Family Offices: A Vestige of the Shadow Financial System

An IPS Inequality Briefing Paper

Chuck Collins & Kalena Thomhave

May 2021

Institute for Policy Studies

INEQUALITY.ORG
AN INSTITUTE FOR POLICY STUDIES PROJECT

Program on Inequality and
The Common Good

Family Offices: A Vestige of the Shadow Financial System
Enabling the Creation of Inherited Wealth Dynasties

Wealthy clans form family offices to accumulate wealth and promote inherited wealth dynasties. But the Archegos collapse reveals how they contribute to financial system risk and why it's time for oversight.

The authors would like to thank IPS Associate Fellow Bob Lord for his assistance on this brief and Sophia Paslaski for editorial and layout assistance.

Authors

Chuck Collins directs the Program on Inequality and the Common Good at the Institute for Policy Studies, where he also co-edits Inequality.org. His most recent book is *The Wealth Hoarders: How Billionaires Pay Millions to Hide Trillions*.

Kalena Thomhave, MPP is a researcher with the Program on Inequality and the Common Good at the Institute for Policy Studies.

The **Institute for Policy Studies** (www.IPS-dc.org) is a multi-issue research center that has been conducting path-breaking research on inequality for more than 20 years.

The **IPS Inequality.org** website (http://inequality.org/) provides an online portal into all things related to the income and wealth gaps that so divide us, in the United States and throughout the world**. Subscribe to our weekly newsletter at Inequality.org or follow us on Twitter and Facebook: @inequalityorg**

The IPS Program on Inequality and the Common Good was founded in 2006 to draw attention to the growing dangers of concentrated wealth and power, and to advocate policies and practices to reverse extreme inequalities in income, wealth, and opportunity. The program has been investigating the intersection of inequality and race, taxation, philanthropy and the problem of hidden wealth.

Institute for Policy Studies -National Office
1301 Connecticut Ave NW, Suite 600
Washington, DC 20036
www.ips-dc.org, Twitter: @IPS_DC
Facebook: http://www.facebook.com/InstituteforPolicyStudies

Institute for Policy Studies –New England Office
30 Germania Street, Building L
Jamaica Plain, MA. 02130
Email: chuck@ips-dc.org

Summary

- Family offices are an unregulated corner of the financial marketplace with an estimated \$6 to \$7 trillion in assets under management (compared to \$3.4 trillion in global hedge funds).

- Ultra-high-net-worth families — those with \$250 million up to the billionaire class — form family offices to bring wealth management services "in house." Key to their purpose is capital preservation and fostering inherited wealth dynasties. They are major utilizers of dynasty trusts to sequester wealth and avoid estate taxes. In this way, family offices serve to entrench multi-generational wealth inequality.

- As the concentration of wealth globally has increased, so has the number of family offices. There are now an estimated 7,000 to 10,000 family offices globally, most having formed in the last 15 years.

- The U.S. family office sector formed the Private Investor Coalition to successfully lobby against financial oversight provisions in the 2010 Dodd-Frank financial reform legislation. As a result, after 2011, dozens of hedge funds converted to family office structures.

- Proponents of family offices believe light oversight is justified because these offices only serve private families. As they are not offering services to multiple clients, the thinking goes, family offices should not be subject to scrutiny. However, the Archegos collapse revealed that family offices can contribute to systemic risk because of their size, secrecy, and growing interest in speculative investments.

- Family offices should be required to register with the Securities and Exchange Commission (SEC) and publicly report certain option and stock positions on a quarterly basis.

Contents

Summary 3
Introduction 5
The Family Office Boom 5
Trillions You've Never Heard About 8
Giant Pools of Unregulated Capital 10
Origins of Modern Family Offices 13
Financial Butlers to the Super-Rich 14
Working in Wealth Defense 15
Growing Inequality, Growing Wealth Defense 16
Family Offices Protecting their Special Status 17
The Case for Oversight of Family Offices 18

Introduction

Here's the recipe: Start with a couple thousand billionaires with trillions of dollars in unregulated pools of capital and add a dash of pandemic speculation. What could possibly go wrong?

Enter the family office, the last known vestige of the shadow financial system. Don't be surprised if you haven't heard of family offices; they intentionally fly below the radar.

The super-rich — those with over $250 million — form family offices in order to bring their wealth management, tax planning, family services, and sometimes charity activities under one private roof.

The spotlight is shining on family offices thanks to the collapse of Bill Hwang's Archegos Capital, which is not a hedge fund but a family office.

Hedge funds are required to register with the Securities and Exchange Commission (SEC) and publicly report certain option and stock positions on a quarterly basis. Single-family offices (sometimes called "family funds") have no such registration requirements and they can structure themselves to avoid disclosing their positions.

In 2010, during the Dodd-Frank financial reform, family offices successfully lobbied and fended off federal oversight. But lack of family office transparency is one reason for the Archegos collapse that led to $10 billion in bank losses at Credit Suisse and Morgan Stanley and an estimated $33 billion in stock value losses. Because Archegos didn't have to disclose their highly leveraged positions, these banks were in the dark.

It is time to bring family offices into the sunny world of financial transparency. Without proper oversight, these hidden giants of unaccountable capital could fuel the next financial meltdown.

The Family Office Boom

Corresponding to the growing concentration of wealth since 1980, the number of family offices has exploded, reflecting the increase in billionaires and the growing updraft of wealth into a few thousand families globally.

