



The Family
Office Association

CREATING A SINGLE FAMILY OFFICE TO MANAGE YOUR FAMILY'S INTERESTS

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Creating a Single Family Office to Manage Your Family's Interests

By Marc J. Sharpe

A Single Family Office (SFO) is a private company comprised of dedicated professionals who are employed exclusively to manage the investment, personal, and legacy needs of one family.

The modern concept and understanding of family offices was developed in the 19th century. In 1838, the family of J.P. Morgan founded the House of Morgan, which managed the families' assets and in 1882, the Rockefellers founded their family office, which prevailed until today. Family offices started gaining significant popularity in the 1980's; and since 2005, as the ranks of the super-rich have grown to record proportions, family offices have also swelled proportionately. Extreme volatility, banking and business failures, and investment fraud, has motivated many families of significant wealth to take control of their financial affairs and preserve their family legacy.

The SFO's financial capital is the family's own wealth, often accumulated over many family generations. Traditional family offices provide personal services such as managing household staff and making travel arrangements. Other services typically handled by the traditional family office include property management, day-to-day accounting and payroll activities, and management of legal affairs. Family offices often provide family management services, which includes family governance, financial and investment education, philanthropy coordination, and succession planning.

While many wealth management firms have "family office" practices or offer "family office" services, this white paper focuses on the "Single Family Office" or SFO in the context of a privately-owned and run operating entity developed for the sole benefit of one family. Each SFO is as unique as the family who founded it. As the old joke goes: "If you've seen one single family office, you've seen one single family office."

Single Family Offices

The modern concept and understanding of family offices was developed in the 19th century. In 1838, the family of J.P. Morgan founded the House of Morgan, which managed the families' assets and in 1882, the Rockefellers founded their family office, which prevailed until today. Family offices started gaining significant popularity in the 1980's; and since 2005, as the ranks of the super-rich have grown to record proportions, family offices have also swelled proportionately.

A single family office ("SFO") provides information, education, opportunities for networking, idea sharing, and pooling of buying power, to affluent families, and prepare the next generation for their wealth. Importantly, an SFO is a private company that manages investments and trusts for a single family. The company's financial capital is the family's own wealth, often accumulated over many family generations. Traditional family offices provide personal services such as managing household staff and making travel arrangements. Other services typically handled by the traditional family office include property management, day-to-day accounting and payroll activities, and management of legal affairs. Family offices often provide family management services, which includes family governance, financial and investment education, philanthropy coordination, and succession planning.

The SFO's are run by trusted professionals with a fiduciary responsibility to a single family. The professionals running these family offices have broadly defined roles, covering multiple areas and multiple skill sets. The offices tend to be staffed with talented individuals who can span accounting, legal, operational, and investment management activities, among others. Defining the service proposition is not straightforward and a common phrase used by industry insiders is: "When you have seen one single family office, you've seen one single family office"

The wealth management industry like to classify family offices based on size of assets under management. Some believe the monetary threshold before a single family office (SFO) makes sense is at least \$200 million in total assets. A better question to ask is: "Are my family's financial and non-financial interests best served by our existing (or additional) outsourced advisors?" If the answer is "no" then a single family office might be the solution...

Some SFOs are substantial wealth management institutions, with large teams of experienced professional overseeing fully diversified portfolios, including hedge funds, private equity, oil & gas interests, direct investments, real estate, commodities, and other alternative investments, as well as accounting, asset management, legal, security, and other functions. Other SFOs are more lightly staffed, with a variety of activities outsourced. Almost all SFOs share the following features:

[1] Swiss Life Global Solutions - "Risk and the Family Office: How Life Insurance Can Help" (May 18, 2022)

- Dedicated focus on the specific needs and requirements of the family
- Alignment with the family's legacy, vision and values
- Privacy and confidentiality is strictly maintained
- Investment time line typically spans multiple generations
- Overseas a complex mix of investment and personal assets
- Purchasing leverage, fee minimization and cost savings
- Avoids many of the conflicts inherent in the wealth-management industry
- Strong coordination between investment, business, philanthropic and personal services

All global families, regardless of geography, industry, ethnic make-up, dynamics and individual objectives, share certain common imperatives to operate effectively:

- Retaining top management talent
- Sustaining growth and profitability
- Optimizing capital structure
- Adapting to evolving risk profile
- Developing a coherent family agenda
- Mapping tax, legal and regulatory priorities
- Evaluating strategic relationships
- Embedding family vision and values in the SFO culture

SFO success depends in large part on how effectively the family reevaluates and reexamines its goals and objectives, especially as family leadership changes.

Depending on the needs of the family, and the size and complexity of the assets under management, the services provided by the SFO can vary widely. They may coordinate and oversee various types of investment-related services, management of complex assets, accounting, tax planning and compliance, asset protection and risk management, as well as family services. Here are the most common elements that each category may include:

Investment Management Services

- Design and implementation of asset allocation
- Development of an investment policy statement (ISP)
- Aggregation and reporting of investment performance
- Sourcing and due diligence for investment opportunities

Management of Complex Assets

- Mineral and O&G interests
- Collections and sports teams
- Socially-responsible investments
- Family bank and intra-family loans
- Residential and commercial real estate

Accounting, Tax Planning and Compliance

- Trust implementation and administration
- Accounting and tax filings, and tax planning
- Administration of private family trust company
- Identification and engagement of outsourced providers
- Development and coordination of estate plans for all family members

Asset Protection and Risk Management

- Insurance policies
- Medical management
- Reputation management
- Personal security services
- Hiring and background checking
- Management of household and family office staff

Family Services

- Organization of family retreats
- Philanthropy and charitable activities
- Next generation education and engagement
- Family mission, constitution and governance
- Personal and property security systems and procedures
- Concierge services (e.g. travel, private aviation, personal shopping)

Reliable data is hard to find, but according to Forbes' latest billionaires list, which analyzes all assets an individual can hold, there were over 2,000 individuals from across the world with personal 10-figure fortunes. They control an estimated \$10 trillion. In the U.S. alone, Forbes estimates there's over 450 American billionaires. In addition, there are currently more than 5,000 U.S. households worth \$100 million or more. China is second with more than 1,000 ultra-rich households.

Estimates of the number of SFOs around the world is much harder to find but is likely currently around 3,000. This doesn't include quasi-family offices: small private family investment companies of limited scale, or family offices embedded within family-owned and – managed businesses. Given the number of ultra-high net worth individuals, why are there so few SFOs? Part of the reason is lack of awareness and education regarding the benefits of an SFO, fear of potential cost and complexity of set-up and management, challenges in hiring capable staff, and lack of professional guidance. All these factors make families reluctant to create their own SFO.

