



Scorpio Partnership



## Swiss Family Offices Best Practices Research

Key Findings

Produced for



**Northern Trust**

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## ABOUT THE SPONSOR – NORTHERN TRUST

Northern Trust is one of the world's leading financial institutions. We specialise in providing asset servicing solutions and asset management to families and their advisors, individuals and institutions around the world.

Our focused and consultative approach enables us to gain an understanding of how best to support our clients and provide the services that bring the most value. We commissioned this research to enhance our understanding of the Swiss market and to ensure we are providing and developing the appropriate products and services.

- Enhanced aggregated and detailed reporting
- Reduction in administrative work in the family office
- Improved risk management
- Security of assets
- Growth of assets through investment
- Easy access to a broad range of financial information

Northern Trust works with 310 families in 15 countries representing nearly 25% of the Forbes 400 global families. We custody CHF120 billion on behalf of these family relationships and manage CHF25 billion. Our clients in Switzerland are serviced from London by staff with the appropriate language skills.

Families and their advisors benefit from the economies of scale from investment of over CHF350 million a year in a single global system which delivers information to all our clients globally, providing consistency in data and processes.

Northern Trust is financially strong. 74% of total revenue is fee based and half of our total revenues is from relationships with families and individuals. At the end of 2004, Northern Trust had assets under administration of CHF3 trillion, assets under investment management of CHF680 billion and total corporate assets of CHF54 billion.

## ABOUT SCORPIO PARTNERSHIP

Scorpio Partnership is a wealth management strategy consultancy based in London. The firm, founded in 1998, has conducted assignments with over 120 private banks, fund managers, family offices, technology firms, resource management firms and related service providers operating in the industry. Scorpio Partnership specialises in qualitative interviewing of high-net-worth individuals and wealth management industry professionals to support strategic business development.

## METHODOLOGY

Scorpio Partnership conducted 25 interviews with family offices and family office intermediaries in Switzerland in January 2005. All interviewees were working with families with at least USD75 million of assets advised in Switzerland.

The sample included: chief executives, managing directors and chief investment officers at single family offices (SFOs) and multi-family offices (MFOs); and tiers gérants (TGs, independent asset managers) dealing with families. Unless otherwise indicated, the term family office (FO) is used throughout this report to denote all types of family office business structure.

Interviews were conducted in person and the research methodology was qualitative, allowing the interviewees to express their views on market trends. Where quantitative data are included in this summary, they are for illustrative purposes only. The sample size is not large enough to be regarded as statistically valid.





## OVERVIEW

The changing dynamics of the wealth management industry in the last five years have thrown the spotlight onto the role of family offices as providers of independent investment services to wealthy families and ultra-HNW clients. As a result, the number of European family offices is expected to grow significantly in the coming years. Yet, the future shape of the family office market in Europe remains unclear.

This study, was undertaken in partnership by Northern Trust and Scorpio Partnership, a UK wealth management consultancy, to identify current practices among the leading family offices in Switzerland and consider potential future trends. Switzerland remains a pre-eminent centre for services to international family offices and a benchmark for the development of global practices.

