

C. Hoare & Co. Conservatism Where It Counts

Business as usual for the last of UK's privately-held banks

STUART FIELDHOUSE

Once upon a time there was a bank that invested in a highly speculative investment vehicle, used derivatives to leverage its position within that vehicle, and timed its exit perfectly, thanks to the presence of one of its partners on the board. That bank was C. Hoare & Co., the year was 1720, and the investment was the South Sea Company.

Alexander Hoare, Managing Partner at the bank, is proud of the fact that the last privately-owned banking entity in the UK has skilfully weathered more than its fair share of financial storms, and continues to work hard to preserve the capital of its clients through good times and bad. It is testament to a conservative approach to where it puts its money, founded on common sense, and which still serves as the bank's investment mantra in today's fast-moving world of alternative investments.

As a bank, C. Hoare & Co. acts as an investor for both the assets of the Hoare family, and for external clients. In some respects it has a little more flexibility with its own money, which constitutes the majority of its £100m capital base, but it sticks religiously to the investment principles that have served it well over the centuries. It focuses on capital preservation, and selecting appropriate third party investments. It is not in the business of developing its own investment products or funds of funds, and when it has adopted new investment strategies (including hedge fund investments) it has only done so after long and careful consideration.

C. Hoare & Co. first started to consider hedge funds seriously in 2001, when their numbers were looking superior to that of long-only funds.

"Our experience with hedge funds has been good," says Alexander Hoare, "and now they are something we would recommend to our discretionary clients. We use hedge funds not for dramatic returns, but for diversification and smoothing of those returns."

The bear market was a major driver behind Hoare's decision to start investing with hedge fund managers, but another factor was the noticeable drift of investment management talent into hedge fund organisations. Many of these investment management figures are now clients of Hoare & Co as well.

Indeed, Alexander Hoare himself has been watching with interest how the hedge fund industry has created new wealth in the City. With many customers of his working within hedge funds, he thinks it natural that the bank itself should have a hedge fund portfolio, and his client base can provide a useful source of expertise in this respect. "They pushed us in this direction even before 2001," he says.

"We start with the people"

As a private bank, C. Hoare & Co. approaches business opportunities differently from an investment bank: relationships are key, and this includes money managers. "We start with the people," says Hoare.

For its private clients, Hoare invests with funds of hedge funds; for its own money, it will consider single managers, although the bank is averse to seeding start-ups, and like other cautious investors in this space, likes to see a decent track record, ideally three years. It has been invested with some of the more blue-chip hedge funds locally (eg RAB Capital), and is obviously far more comfortable with big firms, based in London, where it is easy to meet the principals and get to know them as individuals. A high profile, high octane West Coast US manager may look good on paper, but travelling abroad to meet managers in other time zones is against the grain for this investor. "I don't like any strategies I don't understand, and that includes most of them," says Hoare. "As a 335-year-old organisation, we are as interested in preserving wealth as making it."

The bank's Managing Partner thinks hedge funds are here to stay, and that they will continue to play a key role in the bank's alternative investment portfolio. His big concern, however, is whether London will continue to maintain its primacy as the region's hedge fund capital. His worry is that political interference will eventually upset the apple cart. "We're blessed that London is a world financial capital, and I become concerned when I see the taxman saying that hedge fund managers are not paying enough tax. I could imagine hedge funds quietly drifting off elsewhere, followed by the taxman going after the private equity guys, followed by everyone going offshore."

Interestingly, C. Hoare & Co. integrates its activity in the alternative investment sphere with its traditional fund investment activities, something many other wealth management outfits have yet to do. Some investment firms have carefully ring-fenced their hedge fund investment teams away from their long-only portfolio management activities, but Hoare's approach seems more mature: if you are applying criteria that have stood you in good stead for generations, and across a wide range of investment types, there is no reason not to integrate them.

