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The family office redefined

Andrew Nolan considers the changing role of the family office.

There is no blueprint for a family office, as each should be designed to serve the particular needs of the family concerned. There have, however, been some clear trends over the past two decades that need to be considered by any family establishing a new family office or reviewing the role of an existing one. Indeed, the extent of the changes now taking place in the external environment is challenging the fundamental concept of a modern family office and its economic viability. Never before has it been more important to define objectives and design a working model that can realistically meet those objectives in a cost-efficient manner.

The traditional family office

While a family office should in theory be purpose-built, most have evolved over decades, new functions being added on in response to events. Many started as offshoots of a family business or an estate office. Their role was primarily administrative, keeping accounts, processing transactions and administering trusts and other vehicles. The family would take advice directly from professional advisors such as lawyers, accountants, stockbrokers and land agents, and the family office would implement that advice.

From administrator to gatekeeper

Over the past 20 years, the role of the family office has gradually evolved from administration and implementation to advisor and gatekeeper between the family and its professional advisors. There are four main reasons for this significant change:

- A need for more frequent and more specialised professional advice, reflecting an increasingly complex and litigious environment. Many families require a gatekeeper to identify issues, select appropriate specialists, understand and interpret the advice they give, and integrate that advice into the broader picture.
- Wealth management, in particular, is vastly more complex than 20 years ago, due to a plethora of new products, strategies and structures that require extensive analysis and ongoing monitoring, to ensure the right solutions and advisors are in place. The days of relying on a single stockbroker or investment manager are now a distant memory.
- The increased risks of a fast-changing and unstable economic environment have brought a need for highly sophisticated risk management across the full spectrum of family finances.
- Families themselves have become more complex, primarily because they are increasingly international, but also because many have multiple business interests.

The problem with the current model

The problem is that the need for advice is growing so rapidly that it is challenging for a typical family office to meet the requirements of being an effective gatekeeper.

The combined impact of ever more complex tax compliance, increasing regulation and a highly litigious environment is testing the capabilities of even the largest and best-resourced family offices. Many are so busy responding to the latest tax or regulatory changes that they scarcely have time to consider the bigger picture, especially family strategy, governance and succession planning.

The problem is often exacerbated by loose definitions of the role of family offices, causing muddled thinking and duplication of effort between the family office and external advisors. Some family offices, for instance, have already overreached themselves in trying to duplicate the role of an external asset manager, without the critical mass or resources to deliver a fully competent service. Not only is this inefficient, but, by immersing themselves in excessive detail in one aspect of the family's affairs, they can be distracted from their core responsibility of implementing the family's wider wealth strategy.

Defining expectations of a family office can be more difficult than it sounds, as it involves articulating precisely the relationship between the family, family office and external advisors, both in reaching decisions and in implementation. It will involve analysis of the family, key areas of collective activity, and the extent to which the family wishes to delegate the management of its wealth to a family office, rather than via direct relationships with professional advisors and private banks.

Family history and circumstances

The services required will strongly reflect the circumstances of a particular family:

- its history, number of generations and number of family members;
- the ability, orientation and authority of family leadership;
- geographic and jurisdictional complexity;
- assets collectively owned/collective activities;
- the complexity of structures through which assets are held;
- the family strategy, objectives and values; and
- family governance.

Clearly, it is a very different proposition to run the family office for a first-generation entrepreneur with two young children than for a fifth-generation family with 200 members scattered around the world, led by senior family members who are not particularly interested in business and are thus less involved in day-to-day decisions.

Equally, the family office's role is strongly affected by the complexity or otherwise of the structures through which the assets are held and the governance framework that aligns family decision-making with long-term strategy and objectives. The family office is often the guardian of family governance processes and, in larger families with many different trusts and companies, it requires considerable skill and experience to ensure key decisions reflect the interests of the whole family.

Main areas of collective activity

The priorities of the family office will also reflect the family's main collective activities, which will generally include investment management, banking and treasury; relationships with the family business; private equity and direct business interests; property; philanthropy; and administration (basic or expert) and reporting.

In each area, the precise role of the family office needs to be defined. Take, for example, investment management. How is responsibility for asset allocation and manager selection apportioned between external investment managers, the family office and key decision-makers in the family? Is the role of the family office to be a manager of managers and supplier of investment services, or to stand in the shoes of the family in purchasing such services from the external market? The difference may be subtle, but, if not precisely defined, there is every chance the family office will become a shadow investment manager, with all the resources and cost that implies.

The nature of family office involvement

To address the role of the family office from a slightly different perspective, it is worth asking in principle what level of advice and service the family requires:

- implementation and administration only – the family makes key decisions with direct input from advisors;
- the family office selects and coordinates external advisors;
- the family office plays the role of lead, trusted advisor;
- the family office sets the agenda for the family and plays a leading role in facilitating decisions.

At one extreme, the role of the family office combines that of a service provider, trusted advisor and management consultant, working with a range of professional advisors to identify the right course and build a family consensus, as well as being responsible for implementation and administration.

In practice, the level of input may vary between the different areas of responsibility. For instance, a business family may want the family office to have limited involvement with its business, but a much deeper level of involvement with the investment portfolio. The nature and depth of involvement may also change over time, particularly as the family leadership passes from one generation to the next. The family office may have a role to play in preparing for that transition and for succession planning more generally. Some family offices are led by one or more family members, although this depends on having someone willing and able to fulfil that role who is competent, acceptable to other family members and willing to submit to proper governance processes.

Conclusions

First, it must be accepted that wealthy families will probably pay more tax than in the past and incur greater costs in managing their affairs if they wish to avoid unnecessary risks. Unpalatable though this may be, they have to be realistic and can only set out to manage their wealth as efficiently and effectively as possible.

Second, in order to contain these costs, the objectives and role of the family office must be more precisely defined than in the past, clearly specifying the division of responsibilities between the family, the family office and external professionals such as investment managers and lawyers. An improved definition reduces unnecessary duplication and time-wasting caused by indecision or muddled thinking.

Third, for every significant activity (including high-level strategy), the optimal balance must be found between the expertise and servicing capability to be maintained within the family office and the extent of outsourcing to external specialists. This balance will depend on the volumes and complexity of the anticipated work and the impact on quality, as well as cost.

Fourth, considerable thought needs to be given to the need for a trusted advisor to the family and whether this advisor resides in the family office. Having such an individual regularly involved at the heart of the family's decision-making may not only improve the quality of key decisions made, but also save considerable costs by allowing ideas that are unlikely to be viable to be swiftly rejected, before too much has been invested in their appraisal.

Finally, the model for any family office must be realistic in terms of the ability to recruit, retain and motivate suitable staff, bearing in mind that, while there are benefits to having advisors directly employed, these must be balanced against the benefits of using external advisors who have regular and ongoing experience of working with other clients in their field of expertise.

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