The changing role of the chief investment officer

Whether a family is preparing for a significant liquidity event or transitioning wealth from generation to generation, one characteristic consistent across successful family offices is a strong chief investment officer (CIO). Finding the right solution for the CIO role is crucial for the family office to advance its mission and goals.

Some families outsource this role, some hire in-house executives, and others adopt a hybrid approach to leadership of the investment function regardless of the operating model. Whether your family office outsources the CIO role, maintains an in-house CIO, or operates a hybrid model, the main functions and responsibilities of the role are largely the same, though they may differ depending on the size, complexity, and tenure of the family office. As noted in **Family Office 5.0**, as families grow their investment function, the CIO must provide insight and flexibility to serve varied and changing investment platforms (e.g., real estate, venture, pooled investments, etc.).

Ensuring the safety and security of family assets: Custodians, cybersecurity, internal controls

An ever-evolving role and key function of the CIO is to ensure the safety and security of client assets. Choosing the investment custodian is one of the first important recommendations a CIO will make to the family. It's imperative that your CIO has a sound understanding of the size, scale, and functions of your investment custodian. This includes total assets under custody, credit ratings, and other bank functions and business lines. A good CIO can and should negotiate fees and keep open lines of communication with the custodian.

Cybersecurity threats are a risk that the CIO can mitigate by working closely with cybersecurity professionals to protect the financial assets and data associated with the CIO function. Cyberthreats continue to evolve as hackers grow increasingly sophisticated, and family offices are prime targets, with networks that house confidential information and offer access to significant funds. (For more on cybersecurity in the family office, see "**Cybersecurity: Action items for every family office.**")

Your CIO, in close collaboration with your investment custodian, should consider the following procedures:

Institute secure money movement procedures, and routinely review cash movements to ensure a full reconciliation of inflows and outflows.

IT systems should require multifactor authentication, and staff should undergo regular trainings on cybersecurity best practices.

As threats continue to evolve, processes to detect and resolve new threats must evolve as well, including an ongoing cyberthreat monitoring process.

Managing liquidity for the family office

As the adage goes, cash is king. The CIO is responsible for effective cash management, including understanding sources of income, current and long-term liabilities, and the leverage profile of each family member and portfolio managed by the family office. As we saw in early 2020, liquidity can erode quickly and burden the long-term investment strategy if not managed correctly. In extreme scenarios, ineffectively managed portfolios may have to fire-sale assets at unattractive prices simply to meet expected liabilities. Routine review of cash positions is a simple but meaningful responsibility of the CIO — one that shouldn't be overlooked by any family office.

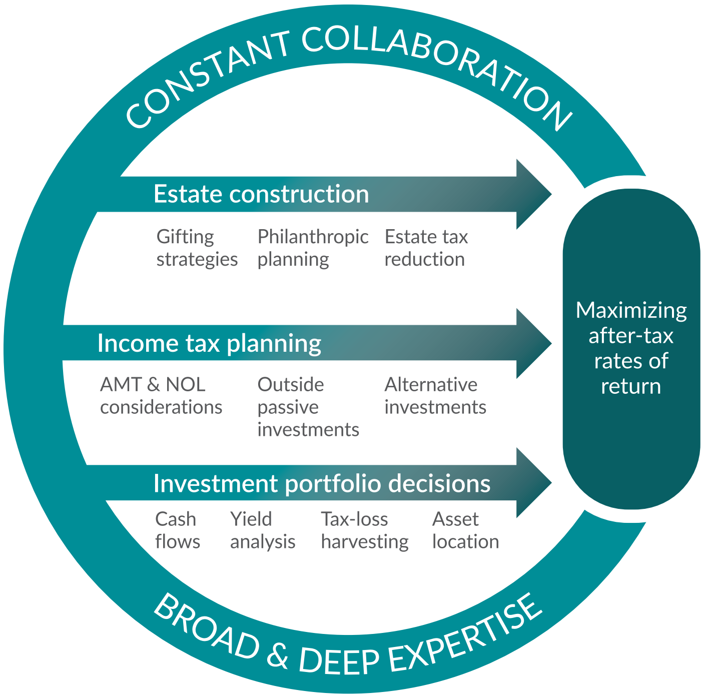
Developing a long-term investment strategy for the family office

A well-known function of the CIO is the creation and implementation of the long-term investment strategy for the family and family office. Less known and more nuanced are the factors the CIO must evaluate when creating said strategy.

COORDINATING WITH TAX & ESTATE ADVISORS

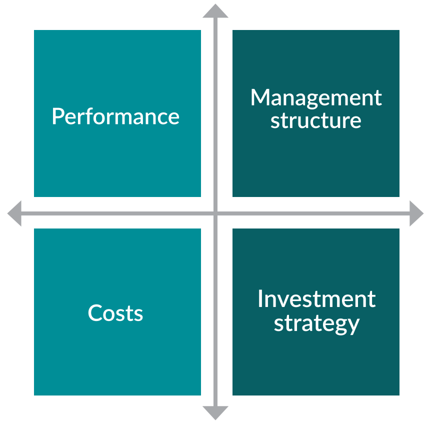
A strong CIO will seek out, encourage, and embrace collaboration with family office tax and legal counsel to help maximize after-tax rates or return in the portfolio. Implementation of estate planning and estate tax reduction techniques, employment of insurance strategies, and charitable and philanthropic planning (among other strategies) are all noninvestment-centric activities that can help grow a family's balance sheet, and are something the CIO should be keenly aware of and involved in.

