

Against a global backdrop of economic and political uncertainty, many of the world's wealthiest families are re-evaluating how and where their wealth is managed and invested. The anxiety caused by the current environment and outlook, exacerbated by diminishing returns and under-performance, particularly in asset classes such as hedge funds, is leading some family offices to make significant changes to their investment strategies, service providers and human resources, bringing "in-house" much of what was previously outsourced. In doing this, they are taking back "control" of their capital and managing their costs and investment decisions more proactively.

## Hedge Funds and Family Offices

If you believe at least some of what you have read about the hedge fund industry in the latter stages of 2016 and early months of 2017, you would be forgiven for thinking that the hedge fund world was imploding, as funds are returned to investors at a startling rate, with countless seasoned investment managers around the world shutting up shop and going home, no longer able to justify their fees in the face of disappointing performance. While the evidence in some jurisdictions appears to suggest that fund closures and a reduction of new launches are leading to a decrease in the overall number of hedge funds, it seems a little premature to be calling the demise of the industry just yet.

However, if the hedge fund community is unable to arrest this performance trend and does not respond to investors' concerns regarding management fees, such that redemptions continue and new money flows dry up, it is going to be interesting to see what the fall out is during the course of 2017 and in particular, given their ties, whether there is an immediate and measurable impact on the family office industry.

There could be a number of ways in which this plays out. For those family offices that remain committed to hedge fund strategies – and it is expected that many would – one alternative approach would be to hire a proven hedge fund manager and task him or her with running their own fund within the family office, assuming the family office has the resources to support the personnel expense.

At the same time, and as we have commented on previously, many family offices around the world appear to be increasingly disposed to allocating capital to private equity and real estate, particularly via direct investments. Where hedge fund interests are being critically reassessed and capital redeployed, such allocations may be made at the expense of hedge funds.

From the "sell side" perspective, for those investment managers struggling to keep investors happy in the face of redemption requests, winding up the fund and simply managing their own money in some form of family office structure, thereby moving out of the regulatory spotlight and into an environment where they do not need to spend time raising new money and communicating with existing investors, may seem appealing. There have indeed been some high-profile examples of this in the recent past. Where managers perhaps do not have sufficient capital themselves to make setting up a formal family office economically viable, joining others in similar situations and forming multifamily offices is another approach that may be attractive for some.

## Changes in Approach to Staffing and Infrastructure

For those family offices seeking to bring hedge fund investments "in house" by managing them themselves, this may necessitate a fresh look at how the family office is staffed and supported, in particular, whether existing members of the team have the skill set for making investments in this asset class and whether they have the necessary infrastructure to be able to efficiently and accurately monitor and execute such investments. Such restructuring or rebalancing would not be without its complications and challenges, both legal and commercial.

One would assume, and anecdotal evidence appears to support the assumption, that particularly with the number of hedge funds on the decline, the market for talent is healthy and family offices are not finding it difficult to find and hire the right people with the appropriate skills. Indeed, it is unlikely to be a particularly difficult sell for those professionals coming out of the hedge fund sector and there may be significant attractions for working in the family office environment. For those family offices seeking to attract this sort of talent, it may be the case that they need to recalibrate their compensation structures, possibly increasing pay and benefit packages, facilitating co-investment opportunities and conceivably offering what would be equivalent to carried interest compensation to the extent that it can be achieved within the applicable regulatory framework and restrictions on family offices.

As well as changes to the personnel profile, adoption of more sophisticated technology platforms may also be required, ensuring that the necessary trading, data reporting and portfolio management and other analytical tools are available. With more functionality and portfolio information brought back under the family office umbrella, a greater investment in cyber security tools and IT support might also be required.

## The Increasing Institutionalisation of Family Offices

The changes outlined above are symptomatic of the increasing institutionalisation of family offices and reflect a broader step change in their evolution and a move to becoming more sophisticated investment vehicles, developing deeper specialist expertise and becoming capable of managing a greater range and complexity of investments themselves. Some family offices might even come to resemble hedge funds of the early days of that industry, when they existed in a more benign regulatory environment: if that is the case, the regulators will doubtless be keeping a close eye on this evolution.

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