

Helping Your Clients Evaluate a Multi-Family Office

Multi-Family Offices: You're hearing more about them - can you recommend one?

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The family office, a product of the early twentieth century, is rapidly evolving in response to a number of factors: the turmoil from the recent consolidation and personnel changes in financial services firms, a heightened sense of the need for improved risk management and objectivity and the high cost of attracting and retaining the professional talent needed today to advise and serve family members on a wide range of issues. Just a couple of decades ago a fortune of \$50 million was more than sufficient to justify directly employing a staff of accountants and investment managers to keep

track of the family finances, including the holdings of various trusts and foundations. Today, the “break even” point is closer to \$250 million and climbing. Hence, many former single-family offices have grown into multi-family offices (“MFOs”), offering unrelated families the ability to share a CFO, CIO, tax professionals, and experienced administrative staff as well as

valuable intellectual and technology resources. In many ways it has parallels to the emergence of fractional jet ownership as high net worth individuals ask, “Given my needs, would I rather own all of a single engine plane or a share of a private jet? And, would I like to pay someone else to worry about hiring the people to fly it and care for it, handle security, do the safety checks, update the insurance and all the other hassles of maintaining a group of personal employees?” Similarly, contracting for a “share” of the staff at an established MFO often can securely provide access to talent, processes, intellectual capital and systems that simply cannot be justified at lower asset levels.

Defining the MFO

Currently, there is no agreed upon definition for an MFO. Recent surveys of the field have listed some typical characteristics: a broad range of services, a high level of personal attention and the ability to put today’s decisions in the context of their impact on the next generation rather than on the next quarter. Services can include those of a typical wealth management firm - financial, estate and tax planning, investment consulting and manager selection - along with those of the traditional family office - bill paying, financial reporting, tax compliance, trust monitoring, charitable consulting, family counseling, and concierge services.

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Meeting Your Clients' Needs

Your clients may consider using some or all of the services of an MFO when there is a change in their lives or in the lives of their key advisors and they:

- Need to manage their cash more effectively
- Need to be sure funds are available even in difficult times
- Want to avoid wading through the often confusing and conflicting information provided by bankers, brokers and other advisors
- Want the financial information they receive consolidated and organized differently to better manage investment decisions, or
- Need objective, professional advice to decide what will best fit into their current asset allocations or estate plans.

Whatever their needs, they want it done securely, competently and conveniently with people they trust.

Meeting Your Needs

You may have been asked to provide advice or arrange for services in areas that are not part of your firm's normal offerings. It is often difficult to price a response to such requests that is fair to both you and your client due to the need to devote higher-cost talent to a "one-off" transaction or service than would be required if procedures for it were standardized and could be leveraged. A referral to a third party is the logical alternative but carries its own set of risks. Demonstrating some level of "due care" in selecting providers can protect you and your firm's reputation.

The Financial Management Component

In order to effectively handle their finances, your clients will be entrusting all their personal data to an organization they don't know well. In addition they will be asked to sign a number of complex forms giving the MFO they choose various levels of authority over the movement of their money and securities. "Trust me" will not usually be enough to assuage their discomfort under these circumstances. Criti-

cal inquiry, carefully verified is a necessary first step. In our experience, that inquiry falls into five broad areas:

- What services will the MFO provide?
- Who are the entities and/or people who will provide those services?
- Does the firm have clients whose profiles and issues match my clients'?
- How does the firm protect its clients' privacy?
- What are the conflicts of interest in its advice?

The scope of services available can range from simple cash management and bill paying to intensive family counseling on values and mission statements. Clearly outlining all the services to be provided, in writing, will avoid confusion later in the engagement. Full disclosure of any services to be provided by third parties should be part of that written initial communication.

The people providing these services are often the most critical factor in client satisfaction. Meeting the people who are marketing the MFO is not enough - you want to know the people who will be involved in the day-to-day handling of your clients' finances, their experience and how much capacity they have to take on additional

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clients. For those services that are outsourced, you should understand the reasons for outsourcing and what criteria were used in selecting those third party providers. You also need to inquire about the firm itself. Its ethics, size, longevity and financial strength are prerequisites to attracting and retaining the kind of talent that will meet your clients' growing needs over time.

Even if people are talented and motivated, if they are working on an unfamiliar issue they may be less cost-efficient. That is one reason clients want to know that their MFO is working for "people like us". For example, if the efficient use of a family limited partnership is an option they want to consider, it would be important to know that the firm has already been through that analysis with at least one other client. Beyond that, clients want to know that they are neither the firm's wealthiest nor its poorest client. If they

are too big, they worry they will not be able to have all their issues addressed competently; if too small, that they will not be important enough to command attention.