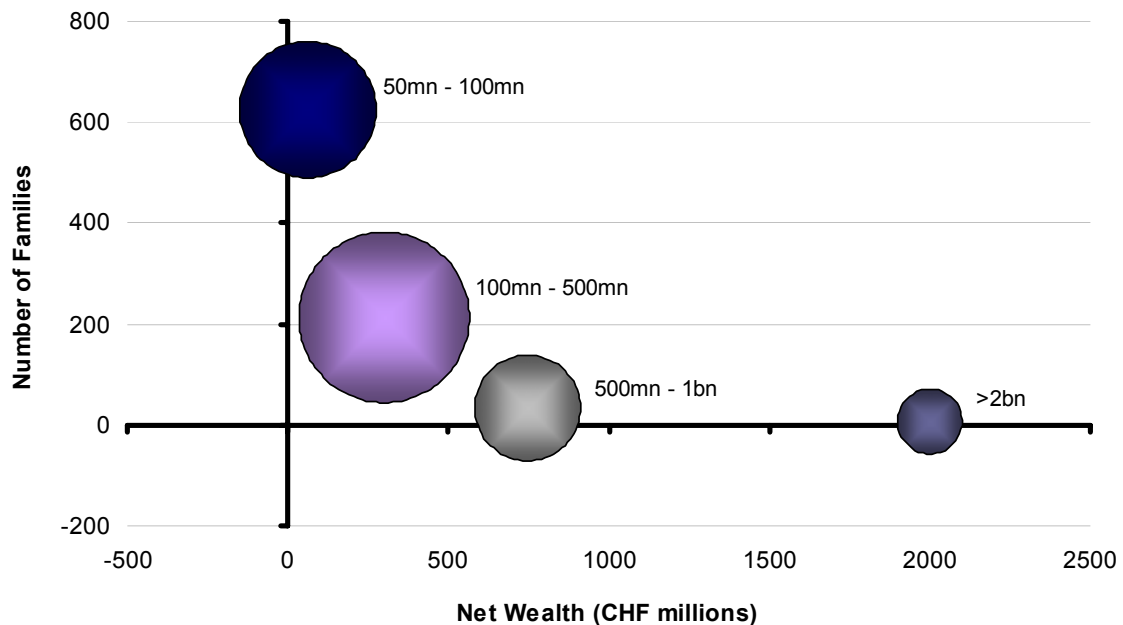
## SWISS FAMILY OFFICE MARKET SIZE AND OVERVIEW

There are estimated to be 750-1,000 families in Switzerland with assets in excess of CHF50 million. Of this total, 250 families are believed to have assets in excess of CHF100 million.

- There are believed to be only 50-100 formally established single family offices (SFOs) and multi-family offices (MFOs) with CHF100 million or more in family assets.
- There are believed to be 2,500 tiers gérants (TGs) in Switzerland, collectively managing more than CHF400 billion.

**Figure 1: Breakdown of Family Office Assets in the Swiss Market**

**Area Represents Assets Held by UHNW Segment**



Source: Scorpio Partnership





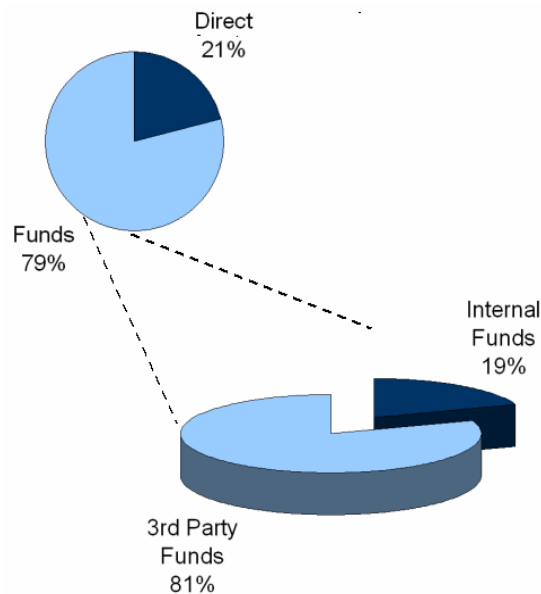
## INVESTMENT MANAGEMENT FOCUS

The majority of FOs in Switzerland were established with the objective of providing independent investment advice to the family. As a consequence, the investment management process is at the heart of the mandate for most Swiss FOs.

However, only a small minority provide direct securities broking services to family members. Instead, it is more usual for Swiss FOs to offer unitised fund management solutions. How these solutions are structured varies depending on the size, age and regulatory status of the FO, as well as the preferences of the family.

- Smaller SFOs and TGs usually buy units in third-party funds.
- Larger SFOs and MFOs typically structure an in-house fund-of-funds. This may be done in conjunction with a third-party fund advisor.
- Large MFOs with a fund management licence may offer segregated accounts.

