

Restructuring the family office

By Elise Coroneos

Keeping up with the Joneses can oftentimes be a struggle for small, one-family family offices. Finding the best strategies and resources with which to manage a family's wealth can take as much time and energy as actually executing the strategies themselves.

For such offices, the economies available to multifamily family offices cannot be mustered with as much ease. As the number of financial instruments grows and the ways in which they are used become more complex, a family with a traditional self-managed family office may find itself behind the eight ball.

To deal with this issue, small family offices have sought to professionalize their operations by bringing in human resources to deal with the increasingly complex issues. To get the most out of such a resourcing investment,

a host-family may look at the possibility of increasing the number of families being serviced by the office beyond itself.

Best of both worlds

Alan Houghton, managing director of Winter Capital International, a small division of the Citigroup Private Bank, says that there is a balance to be struck when restructuring a traditional family office. This balance is to maintain the spontaneity and flexibility in decision-making that is evident in small family offices while taking advantage of the efficiencies inherent in a larger structure.

"One of the reasons family offices have become successful is because they are responsive, they are creative and they are customized to the client," says Houghton. "So you don't want to become too bureaucratic so that nothing moves unless it goes to a committee."

Houghton runs multimanager and strategic investment portfolios for high-net-worth clients and families who want to outsource their investment function. In addition, he is the nonexecutive chairman of the Market Street Trust Co, his own family's family office. It is a professionally run office with a board of directors and a 20 person staff.

Houghton has developed an acute awareness of the challenges faced by family offices seeking to become more commercially oriented. These challenges include finding the right people to complement the values and skills of those in the existing family office, and developing governance structures and

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Small family offices have several options when they want to upgrade their operations.
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SunTrust Banks buys Florida family office

Atlanta-based **SunTrust Banks, Inc** one of the top 10 US banks by assets, recently acquired the holding company for **Asset Management Advisors**, the Jupiter, Florida-based family office, with some \$1 billion in managed assets. SunTrust, has some \$138.4 billion in trust assets under management. The amount of the transaction was undisclosed. AMA, which was founded in 1987, has



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◀1 technical systems to deal with strategic planning and reporting on an ongoing basis.

"You need to find the right balance between having formalized structures so you know whom you are accountable to, but do it in such a way that you still maintain quick decision-making," says Houghton. "It is just a way of having checks and balances for major strategic, business or operational initiatives."

Strategic changes

One of the critical issues for a family office taking the step to professionalize is to decide what it wants to be. This will allow the family to put a strategic plan in place that will allow implementation to be achieved with relative ease.

"One of the key things I tell anyone who has a family office or is starting a family office is that you've got to step back and strategically decide what you want to be and how you are going to get there," says Jonathan Carroll, senior vice president of Asset Management Advisors Inc, a Florida-based firm that serves about 25 families.

The options before family offices include whether to take on external family clients, and if so, how to charge for services. Decisions will need to be made regarding whether services are going to be competitive with the outside world. In this regard, questions may be raised about whether to become a for-profit entity, a not-for-profit entity or a lowest cost provider.

The family will also need to decide in what disciplines it wishes to hire professionals, what kinds of people it wants to hire, and how much it is willing to compensate those people. To make sure that the family's wealth stays in the family, says Houghton, it is important to take the time and pay the money to hire the right people.

In most cases, this will mean going beyond hiring people who are trusted by the family, and instead bringing in professionals who also have capabilities in different sectors of the market—asset allocation, manager selection and reporting of systems. "I think that quality of investment talent is critical," he says. "And the reality is that a lot of people get what they pay for. To get good people can be expensive."

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This is particularly the case in hiring professionals who are multidisciplinary, in the areas of, say, investments and tax structure. "They don't have to be the experts in every area, but they have to know enough that they can ask the right questions," says Houghton.

Granting autonomy

Once a traditionally managed family office has been restructured with the addition of professional staff, says Houghton, how the change is executed is as important as making the change itself. For example, it is likely that professional staff will expect autonomy to be granted to them to make decisions at a certain level. If autonomy is orally granted at the time of interview negotiation but is not forthcoming in reality, discord may emerge between the old guard and the new blood.

After the investment of hiring a professional outsider has occurred, it is important to make sure that person feels like he is valued and trusted. According to Houghton, the granting of real and effective autonomy will go a long way toward achieving this end.

"A lot of people want someone to execute for them, but never give the hired professional the autonomy to make decisions," says Houghton. "That is really critical for moving beyond the patriarch or matriarch family office model."

In addition to granting autonomy, it is also important to ensure that a newly restructured and expanded family office is kept accountable. According to Carroll, this will involve putting governance structures in place and systems for reporting purposes.

"This is important as you move

toward multifamily offices where you become fiduciaries for unrelated family entities," he says. "A lot will depend on how formal a family wants to become, some families will be very formal and they have a governing council which meets on a quarterly basis."

To that end, professional staff may expect to be included on a board of directors that has, until then, been the exclusive domain of family members. It is in the interests of the family to have outside directors on its board. "The one thing you don't want is for staff or family members to be operating in a vacuum," he says.