But families that forego an SFO, whether by conscious decision or lack of awareness, face significant challenges. These families often have fragmented and uncoordinated relationships with multiple private banks, wealth managers and other business, investment and personal service providers. The family pays high fees for this disorganized array of overlapping services. Worse, those fees likely are not fully disclosed, so the family can't quantify or compare them, or effectively negotiate with the service providers. Furthermore, many of the institutions they work with have built-in conflicts of interest: brokers and other client-facing staff often receive higher commissions for selling the institution's own investment products, giving them an incentive to push these products rather than choose the product that best suits the client's needs and circumstances. Families also rarely have the staff or the expertise to vet investment advisors or individual investment opportunities, thereby heightening the chances they may inadvertently enter into a subpar investment, or worse, a Ponzi scheme or other fraud.

Wealthy families are increasingly demanding independent, thoughtful and tailored advice. Instead of buying opaque financial products from third party financial advisors – often incented to meet artificially mandated sales quotas – SFOs provide an objective filter through which everything can be carefully screened to meet the complex business and personal needs of the families. Now more than ever, wealthy families need to coordinate their business, investment and personal relationships, centralize management and oversight, implement appropriate due diligence and risk management procedures, and manage their family affairs more effectively. For a family of significant wealth, an appropriately structured and well-run SFO is likely the answer.

Starting an SFO

Creating an SFO to fit your family's specific needs and circumstances requires considerable thought and preparation. Families considering forming an SFO should put together a motivated group of family leaders and trusted advisors to lead the planning effort, with input from outside specialists as necessary. The following, while not totally comprehensive, serves as a helpful checklist to get started:

Mission Statement

Families planning an SFO should take time at the outset to consider the purpose of the SFO and its role within the family. A critical early task in setting up an SFO is defining the mission of the family office. Developing a concise, focused mission statement to guide the work of the SFO will help to avoid "mission creep" in future years. The founders should avoid drafting a mission statement that is vague and short on specifics. A consultant can help a family mold its vision and values into a practical and useful tool to guide the work of the SFO for generations to come.

Needs and Objectives

There are three critical questions to be addressed early in the planning and development phase of creating your family office:

1. Who are the clients?

Defining which individuals and entities will be served by the SFO is a critical activity. A comprehensive list should include all individuals and entities to be served, including family branches, investment entities, businesses, trusts, trust companies and foundations. The design of the SFO will need to consider each client's unique needs and requirements.

2. What assets will be managed?

Once the clients have been identified, a list of all the assets the SFO will be responsible for managing is needed. This will include marketable securities, hedge funds, MLPs, direct investments, oil & gas leases, operating businesses, residential real estate, commercial real estate, farms, collections, aircraft, yachts, horses, sports teams, etc. The SFO will need to hire or outsource the specific expertise needed to oversee and manage the assets.

3. What services are needed?

Families with extensive investments, or with liquid capital to be invested, will need investment management services, including an investment policy statement and asset allocation plan, manager due diligence, and investment reporting. All SFO clients will need comprehensive and accurate performance reporting, accounting, and tax-return preparation. Coordination of risk management - such as insurance, security and reputation management – will also be needed. Development and coordination of estate and tax planning, possibly including management of a private family trust company, is another obvious need for multi-generational families, but can be equally critical for a first-generation entrepreneur who wishes to perpetuate the family's long term legacy. Other possible services include property management and staffing, bill payment and concierge services.

The adage of “shirt sleeves to shirt sleeves in three generations” is well known. It has been documented throughout the world, across numerous countries and cultures. It is one of the driving reasons why many families of wealth recognize the need for proper family governance and family wealth-planning strategies during the lifetime of the family wealth creator. However, even after implementing a family governance system during the design phase of an SFO, families must constantly refine and reevaluate their values, vision and mission as their SFO adapts to the changing needs of the family and the global environment.

Business Plan & Budget

Once the clients, assets and needs have been identified, a business plan can be developed that outlines the services to be provided, a short- and long-term timeline, employee and outsourced talent required, service partners required (for example, custodians, tax counsel, security services) and technology needs.

A key objective in developing a business plan should be determining the budget. SFOs are not inexpensive to operate. However, when compared with the expense of managing the family's assets via an outsourced or third-party solution - taking into consideration all costs, fees and expenses - the expense of an SFO will likely be lower. Certainly, because the SFO will be custom-tailored to the family's needs, the return on that expenditure will be much higher.

Typically, SFO budgets are defined as a percentage of assets under management. SFO operating costs vary widely. with smaller SFOs, or those managing complex assets, costing more to operate than larger SFOs, or those managing a simpler portfolio, because there are fewer economies of scale to exploit. The budget of an SFO managing an extensive portfolio of alternative investments and commodities for three generations of family members, all of whom also share a passion for modern art and house their collections in multiple homes around the world, will necessarily be larger, both as an absolute number and as a percentage of assets under management, than the budget of an SFO managing a portfolio of publicly-traded securities for a single family unit. The budget will drive the creation of benchmarks to set expectations for SFO performance.

An SFO serving the needs of a multi-generational family must consider how the costs will be allocated and charged to individual clients of the SFO. Future conflict between family office clients or between the family and the office can be avoided if the method of allocating expenses, determining the expected contributions by each client, and collecting fees is made explicit from the outset.

Leadership and Staffing

The plan should identify the expertise required to meet the specific needs of the SFO's clients, given the specific assets to be managed and the available budget. The plan should also specify whether such expertise will be provided internally or outsourced. Once staffing needs are determined, the issues of location, office space needs, technology, security, administrative support etc. can be addressed.

Finding the right talent is generally the most challenging aspect of setting up an SFO. Ideally the CEO candidate should be identified first (if this task has not already been completed). Because the CEO of an SFO must work closely with the family, the office staff and with a wide array of outside service providers, the CEO must have excellent organizational, management and "people" skills. Choosing a CEO purely because of his or

her technical expertise in investing, or in accounting, or in tax planning, is generally a mistake. Often, families will give this important position to a trusted advisor or the controller of their operating business who has been loyal for many years. This can also be a mistake if the trusted advisor or controller is not scalable into the CEO role. Because the CEO carries out a high-level executive function and serves as the family's face to the outside world, candidates should have proven experience leading, managing and communicating successfully in a wide variety of complex situations. It is a critical role to fill, since once identified and hired, the SFO CEO will take on the role of carrying out the build-out of the SFO in accordance with the plan.

SFOs often hire investment team members with extensive prior experience at private banks, investment houses and hedge funds. Such talent is highly sought after; candidates often demand investment rights or bonus compensation based on investment performance. The SFO should take care in structuring such arrangements, particularly considering the Dodd-Frank Act's requirement that family offices comply with RIA registration requirements unless they fit a very narrow exemption. SFOs, both new and established, should seek advice of experienced counsel when bringing on new investment team members or adding new benefits such as carried interest.

