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Generations Spring 2024 - Informal Family Offices: Hiding in Plain Sight

Family offices play a pivotal role in preserving and enhancing the financial and personal well-being of families. While much attention is given to formal family offices, which typically have established legal structures and clearly defined missions for the families they serve, the informal family office typically gets less attention. Often emerging organically, these informal arrangements lack the formal legal structure of their counterparts. This article discusses the role of informal family offices, exploring their formation, function and the critical role they play in managing families' investments and other affairs.

The Rise of the Informal Family Office

The informal family office may take on any of the responsibilities of a formal family office. The informal family office, however, lacks a separate legal structure and typically lacks the clearly defined mission of a formal family office. The informal family office may arise in several ways:

- An employee or group of employees in the family's active business finds themselves devoting some or all of their time to the family's personal matters.
- An accountant, a lawyer or an investment adviser begins to take on a broader role than his/her title and training might suggest.
- A personal assistant or bookkeeper sees his/her role grow over time to encompass a broad range of responsibilities for the family.

The people described above encompass a broad range in terms of education, professional experience and competencies. The characteristics informal family office employees tend to have in common are a close rapport and trusting relationship with members of the family as well as a willingness to take on broader roles. This informal arrangement can often be positive for all involved. The family has people they trust handling their affairs, and the employees enjoy an expanding set of responsibilities for a family with whom they have a rapport. The informal family office typically evolves over time — as the family's wealth grows and their needs increase, the employees find themselves adapting and expanding their skills in order to fulfill those additional needs. They may come to focus primarily or exclusively on the informal family office roles.

Risks of the Informal Family Office

While the informal family office may serve the family well for years, or even decades, there are a number of issues to watch out for, some of which may assert themselves gradually and some very suddenly. While the inflection point may be difficult to detect, there often comes a time when the informal family office no longer serves the family's needs.

- The employees, as competent and loyal as they may be, may find they are taking on roles they aren't suited to. As investments, properties and collections grow more complex, there may be more activity and nuances than the employees can handle. The informal family office may not have access to the resources a formal family office would, relying on notes, spreadsheets and memory rather than more-reliable systems.

- The informal family office is not likely to engage in succession planning or to otherwise have redundancy. The retirement, or even an illness, of a key employee may leave the family in a perilous situation. The issues that arise may be compounded by the lack of proper recordkeeping systems.
- The informal family office's employees, having learned much of their roles "on the job," may miss issues that better-trained employees might spot. They may be less knowledgeable as to when a new development might require reaching out to a lawyer, an accountant or an insurance agent.
- Employees in the informal family office may not be as aware as they should be of issues relating to data security, privacy and confidentiality. Where the informal family office is located within the family business, the privacy and confidentiality risks are apparent. In other situations, however, problems may result from a lack of proper systems or proper training.
- The informal family office located within an active family business faces a unique set of challenges when it comes time to sell the business. There will likely be a need to extract the employees who work primarily on family matters from the business before sale, as well as a need to make sure personal information is not left behind. Employees who hold dual roles, working on both business and family matters, will have to move to one role or the other. A buyer may require that key employees stay with the business.

Evaluating the Informal Family Office

A family that finds it is utilizing an informal family office should take stock of its current operations and consider alternatives. The family could take the following steps:

- Prepare an inventory of who plays what role in the family's affairs, including informal family office employees and outside advisers such as lawyers, accountants and financial advisers.
- Consider what would happen if a family office employee ceased to serve. What succession plans should be in place? Would the family have access to important information? Would they be aware of deadlines?
- Audit recordkeeping and communications systems with an eye toward any data security or confidentiality risks.
- In the case of the informal family office located within the family business, consider what steps would have to be taken well in advance of a sale of the business.

The family should then compare the status quo to alternatives. In many cases, key employees can form the core of a formal family office. A formal family office may offer an opportunity to better define roles, engage in succession planning and upgrade systems to ensure confidentiality. It may also offer tax savings with proper structuring. In other cases, moving to a multifamily office or outsourcing to outside professionals may be the answer. If the informal office is retained, at least the family will have a clear understanding of the risks and rewards as well as an opportunity to make up for any shortcomings that are discovered. Informal family offices play a crucial role in managing personal and financial matters, often growing organically with the family's needs. However, as families evolve, so too should their approach to managing these offices. Regularly reviewing and potentially formalizing these arrangements can ensure that family offices continue to serve their intended purpose efficiently and effectively. Evaluating alternatives, embracing formal structures when necessary and preparing for future challenges are essential steps for securing a family's legacy and wealth.

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