After all, it forces the hedge fund managers C. Hoare & Co. invests with to earn their bread against cheaper, long-only funds. All the absolute return arguments in the world will not save you if you're consistently underperforming a long-only manager in your market who is charging less than you are, and has no performance fee. The new rules

on Basle are forcing the bank's hand, however, much to Alexander Hoare's disappointment. The bank is having to wind down some of its illiquid investments, including private equity, in order to comply with the new regulations. "It's very, very sad, as it has been making tremendous returns," he says. "But they penalise bank's capital ratios, so much so that we recently gave away a hedge fund in order to improve our capital ratio. Banks are having to rearrange their assets because of these new rules. Some of the rules are very, very perverse. Many of the international accounting standards are hitting us at the same time. The problem is that we are accounting as capital, profits we have not yet booked. My only worry about that is that it's not very conservative accounting. I'm sure the regulators did not intend it all to have such a perverse effect as it is obviously having."

The issue of liquidity – or lack thereof – in both hedge funds, and the underlying investments they are trading in, has caused plenty of creased brows in the institutional investment world of late, and Alexander Hoare is no different. But he is sanguine about this trend: he expects a shake-up in the markets eventually, and when this occurs, "some of these funds will be shaken out." The trick is not to be caught holding them. Having said that, he stresses that just because he emphasises liquidity does not mean the bank is not a long-term holder of hedge funds. It values its relationships with those managers that have been able to provide it with consistent returns over the years, and continues to support them.

"Over the last six years, the world has been awash with liquidity," says Hoare. "People have driven down risk premia, and they've leveraged up to unprecedented levels. Sooner or later there's going to be a shock, everyone's going to head for the exit, and there's going to be a nasty crush at the doorway. It's capitalism working as it should do. If you look back at the dot bomb, yes a lot of people got burned, but a lot of other people made some ridiculous fortunes. They were allocating capital to the Internet sector which now we couldn't do without. The capital got allocated, and the job got done."

Structured products

Structured products, which have become very much a core offering for many private banks with an interest in hedge fund investment – and a popular conduit for high net wealth entering the hedge fund envelope – are the subject of some debate at the bank's headquarters at 37 Fleet Street. Alexander Hoare retains his suspicions about how the structurers are being remunerated, and whether fair value is being paid. He feels private banks should be working hard to unbundle such products in order

to perceive this. “We see them as tools for portfolio management,” he says. “We haven’t got a large program of structured products, although I’m very conscious that a lot of our competitors have made a lot of money pushing structured products, but then I’m suspicious of that too. I’m also conscious that consumers tend to like them. The trick is to please your customers without inflating the profits of the investment banks.”

The current mania for listing fund products on exchanges is also something Hoare has noticed, and considers a step in the right direction, at least from the investor’s perspective. It again boils down to the pressing issue of liquidity. “Our proposition is wealth management integrated into private banking,” he explains. “What that means is that our portfolios have to be very flexible. What tends to happen is a client will get a bonus, and his portfolio gets bigger, and then he buys a house, and it gets smaller, and then he pays his school fees, and it gets smaller still. Portfolios are always going up and down, and when they go down, we need the liquidity. Customers don’t give you money and wait to see how you do over five years.” Even long term investors like trusts will have a requirement for flexibility, and it is this flexibility that Hoare thinks his bank can bring to the table. “Anything which could restrict flexibility requires a bit more thought,” he says.

C. Hoare & Co. finds itself in a unique position in today’s UK banking market. A hundred years ago there were 50 banks like it, today it is the only privately-owned bank in the country. “That’s a very nice position to arrive at, but it has happened largely by luck,” says Hoare. “We were sorry to see Leopold Joseph go last year, and Cazenove, and Lazards. I actually think it’s a regulatory failure. I think consumers deserve more choice. My own hypothesis is that for many, many years governments have regulated to protect consumers, but what they’ve really protected is an oligopoly of not-very-efficient banks, and given consumers very little choice.”

Family offices: the new private banks?