All staff members, at every level, should go through a background check and sign non-compete, non-solicitation and non-disclosure agreements. Whether the SFO is large or small, it should have an employee policy manual. The manual should be reviewed and updated at least annually by knowledgeable counsel.

The SFO should be overseen by a board of directors, which will meet regularly and be responsible for setting strategy and overseeing the CEO. Most families control the board of their SFOs, to ensure strategy is in line with the family's wishes. Many SFOs are following the lead of private businesses and bringing independent advisors onto the board to provide outside perspective and expertise.

Contingency Plan

Planning for the SFO should include development of a contingency plan that outlines procedures to be followed in the event of a natural disaster, extreme volatility in the financial markets, theft, or technology breach or failure. At the most basic level, the contingency plan should include provisions for ensuring the safety and security of the family, its critical information and tangible assets, safety of the SFO staff, off-site backup of all information, and a plan for re-establishing critical office activities off-site as quickly as possible.

SFO Governance

Governance is an important issue for any professionally run SFO. Indeed, an SFO that is intended to serve a family for generations is well advised to develop and implement an effective and appropriate governance structure that can significantly enhance the long term success of the office.

At its core, governance is simply a set of procedures that define how an SFO will make decisions. For governance to be effective, the owners, overseers (board of directors or advisors) and executive management must be informed, understand their respective roles and responsibilities, and run the SFO accordingly.

Typically, a successful individual will create an SFO following a liquidity event of some sort. The founder will design the SFO to suit his or her needs and interests. As with any business run by a controlling owner, there isn't a great need for formal governance at this stage, because the owner is fully informed, understands the goals and objectives of the SFO, and may even handle some of the critical roles of the office. Unless the controlling owner has a formal governance mindset, they'll generally run the SFO with minimal overhead or formal structure, making many decisions 'ad hoc'. The controlling owner will often rely on external advisors or a key staff member who knows what is needed and can implement the controller owner's wishes.

This kind of organic, first-generation governance can work quite effectively, at least in the early years of a family office's life. The SFO runs smoothly, makes investments, and accomplishes tasks. However, when the SFO comes to be managed for the benefit of a wider group - typically, upon the controlling owner's death, when the assets pass to descendants or trusts for their benefit - the absence of established, governance policies can create a vacuum. Without the founder around, suddenly no one really knows who's in charge, what needs to be done, who's responsible for doing it, or how that performance will be measured or compensated. If the next generation hasn't been prepared for their new roles, there may be a struggle for dominance, or the opposite: fearing conflict, family members may simply abdicate. The SFO may slowly collapse, or a non-family member may come to fill the vacuum, for good or for ill.

Successful SFOs have strong governance policies to ensure the organization operates in accordance with the family's long term mission and values over multiple generations. These governance structures must be robust yet flexible enough to withstand family conflict, generational transitions, and disruptive changes in the investment environment, whether anticipated or unanticipated. The following are key elements of a good governance structure:

1. The family has clearly articulated its mission, values and vision for the future, and the strategic plan of the SFO is built around this core.
2. The SFO's strategic plan goes beyond investing and includes education of family members, to promote effective stewardship over the long term.
3. The owners have appointed a board of directors to provide perspective, access to specialized experience/skills, and to set strategy and investment policy. The board includes individuals who are not members of the family, members of the management team, or external service providers to the SFO.
4. The powers, rights and responsibilities of owners, board and management are clearly spelled out and followed.
5. Management is free to implement the SFO's strategy, without daily interference from the family or the owners.
6. There are regular owners' and board meetings, with written agendas and complete minutes. Information necessary for effective decision-making is distributed well in advance of voting, and there is adequate time for discussion.
7. SFO performance reports are clear, comprehensive and timely, so that decision-making can be based on accurate and complete information.

An SFO can do much to align its operations with the family's interests, particularly in times of generational change. Some SFOs find that family office meetings become a venue for family members to air family grievances. The SFO can encourage and support the development of a Family Council to provide a forum for discussions of family issues separate and apart from the SFO. SFOs can play a key role in promoting family education, modeling best practices, training next generation family members, and fostering an attitude of stewardship.

SFOs are typically designed to serve multiple generations of a family, but an SFO is not eternal. Over the past decade, there have been well-publicized stories of substantial SFOs that crumbled under the conflicting demands and high costs of serving tens or hundreds of family members, each with comparatively modest holdings. Other SFOs, recognizing that they could no longer achieve the family's mission and vision, or that the mission and vision had changed in such a way that the SFO's activities were no longer cost-effective, have undertaken carefully orchestrated dissolutions. Families should recognize that dissolving an SFO is inevitably a complex, expensive and time-consuming process, and seek the advice of peer families or professional consultants who have navigated this experience successfully.

SFO Infrastructure

The structure of your SFO will depend on the jurisdiction(s) in which it will operate and the types of investments the family owns or intends to own...

Many SFOs in the USA are structured as limited partnerships or limited liability companies, and are organized similarly to hedge fund management companies (i.e. the SFO entity does not own any of the assets it manages; rather, it is a service entity that provides services to the SFO's clients on a contract basis). It is highly recommended you engage with experienced securities counsel who have worked with other family offices regarding the potential impact of SEC rules on their structure and operations.

·Dodd Frank and SEC RIA Registration

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, an organized effort was undertaken by single family offices nationwide that successfully convinced Congress to exempt SFO's meeting certain criteria from the definition of investment adviser under the Investment Advisers Act of 1940 (previously, such family offices were deemed to be investment advisers and relied on the "less than 15 clients" rule to avoid registration under the Act, a rule that was eliminated under Dodd-Frank). The Securities and Exchange Commission (SEC) promulgated the final "family office rules" on June 22, 2011. An SFO that does not fit within the definition of a "family office" or qualify for an exemption as a bank trust company must register with the SEC. While some family offices have opted affirmatively to register with the SEC, others are greatly burdened by the increased administrative burden and loss of privacy that registration imposes.

Any individual or entity providing "investment advice" must register as a Registered Investment Advisor (RIA) unless an exemption is available. Registration can be costly and entails detailed disclosures that families typically are reluctant to make. An RIA must maintain and preserve specified books and records and make them available to Commission examiners for inspection. An RIA must also implement substantive compliance programs, prepare and file reports with the SEC, and provide detailed written disclosures to their clients (known as ADVs). Every RIA is subject to SEC audit. Failure to register may subject an advisor to criminal and civil sanctions and penalties. SFOs may avoid registration by:

1. Structuring ownership and operations to fit within the "family office" exemption to RIA registration;
2. Outsourcing investment responsibility to one or more third party RIAs; or
3. Establishing a Private Trust Company (PTC).

