Family
Capital

Family offices, legacy assets and risk exposures

By Michael Foster

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As the tide goes out, family offices are fretting over their risk exposures, including investments in their own portfolios, which have failed to perform due to bad luck or flawed decisions.

After canvassing 170 family office managers, Matthew McGrath, founder of Emissary Partners, has found duds typically comprise 5% of their portfolio - sometimes more.

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For years, their poor, or zero, returns were concealed by rising markets. Emissary makes a living by analysing the problem, and suggesting a course of action.

Of the changing environment, McGrath says: "There's been a curtain pulled on cheap leverage, particularly for alternative investments. Instead of leverage, family offices are looking at portfolio optimisation to boost returns and free up cash."

Every family is measuring their returns on capital more closely. This can include getting to grips with complex structured products, sold to clients by investment banks, whose underlying performance could deteriorate as interest rates rise.

Geo-political uncertainties increase the risk of confiscating assets by unfriendly governments, as is often the case in the mining industry. Emerging markets lately in receipt of capital flows can be problematic.

Cross-sector international disputes, generally between corporates and governments, can total $2.4 trillion a year. It is an area where family offices can struggle, given that solutions lie in political action.

The rise of a new generation of family office managers has led to questions being asked of deals struck by an older generation, whose advisers have retired.

McGrath says: "We often see legacy assets that are difficult for family offices because they predate the principle or an investment team. It's where a family no longer feels it has control or visibility over an asset."

This can even result from the actions of a disruptive individual claiming personal control over an asset which is actually owned by his family office.

McGrath started his career working for the office of Joe Biden, then vice-president, and later at a strategy firm led by former US secretary of state Madeline Albright, for whom he set up a dispute resolution practice.

Since he started Emissary in 2018, he has built up a team of advisers which aims to review situations from every angle. This includes reputation issues - a special interest of special adviser Peter Donald who once ran communications for the New York Police Department and FBI. Colleague Tyler Godoff used to manage direct and venture investments at Fine Line Group, owned by a family office owned by Ed and Sasha Bass. Top lawyers are also at hand.

Rather than duds, stranded assets or torpedoes, McGrath calls the problems legacy assets. He says: “They tend to be cross-border. They will also tend to have a party on the other side, impairing an exit. It can be a joint-venture partner, a fund manager, a company, a government or a stakeholder. Typically, that partner is suppressing information.”

Emissary carries out a ‘five lenses’ review, which covers investigative, legal, financial, geopolitical and reputation issues to establish the net value of an exit strategy and determine the best way forward.

Litigation might make sense, but it is time-consuming, costly and stressful, even if a principal is keen to exact vengeance through the courts.

Fiduciaries need to consider the position of a family to see whether arbitration or dispute resolution makes more sense.

Emissary evaluates the position of third parties, to test their willingness to settle in the absence of litigation. It puts a time-adjusted worth on assets co-owned with third parties, to establish which decisions make the most sense.

The World Bank’s international arbitration court takes seven years to achieve a resolution. Negotiations leading to a settlement after four years could become more attractive. Emissary has even organised media campaigns to persuade politicians to participate in cross-border cases.