Newsletter – Q3 2013, July 2013

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.

Going institutional?

Institutional versus private banking coverage is a key question not only from the perspective of the banks themselves, but first and foremost from the perspective of the family office and this more and more due to the changing market and investment environment in which investment banks and institutional asset managers have declared family offices as the new big opportunity and family offices have become strong players as “private equity / venture / hedge fund managers” alongside the usual suspects of investment boutiques; needless to say that access to institutional share classes is by now taken as a given.

However, does this mean that institutional coverage and set-up is the future, making private banking obsolete, at least for family offices? As our consulting practice shows, not necessarily or in some cases, not at all.

The world of the “institutionals”

Clearly from a perspective of size, family offices classify since a long time as institutional investors supported by their investment approach, with many professionally set-up offices operating within the “clique” of hedge fund managers, private equity and venture investors in the heart of the financial centres London, New York and increasingly also Asia. The endowment hype of the past few years, which still continues to some extent, has been taken up by family office as much as by pension funds and other institutional players. There is also clearly the question of pricing – even if family offices continue to be covered by private bankers and their wealth management units, the access to institutional share classes and the respective pricing is by now taken for granted. Also financial institutions and asset managers have adapted their business models accordingly, offering increasingly integrated platforms across the business divisions, wealth and asset management as well as investment banking.

Customization vs. standardization

However, how does this all hold from a set-up and infrastructure perspective? Clearly also here family offices continue to increasingly structure their platforms with integrated global custody, prime brokerage and others, previously exclusively seen as institutional solutions, which also means that asset managers, custodians and other providers who previously have been dealing exclusively with institutional clients, have to adapt accordingly by not only increasing flexibility in terms of systems and service offering, but also by hiring resources who are familiar with private client work.

As much as institutional solutions are being demanded by family offices as much customization is requested – a level of customization which is atypical or simply non-existent in the institutional world. Private clients structure their investment portfolios differently with, for instance, hedge fund investments being commonly combined with large real estate and direct investment stakes on top of the single stock position in the actual family business requiring not only bespoken consolidation /reporting as well as risk management frameworks but also advisory support on various fronts.

Although investment and decision-making processes are professionalised, they are by far not, and should not be, as standardized as is the case for institutionals. Whereas their institutional counterparts strictly operate according to fund memorandums and investment guidelines, family offices require the flexibility to invest "entrepreneurial" and therefore need partners who are able to adjust accordingly; and this not only in regard to customized investment reporting, the latter being by far not common practice, for instance, in the world of institutional global custody set-ups where 400-pages of standardized reporting templates are commonly seen, and prime brokerage platforms requiring standard thresholds for leverage and trading activity, but also in terms of compliance and regulatory set-ups. The latter being a challenge to banks and asset managers alike who require their "institutional" family office clients to be "informed" and "sophisticated" investors able to perform own due diligence in order to gain access to the new products.

A question of regulation

And then there is the question of regulation – in today's word more pressing than ever before. Should family offices become regulated and if yes, in which jurisdiction? Does location and regulatory authority make a difference? While some loop wholes currently still exist, such will become less available to family offices in the future. Structures such as private placement funds, i.e., set-ups in Luxembourg, may currently still accept unregulated entities as lead investors, but even then only in combination with governance structures which demonstrate elements of institutional /sophisticated investor business, i.e., independent board of directors or a separation between investment management and decision-making body. This trend will clearly continue in upcoming months and years, the EU's AIFM being only one of the key directives to look out for, FATCA & Co. being others.

A question of costs

In the future one of the critical risk and cost pillars for family offices will therefore be everything that relates to compliance and regulation including the set-up of new structures, respectively the revision of the old set-ups and associated re-organisation, as well as the additional day-to-day administrative work load; the latter being actually often increased for family offices as a result of entering the institutional space in the first place. Standardized custody agreements are only one example where family offices are often searching unsuccessfully for flexibility and support.

It is all of the latter why strong middle- and back-office solutions and teams are becoming increasingly important. Whereby family offices would have previously sought to build up such solutions themselves in form of in-house platforms, nowadays, following the trend to outsource, support in these fields is requested and even expected from the external providers, i.e., the (custodian) banks, asset managers and prime brokers. Private banking teams often play a role in such functions as well, navigating private clients through their institutional business units and offerings – the "set-up of the day", therefore still being a combination of both, institutional business with a hint of private banking.

Family Office Management Consulting Ltd.

33 St. James's Square London SW1Y 4JS Telephone +44 (0)20 3170 5966 Fax +44 (0)20 3170 5967 fomcnews@fo-mc.com www.fo-mc.com