Private Trust Company

With a Private Trust Company (“PTC”), a family-created entity, rather than a third party, serves as trustee of the family’s trusts. Private Trust Companies are sometimes recommended by advisors as a mechanism to avoid RIA registration, but PTCs may also offer substantial additional benefits for the SFO:

1. Greater privacy and confidentiality;
2. Common administrative and decision-making policies for all trusts;
3. More knowledgeable and focused fiduciary oversight for family businesses, alternative investments, start-ups, real estate, and other non-public investments held in trust;
4. Better understanding and knowledge of family circumstances and needs of beneficiaries.
5. Greater participation and input by the family than would be possible if an outside, third party served as trustee;

SFOs seeking to establish a PTC primarily to avoid RIA registration are advised to consult knowledgeable securities counsel with experience advising family offices.

Structuring Investments

The various investments managed by an SFO are typically held in individual limited liability entities, to reduce the risk that losses and liabilities from one investment will affect another. For example, if the SFO holds commercial real estate, each parcel of real property is best held in a separate entity. If a passer-by slips on the sidewalk in front of one building, incurs a severe head injury and sues for medical expenses and lifetime maintenance, any liability in excess of the SFO’s casualty coverage will be limited to the assets of the entity that owns that building, thereby protecting assets held in other entities.

SFOs are increasingly utilizing sophisticated holding structures such as tracking partnerships. A tracking partnership permits family office clients to hold different partnership assets in different percentages, with performance results tracking accordingly. By way of example, assume the tracking partnership has four separate classes of interests: Class B (bond portfolio), Class S (indexed stock portfolio), Class A (alternatives portfolio) and Class R (REIT portfolio).

- Partner 1, an individual seeking a broadly diversified portfolio, might hold a 10% interest in Class B, a 10% interest in Class S, a 20% interest in Class A and a 15% interest in Class R.
- Partner 2, a trust intended to fund education expenses for Partner 1’s 10 grandchildren, might hold 40% of Class B and only 5% of each of the other classes.
- Partners 3, 4, and 5 would hold the balance of the interests in each Class, each in accordance with their individual investment goals.

A tracking partnership gives partners the investment flexibility they would have if they formed several partnerships but permits them to trade between classes from time to time without recognizing gain or loss for tax purposes. Such partnerships offer considerable flexibility, custom-tailoring of client portfolios, and a consistent governance model for SFO clients. However, they also bring with them complex tax, accounting and reporting issues, and so need to be designed with the help of knowledgeable legal and accounting counsel and managed with care.

Carried Interests

A carried interest is a share of profits from a partnership or LLC that is paid to a participant who did not provide any capital to the venture. A carried interest may provide a tax-efficient mechanism to fund family office expenses and may be used to structure incentive compensation opportunities for SFO staff. Particularly considering Dodd Frank and the SEC's family office exemption, staff participation in SFO investments should be reviewed to ensure that they do not unintentionally trigger RIA registration requirements. SFOs are strongly advised to seek guidance from tax and accounting advisors before putting in place any carried interest structure or incentive compensation plan for SFO staff.

Insurance

A critical task for any SFO will be monitoring and managing risk for the family. Property and casualty, liability, health, and life insurance typically will be overseen and coordinated by SFO staff through relationships with an insurance firm that has experience working with SFOs and a comprehensive offering of insurance products. Certain assets, such as private jets and other aircraft, require unique holding structures, insurance coverage and regulatory compliance.

As the SFO grows and its clients and investments change over time, it is a good idea for the family and CEO to undertake a structural audit from time to time, to make sure that the SFO structure is optimal for its purpose. The audit may uncover opportunities for eliminating or reorganizing holding entities within the structure, thereby reducing reporting, accounting and compliance expenses for the SFO.

Business-Owning Families

Many business-owning families create a family office within the business administrative group. The company's accounting team handles personal tax filings and financial record-keeping, while administrative staff keep track of insurance, record-keeping and bill-paying. The benefits of an embedded SFO are obvious: the family can leverage an existing resource, so the family office appears to be extremely cost-effective.

However, there are serious drawbacks to setting up your SFO in this way. First and foremost, the focus of a family office (i.e. wealth preservation) will be very different from the focus of the operating business (i.e. wealth creation). A dual staff will often struggle to manage the varied responsibilities and objectives, and skills that are critical in the business may not necessarily translate into the family office realm. For example, partnership accounting and reporting for trusts and complex investment structures is very different to corporate accounting, and staff may lack the time, training and technology to handle both jobs well. The legal structure and governance of an SFO will also be quite different than those of the business, and mistakes may occur when business practices are automatically carried over to the family office. Lastly, priorities may be unclear, such that if an emergency occurs in both the business and family office, at the same time, there may be significant conflict or a lack of sufficient resources to tackle both. Risks of gaps in reporting and compliance increase exponentially when the same staff are responsible for both the business and the family office.

Families with operating businesses are recommended to seriously explore developing a separate family office to handle their personal investments and manage their non-business assets. Having a separate office provides for greater privacy and confidentiality and allows for hiring staff with the specific skillsets required by the family office. A dedicated family office staff, not subject to the hiring practices of the corporation, will facilitate the development of an SFO-specific organization chart, with separate responsibilities, compensation, and work practices. This will also allow for a longer-range focus for the family's personal strategic planning, as distinct from that of the operating business.

Building the family office apart from the business also increases opportunities for involvement of family members who don't participate in the business. By expanding family involvement, the SFO can become a force for strengthening family cohesion. Some families are using their SFOs to create entrepreneurial venture funds, investing in promising new businesses and technologies, and thereby increasing the odds of growing rather than simply preserving the family's capital.

SFO Technology

Many SFOs fail to invest in the robust technology infrastructure needed to optimize their capabilities, either due to a lack of execution or a lack of awareness around available solutions. Below are the six key technology needs for SFOs, along with a roadmap for the five key activities required for meeting those needs...

Key Technology Needs for SFOs

1. **General Ledger Accounting:** A double-entry accounting system, with workflow and accounting controls, integrated with investment and financial reporting, permits the SFO team to track the inflows and outflows of the family office and related entities.

2. **Financial Administration:** The accounting package should provide for management and payment of all expenses and accounts receivable and payable, ideally, with integration and auto-posting to the general ledger. Automation, along with the appropriate controls (verification and approval workflows), is critical to manage the volume and complexity of transactions that most SFOs face.

3. **Consolidated Reporting:** The accounting package must be capable of providing family members with an aggregated view of their balance sheet, income and cash flows across multiple custodians and financial relationships. The package should also enable robust ad hoc reporting (including risk metrics and performance analytics) on each family member's comprehensive net-worth picture.

