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The Institutionalization of Asian Family Offices

This report was published by INSEAD's Global Private Equity Initiative (GPEI) with support from the Pictet Group, the leading independent global wealth and asset managers.

It was written by Bowen White, Research Associate at the GPEI, under the supervision of Claudia Zeisberger, Academic Director of the GPEI and Professor of Decision Sciences and Entrepreneurship and Family Enterprises at INSEAD, and Michael Prahl, Executive Director of the GPEI.

We would like to thank the family offices participating in our report for their availability, candor and engagement.

Furthermore we would like to specifically thank Claude Haberer, CEO Asia for Pictet Wealth Management, as well as the Family Office Services team from Pictet for their contributions, particularly in the recommendations and conclusion sections, namely Jean-Claude Erne, CEO Family Office Services, Rudolf Hauser, Senior Investment Manager, and Grégoire Imfeld, Head of Family Governance.

GPEI welcomes firms interested in the center's research efforts to reach out to us. For further information on INSEAD's Global Private Equity Initiative, please visit www.insead.edu/gpei.

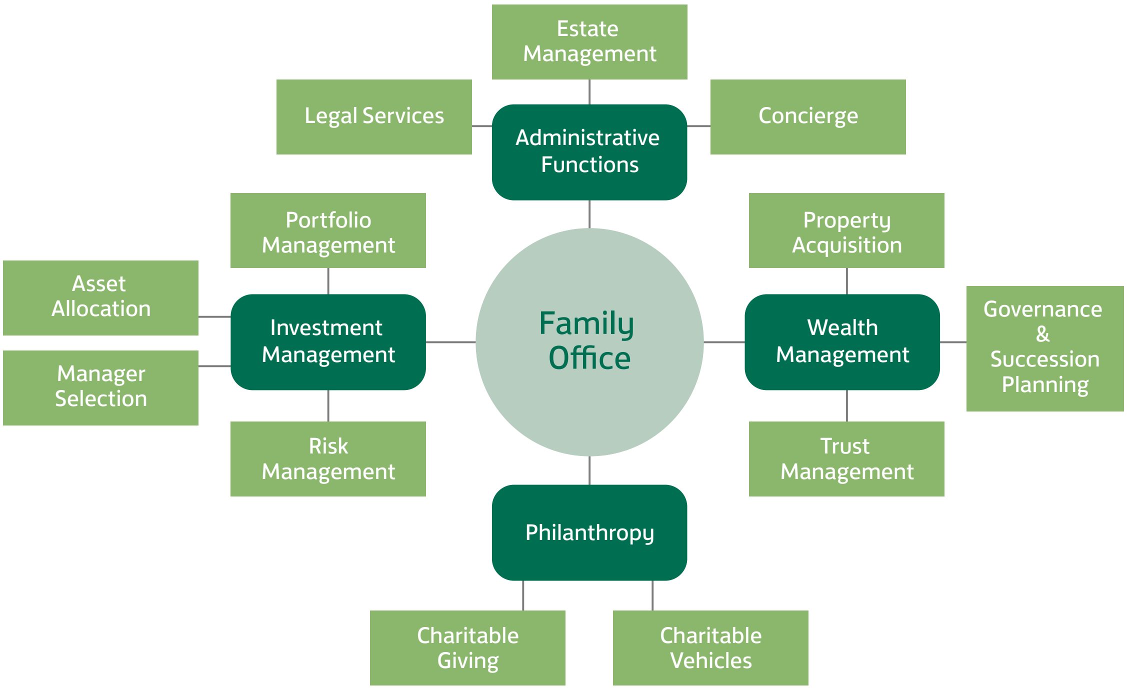
Introduction

When a family takes the decision to set aside a portion of its liquid assets to be managed separately from its business operations, a number of questions arise, such as:

Is there capability to manage these assets within the family?

How should we manage the transfer of wealth to our children?

What are the investment goals for our family assets?



For families with sufficient liquid assets, managing assets via a single or multi-family office structure can be an efficient means to control and preserve wealth for future generations.

As a vehicle for wealth management, the family office is relatively new in Asia. This fact is borne out by the small number of family offices in the region, estimated at between 100 and 200, compared with an estimated 3,000 in the United States and 1,000 in Europe[1]. However, the sharp rise in the number of ultra-high net-worth individuals (UHNWIs) in Asia over the past decade, driven by explosive economic growth and monetization of assets, has catalyzed the viability and the expansion of the region's family office industry.

To explore the capabilities and characteristics of the region's family offices in a global context, INSEAD's Global Private Equity Initiative (GPEI) has developed two frameworks which we use to relate the attributes and anticipated investment performance of family offices in terms of their institutionalization. To gain insight into the state of the family office industry in Asia, we leveraged GPEI's LP network and conducted interviews with 20 single family offices, five multi-family offices, and five family wealth consultants in locales as diverse as China and Dubai.

We begin by examining the drivers behind the recent development of the family office space in Asia. We then introduce our frameworks, present our findings, and suggest practical steps that family offices can take to institutionalize their operations.

[1] Internal estimates and Yadav, R. (2012). *The Global State of Family Offices.* Capgemini.

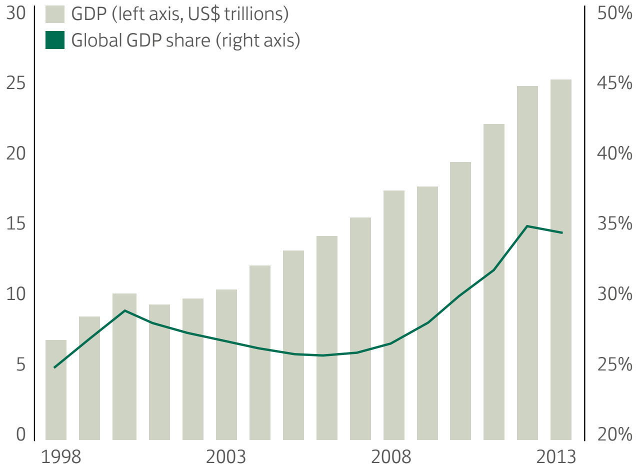
Macroeconomic Context and the Family Office in Asia

In the last two decades, vast fortunes have been accumulated by individuals and families in Asia[2].

Boosted by favourable macroeconomic trends and booming direct investment and capital market activity, the number of UHNWIs in the region has nearly doubled.

In the section that follows, we summarize the drivers of this dynamic wealth creation.

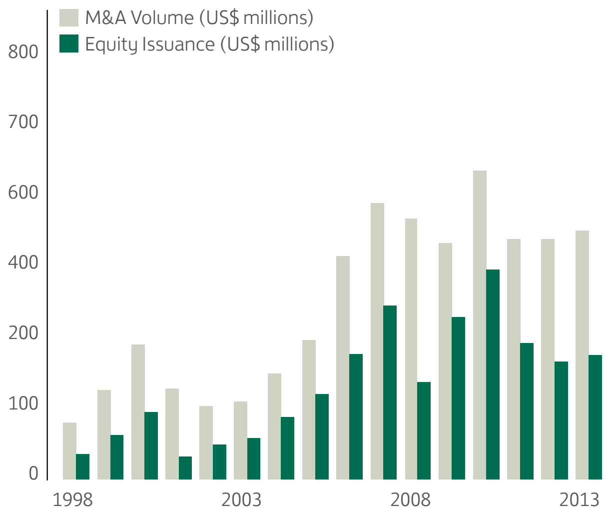
[2] In all cases, the Asia country grouping includes the Middle East, Japan, Australia and New Zealand.



