A progressive shift

As family trends change, so too do family offices. A recent STEP Journal roundtable, sponsored by SANNE, examined the current trends and the impact of increasing global transparency on family offices

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In June 2018, 12 family office experts gathered at the Law Society in London for a roundtable discussion, sponsored by SANNE, to look at the changing nature of family offices and examine what trends are likely to emerge globally over the coming years.

John Riches TEP, Partner at RMW Law and Chair of the roundtable, started the conversation by asking the experts what changes they have seen in this area of practice over the past few years.

EMERGING TRENDS

‘We’re seeing a progressive move away from the unilateral strategy typical of family offices five or ten years ago, where the patriarch or matriarch determined the strategy for everyone,’ commented Deloitte’s Head of Private Office Consulting, David Bowen. ‘There has been a progressive shift in mindset to focus on the next generation, and how they align the deployment of family capital with the way that capital was created: it’s a very different method and approach that is changing the role of the family office.’

Part of this change is reflected in the emergence of single-family office (SFO) collaboration in developing best practice. ‘In the US, family offices are quite cooperative with each other, and they are very frank about the issues that they are facing,’ said Matthew Sperry, Partner and Chair of the Global Private Client Group at McGuireWoods.

Sarah Cormack, a Partner at Mills & Reeve, said that she has seen several multi-family offices revert back into SFOs in recent years, as raising capital via co-investment had proved more effective for them.

Guy Beech, Business Development Director in Kempen & Co’s Family Offices Team, added that families regularly co-invest in areas such as real estate and private capital markets; however, there is still a role for the multi-family office as the hurdle for establishing an SFO capable of direct or co-investment continues to rise.

A further investment challenge for family offices comes with having multiple generations within the family, all of whom have an input into the decision-making process. Beech pointed out that often the principal’s investment decisions will be far more ‘deal-by-deal’, while from the second generation the family will be looking at longer-term or portfolio investment strategies. Here is where it is key to get an ‘alignment’ of interest.

‘The nuance for families is that financial success isn’t the only goal,’ added Daniel Trimarchi, Senior Manager in KPMG’s Family Business Consulting Team. ‘There may be socio-emotional or non-financial reasons for a family to be in business or invest collectively. If they have absolute clarity on what the family’s objectives are and the purpose of the wealth, you can create an investment strategy and, from that, a vision and culture for the family office.’

Trimarchi pointed out that the family’s purpose and the purpose of a family office are two sides of the same coin, and cannot be separated out; however, as the family office moves through different generations of a family, a consensus on that purpose and how it is embodied must be reached.

Without reaching this shared purpose, a family office risks a divergence of views: ‘The office needs a general level of consensus about where they’re heading and why they’re heading there,’ said Trimarchi. ‘Then if someone isn’t true to the values of the family, they can be brought into line in a non-confrontational way.’

Cormack agreed that a consensus within the family is vital. ‘Attitudes are very much shaped by where in the wealth cycle the family are: if they are the wealth generators, the next generation are business managers, and so on,’ she said. ‘As the family moves round the wealth cycle, the shared purpose becomes more and more critical.’

THE GENERATIONAL DIVIDE

Phil Le Vesconte TEP, Senior Director, SANNE Private Client, pointed out that, despite the importance of this shared family purpose, inevitably, the risk appetite will
change through the generations. ‘The first-generation business leaders or entrepreneurs are inevitably risk takers; the wider second and third generations may tend to be more concerned with preserving capital and thus favour a lower-risk investment approach, even though capital is spread more thinly as the number of beneficiaries increases.’

This risk appetite is also influenced by the level of engagement the younger generations have with the family wealth structure and their understanding around the role and purpose of the family office.

‘The whole issue of educating the next generations on the family office, including its governance model and structures, is critical to them understanding where the money comes from, and forming a strong foundation for successful family wealth succession and preservation,’ said Sperry.

Bowen agreed, adding: ‘It’s a process around empowerment and engagement, so that the next generation have the two-way flow of information about what they’ve got, why and what they will be responsible for, and so on. It’s important for developing a framework that helps to ensure they will be sensible stewards of the family wealth.’

However, when educating the next generation in becoming responsible members of the family office, including its governance model and structures, is critical to them understanding where the money comes from, and forming a strong foundation for successful family wealth succession and preservation,’ said Sperry.

Riches noted: ‘The question of how you keep the structure family-oriented is founded on the premise of engagement – but having family members working in the family office as employees also throws up huge numbers of issues about confidentiality and competence.’

‘As trustees, we get asked to talk about the family trust structure and how it links through to the family office. We will explain how it actually works, and we do it in tandem with the lead family who talk through the history of the family and how the wealth has been developed,’ explained Mark Fleming TEP, Director, SANNE Private Client.