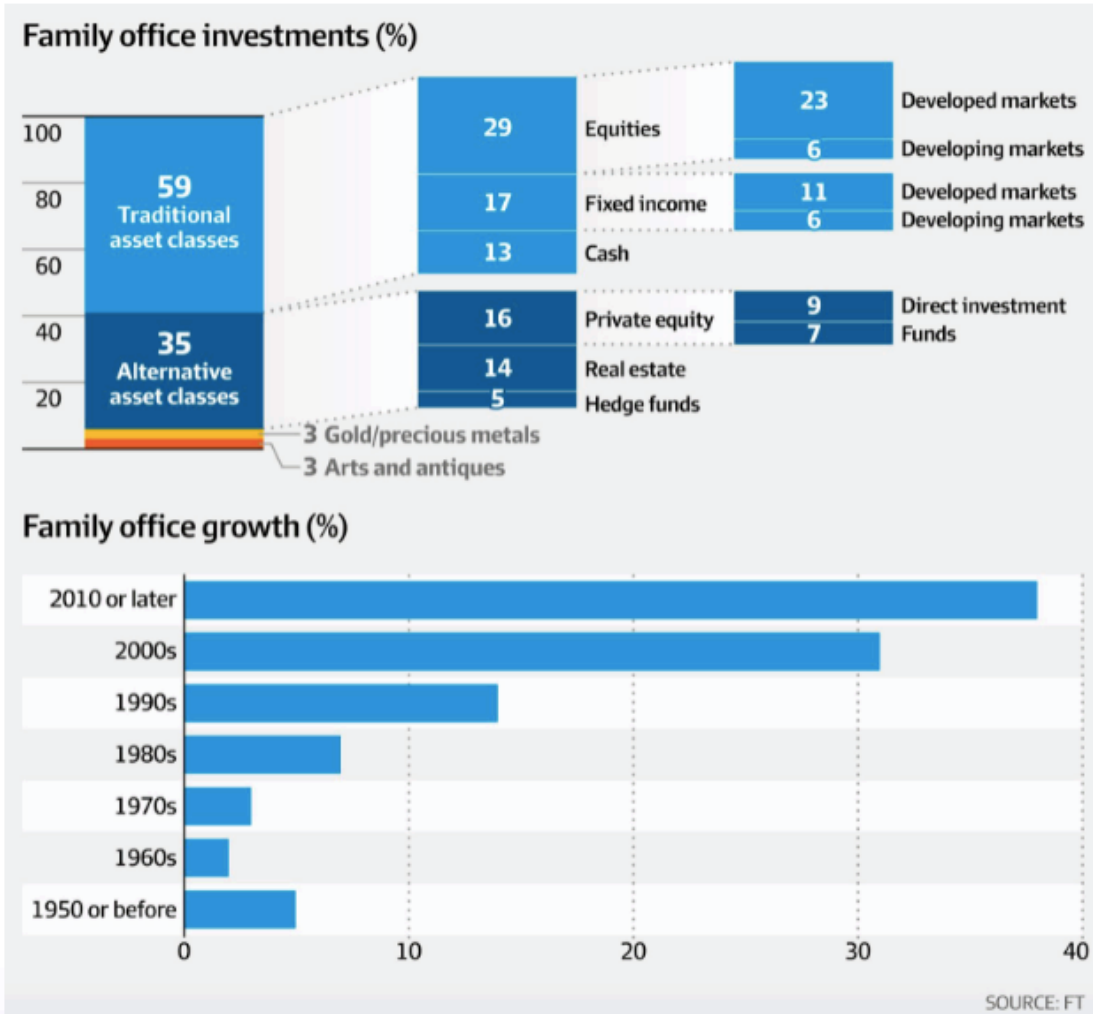
Estimates of the number of family offices around the world now range from 7,000 to 10,000. Over half of these family offices were founded in the last 15 years. One organization that closely monitors wealth trends among the world's wealthiest families is Campden Wealth, a family office membership association. Their research arm, Campden Research, estimated in

2019 that there are now 7,300 family offices, a 38 percent increase over the previous two years. These offices manage an estimated $5.9 trillion for families with $9.4 trillion in wealth.[1] Oprah has a family office, OW Management LLC. The billionaire Koch family has 1888 Management LLC to manage its $94 billion in combined net worth.[2] Hedge fund manager William Ackman and Google co-founder Sergey Brin each have one.

Some family offices serve a small clan while others are sprawling. The family office of the Mulliez clan, owners of the Auchan supermarket chain, serves 600 family members in France.

“Everybody wealthy seems to want to have their family office,” said David Rubenstein, the billionaire co-founder of private-equity giant Carlyle Group LP. He’s even considering one himself.

Families or extended clans with over $150 million will usually form a “single-family office” to serve their unique needs while families with as little as $25 million might engage services through a “multi-family office” that serves dozens of families. Today, the original Rockefeller Family Office has become a “multi-family” home serving over 250 client families. They recently acquired Whitnell & Co., a $1.4 billion wealth management firm and multi-family office, and a subsidiary of Associated Banc-Corp, expanding Rockefeller’s reach into the Midwest U.S.[3]



Three-fourths of family offices are based in North America and Europe. An estimated 1,000 family offices are based in London, managing over $1 trillion in private wealth.[4] Most family offices are in the U.S., which houses over 3,100 offices, or 42 percent of the global total. The emerging market regions of South America, Africa, and the Middle East are home to an estimated 600 family offices.

Asia has seen the most rapid growth of family offices, with over 1,300 offices, most formed in the last decade. Chinese billionaire Jack Ma, retired founder of the ecommerce giant Alibaba — and his right-hand man Joe Tsai — bought the Brooklyn Nets NBA team for $2.3 billion through their family office, Blue Pool.

Singapore and Hong Kong are among the fastest growing centers of family office wealth management, in part because of their loose oversight and the fact that China produced two new billionaires a week in 2017.[5] According to *The Economist*, Singapore's growth has been boosted as the "government [has] greatly relaxed red tape in order to attract more family offices."[6]

There has been some consolidation in the family office industry, driven by more bullish multi-family offices and larger wealth management firms. In November 2014, Fleming Family & Partners merged together with Stonehage, the first family office in South Africa. The Fleming clan includes heirs to Ian Fleming, author of the James Bond books and the childhood classic, *Chitty Chitty Bang Bang*. Their love child, Fleming Stonehage, is the largest independent multi-family office in Europe, the Middle East, and Africa, serving 250 families.[7]

These secretive and opaque institutions now control some of the largest pools of private investment capital on the planet.