Source: IMF World Economic Outlook Database

GDP and Trade

Spurred by the emergence of economic heavyweights China and India, and rising global demand for basic commodities and manufactured goods, economies in Asia have seen stellar growth in recent decades. Aggregate gross domestic product (GDP) in the region more than tripled between 1998 and 2013, with an annual growth rate of 8.2%, accounting for 34% of global GDP in 2013[3]. Similarly, trade between the region and its global trading partners nearly quintupled from $3.6 trillion in 1998 to $17.5 trillion in 2013, and currently accounts for roughly half of all global trade[4].



Source: Thomson One, Bloomberg

Capital Inflows

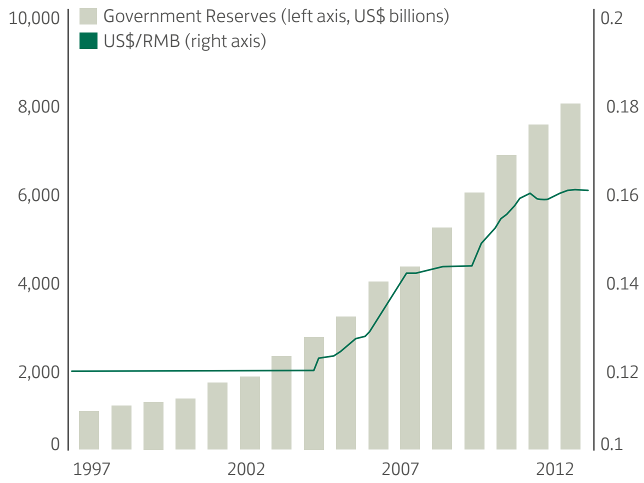
This positive macroeconomic environment has spurred massive capital inflows into Asia. Over the past 15 years, Asia's current account surplus has totaled nearly $8 trillion and its annual surplus has not fallen below $500 million since 2004. Foreign direct investment (FDI) and portfolio equity investment provided another strong source of inflows, totaling $5.9 trillion for the 15-year period ending 2012[5], roughly half of which stemmed from inflows during the five years to 2012. Cross-border and domestic M&A activity and public equity issuance reflected a broader uptick in investment activity, particularly in the decade before 2013 when $4.6 trillion in deals and $2.7 trillion in equity issuance was realized[6].

[3] Source: IMF, World Economic Outlook Database

[4] Trade is defined as the sum of merchandise and commercial services (excluding government services) imports and exports. Source: WTO Statistics Database

[5] Net inflows represent the new investment inflows minus disinvestment from foreign investors. Sources: FDI – United Nations Conference on Trade and Development statistical database (UNCTADSTAT); and Portfolio equity – The World Bank, World Databank, World Development Indicators.

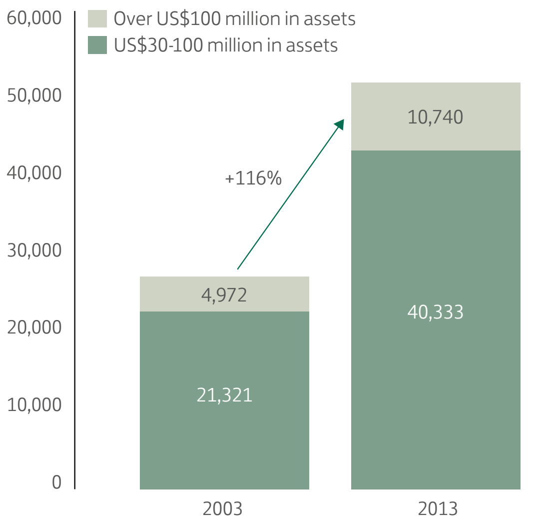
[6] Cross-border M&A activity is a major constituent of foreign direct investment. M&A volumes (deals) consist of investment in Asian target companies. Equity issuance includes both initial and follow-on equity offerings in Asia. Sources: M&A volumes – Thomson One; and Equity issuance – Bloomberg



Source: IMF International Financial Statistics, Bloomberg

Currency Reserves

The economic emergence of Asia over the last two decades and the massive increase in capital inflows to these regions has enriched governments and citizens alike. Total government reserves in both regions ballooned between 1998 and 2013, increasing nearly 900% from $820 billion to $8.1 trillion in 2013. Strengthening currencies in Asia also increased sovereign wealth in dollar terms, as the Chinese renminbi and Singapore dollar strengthened 37% and 33% respectively since the renminbi was floated in 2005[7].



Source: The Wealth Report 2014, Knight Frank

UHNWI Population

Personal income generated from the surge in economic and capital market activity has driven a sharp rise in the number of UNHWIs in Asia in the past two decades, as represented by the chart at left[8]. This increase has largely been driven by UHNWI growth in China, where the number of people with more than US$100 million in net assets grew by 378% between 2003 and 2013, and accounted for roughly one third of the increase across Asia[9]. After China, Singapore and Hong Kong have the second and third largest populations of UHNWIs with more than US$100 million in net assets (7% and 5% of the population respectively).

[7] The vast majority of currencies in the Middle East are pegged to the US dollar. Source: Bloomberg.
[8] UHNWI wealth is defined as net assets excluding the value of a principal residence. Source: Shirley, A. (Ed.) (2014). *The Wealth Report 2014*, London: Think.
[9] The population grew in excess of 375% for various net asset bands: US$30-100 million: 378% to 5,087 in 2013; US$100-1,000 million: 378% to 2,460 in 2013; and over US$1 billion: 384% to 179 in 2013. Ibid.

Singapore and Hong Kong have historically played an additional role for Asian UHNWIs: providing a safe, well-governed haven for family wealth. In addition to the rise of financial services offered by private banks and asset managers in recent decades, Singapore and Hong Kong – along with Dubai – have recently seen the emergence of another vehicle for family wealth management: the family office.

+116%

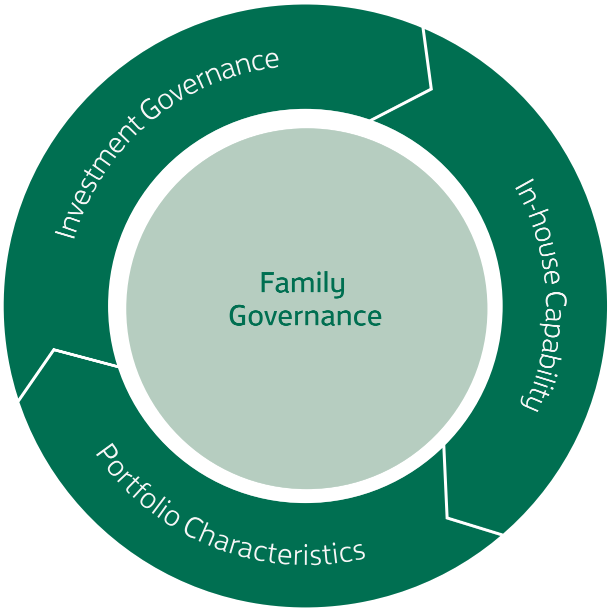
INCREASE IN NUMBER OF UHNWI (WITH ASSETS IN EXCESS OF US$100M) IN ASIA BETWEEN 2003 AND 2013

Development of the Asian Family Office

The family office is fast emerging as a viable means for Asian families to control, preserve and transfer wealth for generations to come. However, a family office tends to account for only a portion of a wealthy family's financial and business interests.

It is therefore crucial for the family to take a holistic view of the ecosystem governing its affairs and to establish clear and consistent priorities related to its management.

Such considerations are especially relevant in Asia, where family wealth is at an early stage of development and families are less accustomed to inclusive succession management.



While defining priorities and aligning family interests is an important first step, our report and research focuses on the mechanisms governing investment and the structural characteristics of regional family offices. Nonetheless, the primacy of family interests is crucial for the development and institutionalization of the Asian family office and deserves further investigation.

Although the exact number of family offices in Asia is at best an estimate, the growth of the family office industry in the region is undeniable. While estimates ranged from 19 to 53 in 2008, the number of family offices in the region swelled to between 100 and 200 in 2013[10].

