



## COMMITTEE REPORT: HIGH-NET-WORTH FAMILIES & FAMILY OFFICES

By **Patricia M. Soldano** & **Kathryn M. McCarthy**

# SFOs Evolve as the Landscape Changes

Converting to multi-family offices is just one of many options

**B**y nature, each single family office (SFO) is unique, serving a range of functions from investment strategy and implementation to family management and more. Devising the precise approach and design for each SFO is crucial to ensure its success today and for future generations.

The SFO faces a transformational time as it tries to continue to have the scale to provide additional and more sophisticated services amid a sea of compliance requirements and the rising cost of attracting and maintaining talent. Add to that the age of the SFO executive, who's nearing retirement, and the question of succession arises.

### Prior Landscape

A dozen years ago, the landscape in which the SFO worked looked less complicated. The top-of-mind concern centered on defraying costs of the growing needs of the multi-generational family office run by an executive in his prime. SFOs dealt with this concern in a few ways.

**Taking on non-family clients.** Many assumed the logical way to address these concerns around cost was to take on outside clients.

Then—as now—the SFO's investment staff had more ideas than dollars at hand. Many wealthy families hoped that sharing the costs of their office services with other high-net-worth families would defray costs and retain professional staff. Naturally, taking on non-family clients

seemed appealing and profitable.<sup>1</sup>

Sharing of costs and pooling of talent and competencies are often prime motivators for SFOs to take outside clients, says François de Visscher, a consultant and advisor to family offices on direct investments, at de Visscher & Co. in Greenwich, Conn.<sup>2</sup>

**SFO to MFO conversions.** Although a number of SFO to multi-family office (MFO) conversions took place, in many cases, the transformation took much longer and was more disruptive than anticipated. The rather straightforward solution came dotted with pitfalls.

Converting an SFO to an MFO had the obvious trials of adding staff, infrastructure and formal reporting procedures, along with required registration with the Securities and Exchange Commission as an investment advisor. Less obvious hurdles included a change to the culture of the SFO.

For some family members, going from an SFO to MFO environment can feel a lot like spending the weekend with a group of strangers in bad weather.

Additionally, few SFOs have cultures conducive to working with diverse, non-family clients. Existing personnel often lack the experience needed to handle multiple families.

Infrastructure and process issues can become so significant that a newly formed MFO not only doesn't reduce costs to the founding family, but also actually increases them.

Fast forward to today, and the question remains: Is conversion from an SFO to an MFO the most optimal or preferred option as the SFO looks to secure its viability?

Although the cultural differences remain between the SFO and the MFO—as do most of the pitfalls that befell conversions—a different environment has emerged replete with new directions for the SFO concerning the shift from simply cost-cutting to obtaining services for the ever-increasing number of family members.

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## A Different Direction

Today's evolving SFOs are taking a different direction from those of the past by looking for options other than converting to MFOs. For example, they're forming joint ventures, taking on other clients in limited areas such as private equity investments, merging into private banking divisions with "family office" services groups and sometimes simply handing over the keys to the SFO to a commercial MFO.<sup>3</sup>

Some emerging trends include:

**Consortia of SFOs.** A 2016 article in *Bloomberg* reported on a consortia of SFOs working together, such as Bill Gates' family office, Cascade Investment.<sup>4</sup> Cascade has joined with two other family offices to back a group of New York-based buyout specialists to source deals for them.

This move to partner with other family offices is an emerging trend, according to de Visscher. His firm's network, Family Capital Partners, is comprised of 400 SFOs around the world interested in partnering with other families on direct investments. This partnering is handled in one of three ways, he says:

1. An SFO partners with another family as a co-investor in this family's legacy business.
2. An SFO teams with another SFO on a new investment.
3. An SFO leads a syndicate offering a direct investment to other families.

"Single-family office consortiums are in a small corner of the single-family office universe," writes Russ Alan Prince in *Bloomberg*. "These consortiums are proving to be very capable investors by leveraging their connections, expertise and vast wealth. Many of them are formalizing their relationships by establishing investment funds."<sup>5</sup>

In fact, investment expertise, particularly in private direct investments, has led some families to adopt a hybrid SFO/MFO approach. The SFO is open to outsiders for specific investment services only. But, this route has a big downside, as de Visscher notes:

Too many times we've seen family offices sourcing direct investments opportunistically without a sound strategy and without the adequate resources to execute and monitor direct investments ... Direct investments also require a proper governance structure allowing the execution and subsequent monitoring of the direct investments.<sup>6</sup>

Families who assess their needs and motivations for a family office often find creative solutions for their SFOs.