Trillions You've Never Heard About

Most readers have heard about private investment banks, hedge funds, and private equity firms. But most have probably never heard of family offices. And family offices prefer it that way.

With their core mission to preserve and pass down wealth across generations, family offices are a central part of the "wealth defense" infrastructure. They are underreported, so when they are periodically discovered, they are discussed in conspiratorial tones. "Clans with nine-figure fortunes are increasingly investing through unregulated firms known as family offices, impinging on the business of investment banking and private equity," reported *The Wall Street Journal* in a 2017 expose, describing the family office as a "disruptive force" on Wall Street."[8]

These entities, set up to manage the fortunes of the wealthy and able to operate under the radar, are making their presence felt with their growing numbers, fat wallets, and hunger for deals.

In light of the Archegos collapse, an unwelcome spotlight has shined upon the industry. "These firms, which manage huge piles of wealth for individuals or families, are proving to be increasingly important to the financial system," wrote Gregory Zuckerman in *The Wall Street Journal* in March 2021. "As they have grown in size, some family offices have embraced the riskier investment strategies used in previous decades by the most aggressive hedge funds….Because most families are private and rarely share details of their operations or investments, it can be hard to track the size and growth of family offices, or the amount of money they borrow to juice their returns."[9]

Family offices are as "quiet as you could possibly find, and they're writing extremely large checks," said Ward McNally to *The Wall Street Journal*. McNally is a great-great-grandson of Andrew McNally, who co-founded atlas publisher Rand McNally.

"We're the most important part of the investment landscape most people have never heard of," one family office executive told *The Economist* in an article, "Family offices become financial titans." Another article in *The Economist* is titled, "How the 0.001% invest."[10]

This dramatic tone is understandable given both the secrecy and lack of accountability surrounding the industry, as family offices are neither registered nor licensed. Some include the words "family office" in their names and others shun it. Many family offices are deliberately given names different from those of their families, such as Waycrosse for the Cargill-MacMillans or Miramar Services, Inc. for the Scripps family. Think of them as family-owned private investment banks and associations.

The media and regulatory spotlights shine elsewhere because family offices appear to be less concerned about amassing new wealth than preserving existing fortunes. But this too is changing as some family offices hazard toward the adventurous edge of finance.

There is nothing innately diabolical about family offices. Many of them provide the most mundane of wealth management services and other activities. But there are growing reasons for concern.

Family offices are formed for wealth defense, to preserve and grow wealth over several generations. So there is a deep bias in their DNA against anything that might reduce or erode capital, including taxation. In achieving this core mission, family offices deploy the range of "tools in the toolbox." These include coordinating basic wealth management, fashioning estate and tax plans to maximize inheritances, creating dynasty trusts, defending family assets from aggrieved ex-spouses suing for divorce settlements, and preparing the next generation for wealth. Some family offices are also involved in administering the family's charitable foundations and activities.

As wealth inequality grows around the planet, family offices are in the dynasty preservation business, sequestering assets for centuries to come. As a result, family offices have themselves become enormous pools of anonymous and unregulated private capital.

Family offices are estimated to hold more than $6 trillion, the equivalent of 7 percent of the world's stock markets.[11] Think about it: Trillion-dollar pools of unregulated, anonymously-owned capital. What could possibly go wrong?

Some functions of family offices are legitimate enough. If a family is coming together around an existing family business, then facilitating business succession is a central focus, especially the transition from a business founder to the next generation. The threat to many businesses surviving for multiple generations is not external — such as regulation or taxation — but internal family dynamics. "The castle usually crumbles from within," says Gao Hao, an expert with the Global Family Business Research Center at Tisnghua University of Beijing.[12]

But some family offices are engaged in aggressive tax planning and reduction. This moves them into the territory of deploying foreign shell corporations, opaque intergenerational family trusts, bank accounts in offshore tax havens, and financial planning techniques to convert one type of income (wage earnings) into another type (capital or royalty income) that may be taxed at a lower rate. As an article in *The Economist* observes, “Family offices are becoming more complex — a third have at least two branches — making tax wheezes easier.”

The multi-family office of UK-based Werner Capital aided a wealthy couple from Azerbaijan to stash wealth extracted from that country by creating shell ownership companies and funneling funds to offshore tax havens. Jahangir Hajiyev, chairman of the International Bank of Azerbaijan, was paid a little over $70,000 in bank salary in 2008. Yet without any other source of income, he and his wife Zamira went on a spending spree between 2003 and 2015. They bought a Gulfstream jet, a golf club membership, and a townhouse in the ritzy London neighborhood of Knightsbridge. Zamira went on a shopping binge, spending £725,000 at Harrods department store on jewelry and designer clothes.

As Bloomberg reported, “the gap between their spending and income apparently didn’t stop a raft of enablers — lawyers, accountants, investment advisers and other professionals — from helping the couple steer their wealth into assets in the U.K. from a web of offshore companies, according to court papers and corporate filings.”[13]

Giant Pools of Unregulated Capital

> “Family offices could endanger the stability of the financial system. Combining very rich people, opacity and markets can be explosive.”
> -*The Economist*

Aside from their money-hiding role, family offices are raising a number of red flags by virtue of being trillion-dollar pools of anonymous and unregulated capital. While many family offices continue the more mundane business of “wealth defense” and preservation, others are moving toward the cutting edge of risk-taking and unregulated investing.

Some finance experts are alarmed with the sheer market power of family offices in the economy, their anonymous nature, and how they contribute to extreme wealth inequality. An additional concern relates to how family offices contribute to a two-tier capital marketplace, one for the super-rich and another for everyone else.