The majority of family offices in Asia are located in Hong Kong and Singapore, home to more than 75% of the family offices established in the region over the last decade[11]. These jurisdictions provide a tax-efficient environment governed by common law for wealthy individuals: North Asian families favor Hong Kong and South Asian families favor Singapore. Indeed several non-Asian families have relocated or set up family offices in these jurisdictions to take advantage of the favorable tax environment. Dubai's emergence as a financial hub and its tax-free zones have also attracted families from South Asia, and it is now a principal and fast-growing hub for Middle Eastern, North African and Russian family fortunes.

Similar to the regional breakdown, nearly all of our survey participants represent family offices based in Singapore, Hong Kong and Dubai, with roughly two thirds based in Singapore. Reflecting the 'new' family wealth in the region relative to Europe or the United States, 18 of the 20 single family offices we interviewed manage wealth for families in which either the first-generation entrepreneur or the second-generation is the key family member involved in investment decision-making, while the remaining two offices are led by third and fourth-generation members. An additional generational dynamic is highlighted by the source of family wealth among our interviewees, with second, third and fourth-generation family offices managing wealth predominantly generated through real assets and asset-intensive businesses – such as commodity production, real estate, and manufacturing – while first-generation family offices manage wealth mostly created via service businesses.

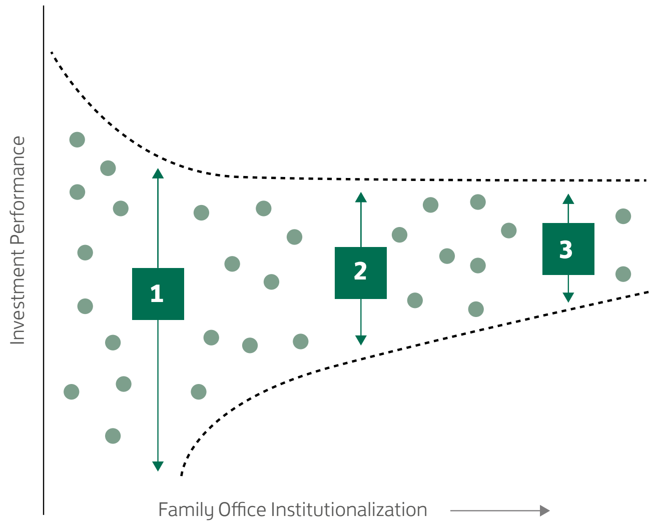
Nearly all of the family assets managed by single family offices in our survey sit in simple local holding companies or trusts, family members being direct owners or beneficiaries of the various structures. The parent entity in turn typically owns various operating subsidiaries and special-purpose vehicles, one of which is usually the family office itself. Some of our interviewees take advantage of regulations created by governments to attract single family offices to their jurisdictions, such as the Family-owned Investment Holding Company in Singapore, and the Single Family Office in the Dubai International Financial Centre[12]. Again reflecting the relatively 'new' wealth in Asia, eight of the families we interviewed continue to operate the business which originally produced the family fortune, while four more own legacy assets or significant stakes in the listed equity of the original family business. In most cases, these family businesses have been brought under the holding company or trust structure and continue to fund a portion of the family offices' investment activity.

[10] Internal estimates and: (2008). *Family Offices in Asia: The Evolution of the Family Office Market.* VP Bank and University of St. Gallen.
[11] The number of family offices in the calculation excludes those located in Japan and Australia. Source: Postelnicu, A., et al (2013). *Coming of Age: Asia-Pacific's Family Offices Find Their Footing.* UBS/Campden Wealth.
[12] The Singapore Family-owned Investment Holding Company (FIHC) was introduced in the 2008 budget, and expired in March 2013; FIHCs that were set up during that period can continue to operate as such. Sources: project interviews; and *Leading Through Uncertainty: Singapore Budget Commentary 2013.* Deloitte & Touche.

Research Framework

While the characteristics of a family office are driven by the unique priorities of each family, the degree to which the investment process has become institutionalized is an important signifier of expected investment performance, investment governance, portfolio attributes and in-house capabilities.

Building on conversations and interactions with family offices across the globe, GPEI has developed two frameworks that crystalize these relationships.



Framework 1: Institutionalization vs Investment Performance

Our first framework compares the family office's stage of institutionalization – defined as process-driven investment decision-making – with its expected investment performance. Regarding institutionalization as on a continuum, we posit that increasing institutionalization leads to more consistent (but not necessarily better) investment performance via more stringent assessment of investment opportunities. In theory, this should also reduce the volatility of portfolio returns and satisfy the need for consistent income generation and wealth preservation sought by multi-generational family offices.

However, more rigorous investment screening may reduce a family office's exposure to high-risk/high-return investment opportunities such as those provided by successful entrepreneur's intuition and networks.

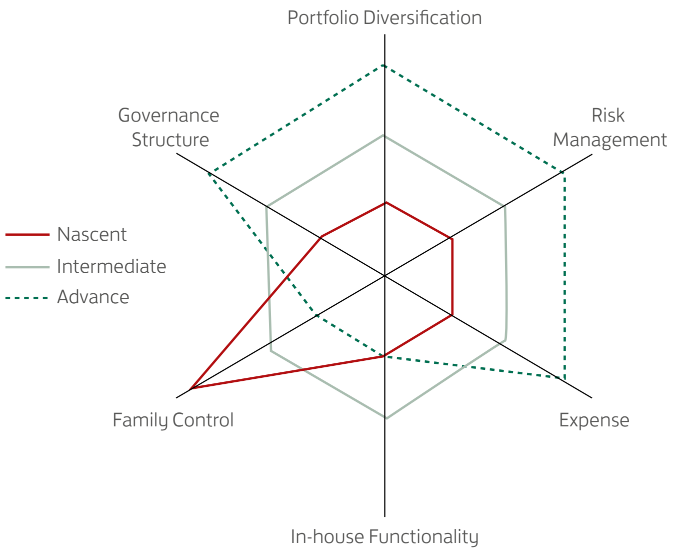
To make our framework more tangible, let's consider three family office archetypes at discrete points in the institutionalization process: nascent, intermediate, and advanced.

1. Nascent – Characterized by little or no process-driven decision-making, expected returns for a family office in a nascent stage of institutionalization vary widely, with both positive and negative outliers. Family wealth is typically managed in a concentrated portfolio geared towards capital appreciation, with first-generation wealth creators driving decisions.

2. Intermediate – With a basic investment process in place and increasing input from professional investors, a family office at an intermediate stage takes a more measured approach to risk, balancing capital appreciation priorities with a greater focus on capital preservation. The range of expected returns tightens as more process-driven decision-making reduces concentration and portfolio risk.

3. Advanced – Exhibiting many characteristics of a professional asset manager, family offices at an advanced stage of institutionalization employ a rigorous investment process run entirely by professional investors, some of whom may be family members. The range of returns tightens further as capital preservation and income assume increasing priority. Advanced family offices may develop expertise in specific investment strategies and raise funds from other investors, often via a multi-family office structure.

Institutionalization does not automatically lead to higher returns for the family office but to better quality returns, meaning it reduces volatility of returns



Framework 2: Institutionalization and Family Office Attribution

Family offices at similar stages of institutionalization exhibit similar attributes in terms of investment governance, portfolio characteristics and in-house capability. Based on our interactions with global family offices, we created a second framework that highlights six distinct attributes of family offices at different stages of institutionalization: family control, governance structure, portfolio diversification, risk management, expense and in-house functionality.

Drawing on the archetypes presented in our first framework, the diagram above depicts the characteristics of family offices at nascent, intermediate and advanced stages of institutionalization. Characteristics that assume greater importance lie further from the center. While all characteristics are to some degree related, there are logical pairings, as follows.

