FOMC - News

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In response to the increasing demand for information within the family office market, Family Office Management Consulting publishes its quarterly newsletter as well as ad-hoc briefing notes on various subjects relating to the family office theme. The selection of topics results from the experience in working with families, entrepreneurs and family offices on a daily basis, current developments in local and international markets and requests by clients.

Featured case study out of FOMC's day-to-day consulting practice – the implementation of a reporting and accounting system:

"Beauty contests": long-term success through structured selection

A well-established single family office serving a business family in several generations with multiple family branches approached FOMC in regard to the establishment of an in-house investment reporting/consolidation, accounting and controlling system. The family office is in charge of overall and individual wealth structures of the owners including traditional (outsourced) asset management, direct investments in private equity, real estate and strategic stakes, as well as other family services including philanthropy and social entrepreneurship. Operations including key management employees and support staff are spread between three main international locations with a number of additional jurisdictions involved in respect to the asset management as well as holding structures.

Efficiency, coordination and risk management

Key requirements for system implementation were defined as follows:

- A solid risk management framework over the entire asset base which includes a single stock position in the family's operating business as well as a substantial (pooled at family level) portfolio of strategic investments;
- Servicing the highly individual requirements of family members in regard to regular performance and risk reporting;
- 24/7 real-time online access for the owners and key employees;
- A group-wide archiving and filing system to enable investment monitoring particularly for real estate and strategic investment projects; and
- Accessibility throughout the entire family office group and at family level including various locations, while at the same time keeping the respect information barriers intact.

Selecting the "right" partners

In this particular case, the family office informed FOMC early in the selection process that the buy-in of a system was the preferred solution as confidentiality and independence were key priorities. Also, the family office was prepared to invest not only the respective funds in the implementation of an in-house system, but also to deploy the respective capital on the human resources side to service on-going system operations.

Following a detailed analysis of the requirements of the individual family office structure including workshop meetings with key management executives and project leaders on the family and family office sides, FOMC developed a detailed outline of the system's architecture and features as the basis for the selection process that followed.

Key milestones in the subsequent selection process included:

- Initial screening of nine selected system providers in three jurisdictions including presentations, system demonstrations and face-to-face interviews with a focus on the specific requirements of the family office structure;
- Development of detailed RFP questionnaire and distribution to pre-selected group of providers (six candidates) for hand-in of formal response proposals including detailed fee structures; and

- Customised prototype development by short-listed (three) service providers; and
- Presentation to the family office in form of workshop sessions for final selection.

Key aspect of the selection process:

Maximum level of confidentiality - throughout the entire selection process, FOMC acted on behalf of the client whose identity remained undisclosed until the system provider was chosen.

It is FOMC's experience that a thoroughly conducted selection process is critical. Although service providers are willing to run prototype system versions on a trial basis anywhere between 3-12 months, providing an external partner with information on structure and operations should be well considered. Also, changing providers during initial implementation phase often proves to be a costly undertaking.

Implementing for long-term success

While implementation is often underestimated, the actual work on the side of the family office starts upon the completion of the selection process.

FOMC typically kicks off the implementation phase with a workshop including participants from the family office's and provider's sides where not only the detailed project and implementation process is defined, but also responsibilities allocated as well as best- and "bad"-practice examples are discussed.

Key aspects of the implementation process:

- Detailed draft outline of reporting requirements on owner's and family office's sides;
- Selection of dedicated persons responsible for on-going system operations including deputy structures;
- Detailed outline of training phase including system support coming from provider side as part of trial contract;
- Integration of external partner networks including asset and real estate managers, trustees and accountants as well as implementation of respective interfaces;
- Definition of support mechanisms to guarantee 24/7 assistance availability; and
- Close coordination with existing IT consultant and service partner to guarantee efficient integration into existing platforms and maximum security levels.

While this case study intends to highlight the key aspects of a thoroughly conducted selection and implementation process for a single-family office set-up, the guest feature article by Clavis Family Office included in this edition of FOMC's newsletter explores the outsourcing needs and processes in a multi-family office setting.

Implementations and set-ups where structured selection/RFP processes are essential:

- Custodians and asset managers
- Trading and portfolio management systems including prime brokerage platforms
- IT and security systems
- Real estate managers
- Asset pooling and fund structures
- Providers of estate planning structures including trustees
- Multi- and virtual-family office services

Guest contribution

Clavis Family Office, Vught, the Netherlands, has just completed an in-depth cross-border study into the role of cooperation in the family office market with a focus on the wide range of external service providers, outsourcing partners and platforms.