4. **Secure Document Portal:** A document vault permits encrypted/secure connectivity and communication among SFO staff, family members and interested parties, along with electronic storage of all family documents (family history, legal agreements, wills, statements, etc.).

5. **Investment Analytics:** An SFO with any degree of in-house CIO function will require portfolio management and trading systems, as well as market data and manager research and due diligence databases.

6. **Infrastructure and Security:** Many SFOs self-host their data and technology solutions (i.e. they have acquired and managed their own IT equipment, software and processes). However, outsourced providers now offer cloud-based virtual hosting services in highly secure (SAS 70 Level II and ongoing security audit testing certification) and cost-effective hosting environments (with disaster-recovery support). SFOs should consider the cost/benefit and ongoing flexibility of the latest hosting options. SFOs also must consider their IT staff and organization: whether full time IT employees are needed or whether IT support can be adequately outsourced.

How to Meet Technology Needs

SFOs must take a strategic approach to designing, selecting, executing and maintaining their IT systems and resources. Given IT is a mission-critical function for every family office, and the task of developing a strategic plan for IT investment is complex, most SFOs engage a consulting group with specific experience designing IT solutions for SFOs.

1. Design: Whether upgrading an existing technology infrastructure or starting from scratch, an SFO needs to begin by assessing its technology needs and requirements, taking into consideration all family members, businesses, investment entities, office staff, and external service providers that must be supported. SFOs are increasingly adopting institutional-like requirements around their IT in terms of mobile and real-time online accessibility, tools for trading, analytics and research. In particular, SFOs are seeking greater visibility into all their direct and manager fund investments, real-time evaluation of the level of risk (through standard deviation, VaR, etc.) and look-throughs on asset class, holding and geographic exposure across investments. They also require monitoring of counterparty relationships and clarity about their global asset allocation at the entity, family, and individual levels. The strategic-planning process will include documenting, confirming and prioritizing needs and requirements, as well as developing due-diligence criteria for vetting potential solution providers. For example, the due-diligence criteria will likely include insource vs. outsource, buy vs. build, firm size and tenure, security standards, and reference checks. Ultimately, the process will lead to a request for proposal (RFP) and evaluation of service providers who meet the criteria.

2. Selection: SFOs have a myriad of options concerning the technology approaches they can take due to the ever-increasing number of vendor solutions to meet the needs of SFOs. Some SFOs opt to leverage and integrate a number of disparate stand-alone vendors. For example, they may use a general ledger from a provider such as Intuit, QuickBooks or Microsoft, coupled with a reporting package such as SAP Crystal Reports, firms such as the Google, Amazon or Rackspace for Cloud hosting, financial administration from the bill pay capabilities of their banking relationship, etc. Others leverage a single provider to meet the majority, if not all, of their needs (examples include: Wealth Touch, Archway Technology Partners, and RockIT). Families with more limited current and forecasted needs, who believe they can ably execute and maintain their technology themselves, typically take the former approach. Those who need a more robust and scalable solution are increasingly partnering with single-source providers. There are obviously pros and cons to both approaches. SFOs should also be aware that a number of financial institutions have begun developing in-house capabilities or partnering with leading family office technology providers that offer families and SFOs IT solutions and related services such as access to market data and tools to manage risk, analytics and trading. Their technologies may be integrated into the family office's investment management and banking systems or on an à la carte basis. These options may be cost-effective for SFOs as they're typically subsidized or simply included for no additional charge as part of the overall service.

3. **Assessment:** When considering multiple-solution approaches and providers, it's important to compile detailed cost data in the evaluation process and benchmark the cost projections against peers. When evaluating options, SFOs should select the solution(s) that provide flexibility and scalability for ongoing growth, require limited investment in maintenance and enhancements, and above all, ensure the privacy and security of the data and documents of the family. One of the key objectives and outcomes of the process should be to achieve collective buy-in across the SFO staff and family members who will use the IT system.

4. **Execution:** This phase often creates the greatest challenge for SFOs, making ease-of-implementation a key priority in the selection process. Sufficient resources, including money, time, focus and attention, must be allocated to implementing the chosen solution. Some SFOs have the technical expertise to evaluate and select an in-house integrated solution leveraging multiple software providers, but most find it overly burdensome to implement, configure and customize, integrate and test the chosen solution. Other SFOs taking the in-house multi-solution approach will engage the software provider's professional-services team or an external IT consultant to implement the chosen IT solution. Using an outside team for implementation can speed up the upfront implementation, but in the maintenance phase it can become very costly over time. Those SFOs that opt to outsource their technology needs via a financial institution or third-party partner will often be able to get up and running more quickly than those that choose a more customized or in-house approach. SFOs with relatively uncomplicated reporting needs that they outsource to an external provider may be able to use modular options, or they may choose to take advantage of the provider's configuration and customization abilities (at additional cost).

5. **Maintenance:** IT costs for SFOs vary widely depending on their needs, the number of entities, global reach, assets under management, type of assets and liabilities, and the approach they take to the IT environment. The total IT budget will typically include the following:

- Hardware costs.
- Hosting and data management.
- Consulting support throughout the process.
- Professional services configuration and customization of solutions.
- Software license fees and annual maintenance costs (typically a percentage of license fees).
- Outsourced operations fees (typically annual fees based on the complexity of services such as aggregated reporting or financial administration: e.g. number of entities, number of transactions, etc.).

The large majority of SFOs have moderate IT requirements. They can choose a basic general ledger and manually create reports via Excel, while maintaining a small or part-time IT staff. These SFOs typically have annual costs in the \$50,000-\$150,000 range. However, SFOs that have significant IT requirements often leverage one of the leading family office services-outsourcing providers (Wealth Touch, Archway Technologies, or RockIT for example), in addition to IT staff and other IT software and infrastructure. They might see total costs of \$3 million to \$ 4 million+, driven largely by the complexity of their balance sheets (the number of entities, alternative investments, transaction and bill payment flow, etc.), customization needs and geographic dispersion.

On average, based on industry research, anecdotal interviews and surveys, SFOs can expect to maintain an annual IT cost base (software, operational outsourcing, hardware and hosting fees, and IT staff) of 10-15 bps of their assets under management.

For budgeting purposes, SFOs must consider ongoing upgrades (software and infrastructure), research and development costs, evolving requirements of the office and family members, the pace of change in technology capabilities, and the complexities of IT security and data management. Given these considerations, many SFOs that previously chose to handle IT in-house are increasingly looking to outsource their core IT needs to third-party providers, while maintaining a small IT staff to attend to less complex office and individual family member needs (e.g. property and personal use vehicle connectivity, security, mobile device management, etc.).