“Family offices could endanger the stability of the financial system. Combining very rich people, opacity and markets can be explosive,” warns *The Economist*.[14]

Still on people’s memories is the 2008 economic meltdown, propelled by trillions in hot money shifted into unregulated hedge funds, derivatives, and other exotic financial investments. Those with longer memories harken back to the 1998 debacle of Long Term Capital Management, the $100 billion hedge fund that blew up and almost brought down Wall Street.[15]

When any entity manages trillions of dollars of capital, it is inevitable that some of it will be invested in the flashing-lights territory of the speculative global "casino" economy in search of high risk, high return propositions. Family offices have vast portfolios with a mix of asset classes that include safe investments such as fixed rate bonds and insured deposits, as well as art, real estate, jewelry, and other forms of wealth storage. It is not surprising that a portion of the wealth, possibly trillions, has moved beyond public securities into venture capital, impact investments, and other more speculative investments.

The special status of family offices — outside regulatory scrutiny — is now one of the biggest drivers of their growth. "Lots of pools of capital are going from a regulated to an unregulated environment, and by the very nature of doing all these direct deals, we must be putting ourselves on the radar of the regulator," says Simon Foster, chief executive of TY Danjuma, the family office of Theophilus Danjuma, a Nigerian business mogul.[16] Some family offices, including those representing the Gates family and the Pritzker hotel dynasty, are major purchasers of high-risk securitized debt.

"Family offices are becoming more ambitious and are evolving to embrace new opportunities accordingly," observed Anupreeta Das and Juliet Chung in *The Wall Street Journal*. "They are forming new partnerships to conduct buyouts and acquisitions; they are financing start-ups, purchasing distressed debt, real estate and esoteric insurance products; and they are even lending to companies and occasionally going to battle with companies as activist shareholders."[17]

Their unregulated nature is the primary reason a number of hedge funds returned their client's money and converted to family office status. In 2011, George Soros converted his $24.5 billion hedge fund, Soros Fund Management, to a family office.[18] David Tepper converted Appaloosa Management from a hedge fund to a family office and other hedge fund impresarios, such as Jon Jacobson and Leon Cooperman, followed suit. Altogether three-dozen major hedge funds adopted the family office structure.[19]

This was true of Bill Hwang, founder of Archegos. After pleading guilty to wire fraud and insider trading in 2012, Hwang took $200 million from his closing hedge fund and started Archegos Capital Management as a family office. He leveraged this into a $20 billion bet on pandemic media and tech stocks.

Hwang deployed what is known as a total return swap, a type of derivative that provides "all the economic benefits of owning a stock without requiring Archegos to spend the money to actually buy it," writes Alexis Goldstein from Americans for Financial Reform.[20]

Those seeking venture capital now understand this and they are actively knocking at the doors of family offices in search of large chunks of flexible investment capital. A number of services connect start-up companies seeking venture capital to otherwise inaccessible family offices. One company, FINTRX, was founded in 2014 to "provide asset raising professionals access to high quality Family Office data," with contact information and asset estimates for 2,750 family offices globally and 11,000 contacts.[21]

Family offices are teaming up to "co-invest" together, assembling larger capital pools to directly invest in ventures. The Perot family started to convene other family offices to form private-equity "club deals." "Perot family office executives said they hatched the idea after having to pass on a deal that needed more cash than they were willing to put up," wrote Das and Chung in *The Wall Street Journal*. This is sending warning signals to regulators. European family offices involved in co-investing might be subject to the Alternative Investment Fund Managers Directive (AIFMD), especially if they involve "politically exposed people," those with power and public roles. They may become subject to greater disclosure and reporting requirements.[22]

"As the Fed and other central banks loosen monetary policy, private pools of capital are searching for ever-more innovative ways to earn returns," said Gillian Tett, the senior U.S. correspondent at the *Financial Times* and author of *Fool's Gold*, a book about the causes of the 2008 economic meltdown. "Indeed, public markets as a whole now seem dangerously hostage to the whims of unfathomable politicians and central banks."

Family offices, according to surveys conducted by Campden and other family office networks, are shifting investments out of low performing hedge funds and public equity markets. Based on one 2018 survey, 28 percent of family office investments were in equities and 16 percent in bonds. Meanwhile, they increased their stakes in private equity to 22 percent and in real estate to 17 percent. Hedge fund stakes were below 6 percent and shrinking, while some family offices were starting to stockpile cash and equivalents in anticipation of a recession.[23]

One dangerous implication of these trends, however, is the widening of a two-tier investment market. One investment market exists for the masses of pensioners and the "mere wealthy" that includes publicly traded equities and bonds with low returns. And another market exists for the oligarchs and the super-rich with unregulated alternatives and speculative investments with higher returns.

This is the $6 trillion dollar catch, says Tett: "The more that elite private pools of capital find juicy returns outside public markets, the more this risks fueling wealth gaps. After all, most non-elite investors remain stuck in public markets and bank deposits, exposed to the vagaries of low interest rates."[24]

This creates some advantages for an already advantaged group of wealthy investors. "Family offices might have privileged access to information, deals and tax schemes, allowing them to outperform ordinary investors," warns *The Economist*. "Hungry brokers and banks are rolling out the red carpet [to family offices] and pitching deals with unlisted firms that are not available to ordinary investors. If all this did lead to an entrenched, unfair advantage, the effect, when compounded over decades, would make wealth inequality disastrously worse."[25]

"This return gap may be going largely unnoticed now, because private markets are so opaque," says Tett. "However, the difference is likely to grow. Therein lies another mostly unnoticed consequence of central bank easing; another reason why the 20th century vision of democratic capitalism based around public markets is under attack."[26]

Origins of Modern Family Offices

The antecedents of the family office date back centuries to when royal stewards handled the fortunes of monarchs. Within dynastic European families, there were well known family formations, such as the "House of Rothschild." The first modern family office was formed in 1882 by John D. Rockefeller to manage the affairs of his Standard Oil fortune.

There's a strong business case to be made for bringing financial and other services "in house," rather than dealing with an array of private law firms, bankers, and investment advisors. As sociologist Brooke Harrington explains, "In business organizational behavior, there is the classic question: should you buy stuff or make it yourself?" She gives the example of how for decades General Motors bought parts from Fisher Body. "At one point, they just decided to buy them and make them part of GM."