Family Control & Governance Structure

Both the degree of family control and the prevalence of a formal governance structure in a family office are correlated with its stage of institutionalization. A defining characteristic of the nascent stage is the high degree of control maintained by a family patriarch over all aspects of the family office. At the intermediate stage, the approach to control is often more managerial, with defined governance structures used to minimize conflict among future generations, draw on objective expertise from outside the family, and share decision-making responsibility beyond the first generation. Highly institutionalized family offices have governance and control structures which resemble limited partnerships, with day-to-day management assigned to professional investment staff and the family's involvement often reduced to strategy and review.

Portfolio Diversification & Risk Management

Portfolios at family offices at the nascent stage of institutionalization are typically highly concentrated, often in legacy holdings or equity positions in industries with which the family is highly familiar. At the nascent stage, there is minimal – if any – focus on risk. Family offices at an intermediate stage of institutionalization begin to diversify away from legacy investment portfolios, placing an increased focus on investment in uncorrelated assets; investment risk is evaluated on a case-by-case basis while portfolio risk is addressed through diversification. Portfolios at the advanced stage are often highly diversified – across asset classes, geographies, passive/active strategies and tenor – with sophisticated risk management systems in place.

Expense & In-house Functionality

The expense and in-house capability of family offices do not both increase with institutionalization. While the expense of running family offices typically increases as the level of institutionalization increases, in-house capability follows a bell-shaped curve. Family offices at a nascent stage of institutionalization typically develop lean, investment-focused vehicles. As they approach the intermediate stage, the number of functions managed in-house also typically increases to include functions such as tax planning, philanthropy and concierge. Those at an advanced stage of institutionalization often have a strong focus on investment, and to a lesser extent philanthropy, while other functions are outsourced.

Instituting a formal governance structure provides a foundation to effectively manage a larger investment portfolio and determine the appropriate mix of in-house and outsourced capabilities

US$400M

MEDIAN AUM OF SURVEYED PARTICIPANTS, RANGING FROM US$50M TO MULTIBILLION WEALTH

Survey Findings

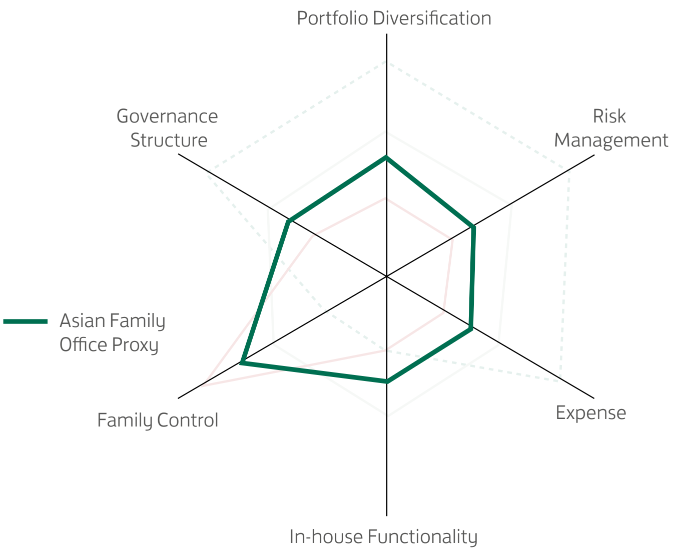
Over the course of our interviews with project participants, we gathered information and data to test our frameworks against the reality on the ground for family offices in Asia.

Reflecting the recent development of family offices in the region, we found the majority of our 20 single family office survey participants to be at an early stage of institutionalization, with 7 at a nascent stage, 9 at an intermediate stage, and the remaining 4 single family offices and 5 multi-family offices at an advanced stage.

The following three sections present our findings in the context of the frameworks described above and via five case studies. The information collected from interviews is analyzed by employing our second framework. A more granular view of the attributes of selected participating offices is achieved with the case studies before we revisit our first framework and present an expected range of returns for family offices in Asia.

The Asian Family Office: Attributes

Over the course of our interviews we collected data that confirms the prevalence of the six attributes presented in our second framework. A summary of the data is presented below. The diagram of an Asian Family Office Proxy displays the attributes most commonly cited by our single family office survey participants. While the Asian Family Office Proxy does not correspond directly with one of our three family office archetypes – which is only to be expected – its attributes equate to a nascent to intermediate stage of institutionalization.



Family Control & Governance Structure

A high degree of family control is the defining characteristic governing investment among our single family office survey participants. Of the 20 interviewed, family members control both tactical and strategic investment decision-making in 12, with one other family exhibiting a strong degree of control through an active Investment Committee. Family control is particularly pronounced in the Middle East, where wealthy families often allocate their wealth across several investment vehicles, with little interaction or transparency between them. In such instances, often only the patriarch knows the true extent and exposure of the family's wealth. The five multi-family offices in our survey, on the other hand, exhibited strong governance structures, with family involvement limited to portfolio strategy and review.

"When you are the principal decision-maker, you tend to have one particular outlook on the world; it's very hard to balance genuinely different views"
– Patriarch of nascent-stage family office

60%

RESPONDENTS WHERE FAMILY MEMBERS CONTROL STRATEGIC AND TACTICAL INVESTMENT DECISIONS

In family offices at a nascent stage of institutionalization, hands-on entrepreneurs are typically involved in all facets of decision-making. While the need for objective investment processes and governance structures is largely acknowledged by regional wealth creators, in practice they typically dictate both strategic and tactical investment decision-making, often over-riding any existing investment processes. Wealth creators that control family office activity explained that one of their main challenges is to balance deliberate and objective investment insight from their professional staff with their own strong views and ability to execute on the spot. This is particularly true of wealth creators from the financial services industry.

In many cases of single family offices at an intermediate or advanced stage of institutionalization, family members continue to wield significant tactical investment authority in a tightly governed investment setting. In several intermediate family offices, investment professionals follow an established process, with senior family members – often with extensive commercial but limited investment experience – responsible for approving allocations above a certain amount. However, many second and third-generation family members currently active in intermediate and advanced family offices have developed an investment capability through experience inside and outside of the family office. In one instance, a third-generation member returned to his family office as Chief Investment Officer (CIO) after a successful career in the hedge fund industry, and soon assumed control of 90% of the assets under management.

Reliance on wealth creators for both investment and non-investment decision-making for many of the nascent and intermediate family offices in our survey underscores the importance of implementing a rational family charter and investment governance structure while the first generation is still in control. Strong governance structures are most prevalent among our single family office survey participants at a late intermediate to advanced stage of institutionalization, particularly those managing wealth for multiple generations. Reflecting this, 11 of the 20 single family offices in our survey have a formal investment committee that meets on a monthly or six-weekly basis.

Portfolio Diversification & Risk Management

As the Asian Family Office Proxy shows, the most common level of portfolio diversification and risk management attributes cited by survey participants equates to an intermediate stage of institutionalization. These family offices typically allocate roughly two thirds of their portfolios to a blend of equity, fixed income and real estate positions, with the remaining third allocated to alternative strategies, structured products, direct investment, or cash. The balanced portfolio of these family offices reflects an increased focus on capital preservation. Allocations to external managers average nearly 25% of their investment portfolios, with a preference for fixed income, hedge fund or private equity managers. These family offices also show a strong appetite for direct investment in private companies, with allocations reaching as high as 30% of family wealth. Direct investment activity is often concentrated in industries in which the family's wealth was created, where families can leverage their experience and existing network to identify high-quality opportunities. Risk management techniques are typically employed on a case-by-case basis, with geographic diversification cited as the most common risk management technique.

