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SFOS FAIL TO PROFIT FROM REGULATORY ENVIRONMENT

Single family offices (SFOs) are missing out on investment opportunities and incurring unnecessary costs because of out-dated misconceptions regarding FSA authorisation and regulation, according to Rosalyn Breedy, managing partner of Breedy Henderson Solicitors.

Most UK-based multi-family offices (MFOs) are regulated by the FSA as discretionary investment managers. However, SFOs tend to shy away from regulation due to misplaced concerns about the costs involved, worries over privacy and the perception that regulatory compliance results in a lack of flexibility to operate.

The costs of initial FSA authorisation and regulation adherence are one-off and minimal and SFOs are contributing to the on-going costs of their investment manager's regulatory capital through the payment of a management fee anyway. As such Breedy argues SFOs are cutting themselves off from longer-term investment opportunities unnecessarily. SFOs not afraid to become regulated can take advantage of a unique opportunity to incubate investment management talent by providing the regulatory infrastructure, as well as seed capital, in return for a share of management and performance fees. This is of particular interest to hedge fund managers looking for a UCITS home.

The process of approval for FSA authorisation may take up to six months but the regulator has a voluntary performance standard to process 75% of correctly completed applications within 12 weeks. The process involves choosing and creating an appropriate legal entity, putting in place an appropriate business plan and capital resources before applying for authorisation. Senior management, customer facing and compliance roles need to be allocated and systems and procedures may need to be introduced, the expertise for which can be bought in, if not available in-house.

Once authorised in the UK, a SFO will automatically be categorised as an 'eligible counterparty' or 'professional investor', which brings with it a number of long-term advantages. Classification of this nature, as opposed to a retail investor, means a full range of investment opportunities can be made directly to the SFO without counterparties having to go through intermediaries or comply with a myriad of risk warnings or exemptions.

Counterparty financial institutions are naturally cautious of opening themselves up to the risk of mis-selling claims, so retail investors do not tend to be offered every opportunity available. This means the unauthorised SFO may not be offered more complex or esoteric investment products, which although risky may actually meet their needs.

As an institutional investor, an SFO will also have the advantage of speed and flexibility. For example, if you come across an attractive investment opportunity that you wish to syndicate with one or more co-investors, then if regulated you are a position to respond promptly and create a new fund quickly. Without regulation in place this would be a much slower and costlier exercise, which might mean the loss of an opportunity.

While we all hate rules, following FSA regulations simply means SFO staff is forced to deal consistently with issues that exist regardless of authorisation. These include procedures for anti-money laundering and determining conflicts of interests in a transparent manner. The discipline of the authorisation process will mean proper money management systems and procedures are in place from the outset. Conduct of business rules address operational and investor concerns.

Privacy is a key concern for SFO but in Breedy Henderson's experience the impact of FSA regulation on privacy tends to be over-exaggerated. At present the FSA is not concerned with taxation and the focus of its scrutiny is firmly on the banks and on its treating customers fairly initiative, rather than initiatives by investors that have the potential to address some of the market failures. It is also easier for US investment managers to deal with an authorised person and paradoxically the provision of an FSA authorised number by a SFO can actually protect privacy by halting numerous questions on the identity of the family from investment managers. Furthermore, regulatory oversight is on the legal entity, its controllers and the approved persons not on the beneficiaries.

The other commonly cited concern is the need to set aside a certain amount of capital. Given that SFOs will be managing funds of £1 billion upwards and a balanced portfolio will be a key part of that remit, then this tends to be covered as a matter of course.

While FSA authorisation and regulation is not a step to be undertaken lightly, Breedy advises SFOs not to dismiss it quickly either. As with any business opportunity, you need to undertake a careful assessment of your particular circumstances and the potential opportunity costs as contrary to popular belief authorisation may be a good thing for the skilled single family office which wishes to aggressively increase its returns.

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