

EXCLUSIVE ROUNDTABLE: FAMILY OFFICES FACE REGULATORY STORM

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Family offices and wealth management firms are analyzing solutions to proposed Securities and Exchange Commission and Congressional regulations that could potentially rattle the traditionally secretive market. PAM Managing Editor Kristen Oliveri recently hosted a roundtable featuring Tony Guernsey, national head of wealth management for Wilmington Trust; Jamie McLaughlin, ceo of Geller Family Office Services; **Carol Pepper**, ceo and founder of multi-family office **Pepper International**; and Loraine Tsavaris, managing director of Rockefeller & Co. Although they agree that firms need to prepare themselves, some doubt that regulations will be adopted, and others see an opportunity for single- and multi-family offices to collaborate in their wake.

PAM: There's been a lot of talk from regulators about enforcing 'fiduciary responsibility.' What is it and is there a difference in how different types of managers apply the standard?

Pepper: I think fiduciary responsibility is really looking at yourself as a trustee of your client. We all have a duty to know the customer and to make sure you are giving them investments that are appropriate for their sophistication level, wealth level and risk tolerance. So even if you're a broker selling securities to receive commissions and fees, you're still supposed to act in a fiduciary capacity.

Tsavaris: The word "fiduciary" is not in the Investment Advisor Act but it's the congressional intention that deems investment advisors fiduciaries: to put clients first and act with utmost good faith and to provide full and fair disclosure and to not mislead clients, and to disclose and seek to minimize conflicts that could affect the client. If you're a nationally chartered trust company, you're regulated by the [Office of the Comptroller of the Currency], if you're a state chartered trust company, you're regulated by the state. The most regulated are the trust companies.

Guernsey: The problem is that it's hard [to enforce.] What you may be doing today may be very different from what you do 30 days from now. If we're going to buy something, we're obligated to buy it from the cheapest price, so we don't have people putting lipstick on the pig and selling it.

McLaughlin: The broker-dealers' businesses models are different; they will find themselves in a regime of new standards under the SEC. This is a small corner of the financial legislation and we're the tail of the dog in this debate. Generally, there is no need for more regulation in this industry. Starting from that premise, we're going to have some unintended consequences if Congress is about to act.

PAM: What are the challenges facing wealth advisors in this climate?

Pepper: The biggest challenge for the whole industry is the Madoff scandal. He wiped out extremely wealthy people all over the world. Clients are saying, 'How on earth did you let us get into Madoff?' The big theme is rebuilding trust and convincing clients this won't happen again.

Tsavaris: This proposed legislation has to do with the following, "If a family office entity or individual in a family office is compensated for giving investment advice, they should be deemed an investment advisor and be regulated." So, that issue for SFOs is huge. Once an SFO becomes regulated by the SEC, you have to have the infrastructure to support the [reporting to the] SEC, you need compliance, procedures, ethics rules, and to control all the investments of the individuals of the firm. Unregistered SFOs are not constrained with any of these requirements at this point. I think the sustainability of the SFO is being challenged through the economic climate and if they have to be regulated it will be a further restraint on their ongoing sustainability.

McLaughlin: The ability for any single individual to deal with all of the issue isn't possible. I think we have an obligation when asked questions to say "I do not know." We have an obligation to find an expert in our domain or outside of it. I don't think we at all recognize that's our highest duty to our clients. Because of the degree of complexity, things have to change. We've got to do things and there's too much to know.

Guernsey: One great thing about our business is that we share these things. If you hear that Rock & Co. did something good, call them up and ask them how they did it. We don't have all the resources. If I don't know something about airplane leases, I call someone up and ask.

PAM: What are firms doing to prepare for regulatory changes in this area?

Pepper: I don't think people are preparing for changes now. They have to wait to see what actually is passed. I don't think people can spend money on consulting with attorneys until there's something that you can actually really react to.

McLaughlin: All of us under the current regulatory structures that we operate under are ready; we're planning now for a surprise audit. The Investment Advisor Act has been around a long time. We live by the standards, [even though] they were not enforced for family offices.

Tsavaris: We're as prepared as we can be. It's if you're not regulated and are pulled into the sweep, you have to think about anticipated regulatory situations. The issue is that if the Smith Family Office, which manages \$500 million, is held to the same checks and balances as everyone else, everyone will know they have \$500 million through their mandated regulatory filings.

McLaughlin: What's extraordinary about this is there is not a member of Congress who's going to be the champion of the super-wealthy in regulating single family offices. But the irony of it is that in today's electronic world, privacy and electronic security ranks as the number one issue. From the super wealthy to the average person, all of us want privacy from our Big Brother. For someone to champion that the SFO needs to detach from the super wealthy group is to champion that the veil of privacy be broken.

PAM: If family offices are required to disclose client assets, what does this mean for the family offices' privacy obligations?

Tsavaris: I feel that there will be basically no difference in how people will invest, but there will definitely be a difference on how they execute. With the elimination of a pooled vehicle that meets a multiple of family needs— if that happens—there's going to be a lot of Excel spread-sheeting going on, and all sorts of problems. It will make it very cumbersome and go back to the separate account era. It can cause all sort of problems in the execution.

Guernsey: You could probably put some of these assets into some sort of trust structure to avoid disclosure, and five years from now you can open up the envelope and see what it's worth.

Tsavaris: A simple solution is to align yourself with regulated advisors so your assets are pooled with theirs from a reporting aspect. A regulated advisor may be reporting on a couple of billions of dollars of assets. I think there will be cooperation between more regulated MFOs and some SFOs, resulting in some creative opportunities to help the vision of the family office continue.

Pepper: In other words, the families are going to fight back instead of ripping off the veil of privacy. There's this obsessive hunger right now to find out what the rich are doing and how much money they have. It's very dangerous for families to have their assets exposed. There are huge predatory interests to know, so people can go out and kidnap their children, kidnap and extort from the family and assault them physically. So they will fight back, and they should fight back, and we'll help them.

PAM: Suppose the family office regulations are enacted. What then?

Guernsey: You can either merge it or consider your options very closely. What is the cost of it? Who can pay for it?

Tsavaris: It goes back to sustainability of existing SFOs that are not regulated. Can they sustain the increased burden of this legislation?

McLaughlin: We have a lot of wealthy families in the U.S. and the large majority of them have had closely held family-held businesses. Literally, it's who they are as a family. The family office and the company are all inter-merged and when you're trying to tackle this, there's no elegant vertical structure to separate the people from the business structure. I'm convinced no one in Congress has thought about this for a second.

Pepper: This forces people to create bigger, bulkier and less nimble and more conforming type of organizations solely to bear the cost of regulation. They shouldn't be forced to manage their money in a certain manner when they're a private family and not an institution. It just doesn't make sense. Why should they be forced to act like they're public money managers?

—Kristen Oliveri

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