**Global wealth management firms.** Global wealth management (GWM) firms have emerged to serve multi-jurisdictional families looking for global investment and wealth management solutions.

These families may have their own local SFOs, but aren't able to attract or afford the investment talent needed for the investing solutions they wish. The global, multi-jurisdictional climate, for example, is much more restricted and regulated and requires knowledge, experience and money to navigate. Or, these families may not be interested in managing or operating a fully staffed family office business and so would consider having the GWM firm do that for them.

While a GWM firm can be a full service family office, it doesn't intend to encourage or solicit concierge services or pay bills. Its focus will be on attracting families interested in leveraging its global investment and wealth management expertise.

## Creative Solutions

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SFOs. Here are two recent examples in which thinking it through and knowing the SFO/MFO landscape has led a family to the right solution.

**Solving the multi-generational SFO quandary.** An SFO established by the first generation (G-1) often faces a different landscape when the family grows. G-1 family offices often must overcome the challenges of many family members with diverse needs and develop possible solutions.

**Example:** G-1 formed the SFO, which worked as an efficient operation with a significant \$200 million asset base.

Most SFOs face the issue of viability/sustainability at some point.

After 25 years of having a well-maintained SFO for G-1 and the second generation (G-2), the issue of whether it made sense to provide services to the emerging adult third generation (G-3) became a reality. The family considered taking on investment-only outside clients. The investment record was very good, and the family wealth was actually created in investments. However, G-3 actually rejected the idea—much to the relief of their parents who didn't want the responsibility of running an investment business at their stage of life.

G-3 also concluded that their children (G-4) wouldn't need an SFO and that they didn't want to manage an SFO anyway.

Then the quest for the right solution started. Should they go their separate ways? Who'll provide the ever-increasing personal services for the aging patriarch? What about the family limited partnership? The family foundation?

So, this family took a big leap forward and merged into a commercial MFO.<sup>7</sup> This was the first time this particular commercial MFO took over responsibility for all of the family office services—including the family archive project. The firm was a private investment company with some wealth planning services. However,

chances for a successful integration were good with some very detailed planning. For example, a line was drawn at taking over the personal lifestyle services for the patriarch. In addition, G-3 family members took over responsibility for managing the family vacation compound. A compromise was reached on the patriarch's care with a retiring trusted employee willing to assume the majordomo role for the patriarch.

**Designing an SFO with an MFO future.** SFOs established by successful hedge fund, venture capital and private equity managers have increased significantly over the last decade. They aren't the traditional multi-generational offices of the past. In fact, many don't have G-2s or G-3s involved in the business.

**Example:** A well-known hedge fund manager established an SFO after closing his fund. Being an analytical type and familiar with investments and financial services, he surveyed the marketplace for best practices, pitfalls and alternatives to setting up his own SFO. The SFO was, in reality, the default option.

In reviewing his wealth management options, he soon realized that he would be a difficult client and needed more flexibility than most MFOs or wealth managers offered. Part of his decision to go it alone was his view that the SFO could only thrive if he built it to eventually take on outside clients with similar interests to his own.

Investments were at the top of the list and philanthropy a very close second. So, this family planned to organize itself to take on other like-minded families from the beginning.

The SFO was set up with state-of-the-art technology systems, establishing commingled investment funds, which would eventually have performance records, establishing a philanthropy group and joint venturing with an art advisory group. The idea was to operate for a couple of years and then become an MFO. This certainly isn't the historical conversion path of SFO to MFO, but happily, his theory is working out, and outsiders are interested. For other examples, see "Solutions for Small MFOs," p. 67.

### Some Final Thoughts

Most SFOs face the issue of viability/sustainability at some point. It's clear that converting to an MFO isn't the only option today. As we've seen, there are many



## Solutions for Small MFOs

*Examples of how they addressed their challenges*

Small multi-family offices (MFOs) face challenges similar to those faced by single family offices. Here are three examples of how MFOs successfully accomplished their goals.