SFO Risk Management

While most SFOs are founded to provide investment and concierge services for the family, perhaps the most important role of the SFO is to monitor and manage risk. With all investments and related activities managed by a single team, the SFO is in a better position than any individual family member, advisor, or external service provider to measure risk systematically and ensure SFO assets are protected. While a comprehensive risk-analysis discussion is beyond the scope of this whitepaper, a well-run SFO should be, at least, focused on the following risks a family may face:

Reporting Risk

SFOs tend to manage many, complex private entities within a broad portfolio of private and public investments, all of which report their individual performance at different times and in different formats. As a result, generating timely, accurate and comprehensive investment performance reports is one of the most difficult challenges for most SFOs. When a family considers creating an SFO, it should plan to allocate a significant portion of the annual budget to consolidated investment performance reporting-related expenses. At the very least, a consolidated P&L and balance sheet should be generated and available to the team responsible for managing and oversight of the family office. SFOs that under invest in developing their reporting capability often find themselves trying to make decisions with inaccurate, outdated information.

Accounting and Tax Reporting

Most SFOs manage tax reporting and estimated payments for family members, who will have local, state and federal tax filing obligations and may need to file in multiple jurisdictions. With complex holding structures, incorporating multiple pass-through entities and grantor trusts, the task of complying with tax reporting obligations can become very difficult. The risk is significant: failure to file accurate tax reports and make timely payments can subject the client to audit, interest and penalties. In addition to working with in-house and outside tax counsel, to ensure timely filing and payments, the SFO will need to stay ahead of tax law changes and new filing requirements.

Estate Planning

Most SFOs play an important role in helping families put in place effective tax planning, and ensuring the plan is properly implemented. As with accounting and tax reporting, the prevalence of complex investment and wealth holding structures can lead to highly complex estate planning structures. The SFO will generally be responsible for coordinating with counsel on the development of estate- and gift-planning strategies and updating the plan as circumstances and assets change. SFO clients often include one or more multigenerational trusts created by prior generation family members, and the SFO is

typically responsible for handling much of the administrative work for existing and new trusts, including maintaining accurate books and records, producing detailed accounts, and handling tax reporting and compliance. If the trustee of the trusts is a Private Trust Company (PTC), the SFO will typically manage administrative and investment functions for the PTC.

Investment Risk

In addition to direct investments in equities, fixed income and other securities, SFOs typically invest a substantial portion of the family's wealth in mutual funds, hedge funds and private equity funds, in an effort to diversify the portfolio and boost alpha-related returns. Fund investments deserve careful due diligence before capital is committed and regular oversight reviews for as long as the investment is in place. Investing in funds can bring a variety of risks that need to be monitored by the SFO and its advisory team:

1. Funds may exhibit "style creep" as managers venture into new markets to enhance returns.
2. Successful funds may become too large to function optimally in a given market, hurting returns.
3. Funds can be a way to diversify a SFO portfolio or provide expertise in a specific area of interest. However, this diversification benefit can backfire when multiple fund managers are investing in the same security or sector. It can be difficult to monitor such concentrations due to lack of transparency at the fund level.
4. Offshore funds may offer even less transparency than U.S. funds, and may create expensive tax reporting obligations.
5. Particularly in times of extreme market volatility, redemption limitations or "gates" can impair the SFO's ability to generate liquidity.
6. The potential for fraud exists in any investment. Fund structures provide a level of opacity that makes them particularly susceptible. As a number of well know frauds have illustrated, regulatory oversight of funds is extremely limited.

·Asset Protection and Reputation Management

A major creditor claim - whether from a divorcing spouse, an injury occurring on family property, or consequences of a car accident - can be a significant threat to a wealthy family. How a given asset is titled, held and insured can be critical to managing such threats successfully. The SFO generally will be responsible for managing asset protection strategies and for implementing multiple strategies (such as limited liability holding structures, insurance, indemnification agreements) where circumstances warrant a layered approach. SFOs for celebrities and prominent families should develop detailed risk-management plans that lay out procedures for family and staff to follow in the event of an incident or emergency. Such plans are particularly important for families that travel abroad frequently or maintain a high public profile. With the rising use social networking sites by family members, many SFOs are also developing reputation-management protocols to reduce the risk of identity theft, kidnapping, extortion or harassment of family members.

Background Checking & Monitoring

One of the biggest risks to a wealthy family is a theft or other crime perpetrated by a member of the family's inner circle of staff, advisors and service providers. Most SFOs undertake detailed background checks of potential hires, and many do extensive vetting of advisors and service providers as well. Appropriate monitoring of the SFOs staff and external advisors should be an ongoing activity, not simply a one time event at the time of hire.

SFO Personnel

The people that comprise the team who oversee and manage the SFO will be the most critical factor in the ultimate success of the family office. While staff can be hired and fired, having a stable and high functioning team is desirable, if not essential. There's an old adage in the family office world that an SFO is either the best place in the world or the worst place in the world to work, and it all depends on the family and how they treat the people that work for them. If you want great talent, who will stay with you over the long term, you should expect to treat them well and pay them competitively. There may be a trade-off, in terms of a better life style at a family office versus corporate America and Wall Street, but great talent will only stay if they are treated well and compensated fairly.

Given the importance of talent, the family should strongly consider interviewing and selectively working with one or multiple recruitment professionals that have experience with staffing senior SFO positions. With any position, there needs to be a clearly defined mandate and job description, a process for hiring and a due diligence investigation conducted for all potential hires. An employee handbook outlining protocols and procedures drafted by an employment attorney is recommended. In addition, the attorney needs to draft non-disclosure and privacy documents for all interviewees and further documentation, including employment agreements, for all hires.

The family office should also engage a compensation, specialist experienced in SFOs, to assist in designing a compensation and benefits plan to attract, retain and motivate the most qualified candidates. A compensation specialist can design a compensation package that includes short and long-term incentive bonuses, carried interest opportunities, co-investment opportunities, qualified retirement plan offerings, insurance, and deferred compensation (409A) / phantom stock "golden handcuff" strategies. The right mix aligns interests, encourages long-term employment and productive relationships.

It is recommended to hire carefully and prudently to ensure the right personnel. Many families hire only the employees that are absolutely required initially, while outsourcing other functions. Over time, additional employees are hired to replace outsourced services in a phased approach. It is common for the first hire at a newly formed SFO to be a trusted relationship who has worked for many years with the family. Typically, this will be

the Controller in the family business, who can manage the accounts and execute administrative tasks, or the external CPA or Tax advisor, who's familiar with the family dynamics, assets and planning. While expedient in the short term, this can lead to problems later in the life of the SFO when more senior and experienced talent, with a broader set of skills, is needed to manage complexity of a larger team. Any high quality CEO or President will want to know the team they have working for them is both loyal and capable. Where possible, it is better to hire the most senior position first and allow them to have some input into the hiring process as the SFO team is built out.