Will the day ever dawn when another family office decides to create a bank to sit alongside its existing investment activities? Hoare doubts it. Not in this regulatory climate. To set up a small bank today is extremely hard, he says. What is happening instead is wealthy individuals are creating new family offices so that they no longer need to deal with the big banks. Hoare is seeing a lot of welcome innovation arising from multi-family offices, and is finding his bank working for them by providing them with basic banking services - such is their aversion to dealing with the blue chip behemoths. “They want flexibility, they want speed, and they want efficient execution,” he says.

C. Hoare & Co.’s appeal to the family office market is similar to its offering to private individuals. It is the relationship that counts. Fifteen years ago, at the height of the bull market, private banking relationship managers were listing their ability to manage relationships at the top of their added value list when contrasting their services with ordinary retail banks. That hasn’t changed. If anything, it has become more important as service levels at the big banks have noticeably declined, and as increased automation and a tendency towards relying on call centres has alienated consumers even further. Hoare’s perspective on this is refreshingly traditional, but bears out the mantra of seasoned private banking professionals – you cannot beat the personal touch. Says Hoare: “They get a relationship with people who understand their needs, they get flexibility, a ‘can do’ attitude, they get fast decisions, they get accurate execution, they get a little bit extra, and a much better service.”

These family offices are now hiring their own investment management staff out of the big investment banks, in order to oversee large portfolios, including alternative investments like hedge funds. They turn to C. Hoare & Co. in an effort to recreate the machinery of a wealth management enterprise: why buy a banking system when they can tap into one that has over three centuries of pedigree?

Retail hedge funds

As for the prospect of retail hedge fund products, Alexander Hoare is of the school of thought that such funds will be authorised for the UK public’s consumption, and that this will be a good thing. It is not a view he shares with some hedge fund managers, but then he has a consumer’s perspective. “I think given the huge degree of ignorance and mystique about hedge funds, it is probably as well to keep them away from retail punters, but actually they’re not dramatically different from any other investments.”

Despite a customer base that has mushroomed, and transformed out of all recognition, since Alexander Hoare left the world of management consultancy to join the family business, C. Hoare & Co. feels it can serve its client base efficiently from its two offices in London. The bank now has customers all over the planet, including many foreign nationals, both resident in the UK and overseas. It has developed a range of offshore services for those qualified to take advantage of them.

As a small bank it does not see a need to open an office in New York or Paris, instead satisfying itself with working with partner institutions of a similar scale. It is a member of the Groupement Européen de Banques, a small fraternity of European private

banks, with one member in each of 10 European countries. The network includes Gruppo Banca Sella in Italy, Banque Martin Maurel in France, Banif in Portugal, and Bankhaus Lampe in Germany. In the Channel Islands, C. Hoare & Co. works with its clearing bank, Royal Bank of Scotland, as well as with Bank Julius Baer.

In the US it works with three private banks. But alongside this, Hoare and his colleagues travel extensively to keep in touch with the bank’s overseas clients. In a global village, it wants its customers to feel it is just around the corner, and does not see a vast global network as necessary to achieve this.

Ultimately, as the City of London continues to enjoy its pre-eminence as Europe’s leading financial centre, C. Hoare & Co. remains well-placed to serve the banking requirements of those who have achieved success in this vibrant and dynamic money management capital. Alexander Hoare seems upbeat about his bank’s future, and its service formula: “It’s lucky to own a bank, but to own a bank in the right city, at the right time, that’s dead lucky,” he says. **THFJ**

Biography



ALEXANDER HOARE

Alexander Hoare is the eleventh generation Chief Executive of C. Hoare & Co. The private bank was founded in 1672 and remains 100% owned by the direct descendants of the bank’s founder.

Prior to joining C. Hoare & Co., Alexander Hoare worked as a marketing consultant for PA Consultant Group until 1987. He is non-executive director of Jupiter Green Investment Trust, a member of the Westminster Abbey Finance and Advisory Council, a trustee of Training for Life, a former trustee of Trinity Hospice, and a former President of the Groupement Européen de Banques.

Born in 1962, he graduated from the University of Edinburgh with a B.Comm with honours in marketing.