- To provide more sophisticated investment options, one small MFO, which couldn't attract the talent needed to do so, sold to a bank-owned MFO. This move also provided the needed succession for the firm and the scale to deliver broader, deeper services, such as governance and education, which the clients requested. In addition, the larger MFO could provide the capital needed to grow the business and provide resources for regulation and compliance.
- A small registered investment advisor (RIA) firm, which only provided investment management, merged into an MFO in exchange for ownership to provide for firm succession and succession of senior management, as well as more capital and resources. Employees of the small RIA became employees of the MFO, and clients joined the merged firm as well. As part of a larger firm with resources other than investment management, clients of the small RIA had access to services that they heretofore hadn't been able to secure.
- A small MFO joined a larger MFO/holding company firm to provide for expansion opportunities and resources. The small MFO maintained its firm name, identity, client experience and services. This relatively seamless transaction allowed the small MFO to keep its "brand," the same service team and the high touch services to which the clients were accustomed. At the same time, the larger holding company structure allowed for human resources services, marketing, capital and other resources that could connect all the merged firms together to share intellectual talent.

— Patricia M. Soldano

alternatives if the family and the family office executive assess needs carefully and think creatively.

Will there be more mergers of SFOs into wealth managers like William E. Simon & Sons into Massey Quick & Co. LLC, a wealth management and investment consulting firm, to create an MFO? "For the past 29 years, our family has entrusted us with preserving its financial health and legacy for generations," said Peter Simon, co-chairman of William E. Simon & Sons, in a press statement. "With the growth of our extended family, we have looked to partner with a firm that shares our

approach and world view. Massey Quick's investment capabilities and stellar reputation makes it an obvious choice as we begin a new era for our family."<sup>8</sup>

Will SFOs actually be sold to institutions as Liz Nesvold, Founding Partner of Silver Lane Advisors, mentioned in an interview for the *Family Wealth Report*? "A single family office with only one client family is clearly difficult to value." Liz went on to say, "The discussion really needs to begin with culture/values and then pivot quickly to capabilities. If the cultures don't mesh, the deal will never work. After that, it's more of a strategic discussion—how can you help me grow my business and vice versa? If the cultures mesh and you have a shared vision for growth, ok now we can talk about how we share the rewards among all the constituents."<sup>9</sup>

It's hard to say. What new directions SFOs will take in the quest for sustainability is difficult to predict. We know that SFOs face a more rapidly changing internal and external environment than they did a dozen years ago. We're confident that there will be many more and better solutions than before. Beyond this, we'll all have to wait and see. 🌐

## Endnotes

1. Patricia M. Soldano and Kathryn M. McCarthy, "SFO to MFO Conversions," *Trusts & Estates* (August 2005), at p. 44.
2. Interview with François de Visscher by Kathryn M. McCarthy (June 9, 2017).
3. Commercial multi-family offices generally don't trace their roots to a single family office. Rather, they're started by groups and institutions with the goal of serving a number of families and individuals from inception.
4. Miles Weiss, "Gates's Cascade Gets Deal Leverage With Bespoke Buyout Venture," *Bloomberg* (September 2016), [www.bloomberg.com/news/articles/2016-09-27/gates-s-cascade-gets-deal-leverage-with-bespoke-buyout-venture](http://www.bloomberg.com/news/articles/2016-09-27/gates-s-cascade-gets-deal-leverage-with-bespoke-buyout-venture).
5. Russ Alan Prince, "When single-family office consortiums create their own investment funds," *Bloomberg* (May 2017), [www.bloomberg.com/professional/blog/when-single-family-office-consortiums-create-their-own-investment-funds/](http://www.bloomberg.com/professional/blog/when-single-family-office-consortiums-create-their-own-investment-funds/).
6. *Supra* note 2.
7. *See supra* note 3.
8. [www.prnewswire.com/news-releases/massey-quick-and-william-e-simon-sons-announce-merger-300441570.html](http://www.prnewswire.com/news-releases/massey-quick-and-william-e-simon-sons-announce-merger-300441570.html).
9. Liz Nesvold's interview with Joseph Reilly, "EXCLUSIVE INTERVIEW: Talking Wealth Management M&A With Silver Lane Advisors," *Family Wealth Report* (Feb. 28, 2017).