

## Governance in family offices - Part 1

### **Russell**

My name is Russell Prior and I'm the Regional Head of Family Governance, Family Office Advisory and Philanthropy for HSBC Private Banking in EMEA. And I'm joined on this video by my colleague, Andra Ilie, who's a Senior Adviser in the regional team. Welcome to part one of our video series on governance in family offices. In this first part of our video series, we're going to cover some of the basic concepts around family offices, why they're used, and why we believe they're here to stay.

### What is family office?

### **Andra**

There is no clear definition of what a family office actually means. And an interesting way to look at it is if we go back in time, back to king's court stewards or perhaps later on to British landed estates. We tend to see one or more individuals that are around a family of notable wealth, that would be looking after it. So they would help with the management of the wealth and other affairs for the family, which I suppose in its simplest way is what a family office is.

### **Russell**

But I think as we look at things more in the modern environment, actually the confusion and complexity around what the term 'family office' means has continued to increase even more.

So I think if we look at issues like there is no single service definition for what a family office provides, there's no single definition of what a family office is. Today we see the complexity around things like single family offices, multi-family offices, virtual family offices, embedded family offices. And even the single family office concept isn't simple because it ranges for anything from a small tightly managed single family office to a huge institutional level family office.

And if that isn't bad enough the range of legal entities in which family offices can be formed is vast and in the international environment across different jurisdictions. Again, we're seeing slightly different approaches. And that's before we even get onto the topic of regulation, which I know will come back on, because again, we're seeing regulatory approaches develop differentially internationally as well.

### Why establish a family office?

#### **Andra**

There are many reasons why families or individuals might decide to establish a family office and whilst no two single family offices or any other types of family offices are the same. Typically you would have some sort of a transition element. So to use an example, if you look at your typical entrepreneur, he or she, they establish a business, they grow it successfully and then they end up selling it, the resulting wealth and the challenges that come with that accumulated surplus wealth are completely different to the ones before. So before the entrepreneur would be concerned with how to run and operate that business. Whereas now in the context of this huge pot of wealth, because a lot of the times the amounts are vast, are completely different.

So some individuals in answer to these challenges might decide to establish a family office and like this they would bring in a team of experts to plug in those gaps around knowledge and expertise.

## **Russell**

And as you think about how they go about that, it's I think really important that three or four critical points are covered. The first one is to absolutely be clear on the need for the family office as you say. I think the second one is actually what is it going to do? What is the scope of activities? And if you can clarify those two things, then it becomes about, is there a clear plan for the establishment of a family office? And finally, and clearly in relation to the topic we're talking about, has the governance, the management, the risk management and the oversight been considered for that family office?

What are the benefits of establishing a family office?

## **Russell**

When we come to consider, what are the benefits of setting up a family office, I think it's a really interesting topic because some of the benefits I think are quite broad in concept. So it's about things like focus, control, privacy, management of risk. But we also hear a lot of people setting up family offices talking about the benefits of flexibility and agility.

But it's also, I think, really important we recognise what are some of the potential issues around setting up a family office. And I see these perhaps falling into two or three areas. I think the first one is to understand the costs. I think the second one is to recognise that there are concentration risks. And the third one is to recognise that you are running issues around what I call expertise risk, and perhaps I'll just briefly cover those. I think the cost ones are quite straightforward, it's about you know, adding up the bills and seeing what it costs. When it comes to the concentration risks however, what we have to recognise is that in setting up a single family office for instance, you are

concentrating all of the risks in that small unit and the small team that are managing it. And if you think about the way the risks will be managed if you were working with a big external organisation, clearly they have all of the benefit of being huge and all of the resource they can bring to it, so concentration risk, I think is important. And then if I come back to the final one of those three, which is around the expertise risk, it's about recognising the level of expertise you need to have across the broad range of things the family office will need to do and recognising whether you've got the levels of expertise in that team of people that you would have if you were using big external service providers.

**Andra**

That's really interesting, one point that jumped to me is one of the families said to me at some point that the reason they wanted to establish a family office was to protect their unborn children against future risks. So I think that has really hit home with me.

**Russell**

Yeah, absolutely.

Has there been a notable shift in the number of family offices over the years?

**Andra**

It's actually very interesting because there has been a notable shift in family offices and more generally in numbers. So if we go back to 2019, according to market research and again, I'll have to pause here and say let's remember there is no clear definition of what a family office actually is, the numbers were set at about seven and a half thousand which was already a 40% increase over the last two years.

Now if you ask “why has this increase taken place?”. There's a number of reasons, so there's about three or four reasons. The first one I think is to do with the fact that there's been just a general increase in global wealth, again, looking at research and statistics out in the market in 2021, there was a shift of about nine and a half percent just under that in the number of ultra high net worth individuals. And they are defined as people with a net worth of over 30 million dollars.

It's also expected that the numbers will increase even further and by 2026 we're expecting something around 800,000 of these individuals. So with this increase in levels of wealth their complexity and need for services such as those provided by family offices will arise. Secondly there has been an increase in levels of professionalisation of family office hubs across the world. So we know North America has the largest amount of single family offices, but centre such as those in Asia. So Singapore and Hong Kong are coming through Latin America, Europe with the UK, Switzerland, Monaco and others. Greece has recently released some legislation in this space. It's attracting individuals to establish these structures. And I think probably the last reason is to do with the change in demographics and also in the lifestyle of people. So we've all heard of the great wealth transfer, where the silent generation and the Baby Boomers are expected to pass tens of trillions dollars to the next generation. Again, what are these people going to do with all of this wealth? They are going to need help and support.