"Essentially the same intuition occurred to John D. Rockefeller about a century ago," says Harrington. Because his personal fortune was so vast and complex, Rockefeller was essentially contracting out with an army of lawyers and accountants and advisors, even philanthropy advisors, to take care of his affairs. Eventually he realized, "I should just buy them." So rather than making them contractors he made them employees. "The organizational device for this was the family office, a dedicated trust company plus soup-to-nuts wealth consultation firm."

"You reduce information asymmetries and transaction costs," says Harrington. "When you are working with an expert — there is always stuff the expert knows that you don't. You might be left wondering, 'have they told me everything?' When you're rich enough you put an end to that question and make them your employee rather than consultant." A family office might also be better able to enforce confidentiality and non-disclosure, protecting family privacy.

Other dynastically wealthy families followed suit, including J.P. Morgan and others with wealth emerging from the industrial revolution and the early 20th century Gilded Age.

Boston became a center of family offices where old wealth New England families discreetly managed their affairs, largely outside the spotlight. During the industrial revolution, Boston was the Silicon Valley of its day. Huge fortunes emerged from early manufacturing that was substantially bigger and different from land-based fortunes. The Cabots and Lodges, with wealth from shipping, merchandise, and early manufacturing, literally had more cash than they knew what to do with.

State and federal officials were developing tax systems — initially to “conscript wealth” to pay for wars. As these modern tax systems came together, public officials were obviously very interested in how to tax these great industrial fortunes.

“The Cabots and Lowells deployed people to ensure that the state didn’t get their hands on their money,” says Harrington. “And that’s been the job of the wealth manager ever since.”

Harrington explains that alongside these new forms of production — like the wool and cotton mills in Lowell and Lawrence — emerged the financial and legal innovations to manage this wealth. For this reason, Boston became the cutting edge of trust law and fiduciary rules. “Much of what is the established law of managing private wealth comes out of early 19th century Boston — because that’s where the rich people were.”

More family offices eventually cropped up in New York City, Chicago, and other financial centers, and over the 20th century several hundred wealthy families formed offices, some now serving the third and fourth generations.

Financial Butlers to the Super-Rich

Some family offices offer more personal “concierge services,” such as arranging for travel, including booking private jets and making sure the ground transportation limos have the right beverages and snacks on hand. Think Lady Gaga on tour.

“They are like a Swiss army knife for the wealthy,” quipped Ben Cowdock from Transparency International, referring to family offices. “It does everything.” [27]

Ultra-high-net-worth families usually have multiple properties to staff and manage. The family office might oversee some of these domestic operations, especially as families decamp from New York City to Sun Valley, ensuring cooks, housecleaners, drivers, and other services are all in place.

Cheryl Howard of Maitland Family Office, one of the largest multi-family offices in South Africa, said that the wealthy are quickly becoming “global citizens” and need a service that is truly international and delivered seamlessly across borders. She believes family offices offer several advantages over banks, hedge funds, and private equity firms, including “the management of longer-term capital needs and generally a more personal touch when it comes to support services.” She once helped a client choose the interior color of his new Bentley.[28]

Globalized family offices are involved in helping foreign nationals to obtain residency visas, purchase real estate, and secure spots in the best private schools for their children. They oversee family cybersecurity and monitor invoices. Apparently yacht service firms are notorious for overcharging if they think bills will not face close scrutiny.

At the beginning of the Covid-19 pandemic, family offices swung into action both to protect the assets of their patrons and to set up remote locations for family members. Many family offices, anticipating economic volatility, moved investments into cash or looked for profits in health care. Others actively promoted new trusts and wealth-hiding strategies for their clients.[29]

In non-emergency situations, the tasks can be quite diverse. One family office staffer described that he had spent his day arranging transport for a golden retriever from Boston to Dubai. A wealthy heir to a dynastic Middle Eastern family had graduated from a Boston-area college and needed to get his dog home.

As one Bloomberg reporter quipped, family offices may be involved in "hiring jets and helicopters, maintaining yachts and getting choice tickets to sporting events. They will even walk your Pomeranians."[30] They are "financial butlers," providing "super-help…for the super-rich."

Preparing the next generation for wealth includes teaching financial literacy, helping young adults get out of trouble, and guiding the generations through the inevitable family cycles — birth, marriage, children, divorce, remarriage, grandchildren, and death. Family offices are where children learn the importance of the pre-nuptial agreement as a mechanism to protect family wealth.

Working in Wealth Defense

For those seeking jobs within the Wealth Defense Industry, working at a family office is attractive to many newcomers and veterans in finance. "Working directly for some of the richest people in the world brings perks such as trips aboard superyachts, but it can also come with family drama and offbeat personalities," reported Bloomberg Markets in an interview with two family office recruiters.

For people coming from investment banks, working at a family office could be a big change in culture and mindset. "The willingness and the attitude to be at the beck and call of the family can be a culture shock," said family office recruiter Paul Westall. Families can be particular. "Finding someone who is trustworthy and discreet and someone the family can rely on is the main concern because their fortunes, their livelihoods, and entire generations of wealth are at stake."[31]

Instead of toiling for 70 hours a week at a hard-charging private equity firm or hedge fund, working at a family office might be less onerous, according to Ben Ingram from the recruiting firm Berwick Partners.[32] But there is also less status than in the world of high finance. Working in financial firms that believe they are "wealth creators" brings both higher compensation and cultural cache. Family offices and other wealth defense occupations are more about "wealth preservation." Though, as described above, this is rapidly changing.

In recent years, family offices have lured away skilled wealth management professionals from other financial institutions because of the advantages of working in a less regulatory environment. In 2015, Thomas Pritzker, the billionaire chair of the Hyatt Hotels Corp., poached Joseph Gleberman, senior banker at Goldman Sachs private equity division, to help run his family office.[33] Greg Fleming, once seen as the future leader of Merrill Lynch and Morgan Stanley, went to the Rockefeller Family Office.

Investment professionals at family offices get to focus more on direct ventures and alternative investments outside the traditional securities market, while also having a better work life balance. For those wanting to devote their life's labors to helping the billionaire class get richer, this is one career option.