A critical measure of an MFO is the passion with which it guards its clients' privacy. This can be reflected in the background checks that are part of its hiring process, confidentiality agreements required of employees, the lengths to which it goes in limiting access to personal data among its staff, the security it has employed on computer networks including encryption

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of all personal data on servers, its policies on disposal of information and the procedures it has in place for storing data electronically rather than on paper. It is also reflected in the confidentiality agreements it has with third parties to whom it outsources and the due diligence it performed in selecting those providers.

Finally, to the extent an MFO is providing advice, clients want it to be objective. Full disclosure of all the MFO's sources of revenue is a starting point. You need to know how that may result in potential conflicts of interest and how those conflicts are disclosed and managed. Also, to the extent the MFO will be privy to a client's planned securities transactions, you should examine the procedures it uses to monitor its employees' trades to avoid even the appearance of potential profit from that information.

The Investment Component

In addition to keeping track of your clients' finances, many of today's MFOs will provide investment advice often coupled with an "open architecture" access to unaffiliated managers. If investments are among your clients' concerns, you will want to understand the MFO's investment process, manager selection resources and potential conflicts of interest. The firm's Investment Adviser Registration Form ADV usually addresses these issues in rather broad terms. Issues you should explore more deeply include:

- Is there a written investment process? Is it consistently applied to all clients?

- What does a typical Investment Policy Statement look like?
- Who are the individuals responsible for personalized strategic asset allocation and risk evaluation? What are their credentials and experience? What resources are available to support their work?
- How do they help choose managers and/or evaluate outside consultants for this role?
- What role do alternative investments play in their process? What access does the firm have to private equity, hedge funds, etc.?
- How is investment performance monitored and communicated? What does a typical statement look like?
- Can you receive independent confirmation of transactions and balances? Will the firm work with custodians you choose? Are any client funds commingled?
- What is the fee structure and how does it impact the firm's objectivity? For example, if fees are based on a percent of assets under management, would you be advised to pay off a mortgage or use passive investments for a portion of the portfolio, thereby reducing its fee?
- Does the firm endorse the Prudent Investment Practice Standards published by the Foundation for Fiduciary Studies?

Looking Forward

You and your clients seek help you both can trust. Beginning a relationship with an MFO (or changing one) represents a significant expenditure of time and emotional commitment, along with a not insignificant monetary cost. It is important to get it right. Increasing your confidence in your choice through objective standards can supplement your sense that the "chemistry" of the people with whom your client will be working will last a long time. The next time you are asked to look for an MFO, suggest to your client that he or she think about the relative importance of obtaining the right answers to the questions that follow.

For additional information on this topic, please contact Susan W. Sofranos at 212-583-6001 or ssofranas@gellerco.com

10 Questions for Your Potential Family Office

1. *Scope of Services*

Of all the things listed in your marketing brochure, which ones will you do for me? Will that be in writing? Can I see a sample engagement letter? What portions of it are done by your firm and what is outsourced?

2. *Primary Contact Team*

Who will be my primary contact? Who are the other “team” members? What are their credentials and experience? What were the background checks you performed before hiring them? How many other clients do they handle?

3. *The Firm*

What is the firm’s history? How long has it been in business? How is it owned? What other companies are affiliated with it? What do they do? Can I see an organization chart? How diversified is its revenue base? Is it financially strong? What professional liability coverage do you carry? Can I see it?

4. *Clients*

How many clients does the firm have? What is your typical client like? Age? Net worth? Occupation? Can you provide references? How do you measure client satisfaction? Have you lost clients? Why?

5. *Experience with My Issues*

One financial issue that we need to resolve soon is _____. What have you done for your other clients in this area?

6. *Confidentiality*

What procedures do you have in place to maintain the privacy of my financial information? How many employees have access to this information?

7. *Security*

How secure are your computer systems? Are paper files scanned and archived? What is your disaster recovery plan? How do you control the security of those portions of my work that are outsourced? Are there confidentiality agreements with those providers?

8. *Potential Conflicts*

Other than the fee I may pay you, what are your other sources of revenue or indirect compensation that result from advice you give clients? Do you refer clients to affiliated companies? How does your fee structure create potential conflicts? What other conflicts of interest do you have?

9. *Communications*

What methods will you use to report on my progress? How frequently? Can I see sample reporting packages? How is performance measured and reported? How much of this will be accessible online?

10. *Verification*

Are your activities subject to government or industry regulation? If you provide investment advice are you registered with the SEC or the states? What written policies and procedures have you established to satisfy your regulatory requirements? Can I see them? Can I receive independent confirmation of balances and transactions from custodians I choose? Can I visit unannounced to see how the office works - to see how client information is being protected, how secure blank checks are, how the things you say you do and the way you do them are in fact being done?