**Figure 2: Swiss FO Assets Managed via Funds and Direct Investment**



*Source: Scorpio Partnership*

## BESPOKE INVESTMENT OBJECTIVES

Rather than having a house investment style, 47% of Switzerland's FOs are dedicated to providing tailored investment solutions to individual family members. Of those with a dedicated house style, 32% focus on capital preservation and 21% focus on wealth accumulation.

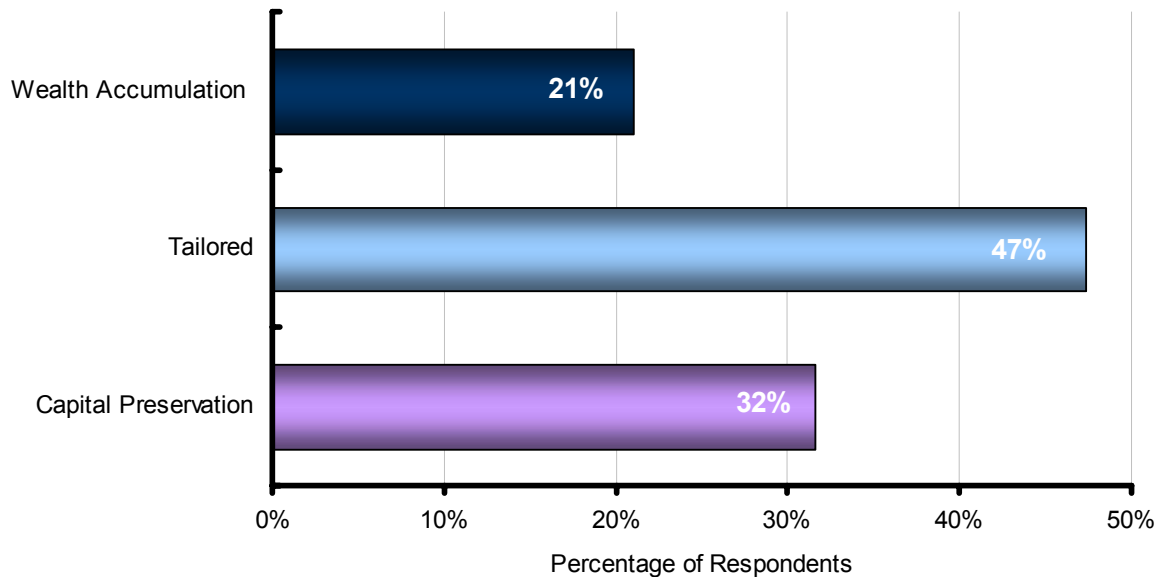
The older and more established the FO, the more likely that there will be a number of second or third generation family members relying on smaller portfolios and seeking capital preservation and income.





By contrast, if the FO founder is still active, there will be more emphasis on wealth accumulation with an investment strategy targeting growth.

**Figure 3: Swiss FO Investment Management Objectives**



*Source: Scorpio Partnership*

## GUIDED ARCHITECTURE

Limiting the number of external fund managers enables FOs to manage risk (see Effective Risk Management) at the same time as achieving effective diversification. Typically, 5-20 managers are included in FO investment portfolios and the common view is that 10 managers will provide effective diversification.

- Managers are selected with a view to buying-and-holding. FOs that do tactically rotate managers will not typically turn more than 30% – 50% of total portfolio per year.
- Around half of Switzerland's FOs are long-only in orientation. Reasons cited include high costs and the lack of transparency associated with hedge fund managers. Also, high levels of investment activity in private equity and property among family members fulfils alternative asset allocation.
- Those FOs that do invest in hedge funds tend to select single managers and there is a move towards style-specific portfolios.

Notable trends in the front office include a drive to gain institutional pricing from underlying fund managers as well as an expectation that established FOs will open their manager selection architecture and operate increasingly as MFO suppliers in order to gain efficiencies and critical mass.