‘Often, family members then go out into the world and build up their experience in a particular area, before joining the family business in that specific role.’

Cohen agreed that this understanding and experience outside of the family office is of vital importance. ‘If a member of the family can’t see the big picture, or can’t really find a place in the business, then it’s very difficult for them to run a capable family office.’ He went on to emphasise that if the family office sits too separately from the family then it won’t be trusted, won’t have the voice of the family and will how to stop them failing, that’s a much more positive approach.’

‘When you get to the third and fourth generations, you hope that you’ve passed on some of the values and the ability to run the business and oversee the family office,’ said Russell Cohen TEP, Partner at Farrer & Co. ‘But there’s a new challenge as the numbers in each generation increase: where does the influence lie? How do they determine who’s going to enjoy the benefits of the wealth? Who is part of the business? We have to find ways of helping them deal with those questions.’

BUILDING A BALANCE
A key part of meeting these challenges is through establishing a strong relationship between the family, advisors, trustees and other service providers, as well as within the family office itself.

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never properly represent them – but that if it is only made up of family members, there is a risk of a lack of experience and conflicting opinions.

‘Generally the most successful model is an independent professional family office with an overseeing board staffed with a good number of family individuals,’ Cohen said. ‘That’s where good governance comes in.’

Noel-Smith also pointed out the importance of in-office professionals being aware of their limitations in terms of institutional memory and expertise. ‘A good advisor knows when to bring in an expert to deal with specific issues, such as tax or succession,’ she commented. ‘A family office won’t function well with an in-house team which resists outsourcing.’

Rupert Howard, Partner at Saranac Partners, agreed. ‘Sometimes family offices are very transactional in how they relate to third-party providers. As a provider, you have to think about your proposition and what you want to offer, in order to create something long term and aligned.’

This approach on both sides is crucial to the governance framework of the office: ‘If you’re fulfilling various roles, for example if you’re both the trustee and the investment advisor, then you will have some conflicts to manage,’ said Anton Seatter, Director, SANNE Private Client. ‘From the service provider’s perspective, you need to be able to understand exactly what the purpose of the family office is and what your role in that overall structure is.’

COMPLIANCE IN A CHANGING WORLD
In turn, a robust and defined governance structure ensures that clients understand their reporting responsibilities, and provides the integrity that is required at a time when compliance is paramount.

Riches asked the roundtable participants how much time and energy they felt family offices are now devoting to international reporting standards such as the Common Reporting Standard, Foreign Account Tax Compliance Act and the EU’s General Data Protection Regulation.

‘The regulatory regime is becoming more intrusive,’ responded Howard. ‘Five years ago family offices did not need to have much regard for regulation or compliance. Now it’s very different.’

Howard pointed out that the constant state of flux around the reporting of beneficial ownership of assets internationally is causing much more complexity for families: ‘The reputational risk implications are making them really want to understand their data flows and who’s responsible for what. Many families now ask how they can simplify their structure and remain fully compliant, so they know the right information is going to the right jurisdictions, and they are not going to be in a position where a simple misunderstanding has far-reaching implications.’

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– Anton Seatter

‘You have to examine how well positioned you are for a crisis to occur. What are your administrative gaps, the implications in terms of your personnel, or the tax consequences if the unexpected happens?’ added Bowen.

On top of the compliance burdens now placed on families, the speed of legislative change and amendments to tax rules has a huge impact on structures.

‘Some family offices have ceased to become tax neutral overnight, and are on the back foot trying to restructure away from something that worked operationally and met the needs of the family, but is now catastrophic from a tax perspective. You need to keep alert and remain proactive to change,’ noted Cormack.

A FAMILY FUTURE
Looking to the future, Riches asked: ‘How can you engender that culture? And what will shape and change the way that family offices operate in the next few years?’

Several of the participants commented on the challenge with both family growth through the generations and greater global mobility. ‘As families are increasingly multinational, often with very different cultural frameworks, the family office’s role in keeping everyone as one unit is becoming extremely challenging,’ said Seatter.

‘And there is no one set structure in terms of alignment of interest,’ noted Fleming. ‘You have to take that into account when working through the generations on risk management-related matters.’

Cohen also pointed to increasing vulnerability of reputation: ‘Reputation is built up over decades and generations, and can be lost in a moment. It’s very difficult for us to envisage what the world will look like even in five years’ time, but I think we can see that it’s going to be increasingly transparent and dangerous for those family offices who aren’t proactive about reacting to change.’

For many of the experts around the table, the increasing trend of collaboration between family offices and professional advisors is a crucial part of preparing for the many legislative changes facing them on an international level. The willingness of professionals to embrace knowledge from others will allow them to put the client front and centre, while bringing all the necessary knowledge into the family office to support and engage the younger generations.