Then, once the risk and tax profiles of the investor are evaluated and the long-term goals and objectives overlaid, the CIO is responsible for implementing the investment plan through strong and reputable investment managers.



UNDERSTANDING FAMILY MEMBERS' INVESTMENT & TAX PROFILES

The CIO is responsible for understanding each family member's investment goals and objectives, time horizon, tax profile, risk tolerance, cash flow needs, and estate profile, since each of these factors impacts overall and subasset allocations.



LEADING DUE DILIGENCE EFFORTS

The CIO heads all due diligence efforts for the family office investments and should be able to define each investment manager's role within a particular portfolio. This responsibility spans the full spectrum of investment vehicles, from high-quality bonds and domestic and international equities to alternative and illiquid strategies such as hedge funds and private equity.

More liquid ⟷ Less liquid

Equity	Equity mutual finds & ETFs	Long/Short equity hedge funds	Private equity secondaries	Private equity	Venture capital
Fixed income	Treasuries	High-yield bonds	Structured credit	Credit hedge funds	Distressed/ Mezzanine debt
Real assets	REITs/commodity funds	Liquid real estate debt	Private real estate debt	Private real estate Private infrastructure	

The family office CIO should create a consistent and reliable process for evaluating the quantitative and qualitative characteristics of all investment managers and investment strategies. This process involves understanding the costs, performance, tax efficiency, and style of every investment manager in a particular portfolio. In addition to in-house due diligence processes, your CIO should have access to research databases covering both public and private markets.

DEVELOPING & IMPLEMENTING PRIVATE MARKET STRATEGIES

As investment markets have evolved over the past decade, access to private markets and illiquid strategies has grown in unison. Your CIO should have industry relationships and connections to support the development and implementation of any private markets strategy your family chooses. Further, the CIO is responsible for understanding the cash flow requirements of the private markets portfolio and the tax ramifications of any investment, considering alternative investments routinely have differentiated liquidity provisions and nuanced tax consequences.

Overseeing family office direct investments

The CIO plays a crucial role in determining the family office's overall **direct investment strategy**. This role includes sourcing deal flow, managing the investments, and reporting investment results to the family. For a family with a sizable direct investment portfolio, the CIO may spend significant time in this area.

The CIO also has responsibility for analyzing the exit strategies and building the investment team. Family offices should be aware that professionals with this expertise often come from investment management roles or private equity firms and may expect a different compensation structure than a more traditional CIO.

Ongoing family office investment monitoring and performance reporting

A strong CIO will implement a robust and thorough monitoring process for your family's investments so that investment decisions can be properly evaluated and appropriately benchmarked. The growth of passive investment strategies over the past decade means that any decision to deviate from low-cost index strategies should be evaluated. Are reasonable rates of return being achieved on an after-fee and after-tax basis?

Family offices with in-house CIOs and investment teams will need to subscribe to research and information databases to conduct appropriate monitoring and peer review. Family offices that outsource this function should understand how their advisors are evaluating and benchmarking investment decisions and strategies over time.

SELECTING PORTFOLIO MANAGEMENT SOFTWARE FOR THE FAMILY OFFICE

Selecting the appropriate portfolio management software is another important factor for family offices with an in-house CIO and investment team in order to appropriately analyze and review investment decisions and managers within the portfolio. Slight nuances, such as reviewing internal rates of return (IRR) instead of time-weighted returns (TWR) for a liquid investment strategy, can drastically skew performance analysis.

It's important for family office CIOs to understand the strengths and weaknesses of any system in use and how the system's features can help the family achieve its long-term goals and objectives. Without proper data analysis, it's impossible to make appropriate hiring and firing decisions for portfolio managers. Portfolio management systems can run upwards of hundreds of thousands of dollars per year, not including staffing within the family office to maintain system data integrity. Because of the costs and complexities associated with implementation and maintenance of a portfolio management system, many family offices choose to outsource this function.

MODIFYING THE FAMILY OFFICE INVESTMENT STRATEGY OVER TIME

As time passes, underlying investor characteristics — risk tolerance, time horizon, cash flow needs — will change, and the CIO is responsible for reviewing, reconfirming, and modifying the investment plan accordingly. No matter the cadence of your family office investment reviews, confirmation of the pillars of the investment strategy should always be on the agenda. A strong CIO will come prepared with any necessary changes or recommendations to the underlying strategy or manager lineup, including the associated tax consequences.

Final thoughts on the family office CIO role

The family office CIO has wide-spanning responsibilities. Although much of the CIO's role is focused on investments and the investment decision-making process, many CIO responsibilities aren't investment-centric and absolutely will impact the long-term success of the investment strategy — and therefore the long-term success of the family office as it continually evolves to meet its mission, goals, and objectives.

Please contact us with any questions

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