Growing Inequality, Growing Wealth Defense

As briefly mentioned, the expansion of the family office sector is directly tied to growing inequality and the dizzying concentration of wealth among ultra-high-net-worth households. The greater the concentration of wealth, the more wealth defenders can find employment.

As of March 2021, there were 2,755 billionaires globally, with a combined net worth of $13.1 trillion.[34] Over the first year of the pandemic, billionaire wealth surged over $4 trillion.

According to Credit Suisse, an estimated 89,500 adults in the U.S. had wealth above $50 million at the beginning of 2020 (about half of the world total).[35] As of April 2021, 710 U.S. billionaires hold more than $4.6 trillion combined.[36] Many of these may use traditional wealth management companies like Fidelity, not a family office. But they are the constituency for family office formation.

With an intergenerational wealth transfer estimated as high as $68 trillion over the next 30 years, the need for such family offices will increase.[37] Most of this transfer will be happening in the upper canopy of the wealth forest, between households in the top 0.01 percent. Households with wealth over $5 million will transfer an estimated $15.4 trillion by 2030 to the next generation.[38]

There are several additional drivers of family office expansion. In the aftermath of the 2008 economic meltdown, many wealthy families reevaluated their financial arrangements. A preference for a family office grew in part out of disillusionment with third-party investment managers fueled by "scandals over opaque and abusive fees, and banks pushing their own expensive products."[39] This provided another good reason to bring financial services in house.

Many surges of private wealth are the result of "liquidity events," as business founders or heirs cash out of enterprises after sales or initial public offerings, and have large pools of cash that need managing. Think Facebook or Uber going public, or other windfalls from business start-ups.

Carol Bernick founded her family office in 2002 to manage assets from outside the family-owned hair-care company, Alberto Culver, founded by her father. But when the beauty-supply business was sold to Unilever for $3.7 billion, the family's wealth surged. Today the family office, Polished Nickel Capital Management LLC, has 14 employees and invests with other families and private equity firms.[40]

For some among the very wealthy, family offices are a status symbol. *The Economist* observed, "newly minted billionaires, from Asia in particular, feel increasingly that they are not full members of the club without one."

Family Offices Protecting their Special Status

The global movement for greater transparency may impact the special status of family offices. In the aftermath of the 2008 economic meltdown, the U.S. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. This legislation repealed the "private advisor exemption" for hedge funds and other private fund advisors, requiring them to register with the Securities and Exchange Commission. Family offices had historically been excluded from regulation under the Investment Advisers Act of 1940, a post-Great Depression reform.

Family offices swung into action to protect their unregulated status. They formed a lobbying arm, the Private Investor Coalition, and worked to ensure that single-family offices would have a "carve out" in Dodd Frank.[41] According to their lobbying disclosures, they spent hundreds of thousands of dollars, arguing that "family offices are aimed at preserving wealth and making conservative investments, not trying to beat markets over time."[42]

They succeeded in protecting their special status, but the Securities and Exchange Commission was charged with defining what constituted a "family office" to be eligible for exemption from rules. Under these regulations, family is defined as:

> *Family members*. Family members include all lineal descendants (including by adoption, stepchildren, foster children, and, in some cases, by legal guardianship) of a common ancestor (who is no more than 10 generations removed from the youngest generation of family members), and such lineal descendants' spouses or spousal equivalents.

After ten generations, there could be several thousand descendants to the original ancestor, so this definition allows for a potentially enormous conglomeration of wealth, especially if dynasty sequestration measures are successful in the decades to come.

As long as the family office "does not hold itself out to the public as an investment advisor," it falls outside SEC oversight.[43] But family offices may still engage in activities that do fall under oversight, such as investing in privately offered securities and investment funds, commodity options and swaps, and other vehicles that themselves are subject to regulation.[44]

In Europe, family offices have flown under the radar, but have captured some unwanted publicity in the post-Panama Papers era. The European Network of Family Offices formed to be a voice in the public policy and lobbying space, led by Francois Mollat du Jourdin, who also serves as the secretary general of the French Family Office Association.[45]

In the UK, family office groups are forming a lobbying arm. "Many UK-based family offices find it frustrating dealing with the Financial Services Authority, the main UK regulator because of its lack of understanding of what they do," said Yogesh Dewan, chief executive of Hassium Asset Management. "Regulators are more focused on asset managers, private equity, hedge funds and banks, and don't seem too concerned about the activities of family offices."[46]

But the movement against tax haven abuse is also bringing scrutiny to family offices. "Demand for enhanced information sharing comes not just from the US," writes Sarah Cormack, a partner at the UK office of Withers. "Even those jurisdictions that were selected historically because of the privacy they could offer now carry with them an increased compliance burden."

Paul Golden observes, "Family offices often look for regimes with a 'lower key' approach to regulation ... not only to minimize the amount of information they have to share, but also because regulation is usually designed for commercial enterprises and the requirements can be onerous and wasteful for family investments."[47]

Indeed, regulation designed for large commercial investment institutions might not be appropriate for a single-family office managing $250 million for one family. But what happens as more billion-dollar fortunes are shifted from other investment vehicles, such as hedge funds, into family offices? And what happens as family offices move more money into "direct" and "alternative" investments outside of already regulated financial markets?

The Case for Oversight of Family Offices

Family offices argue that because they are just managing one family's money that they shouldn't be subject to the same oversight as a financial institution with multiple clients. And this may be true. Although to read the definition of "family" in the family office statute above would allow for hundreds of families.

Regulators are rightfully taking notice. In early May 2020, Dan Berkovitz at the U.S. Commodity Futures Trading Commission said oversight of family offices "must be strengthened," noting that they "can wreak havoc on our financial markets."[48]

“Family offices can still do bad things,” said Tyler Gellasch, a former SEC official and executive director of Healthy Markets, in an interview with the *Australian Financial Review*.[49] “They can still hurt the overall market. We now have a clear example of someone exploiting the family office exemption and creating systemic risk.”