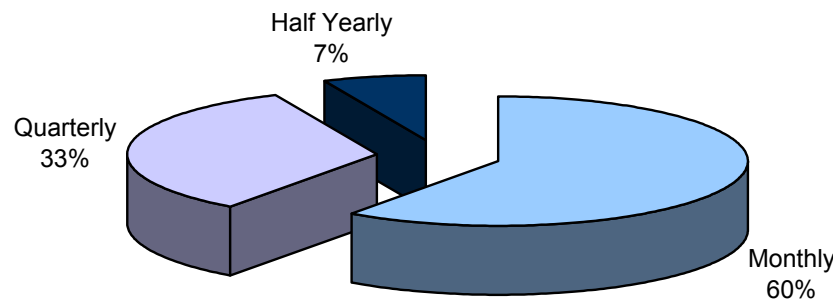




## EFFECTIVE RISK MONITORING

Effective risk management is universally acknowledged to be of significant importance in the investment management process. All the FOs in the sample undertook regular performance attribution and risk analysis.

**Figure 4: Frequency of Performance and Risk Analysis Undertaken by Swiss FOs**



*Source: Scorpio Partnership*

However, the quality and frequency of that analysis varies. Even those FOs that place high importance on risk monitoring note that they are unable to obtain the quality of data necessary to achieve regular portfolio-wide observation.

- Lack of timely, accurate, securities-level data from underlying managers or custodians is a particular problem, especially with hedge fund managers.
- Difficulties accounting for direct holdings in private equity and property also hinder the process.

As a result, it is common for FOs to lay the ultimate responsibility for risk analysis with the underlying managers. Consequently, FOs place high importance on the risk management policies of managers as part of their due diligence process. Moreover, FOs may limit the number of managers in order to monitor their risk management on an ongoing basis.

This situation is not regarded as wholly satisfactory and many FOs are seeking risk assessment tools that allow detailed portfolio-wide observation; using a clearly identifiable academic approach and allowing detailed analysis, including forward-looking cash flow and investment scenario analysis.

## VIRTUAL CUSTODIANS

Providing consolidated reporting to family members is second only to the importance of independent investment advice in the FO mandate. For most FOs, the objective is to report to each family member within a two-week period of month-end.

Indeed, finding efficient solutions to the problem of providing detailed consolidated reporting to family clients was identified by most Swiss FOs as their most pressing strategic imperative. At present, the process is hindered by a lack of transparency and poor quality data from managers and custodian banks as well as the lack of tailored systems to handle the complex investment accounting necessary to the task.