The most common SFO positions are outlined below:

Chief Executive Officer (CEO)

The Chief Executive Officer (CEO) should be a highly experienced professional, with a broad set of skills and experience, who can lead the SFO. Trustworthiness, leadership, communication and the unwavering ability to execute the family plan are essential. This is a role for an "Expert Generalist". Using a sports analogy, the CEO is the "quarterback" who needs to maximize and coordinate the efforts of all the "players".

There is no set formula and the SFO and its personnel must be customized per a family's needs. Usually, the CEO is an experienced business professional with a broad knowledge in finance, accounting, technology, and other technical areas; however, the CEO does not have to be a true expert in every technical aspect of the SFO. There are times when a very strong financial, accounting or legal background is preferable to business and leadership savvy. The right CEO for an SFO that runs multiple operating businesses will likely not be the right CEO for an SFO that invests primarily in public markets.

The CEO needs to carry out the mission and coordinate effectively all aspects of the SFO in a synchronized effort in fulfilling the family's mission and vision. The CEO needs to be engaged in all aspects of the SFO yet understand the importance of delegating (with oversight and accountability). The CEO needs to communicate on an on-going basis with the family and focus on the SFO's mission. This position answers directly to the family leaders and SFO board/committee. For a CEO to be effective, he or she must have the ability to engage multiple family members and generations. Education and motivation of the younger generation will be critical to the long-term success of the family and the SFO. An understanding of family dynamics and the ability to facilitate critical family discussions effectively is important.

There is a very broad range when it comes to SFO CEO compensation. Based on limited market data and anecdotal research, the CEO in a small SFO commands \$300,000 - \$600,000 and in a larger SFO (or small SFOs with more dynamic requirements and/or family members that see the value in a great aspirational candidate regardless of cost) can cost anywhere from \$500,000 - \$3,000,000, inclusive of base salary, short-long term

incentive bonuses, deferred compensation and, possibly, co-investing opportunities. SFOs are competing with global institutions and must have compensation plans that attract, retain and motivate the best talent.

Chief Investment Officer (CIO)

After the CIO, the next most senior position in an SFO is usually the Chief Investment Officer (CIO). Broadly this role falls into two camps: direct investors, and allocators to managers.

Although less common than allocators, many larger families and entrepreneurial families see the value in being direct investors. This commonly means hiring a CIO with significant direct investment expertise. There are many advantages to being a direct investor, such as controlling the investment cash flows, reducing investment-related expenses, and timing exits to ensure favorable capitals gains tax treatment. For SFOs that seek to be direct investors, the CIO needs a strong grounding in direct deals and a great network for unique deal sourcing.

More commonly, SFOs are allocators. In this scenario the CIO needs to be first and foremost excellent at planning, organizing, sourcing (money managers and business opportunities), due diligence, monitoring, validating and reporting on all investment activities. The CIO of an allocator SFO needs to source best-in-class money managers who carry out the actual investing of a particular allocation, such as cash management, bonds, equities, real estate and commodities. In addition to (or instead of) traditional long-only managers, alternatives managers may be selected for a given allocation to add shorting, leverage and derivative strategies. Some allocator SFOs provide deferred compensation in the form of incentive allocations, though such incentives are less common than for direct investor SFOs.

Direct investor CIO base salaries can range from \$250,000 to \$500,000. However, factoring in annual cash bonus and deferred compensation from incentive allocations in deals sourced by the CIO can bring total compensation for a top direct investor CIO to several million dollars or more. Purely Allocator CIO base salaries also range from \$250,000 - \$500,000 with bonuses ranging from \$200,000 to \$600,000. Both CIO types are often presented with the opportunity to co-invest alongside the family as part of a deferred compensation plan. Many SFOs require the CIO to co-invest, seeking full commitment into the investment and aligned interest.

Both the direct investor and allocator models will generally require the SFO to hire junior analyst(s) to source and evaluate opportunities. Total costs can vary and include some of the same structure of salary, bonus, deferred compensation and co-investment opportunity as in the CIO position. Salary levels + bonus typically total between \$150,000 - \$300,000 per analyst.

Chief Legal Officer (CLO)

Families with highly complex and/or multiple business interests can benefit greatly from hiring an in-house legal professional. The Chief Legal Officer (CLO) can evaluate business, real estate and complex investment opportunities from a different perspective than the other senior executives of the SFO and can negotiate business transactions and perform closings. The CLO may be hired for both business and personal needs, or have a focus on the personal family needs, organizing and monitoring family trusts and partnerships, as well as trust & estates issues. Families of significant wealth often need multiple specialized experts in business, patents, litigation, marriage law/pre-nuptials, trust & estates, etc. A well-diversified and connected CLO can manage these areas through internal staff and outsourced relationships and coordinate all efforts. CLO base salaries frequently range from \$175,000 - \$250,000. Salary, combined with short-long term bonuses, deferred compensation and (although less common) may include co-investing opportunities, combined compensation frequently will vary between \$300,000 - \$550,000.

Director of Philanthropy

Most commonly, the family's philanthropic initiatives are directed through a separate entity, such as a family foundation(s), as opposed to directed by the family SFO. However, some families do elect to create a Director of Philanthropy position.

Most families of significant wealth desire to improve their ability to identify and verify philanthropic opportunities for causes that are in alignment with their family values, investment focus, and personal passions. More often, the decision is based on passion and engagement, and less so by financial motivations. It is recommended to create separate entities for the SFO and the family foundation(s). Until a family's philanthropic mission and giving level is sufficiently expansive to warrant hiring a full-time director, typically an engaged family member assumes the responsibility for the role. The family member or director selected to undertake this endeavor needs to understand how philanthropic endeavors fit within the family mission statement and business plan. Focusing active family members and engaging younger generations in their passions is critical to this role. Philanthropic giving goes deeper than tax benefits and helps to teach the younger family members about compassion, giving and choices.

The Director of Philanthropy, along with a specific philanthropic advisory committee, sources and vets philanthropic opportunities aligned with the family mission statement and business plan. If the family seeks outside contributions, fundraising experience is preferred, with both traditional and online expertise. Executive management experience at a foundation or other charitable experience would be recommended. How the family should donate money to various organizations involves legal and tax implications. This is best left to experienced in-house or outsourced legal and tax professionals. Family foundations, charitable remainder trusts, and charitable lead trusts are all viable options.

The Director of Philanthropy should assist in managing the process and distributions to charity (no matter the vehicle), as well as following through to gauge and measure the results. If going outside the family to fill the position, salary can range from \$150,000 - \$200,000.

Director of Information Technology

Large SFOs frequently hire a Director of Information Technology (IT). This position is vastly underrated and should be considered in all SFOs. This position advises and coordinates the technical infrastructure of the SFO. Many SFOs have critical computer needs and highly specialized software requirements that all need to be supported and upgraded on an ongoing basis. This position should positively impact family connectivity and communications as well as costs and control of the SFO. This position can range from \$150,000 - \$200,000, depending on the complexity of the technology infrastructure required.