The composition of portfolios for family offices in our survey at a nascent stage of institutionalization is broadly driven by a single factor: whether the family wealth creator came from a career in financial services. Wealth creators with such a background have a well-developed understanding of risk and appreciation of portfolio diversification; the portfolios of these family offices are skewed towards stable and uncorrelated assets – with a focus on real assets and absolute return strategies – and risk in liquid portfolios is closely monitored. If the wealth creator has another industry background, the (nascent) family office tends to have a more concentrated portfolio skewed towards equity investment – via both public markets and private deals – with target allocations to equity reaching up to 65% of investment. Two of the family offices in our survey at a nascent stage of institutionalization – both set up three years ago – are in the process of unwinding equity stakes in listed legacy businesses representing 70% of their respective portfolios. While

25% AVERAGE ALLOCATION TO EXTERNAL MANAGERS BY INTERMEDIATE STAGE FAMILY OFFICES

70% HIGHEST PROPORTION OF LEGACY FAMILY BUSINESS ASSETS IN PORTFOLIO AMONG SURVEY PARTICIPANTS the target for equity exposure for both family offices is well below its current level, the need to exit such large positions in a prudent, patient manner is a key challenge in the quest for diversification.

Portfolios among the four single family offices and five multi-family offices at an advanced stage of institutionalization are managed by professional investors both internally and externally. Risk management is integral to the investment process, particularly for liquid portions of the portfolio. Internal capabilities often include independent risk managers who help define the family office's risk appetite, provide clear guidelines for executing an investment mandate, and monitor portfolio risk metrics on an on-going basis. Each of the single family offices at an advanced stage of institutionalization show a distinct taste for global alternative investments – specifically hedge fund, private equity and real estate investment – with roughly 65% of their portfolios (in all four cases) allocated to alternative strategies[13]. While external manager allocation is a key strategy for two of them, one advanced family office manages 90% of its assets in an absolute return strategy executed by a family member with extensive portfolio management experience in the hedge fund industry.

Regional Comparison: East Meets West

Investment portfolios among single family offices in Asia are broadly different from those found in Europe and the United States, both in terms of geographic and asset allocation. Both groups of family offices show a distinct home bias, as family offices in our survey allocate roughly 60% of their portfolios to investment in Asia, and five out of the seven offices at a nascent stage allocate between 90% and 100% of their assets to Asia. Similarly, the US-and-European-dominated global family office industry – according to a recent Financial Times survey – allocates nearly 80% of assets to investment opportunities in North America and the United Kingdom/Europe[14]. However, as Asia accounts for only 20-25% of global debt and equity, the risk associated with geographical concentration is significantly more pronounced for family offices in Asia[15]. In fact, several investment professionals we interviewed mentioned that their priority was to increase the geographic diversification of assets and allocate more to opportunities in developed economies.

Asset allocation by participants in our survey differs significantly from the broader family office industry. Those in our survey have a clear preference for real estate, and allocate nearly 30% on average and up to 70% of family office assets to real estate investment, compared with less than 10% in the industry as a whole[16]. Private equity investment, of which direct and co-investment is a significant component, is markedly higher in our participant's portfolios than the broader global family office industry, at roughly 17% (versus 10%).

Expense & In-house Functionality

The expense and in-house functionality of the bulk of family offices in our survey places them between a nascent and intermediate stage of institutionalization. Investment teams among these family offices are lean and family-controlled, averaging two investment professionals per family office with a range of 0 to 5. The lack of in-house investment team depth necessitates a high reliance on banking relationships providing a broad range of services – several family offices in our survey maintain banking relationships with more than 10 institutions. This tendency also reflects the desire to decentralize their asset base under several custodians.

Professional CIOs lead investment activity in only six of the single family offices in our survey, five of whom work for advanced or late-stage intermediate family offices and one for a nascent-stage family office currently optimizing its portfolio. Family offices with a CIO employ varying numbers of investment professionals, ranging from 4 to 18 supporting their investment activity. One family office at an intermediate stage of institutionalization outsources investment decision-making for its liquid portfolio to a multi-family office – with regular, weekly review by the family office – while direct investment is managed by the family.

The broad functionality of family offices in our survey also reflects a nascent to intermediate stage of institutionalization. The majority of the family offices at a nascent stage of institutionalization in our survey maintain basic legal, accounting and control functions in-house – or tap the capability of the family business to fulfill these functions – to address regional investment activity. Several of those at an intermediate stage of institutionalization have expanded the number of in-house functions to include lifestyle services such as concierge and philanthropy, while administrative, legal, accounting and control services are often outsourced. Family offices with an investment reach outside of Asia – typically at the intermediate and advanced stage of institutionalization – hire external legal, advisory and accounting expertise in regions where the family office does not typically invest.

[13] Investment in this case refers to the aggregation of each family office's percentage allocation to alternatives, not aggregate assets under management.
[14] (2014). *Family Office Research: Spring/Summer 2014*. Financial Times.
[15] Roxburgh, Charles et al (2011). *Mapping global capital markets 2011*. McKinsey Global Institute.
[16] (2014). *Family Office Research: Spring/Summer 2014*. Financial Times.

“Most of the day-to-day work is outsourced; our team mostly provides guidance and monitors the external process.”
Advanced-stage family office CIO

30%

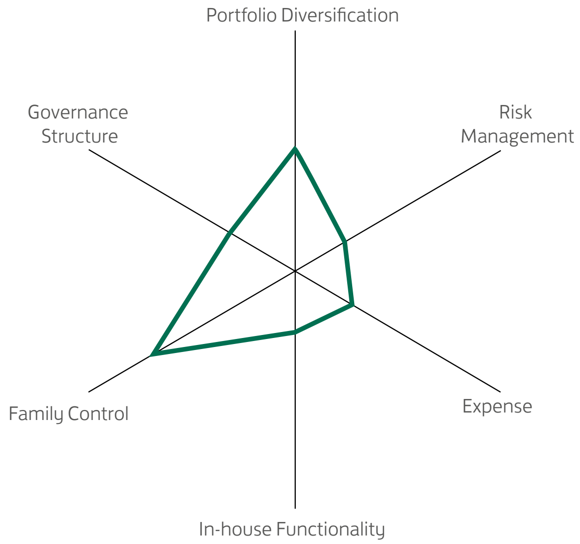
SINGLE FAMILY OFFICE INTERVIEW PARTICIPANTS WITH AN IN-HOUSE CIO

Case Studies

To provide a more tangible sense of the attributes of family offices in Asia, the following section presents five fully-anonymized case studies of single family offices participating in our survey.

Each includes a snapshot of the six attributes presented in our second framework, as well as a basic overview of each family office's investment goals and legal structure.

The Financier



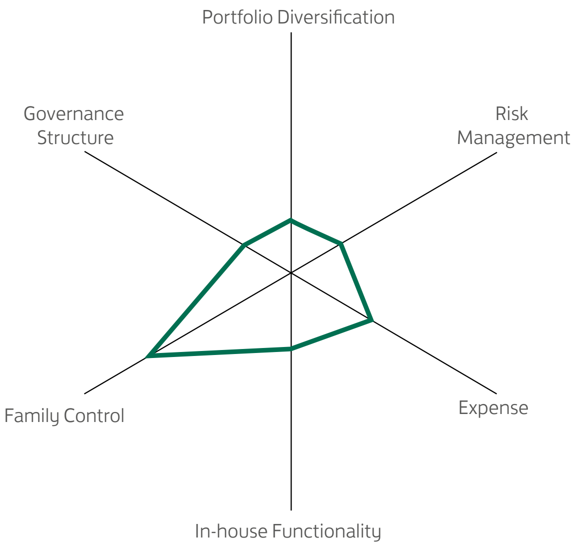
Following a successful career in the financial services industry, the head of this family office set up a single family office under the Single Family Office Regulations in the Dubai International Financial Centre (DIFC). The founder's primary goal is to produce income for the family and preserve capital for future generations. Among the key considerations for founding the family office in Dubai were the absence of income tax in the DIFC, the founder's familiarity with the Middle East, and the robust financial services offerings in Dubai. The founder was the sole shareholder of the family office until recently, when 100% ownership was transferred to an off-shore trust to better manage succession.