The following featured guest article by Clavis Family Office summarizes the study´s key findings:

Outsourcing Platforms through Cooperation with Service Partners

Family offices have to build stable infrastructures, while taking interests such as privacy, independence, continuity, and the preservation of family capital as basic starting points. We believe that in today's world, a family should consider outsourcing of activities and seek cooperation with service partners. We first go into the dynamics of in-house operations versus outsourcing. Secondly, the available technical setups of a wealth management platform are elaborated, including Excel and other in-house software solutions, outsourcing to a third party, and global custody.

Our recent study of cooperation between family offices and service providers finds that although customization of solutions for ultra-high-net-worth (UHNW) clients is essential to meet the individual client's needs, standardization is also needed to manage costs and complexity – the main downsides of customization. As they are a common need, platforms for administration, consolidation, and reporting often are a source of standardization for family offices.

However, many family offices appear to struggle with the mode of standardization. Some family offices internalize the platform (administration, consolidation, and reporting), while others outsource these activities and focus on the coordination of the family's total environment themselves.

Internalization of a platform may seem beneficial, as the number of third parties involved with the specifics of the family capital is reduced. The comforting idea of this approach is that the privacy-sensitive family data remain safely within the family office walls. However, a platform in-house in most cases means implementing – or sometimes (co-) developing – a software solution or even an "Excel-solution". Usually without the continuous input of best practices, this is a tedious and time-consuming process, which is only done once. Therefore, internalization neither offers much flexibility to adapt to changing needs, nor does it guarantee continuity and full grip for the family at all times. If you do want to adapt to developing needs, as a family office with an internalized platform you have to reinvent the wheel over and over again.

By externalizing the platform in cooperation with service partners, a family office does remain flexible to adapt to changing family needs. Nevertheless, there are other factors in play as well. Probably the most important issue is the family's continuity, in the sense that the family office – a relatively small but all-round organization – is protected against defaults of both people and systems. Assuring continuity can best be achieved through outsourcing, because the family will retain a real-time overview and grip on the assets at all times, being able to see the woods and not only the trees. We have had good experiences with managing the possible downsides of the privacy aspect.

Secondly, the family office needs to safeguard unbiased reporting, which can be achieved by outsourcing the platform. For instance, the roles of the 'referee' (reporting and risk & performance analysis) and the 'alpha-generator' (asset manager(s)) should be separated. If the family office is also an alpha-generating asset manager, this is even more important. By doing so, the conflict of interest that one is assessing their own assignment is prevented from happening.

Another important argument for outsourcing is that cooperation itself is beneficial for the coordination of the family's wealth management. We find that after an often tedious process to establish committed trust relationships, the family office benefits from the continuous developments of platform services by service partners. Through knowledge exchange with their respective clients, these partners do achieve the needed scale and inputs in order to keep effectively optimizing the platforms they offer. This is not the case for a family office; neither can it be viewed as a core activity when compared to the tasks a family office has regarding the coordination of the family's overall environment.

With regard to the different available ways to setup a platform for administration, consolidation, and reporting, we identify broadly three categories: Excel and/or other software solutions, outsourcing to a third party multi custody platform provider, and global custody. The software category is associated with an in-house operation and is discussed above. The latter two categories provide means of outsourcing, albeit via different approaches.

While we do acknowledge the potential downsides of a global custody platform (counterparty risk and all your eggs in one basket in terms of custody), we have the experience that this is often manageable to a certain degree. Given the highly individual and complex environments of UHNW families, there are circumstances under which a global custody platform is not applicable or acceptable. We mark out a spectrum of multi-custody solutions that can fit the needs in such cases. Multi-custody platforms have in common that consolidation and reporting of portfolios at multiple custodians – and sometimes also back office administration – is performed by an external service provider. In the end, this type of platform is capable of providing similar output as a global custody platform. Nevertheless, a price for not accepting a global custodian is paid in terms of lower efficiency and higher costs.

As global custody combines 1) the efficiency of transactions recorded only once for both reporting and accounting purposes; 2) the ability of dealing with complex environments (multiple entities, jurisdictions, beneficial owners etc.); 3) low error sensitivity; and 4) low costs, it offers a solution that conceptually cannot be matched by any other type of platform. Although it is not (yet) a commonly implemented concept, we see significant growth regarding UHNW families who use global custody platforms. We also note ongoing developments in global custody service models for the specific UHNW clientele. With the growing scale we notice and expect the pricing of global custody solutions to gradually decrease further.

There are great opportunities for family offices to take the quality of their services to a next level. By coordinating a platform in cooperation with expert service partners, a family office can provide the family with a stable infrastructure, preserving and managing wealth flexibly and independently while offering the family continuity and grip at all times. The family can then also benefit from an up-to-date platform and from best practices offered by service partners.

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