“We should not be surprised if this leads to a re-evaluation of where family offices fit within the regulatory structure,” said Marlon Paz, a partner at the law firm Mayer Brown, in an interview with InvestmentNews.[50]

At minimum, family offices should be registered with the SEC and should disclose the size of assets under management. They should be required to make 13F disclosures on a quarterly basis to declare all portfolio positions, as hedge funds must do.

Senator Sherrod Brown, chair of the Senate Banking Committee, recently opened an inquiry related to Archegos. Brown wrote in a letter to Credit Suisse, “the massive transactions, and losses, raise several questions regarding Credit Suisse’s relationship with Archegos and the treatment of so-called ‘family offices.’”[51]

And even before the Archegos collapse, the SEC was planning to review the rules governing family offices and their privileged status.[52]

As a result, the family office lobbyists at the Private Investor Coalition registered new lobbyists in February 2021,[53] and are raising money to engage in another round of lobbying to fend off oversight.[54]

Family offices may appear largely benign, but because of their size and secrecy they could also contribute to the next financial destabilization crisis. Together they manage trillions in unregulated financial capital, some invested in the next generation of exotic financial instruments and profit-making schemes.

Archegos is an early warning sign about how new speculative investment tools — the equivalent of credit default swaps during the 2008 economic meltdown — will arrive on the scene. Don’t be surprised when the delivery systems are capital supplied by family offices.

NOTES

[1] Ryan Swift, "Global family offices grow assets under management to nearly US$6 trillion, report shows*," South China Daily*, July 23, 2019. https://www.scmp.com/business/money/wealth/article/3019665/global-family-offices-grow-assets-under-management-nearly-us6.

[2] *Forbe*s Real Time Billionaires, accessed May 20, 2021, latest estimates of Koch wealth https://www.forbes.com/real-time-billionaires/.

[3] Business Wire, "Rockefeller Capital Management Expands in Midwest with Acquisition of Whitnell & Co.," January 5, 2021. https://www.businesswire.com/news/home/20210105005939/en/Rockefeller-Capital-Management-Expands-in-Midwest-with-Acquisition-of-Whitnell-Co.

[4] David Batty, "How London's booming 'butler class' takes care of the wealthy elite," *The Guardian*, March 12, 2016. https://www.theguardian.com/business/2016/mar/12/family-office-private-wealth-funds.

[5] Rebecca Gooch, Campden's head of research, estimates 5,300 according to *The Economist*, in "Family Offices become financial titans," *The Economist*, December 13, 2018. https://www.economist.com/briefing/2018/12/15/family-offices-become-financial-titans. The Guardian estimated closer to 10,000. See Batty, 2016.

[6] Ibid.

[7] Bloomberg Professional Services, "The Future of Family Offices: Regulation," *Bloomberg Professional Services*, March 9, 2015. https://www.bloomberg.com/professional/blog/future-family-offices-regulation/.

[8] Anupreeta Das and Juliet Chung, "New Force on Wall Street: The 'Family Office," *The Wall Street Journal*, March 10, 2017. https://www.wsj.com/articles/the-new-force-on-wall-street-family-offices-1488991396.

[9] Gregory Zuckerman, "Family Offices Like Archegos Take Big Risks Like Hedge Funds," *Wall Street Journal*, March 31, 2021. https://www.wsj.com/articles/family-offices-like-archegos-take-big-risks-like-hedge-funds-11617223998

[10] *The Economist*, 2018, "Family offices become financial titans."

[11] At the end of 2019, the global value of equities markets was $85 trillion: https://www.cnbc.com/2019/12/24/global-stock-markets-gained-17-trillion-in-value-in-2019.html. In 2018, *The Economist* reported that family offices held $4 trillion, the equivalent at the time of 6% of global equity markets. See Economist, December 13, 2018.

[12] Henny Sender, "China's tech billionaires keep it in the family office," *Financial Times*, October 30, 2019.

[13] Edward Robinson and Gavin Finch, "Dirty Money Spotlights Role of Family Offices as Enablers," *Bloomberg,* July 30, 2019. https://www.bloomberg.com/news/features/2019-07-30/dirty-money-spotlights-role-of-family-offices-as-enablers.

[14] "How the 0.001% invest," *The Economist*, December 15, 2018. https://www.economist.com/leaders/2018/12/15/how-the-0001-invest.

[15] See Nicholas Dunbar, *Inventing Money: The story of Long-Term Capital Management and the legends behind it (New York:* Wiley*, 2000). And Roger Lowenstein, When Genius Failed: The Rise and Fall of Long-Term Capital Management (Random House, 2000).*

[16] David Bain, "Family offices: investments under the spotlight," *Financial Times,* October 20, 2017. https://www.ft.com/content/4c6d79aa-a9cb-11e7-ab66-21cc87a2edde.

[17] Das and Chung, 2017.

[18] Robert Frank, Gregory Zuckerman and Steve Eder, July 27, 2011.