The family office has been kept intentionally lean, with only family members active in the office. The founder drives all investment decision-making and he and his wife – the two directors of the family office – are its only active staff. The family office maintains detailed accounts to track portfolio exposure, and performance is formally reviewed on a quarterly basis by the family. All other functions are outsourced, including the audit function, general legal advice, and external counsel specifically related to the family office's real estate holdings and investment.

The founder uses the family office both as a holding company for family assets and an investment vehicle. Roughly 90% of the family's personal and investable assets are held via the family office, with a geographic allocation of roughly 30% to Asia and the remaining 70% to Europe and the United States. The family office's liquid, investable assets – which account for roughly 80-85% of the family's wealth – were first invested in 2009. Roughly 60% of liquid assets were "locked-up" in developed market government securities, with a pure focus on capital preservation; the founder of the family office estimates that these securities have produced a negative real return since investment. The remaining 40% of liquid assets are allocated across a real estate-heavy book with an asset allocation of 50% real estate, 30% listed equities, 10% allocated to hedge fund managers, and 10% to direct investment in regional SMEs and venture capital. Risk management activity is predominantly related to the liquid equity allocation of the portfolio, and executed through constant monitoring of portfolio holdings and global markets.

"Some family offices get to a certain size where they institutionalize too much and eventually the family has no clue what's in the portfolio"
Founder @ The Financier

The Opportunist



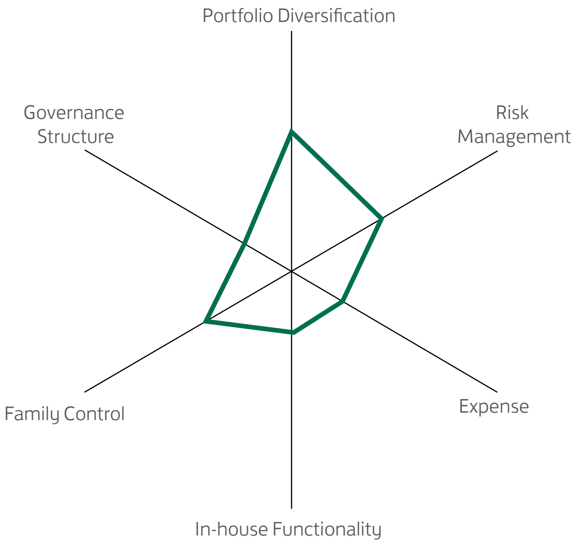
The family wealth managed by this family office was initially generated via a successful Singapore-based family firm in business services. Prior to the establishment of the family office, several opportunistic investments in real estate and financial services significantly augmented the family fortune and enabled the establishment of a single family office. The office is structured as a simple holding company, with a Singapore private limited company managing its liquid assets and various SPVs holding direct private equity and real estate investments. The primary goal is capital appreciation, although in the last few years the family office has increasingly considered the family's annual income requirements when making investment decisions.

The family office is solely focused on investment and wealth management. Investment decision-making is entirely controlled by the first-generation wealth creator and his son, who is becoming increasingly involved and assertive. A formal investment process was implemented in 2011, but abandoned two weeks after its introduction. Two professionals employed by the family office and four advisors support investment activity. The family office draws upon 15 banking relationships for research and execution. Our interviewee – one of the investment professionals – described one of his main roles as providing a balancing voice to the risk-taking employed by the family. The majority of accounting, control and legal functions are executed in-house, although external expertise is often sought to help establish new investment structures.

Until the Global Financial Crisis, the family office's entire portfolio was invested in public and private equity and real estate. Following the Crisis, the family office consciously built up an allocation to fixed income, which grew to roughly 30% of the portfolio, although this has been reduced over the last few years and currently stands at 15%. In addition to the fixed income allocation, listed equity accounts for 45% of the portfolio, private equity – both direct and allocation to private equity funds – accounts for 20%, and real estate for a further 20%. Within the listed equity portfolio, financial services investment receives a large allocation, reflecting the founder's familiarity with the industry. The family office's investment activity is concentrated in Asia, with 95% of the portfolio split between opportunities in Singapore and India, and the remaining 5% allocated to opportunities in both developed and emerging markets. Portfolio risk is managed through an informal review of the family office's weekly accounts and P&L.

"We try to slow down the risk-taking and leverage, but it is hard to steer the ship away from what has worked for so many years"
Investment professional @ The Opportunist

The Satellite



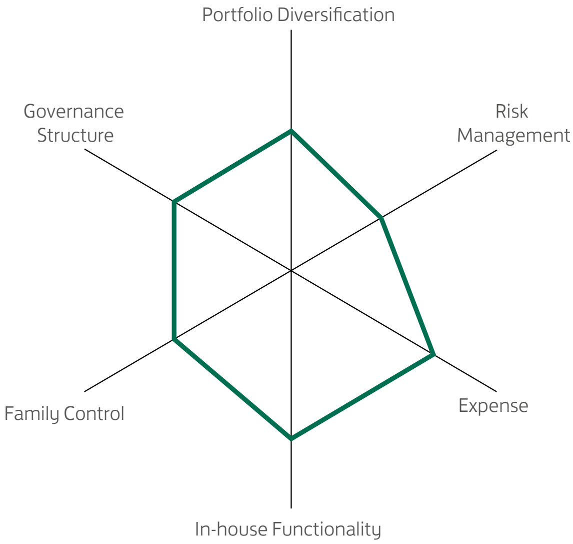
This Singapore-based family office is one of two main vehicles managing the wealth generated from the sale of a third-generation European family business. One of three siblings in the third generation manages a portion of the family's financial wealth via a Singapore Family-owned Investment Holding Company (SFIHC), with a second sibling managing additional wealth in a Europe-based structure. The goals for Singapore-based bankable assets are income generation and wealth preservation, while investment activity in real estate and private equity across Southeast Asia are more geared towards capital appreciation. The siblings of the third generation own the various global vehicles, while a trust structure also incorporates the second generation as a beneficiary of the family's investment activity.

The Singapore-based entity predominantly operates an outsourced business model, with a family member and one analyst overseeing family office activity. It employs a multi-family office to manage its bankable assets, with tactical investment decision-making carried out via regular but informal communications between the head of the single family office and the investment managers at the multi-family office. Non-bankable assets invested in real estate and private equity are managed directly by the family, with external advisors providing support on a project-by-project basis. If disagreement occurs between the Singapore-based sibling and the multi-family office, one other sibling is consulted to decide the matter. Frequent communication between the third-generation siblings sets the top-down, strategic direction for the family office's investment activity, with a more formal review of the portfolio and investment strategy taking place on at least a quarterly basis. The multi-family office looks after consolidation, reporting and risk management for the bankable assets, and accounting and audit functions are also outsourced.

The Singapore-based vehicle's portfolio consists of a 60% allocation to bankable assets, 25% to real estate, and 15% to direct private equity. The bankable assets are invested in developed markets, with a 35% allocation to bond funds, 25% to equity, 10% to alternatives, and a 30% allocation to cash. The family office's real estate portfolio is predominantly allocated to commercial opportunities in emerging Southeast Asia and reflects the family's longstanding passion for project development. The family office's direct private equity investment is predominantly allocated to regional opportunities, with a weighting towards venture capital and growth equity investment.