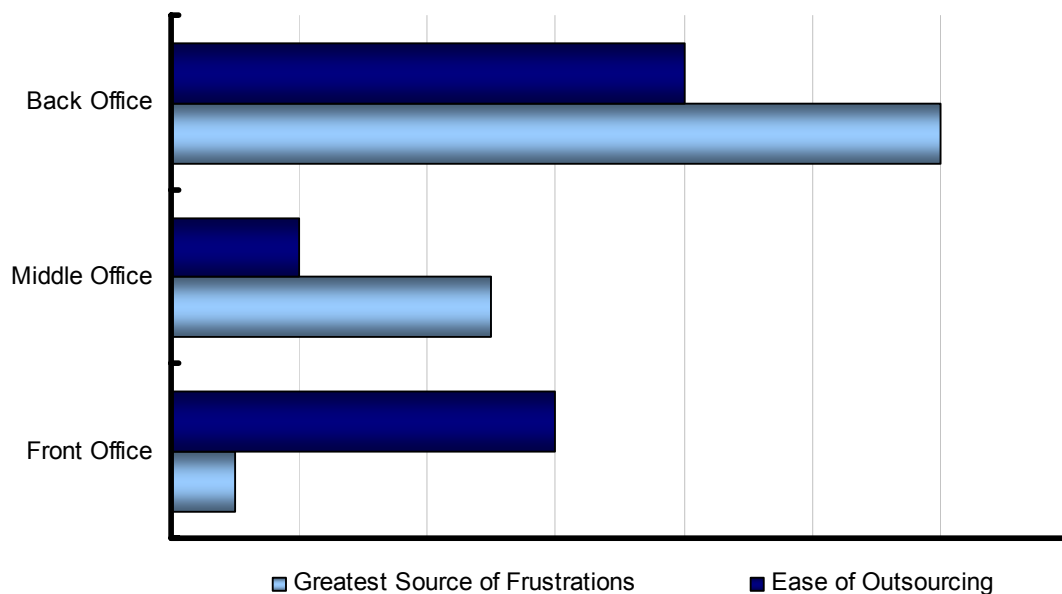


As a result, many FOs are acting as virtual custodians. They will seek to receive tickets for every transaction, check the data and input it – often manually – into in-house systems. These systems vary in sophistication and many Swiss FOs are seeking solutions to improve the efficiency of their back-office processes:

- Through an improvement in data quality; and
- Automated solutions to investment accounting and data consolidation problems.

The most notable trend in the back office was the acknowledgement by many Swiss FOs that outsourcing may be an effective solution to problems in the back office and are starting to seek third-party partners. Historically, Swiss FOs have avoided outsourcing back office functions for reasons of confidentiality. Now, as well as outsourcing, a number of SFOs and MFOs that have comprehensive in-house back-office systems are seeking to commercialise those systems through third-party agreements.

**Figure 5: Drivers of Swiss FO Outsourcing Trends**



*Source: Scorpio Partnership*

## MULTI-BANKED

While service levels are acknowledged to be very high among Swiss custodians, Swiss FOs regard their relationships with custodian banks to be of secondary importance to in-house processes. They typically deal with multiple custodian banks to achieve retrocession income and to avoid concentrating risk with one provider. As a result, the fees paid by Swiss FOs for custody are high by international standards with many FOs paying 20bps-40bps before retrocession.

Moreover, Swiss FOs do not seek a full-service arrangement from their custodian banks. At most, they may leverage custodian relationships in order to gain fee rebates on securities lending, or to use assets under administration as collateral for credit arrangements. Failure to maximise these relationships also contributes to high back-office costs.





## **FEE PRESSURE**

At present, only large SFOs or MFOs with portfolios in excess of CHF500 million or more will demand institutional pricing. Below this threshold, service providers charge essentially retail rates; although they will typically start to negotiate on these rates on asset levels in excess of CHF10 million, with secondary hurdles set at CHF25 million and CHF100 million. However, many FOs expect fees will come under pressure within the next three years.

- Challenges to Swiss bank secrecy will affect the premium charged for Swiss private banking services.
- The low return environment will pressurise asset management fees.
- The growing trend among introducers to pass retrocessions to end clients will increase fee transparency in the market resulting in downward pressure.

Ancillary to any pressure on investment manager fees, the internationalisation of family members may increase pressure on custody and administration fees, with a view to moving these in line with international standards.

## **CONCLUSION**

The drive towards an MFO business model was the most notable trend among Switzerland's FO sector, in both the front and back offices. Established SFOs that are facing increased portfolio fragmentation and new SFOs alike are seeking to exploit gaps in the family office market to commercialise their processes for other families.

This trend suggests a market in transition, where outsourced solutions are likely increasingly to become the norm, for middle- and back-office processes, as well as in the front office, as is the case now.