[19] Das and Chung, 2017.
[20] Alexis Goldstein, "These Invisible Whales Could Sink the Economy," The New York Times, May 18, 2021
https://www.nytimes.com/2021/05/18/opinion/archegos-bill-hwang-gary-gensler.html
[21] See FINTRX https://www.fintrx.com/.
[22] Bloomberg Professional Services, "The Future of Family Offices: Regulation," *Bloomberg Professional Services,* March 9, 2015. https://www.bloomberg.com/professional/blog/future-family-offices-regulation/.
[23] "Wealthiest families are stockpiling cash," *Investment News*, September 29, 2019
https://www.investmentnews.com/wealthiest-families-are-stockpiling-cash-81455
[24] Gillian Tett, "Family offices are diving into new markets," *Financial Times*, August 1, 2019.
https://www.ft.com/content/dd01c02a-b45f-11e9-8cb2-799a3a8cf37b.
[25] The Economist, "How the 0.001% invest," *The Economist*, December 15, 2018.
https://www.economist.com/leaders/2018/12/15/how-the-0001-invest
[26] Tett, 2019.
[27] Robinson and Finch, 2019.
[28] Ruan Jooste, "Family Offices: More than just keeping it among the kin and paying it forward," *Business Maverick* (South Africa), November 26, 2019.
https://www.dailymaverick.co.za/article/2019-11-26-family-offices-more-than-just-keeping-it-among-kin-and-paying-it-forward/.
[29] Family Office Exchange, "GRAT Expectations: Extra Opportunity in the Current Environment," June 10, 2020. https://www.familyoffice.com/knowledge-center/grat-expectations-extra-opportunity-current-environment. Also see: H.F. Rick Pitcairn, "Investing Beyond the Pandemic," Pitcairn, April 8, 2020.
https://www.pitcairn.com/trending/investment-commentary/2020/04/08/pitcairn-global-market-update-investing-beyond-the-pandemic
[30] Robinson and Finch, 2019.
[31] Bloomberg News, "The truth about family office jobs," *Investment News,* June 12, 2019.
https://www.investmentnews.com/the-truth-about-family-office-jobs-79947
An interview with Paul Westall and Tayyab Mohamed, directors of Agreus Group, a recruiter for single family offices.
[32] *The Economist*, December 13, 2018.
[33] Das and Chung, 2017.
[34] Kerry Dolan, "Forbes' 35th Annual World's Billionaires List: Facts And Figures 2021," Forbes, April 6, 2021. https://www.forbes.com/sites/kerryadolan/2021/04/06/forbes-35th-annual-worlds-billionaires-list-facts-and-figures-2021/?sh=3fbb5a935e58
[35] Credit Suisse Research Institute, "Global wealth report 2020," Credit Suisse, October 2020.
https://www.credit-suisse.com/about-us/en/reports-research/global-wealth-report.html
[36] "Billionaire Pandemic Wealth Gains," Americans for Tax Fairness and Institute for Policy Studies, April 15, 2021. https://ips-dc.org/wp-content/uploads/2021/04/IPS-ATF-Billionaires-13-Month-31-Year-Report-copy.pdf
[37] "The numbers vary wildly, but all are dizzying: $15 trillion. $30 trillion. $59 trillion. $68 trillion," from Scott Reyburn, "A 'Great Wealth Transfer' is Coming. What will it mean for Art?" *The New York Times*, December 18, 2019. https://www.nytimes.com/2019/12/18/arts/design/great-wealth-transfer-art.html.
[38] Abby Shultz, "The Wealthy Will Transfer $15.4 Trillion by 2030," *Barrons*, June 26, 2019.
https://www.barrons.com/articles/the-wealthy-will-transfer-15-4-trillion-by-2030-01561574217.
[39] *The Economist*, December 13, 2018.

[40] Das and Chung, 2017.
[40] Ryan Smith, July 2019.
[41] Private Investor Coalition: https://privateinvestorcoalition.com/. From their web site: PIC was formed in 2009 when, after 70 years of exemption from registration as investment advisors, single family offices were facing registration under Dodd-Frank. In 2009 and 2010 PIC successfully led the initiative under the Dodd-Frank Wall Street Reform and Consumer Protection Act to exempt single family offices from Securities and Exchange Commission registration as investment advisers.
[42] Robert Frank, Gregory Zuckerman, and Steve Eder, "Soros Fund All in the Family: Billionaire's Firm to Return Outside Cash, Convert to 'Family Office'; Avoiding Dodd-Frank," *The Wall Street Journal*, July 27, 2011.
https://www.wsj.com/articles/SB10001424053111903999904576469761599552864
[43] United States Securities and Exchange Commission, "Family Offices: A Small Entity Compliance Guide," U.S. Securities and Exchange Commission, Issued June 22, 2011.
https://www.sec.gov/rules/final/2011/ia-3220-secg.htm.
[44] Nathan J. Greene, "United States: A U.S. Federal Securities Law Primer for Family Offices," *Mondaq*, March 14, 2017 (originally published in the February 2017 edition of Trusts & Estates).
https://www.mondaq.com/unitedstates/Finance-and-Banking/576602/A-US-Federal-Securities-Law-Primer-For-Family-Offices.
[45] Paul Golden, "Lobbying Times," *Campden FB* Issue 14, June 18, 2012.
http://www.campdenfb.com/article/lobbying-times.
[46] Golden, 2012.
[47] Golden, 2012.
[48] Robin Wigglesworth, Laurence Fletcher, and Katie Martin, "Archegos and the $10trn world of family offices," *The Australian Financial Review*, April 6, 2021.
https://www.afr.com/wealth/investing/archegos-and-the-10trn-world-of-family-offices-20210406-p57gtp
[49] Ibid.
[50] Mark Schoeff, "Archegos implosion could lead to family-office regulation," InvestmentNews, April 8, 2021. https://www.investmentnews.com/archegos-implosion-could-lead-to-family-office-regulation-204956
[51]https://www.banking.senate.gov/imo/media/doc/brown_letter_to_credit_suisse_48.2021.pdf
[52] Federal Register, Volume 86, No. 56, March 25, 2021. https://www.govinfo.gov/content/pkg/FR-2021-03-25/pdf/2021-05928.pdf
[53] Caitlin Oprysko, "Chamber stuck between a rock and a hard place," Politico Influence, February 12, 2021. https://www.politico.com/newsletters/politico-influence/2021/02/12/chamber-stuck-between-a-rock-and-a-hard-place-793361
[54] Joe Light and Benjamin Stupples, "A $6 Trillion Family Office World Fights Post-Archegos Crackdown," Bloomberg Wealth, April 22, 2021. Alsohttps://www.bloomberg.com/news/articles/2021-04-22/a-6-trillion-family-office-world-fights-post-archegos-crackdown
Also see: Center for Responsive Politics, "Client Profile: Private Investor Coalition," OpenSecrets.org.
https://www.opensecrets.org/federal-lobbying/clients/summary?cycle=2021&id=D000055699