"If we make 4 or 5% on the bankable assets, we are happy ...
the family's focus is on the real estate business"
Third-generation family member @ The Satellite

The Industralist



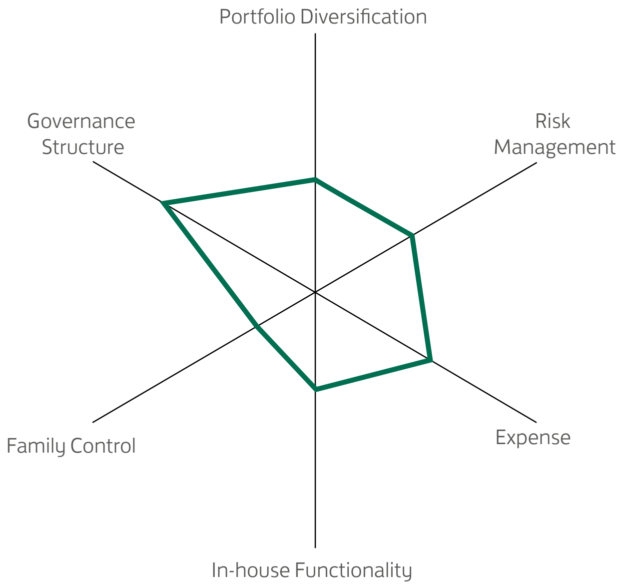
This family office was formed to manage the excess liquid assets generated by a decades-old family business focused in the resources sector. The family business continues to be wholly owned by the family and provides an on-going source of capital for family office investment. The main goals of the family office are to manage and preserve family wealth, provide a shareholding superstructure for all family business and investment holdings, and provide a vehicle through which to prepare the second generation for family business succession. Until recently, these functions were all managed within the family business. The family office is currently led by the founder, although the second generation is becoming increasingly involved in family office activities.

The family office provides a wide range of functions to the family ranging from investment to personal property management and event-planning. An investment advisory committee consisting of five family members, two external advisers and a family office executive devises the family office's investment strategy, while a family council of broadly the same members governs additional aspects of the family office. A CIO from a major financial center has been hired to oversee two investment teams based in Hong Kong and Singapore, which will consist of approximately 10 investment professionals each; a dedicated risk manager was also recently hired by the family office. In addition to investment, risk, legal, accounting, and control functions, the family office provides the family with lifestyle services including concierge, philanthropy and a conduit through which to preserve family values. Bi-monthly meetings are held to update family members on general developments within the family office, while monthly meetings are held to review the investment portfolio.

The family office's portfolio consists of liquid investments, real estate, and direct investment in private businesses. The liquid portfolio accounts for a vast majority of the portfolio and is targeted to produce returns uncorrelated to the family business. The liquid investment portfolio is governed by a strategic asset allocation established by the investment advisory committee, while day-to-day management of the portfolio is managed by the CIO and his team. Investments which represent a substantial percentage of the portfolio or are in new product categories are also presented to the investment advisory committee before they are pursued. The family office's liquid portfolio targets 30% exposure to listed equities, 30% to structured products, 20% to bonds, and 20% to external managers. The portfolio was originally allocated entirely to equity investment, but it has been consciously diversified as it has grown. The family office's direct investment activity often focuses on private businesses related to the family business and originates from the family's network. These investments are managed from the family office as private equity investments, although those that reach sufficient scale can be shifted into the family business as a new division.

"A key challenge is to get the first and second generation to buy into the governance processes, when the Chairman is used to sitting down with his team and making decisions quickly"
General Manager @ The Industrialist

The Legacy



The 'Legacy' family office is Hong Kong-based and was founded two decades ago from capital generated through a successful family business focused on real assets. The family office itself is a private trust company owned by the family that charges trustee and management fees for managing the various family trusts and foundations. While the family has retained a certain percentage of the equity in the family business, no family member is currently active at an operational level. The primary goal of the family office is to generate income for the family and to support the family's philanthropic giving. The family office formally manages portfolios for two generations, while the third generation is gradually being introduced to the responsibilities of participating in the family office.

The family office is solely focused on investment, with a CIO supported by four investment professionals executing individual investment strategies for the first-generation family business founder and each member of the second generation. An external advisory board consisting of directors and trustees of the family's investment vehicles meets on a monthly basis to review performance and matters concerning the family office. Family involvement in the investment process is minimal, as each member meets annually with the investment team to decide on asset allocation and quarterly to review portfolios. In addition to investment management and advisory, the family office maintains trust structuring and accounting services in-house, and manages interaction with external professionals overseeing legal and tax planning. Tax planning is a particularly relevant function for the family office, as family members hold citizenship from a variety of countries and tax jurisdictions.

The investment team manages bespoke investment strategies for each family member in the first and second generation and the family's charitable trust, with exposure to Asian real estate and global capital markets. All assets are managed externally, either through real estate management companies or external investment managers. Asset allocation for the first-generation family business founder is heavily weighted towards real estate, which comprises 70% of the portfolio, while the remaining 30% is allocated to managers investing in debt and equity capital markets. The investment portfolios for the second-generation family members are broadly consistent and reflect a more aggressive approach to risk, with 70% allocated to managers investing in capital markets and 30% to real estate. Asset allocation for the charitable trust sits between the generations' portfolios, with 50% allocated to real estate and 50% to managers in capital markets.

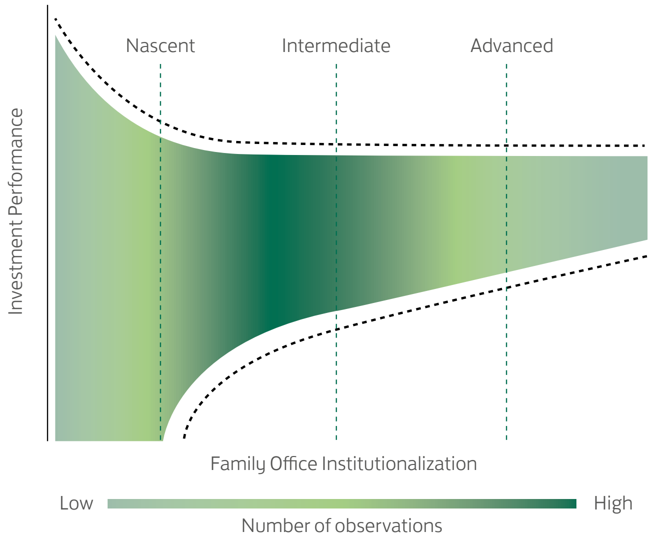
"The family is moving from operating a family business, to operating a foundation ... essentially, what the family is looking at is charitable giving – or philanthropy – will be the so-called family business"
CIO @ The Legacy

Institutionalization vs Investment Performance

In this section of the report we bring our findings full circle by presenting the expected range of investment performance based on our single family office survey participants' level of institutionalization.

To present this information in aggregate, the heat map on the following page highlights the concentration of our single family office survey participants at different levels of institutionalization.

Reflecting the group's predominantly nascent-to-intermediate level of institutionalization, we expect a wide range of investment performance for single family offices survey participants.



Survey Heat Map

The predominant role played by family members – particularly among family offices at a nascent stage of institutionalization – is a key driver of the wide range of expected returns. While many single family offices with a process-lite investment decision-making mechanism focus on capital protection, several participants (at the nascent stage) target returns in line with the healthy annual returns produced by successful family businesses in the past. Many participated in the booming Asian economy and the asset bubbles leading up to the Global Financial Crisis, which contributes to the high expected returns for many family offices at a nascent stage.

One of the key progressions exhibited by family offices at an intermediate stage of institutionalization is the alignment of performance expectations with current market conditions and capital preservation, which produces a tighter range of returns for this group. While several survey participants highlighted the importance of second and third-generation family members to drive this change, successful entrepreneurs who weathered the Crisis or created wealth via a career in financial services are more likely to have realistic return expectations and a more ingrained appreciation of risk. For example, one survey participant whose wealth was generated by a 2009 IPO of a family business and had two difficult years managing his own wealth, quickly gravitated towards a family office managed by a professional manager, with target returns of "inflation plus up to 4%." In addition, wealth in three of the single family offices in our survey was created by professional investors from the financial services industry over the past decade; although firmly under the control of first-generation wealth creators, these family offices execute investment strategies with performance expectations of inflation-adjusted capital preservation.