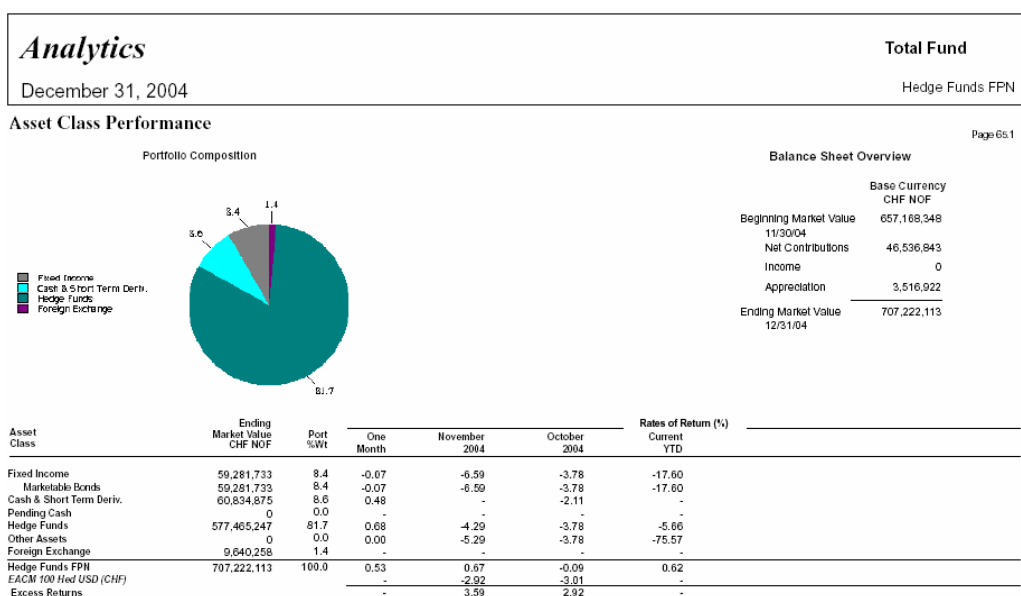
## NORTHERN TRUST'S SERVICES FOR FAMILY OFFICES

Northern Trust offers a comprehensive array of services to family relationships and is currently enhancing the existing web-based daily information delivery system, Passport, to provide a virtual family office platform with enhanced capabilities to family offices, family members and their advisors. Enhancements are targeted at reporting, supporting an increasingly complex range of assets and integration of accounting capabilities.

- Aggregated and detailed reporting via the web
- Record keeping and valuations for all assets - custodied and non-custodied
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- Complete package of performance measurement services
- Full risk management programme, tailored to support your objectives
- Foreign exchange trading coverage in 75 currencies, with active trading in 58
- Leading investment management services
- Transition management (restructuring portfolios)
- Cash investment and cash sweep capabilities in 20 currencies
- Secure on-line trade and cash instructions
- Securities lending
- Support and replacement of back-office functions
- Onshore and offshore fund administration
- Offshore trustee services
- Safekeeping and settlement in 89 markets
- Income on payable date in 36 countries
- Corporate actions and proxy services

Northern Trust also offers a broad range of performance and analytical reports and consultation. All information is accessible on-line via Passport. Our capabilities range from basic rate of return information to in-depth evaluation of client portfolios and full consulting services. We offer tools to help our clients design, monitor and evaluate their worldwide investments.

Performance measurement is calculated at security, asset class, country, portfolio and overall fund level. As many composite returns of different accounts as needed can also be calculated. Our system is a multi-currency calculation engine and results can be provided in any base currency.





Northern Trust's analytics reporting package monitors style, allocation, and risk and return for individual portfolios as well as consolidating this information across a number of portfolios. The reporting enables clients to compare investment results against benchmarks while analysing detailed country, sector, industry and security information. By designing reports in both on-line tabular and graphical exhibits, the statements clearly set out information in order to help clients monitor and evaluate the results of their investment programme.

Analytical reporting combines traditional performance analysis reporting and benchmarks in a customisable package. Clients can analyse their funds worldwide on multiple performance levels including by:

- Rates of return
- Asset allocation
- Benchmark comparisons
- Manager analysis

In addition, Northern Trust provides on-line interactive analysis that allows clients to measure and review their investment managers' performances on a worldwide basis. Clients can request immediate on-line analysis through three main methods:

- Attribution models
- Manager comparisons
- Statistical analyses

Northern Trust provides on-line reports to communicate performance data, performance analysis displays information in graphical and tabular form.

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