a robust infrastructure was the inability of most participants to look at market events in a holistic manner and decide on an appropriate course of action. What we noticed instead, were knee-jerk reactions based on a market-driven tactical approach as against forming a view based on the obvious shifts at a macro level. In order to succeed henceforth, industry participants would have to develop core asset management skills in addition to their “advisory capabilities” so that they can help clients achieve their goals through effective asset allocation models as against taking opportunistic positions resulting from a myopic approach. This becomes obvious when we notice large endowments and pension funds increasingly leaning towards private investments – a domain best served by EAM/MFOs. A recent survey by the economist found meaningful allocation by these investors to private market opportunities – the largest being the Yale Endowment which invested almost 70% of its assets therein. Lighthouse Canton has always been a strong believer in developing both the depth and breadth of our offering and follows a robust investment framework backed by well thought through asset allocation strategies. The EAM/MFOs of the future may have to evolve into institutional asset managers in order to compete at the scale required, both in terms of the depth as well as the breadth of the services they can offer.

- **Technology would be the mantra:** One of the key hurdles faced by clients and market participants alike was the breakdown in conventional conduct of business caused by lockdowns enforced by countries globally. As a result many EAM/MFOs struggled to cope and found themselves shorthanded to address the clients' needs due to lack of technology, robust infrastructure, risk, and operational capabilities along with the inability to meet with the clients in-person and have a detailed discussion. The conventional "office space" was no longer accessible and "in person" meetings became challenging. As such, telecommuting and the ability to work remotely became the need of the hour. Going forward, this arrangement could potentially be the way most businesses will be conducted and even be preferred by clients (as they are being conditioned to – given the circumstances). With this possibility in mind, it would be imperative for EAM/MFOs to establish a robust technology platform around which the whole ecosystem would need to be built. Technology will not only enable efficient telecommuting but also bring down costs of doing business and enable improvement in service delivery in the form of better risk reporting, transparency, more sophisticated decision making and advice to clients – all in a consolidated manner across their banking/non-banking portfolios.

- **Quality of advisors and a fee-driven model for independence:** As discussed earlier in the memo, independence and quality of advisors differentiate one EAM/MFO from another not only in challenging market environment but during good ones as well. Upholding the trust of the clients is key in preserving a long-term relationship through thick and thin. At Lighthouse Canton, providing unconflicted advice strongly aligned to clients' interest backed by an institutional approach to investing and a fee driven model has helped us to achieve that. Clients appreciate the transparency and comfort of knowing that we have robust processes in place to ensure that their interests are protected at all times.

- **Consolidation is inevitable:** A careful reflection on the aforementioned factors has led me to conclude that consolidation within the EAM/MFO space is also inevitable. To be able to meet the challenges and match up to the needs of the new paradigm shift, it is imperative for the smaller EAM/MFOs to grow to scale or be open to exploring strategic partnerships with larger players as the industry consolidates. As per the UBS-Campden Global Family Office survey 2019, the average AUMs of MFOs globally are USD 1.5Billion whereas the same stands at less than USD 700Million for Emerging Markets and the Asia Pacific. However, that number is quite skewed in favor of a few large players, which means that majority of the EAM/MFO firms are operating at sub-optimal levels. In order to be able to adopt technology as an integral part of the business model and to build an institutional infrastructure that is both scalable and modular, industry players must have the resources and be prepared to invest heavily. EAM/MFOs that had invested in building their infrastructure ahead of time were accorded a distinct advantage as they could telecommute, easily implement their BCP without much interference to their ability to service clients and their reporting and risk management systems could cope with market disruptions that might have only lasted for a week but had magnified outcomes. Similarly, in order to attract and retain quality talent, EAM/MFOs should be willing to offer a working environment and support system that enables high performing teams as opposed to making them feel restrained/shorthanded for the lack of platform, resources or network. All this not only calls for thoughtful leadership and foresight but also needs significant resources and management bandwidth and capability. Those who can demonstrate that foresight and commitment to developing capabilities in these areas will be able to scale up and become a meaningful player through both organic and inorganic growth. Those who insist on operating on a "conventional model" will potentially find themselves either being bought out by bigger players or sadly get gradually phased out of business.

Kind Regards,

Prashant Tandon

Managing Director, CEO (DIFC)