The four single family offices at an advanced stage of institutionalization have clearly defined investment processes, and target capital preservation and income generation. In each case, these family offices manage second, third and fourth-generation wealth created by family businesses in financial services and real assets. Each execute a well-defined investment strategy implemented entirely by investment professionals, with non-professional family members involved only in investment strategy definition and review. The five multi-family offices in our survey also exhibit at an advanced stage of institutionalization. Some of these multi-family offices evolved from a single family office set-up, while others have been set up more recently by financial service professionals with experience in banking and fund management. The range of investment returns produced by these advanced stage family offices is expected to narrow further, reflecting their income generation and capital preservation mandates.

In the years to come, we expect the existing Asian family offices to mature into an intermediate to advanced stage of institutionalization while a steady stream of newly established family offices will face teething challenges at the nascent stage

Recommendations: Increasing Institutionalization

This section of the report provides food for thought for family offices in Asia – as well as wealthy families considering the establishment of a family office – on how to increase the institutionalization of their operations.

While increasing institutionalization will not necessarily lead to higher returns, the quality and consistency of investment performance should increase.

Family Governance

Define a common mission and vision for the family and its wealth in a family charter, incorporating the priorities of both current and future generations. Establishing a family council or other governing body provides a forum to discuss control, succession, and other topics apart from the technical details of wealth management. In addition, a family council provides an opportunity to align and transmit the learnings of 1st generation wealth creators and the new approaches of subsequent generations. Developing a holistic approach to family governance also helps to identify family strengths and those areas where external support would be beneficial.

Investment Governance

Implement a formal investment governance structure to control investment decision-making and monitor investment performance. Even if the structure is simple and consists of only family members, instituting an investment process and system for review will aid the consistency of decision-making, improve performance and risk tracking, and help align family office activity with family goals. Track decisions and their outcomes to gain insights about inherent decision-making biases and work on reducing them. Tapping the expertise of an investment advisor or in-house investment professionals can help bring best practices to the investment governance structure.

Portfolio Characteristics

Manage capital both internally to leverage the unique network and capability of the family office and via external investment managers to increase asset and geographic diversification. Decide on a portfolio allocation strategy and stick with it over the mid-term (at least one full cycle) to avoid chasing fads. Allocating capital to alternative investment strategies – such as those executed by hedge funds or private equity managers – can reduce the correlation of assets and help stabilize performance during market volatility. Employing risk managers in-house can further rationalize an investment portfolio by developing clear parameters for investment activity and tracking portfolio risk metrics.

In-house Capability

Leverage the human capital and capability available in Asian financial hubs to build an appropriately-sized investment team in-house and outsource non-core functions to professional service firms. Empowering investment professionals in-house not only helps a family office develop process-driven decision-making, but allows a family office develop process-drive decision-making, but allows a family office to eliminate unproductive banking relationships and focus its activity with strong teams within each bank.

Simple Legal Structure

Develop a simple, flexible structure in the tax-friendly jurisdictions of Hong Kong, Singapore and Dubai with an eye towards wealth transmission. Establishing a simple approach to ownership and holdings allows a family office to focus on executing the family's goals related to investment. Considering the mechanisms required to transmit wealth to future generations upfront can help avoid restructuring at a later date.

Realistic Performance Expectations

Establish investment performance targets in-line with capital preservation and the current investment climate. Transitioning return expectations from those attributed to a successful family business and wealth creation to those of a successful wealth manager and wealth protection is a crucial step in the institutionalization process. In addition, calibrating expectations with the post-Global Financial Crisis climate and the lower productivity of risk capital is another step towards institutionalization.

Conclusion

The family office has fast emerged as a viable structure from which to manage the assets of wealthy families in Asia. The rapid growth of the UHNWI population in the region and the tax-friendly environment and robust capability provided in regional financial hubs suggest a further expansion of the industry in years to come.

Reflecting the recent development of wealth and the family office space in Asia, single family office participants in our survey exhibit a nascent to intermediate stage of institutionalization in aggregate and a high degree of family control.

As both the needs and new ideas of subsequent generations prevail within these family offices, it is important to establish a holistic approach to family and investment governance to efficiently manage family wealth.

About us

PICTET
www.pictet.com/contactpwm

Founded in Geneva in 1805, Pictet is today one of Europe's leading independent wealth and asset managers, with more than US$ 440 billion in assets under management and custody at 30 September 2014. The Pictet Group is owned and managed by eight partners with principles of ownership and succession that have remained unchanged since foundation. These principles encourage a spirit of collegial management and entrepreneurship, a long-term vision and commitment and a prudent risk-management policy, the corner-stones for the bank's reputation as the reference wealth manager for business-owning families and their family offices.

The Pictet Group, headquartered in Geneva, is present in 26 cities and employs more than 3,600 people. Pictet Wealth Management has been present in Asia since 1986 in Hong Kong and 1994 in Singapore and both offices are full-fledged booking centres. Combining the core Pictet offering and specific Asian investments and services, our Asian set-up has over 200 staff and 40 bankers and offers the full range of Advisory and Discretionary portfolio management and services to Family Offices situated in all main Asian markets. Pictet is delighted to partner with Insead in this in-depth study which will shed new light to the fast-growing number of family offices in the region.

PICTET FAMILY OFFICE SERVICES
www.pictet.com/familyoffice

In an increasingly complex world, the successful management of wealth needs to draw on a diverse range of services. The protection and enhancement of a fortune is no longer just about choosing the right investment strategy, vital though that is. Without a robust overview of the assets owned and the risks involved, it is difficult to coordinate all aspects of wealth planning and satisfy the ambitions and needs of every family member. Too many wealthy investors find themselves dealing with issues as they arise, through a variety of advisers each promoting their own products and services.

Pictet's Family Office Services offers a comprehensive professional approach to all aspects of managing a fortune. We serve a variety of wealthy clients, including first-generation entrepreneurs, owners of inherited businesses and families with large, diversified fortunes built up over many years. They have turned to us to help them deal with their complex needs, to develop a coherent approach to managing their wealth in collaboration with their trusted advisers, and to benefit from our world-class custody arrangements which assist them in controlling their fortunes.

INSEAD GLOBAL PRIVATE EQUITY INITIATIVE
www.insead.edu/gpei

The Global Private Equity Initiative (GPEI) drives teaching, research and events in the field of private equity and related alternative investments at INSEAD, a world-leading business school. It was launched in 2009 to combine the rigour and reach of the school's research capabilities with the talents of global professionals in the private equity industry. The GPEI aims to enhance the productivity of the capital deployed in this asset class and to facilitate the exchange of ideas and best practice.

INSEAD's global presence – with campuses in France, Singapore and the UAE – offers a unique advantage in conducting research into established markets for private equity, while at the same time exploring new frontiers in emerging markets to arrive at a truly global perspective on this asset class. The GPEI also focuses attention on newer areas shaping the industry such as impact investing, growth equity, infrastructure PE, and specific groups of LPs like family offices and sovereign wealth funds.

The GPEI looks to partner with stakeholders in the private equity industry to collaborate on research ideas and projects. Its core supporters are:

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www.pictet.com

INSEAD

Europe Campus
Boulevard de Constance
77305 Fontainebleau
France
Tel: +33 (0)1 60 72 40 00
Fax: +33 (0)1 60 74 55 00

Asia Campus
1 Ayer Rajah Avenue
138676 Singapore
Tel: +65 67 99 53 88
Fax: +65 67 99 53 99

Abu Dhabi Campus
4th Street - Muroor Road
P.O. Box 48049
Abu Dhabi
United Arab Emirates
Tel: +971 2 651 5200
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