"For issues such as systems, consolidated reporting, custody and diversification in investment products, an advisory committee can be very helpful in augmenting what the staff does in a family office."

What about outsourcing?

As an alternative to bringing in increased resources to fill the gaps evident in a family office requiring multidisciplinary functions, some may opt to outsource those functions. The decision whether to execute a function internally or outsource it to an external supplier on a fee basis is a big issue for many family offices.

One firm that has seen the need to provide family offices with a viable outsourcing alternative for investment management is Pittsburgh-based Peregrine Advisers. The firm, which has until now operated as a search and selection specialist for alternative investments, has partnered with its family office clients to put together a hedge fund of funds. Called the Osprey Hedged Equity Partners, it is due to be launched in mid-May with \$80 million in capital.

According to Peregrine Advisers president Larry Letterio, the product is the first stage in building a family office consortium, with his firm executing the statistical and due diligence functions. Families receive the benefits of professional knowledge and investment management experience while not having to invest in, maintain or manage the people or systems required to make it happen.

Letterio, who founded the firm in 1992, says this is appealing to family offices that acknowledge that 24▶

STRATEGIES

◀10 pretax profit from the service.

Based on this analysis, Datamonitor says there are unlikely to be enough customers in the mass affluent market for all the competitors launching into it to gain the customer base they are aiming for. Its forecasting shows that there will be 2.3 million individuals with liquid wealth of between £100,000 and £500,000 by 2004 in the UK.

Assuming that 100% of these individuals use mass affluent services, this leaves room for only nine players the size of operators such as the Lloyds TSB's Create wealth management service to be in this

◀22 investment search and selection is a fulltime job requiring a lot of experience. "A person with the education, experience and time to find a particular hedge fund with a certain correlation is not necessarily housed in a typical family office," says Letterio.

"And because we are partnering with these families, as opposed to being a

◀20 keter shortly before he turned Berger in to the Securities and Exchange Commission.

Sources familiar with Schilling and the third-party marketer claim that both men openly discussed the plight of the fund with investors and other interested parties at least seven months before Schilling called the SEC.

Just as the suit accuses Bear Stearns of allowing the fraud to continue because it was in the firm's interest to do so, this third-party marketer was similarly situated. According to a source, this marketer brought some \$240 million in

market.

Datamonitor says that Germany is forecast to be slightly larger, and could support 10 players of Create's size. In France, however, there will be room for only seven large players; in Italy, six; and in the Spanish market, only three competitors each with a customer base of 250,000.

These figures, says Datamonitor, assume that 100% of the individuals with liquid assets between \$144,000 and \$718,000 will use mass affluent services; and none of these 2.3 million individuals will choose to be served by the

cost center to them, they are getting the best of all possible worlds. They have a certain amount of control because they are our partner, and they simply allow us to do what we do best."

While some may argue that outsourcing requires a family to compromise a certain level of privacy, Houghton says it is simply a trade-off. "It is a question of

assets into the fund in 1998 and 1999. At least \$100 million of that was brought in after the fund's problems were fully understood.

Despite the actual condition of the fund, however, this marketer continued to bring in investors and was allegedly receiving 3% of assets under management at the fund plus 25% of all fees, says the source. In addition, this marketer controlled two affiliated broker dealers that were billing the fund as research providers and receiving between \$140,000 and \$200,000 a month.

current range of premier services in the market.

The likelihood that both of these assumptions will be true is slim, says Datamonitor. Therefore, it concludes, mass affluent services may be looking at an even smaller market than this analysis supposes.

Datamonitor notes that Abbey National's Inscape may have already encountered problems in the UK's mass affluent market. In mid-March, the company stated that it was considering lowering its £50,000 liquid asset threshold to £20,000. +

whether you want to be in the relationship business or the people business," he says.

"The problem with some family offices is that as they grow they tend to add internal bodies, and it may be better to simply focus on maintaining relationships with advisors rather than having to deal with hiring and firing." +

"There was a discussion about the assets actually in the fund, about \$60 million, compared to what was being reported, which was between \$380 million and \$420 million," the source says. "Everybody seemed to have the same idea about the figures, showing how poorly the fund was doing at that point."

"They said the fund had significant losses and they were implying that it was effectively running only as long as fresh money came in," the source says. "Fred [Schilling] was very aware of the fraud." +

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Managed Account Reports, LLC

220 Fifth Ave., 19th Floor
New York, NY 10001-7781
United States of America
Tel: (212) 213-6202
Fax: (212) 213-1870
<http://www.marhedge.com>

President

Greg Newton
email.grenewton@marhedge.com

Editorial

email.cull@marhedge.com
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Conferences

email.conf@marhedge.com
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Subscriptions/Marketing

email.subs@marhedge.com
Marketing Manager
Gina Dzurenda

European Operations

International Business
David Setters
Tel: +44 (207) 827-9977
Fax: +44 (207) 827-5236
Publication Consultants
Leon and Jay Rose
11720 Woodelms Way
Columbia, MD 21044
Tel: (410) 730-5339
Fax: (410) 730-3873
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