Family Office Manager

The Family Office Manager is a unifying position that focuses on the SFO running as efficiently and effectively as possible. This position can involve HR functions (managing directly or in coordination with an outsourced firm). The Family Office Manager frequently is the conduit for the family and in-house staff and assists with coordinating outsourced professionals. The Family Office Manager is commonly less defined by a traditional role than other positions. The position requires a person of diverse talents who learns quickly, is highly organized, and initiates solutions. In smaller SFOs, the Office Manager will coordinate business and personal services for the family, in conjunction with the executive assistant. This position can range from \$150,000 - \$200,000.

Executive Assistant

Families can have one or multiple executive assistants depending on the size and number of employees of an SFO. Frequently, there is an executive assistant to the key family leader(s) and another executive assistant assigned to key SFO personnel. The responsibilities of this position, particularly at the personal level, can vary widely. An executive assistant may act as the primary person coordinating household management and personal household staffing needs. They may manage multiple personal matters such as medical information, insurance, family vehicles, child care, and collectibles. They may be the primary conduit to the family leader for personal appointments, calendar management and children's needs. Personal service and impeccable organizational skills are the hallmarks of this qualified professional. Being infallible under pressure and proactive in the identifying and meeting needs of the family or key SFO personnel. The executive assistant is excellent at communication (written and verbal) and proficient in technology. This position can range from \$100,000 - \$150,000.

Bookkeeper

This position often supports the CFO, or in smaller SFOs without a CFO, may take on additional responsibilities. Managing payroll (or coordinating with an outsourced firm), handling receivables, paying business and personal family bills, coordinating medical and insurance claims, processing and coordinating mail (this may also be handled by an executive assistant) are just some of the traditional responsibilities of this position. This position can range from \$100,000 - \$150,000.

Family Security Director

Many families are concerned about security and see a need to hire a Security Director to manage and mitigate family residence, business, cyber and outside activity risks. If not a direct employee of the SFO, the security director can be an outsourced specialist. The Family Security Director is responsible for the security measures within the SFO, including offices, technology security and family safety. This position can range from \$150,000 - \$200,000.

SFO Advisors

Most SFOs draw on the expertise of a variety of outside advisors, including lawyers, accountants, bankers, insurance providers, investment advisors, philanthropic consultants and information technology specialists, among others. Seeking advice when needed, contracting for services, and coordinating the efforts of these specialists is a major responsibility of the SFO.

A well-run SFO will have a clear process for selecting and vetting advisors. While many members of the SFO team will have experience working with various service providers, it is important for the team to have clear procedures for selecting advisors to avoid conflicts of interest or playing favorites. Many SFOs establish budgets for advisor-related expenditures on an annual or more frequent basis, thereby prioritizing needs and giving SFO staff clear parameters for defining the scope of each project with advisory team members. Performance of existing advisors should be reviewed frequently to ensure the services they provide are of high quality and appropriate to the problems the SFO faces. Important questions to ask on a regular basis include:

1. Is family privacy and confidentiality respected?
2. Are fees appropriate to the work accomplished?
3. Are the advisor's services relevant, comprehensive and delivered on a timely basis?
4. Does the advisor alert SFO staff to newly arising or unexpected issues or opportunities?
5. Does the advisor coordinate with other service providers working on the same issues?

While many SFOs seek to develop in-house expertise in certain areas, many SFO activities can be outsourced, which may offer the family greater access to expertise at lower cost. An extreme example of this trend is the virtual SFO, an entity without an office or even dedicated staff of its own; rather, SFO services are provided by a group of advisors on a contract basis, quarterbacked by one of those advisors. The advantages of having an in-house, dedicated team to manage the SFO are clear:

1. The team's focus will be undivided; its skills will be matched to the needs and requirements of the family, and the SFO's specific assets rather than those of each team member's own general client base;
2. The family's privacy and confidentiality will be maintained, and the expertise will be on-call and available whenever needed. Highly confidential and mission-critical services should be the first priority when determining which activities will be handled in-house.
3. Generally speaking, in-house professionals will tend to be more focused on and responsive to the family's needs, and their work will be under the sole control of the family.

Having said that, the advantages of outsourcing SFO services are also significant:

1. Lower cost, exposure to a broader range of advice and the perspective and experience gained from serving multiple similarly situated families;
2. Economies of scale and access to higher-level expertise, particularly in areas where the SFO's investments or needs don't justify the expense of a full-time individual or bespoke service.
3. Highly complex services requiring substantial capital investment and delivered in rapidly changing environments and circumstances should be the first priority when determining which activities will be outsourced.
4. Generally speaking, outsourced service providers tend to have better access to a wider range of information, and are subject to the discipline and best practices of the wider marketplace.

Adapting to Change

As families grow and circumstances change, the SFO will also need to change and adapt. Anecdotal evidence suggests the ratio between the assets managed and the number of family members served is an important predictor for the long-term success of an SFO. The larger the value of the assets, and the smaller the number of clients, the more efficient and cost-effective the SFO will be. This is not to say that there aren't successful family offices for very large clans, but as the number of family members grows, SFOs must strengthen management and governance and manage service creep to remain viable. It can be particularly difficult for a SFO serving a large family to remain cost-effective when family members have widely varying personal assets and net worth. In such circumstances, unless a single family member is willing to bear the expense for the entire office on behalf of the rest of the family, spreading the cost of the SFO's services through pricing mechanisms can be extremely difficult and, if not done fairly, and with full transparency, can generate conflict and dissension.

Strategies that SFOs have employed to deal with changing circumstances include:

1. Dissolving, to permit clients to create their own, smaller SFOs or join a multi family office (MFO).
2. Reducing the number of clients served ("pruning the tree") to permit focus on a subset of clients with common needs.
3. Narrowing the services provided by the SFO (for example, focusing only on investments and requiring family members to contract outside the SFO for accounting, tax reporting, bill paying etc.).
4. Bringing in outside clients, thereby becoming an MFO.

Families who opt to dissolve their SFOs, or significantly reduce the number of clients, should prepare for a time-consuming process. Closing an SFO or redeeming a client out of interlocking and complex investment holding structures is a multi-step process, even if every investment is liquid and notice periods are short. When the investments include hedge funds with long notice periods and gates, extensive commitments to private equity funds, natural resources, and real estate, generating the necessary liquidity can take years. For redemptions of SFO investments, as with redemptions of interests in any privately held, illiquid entity, the challenge will lie in valuing and redeeming the client's interests in the SFO's funds. Such interests will be subject to discounts from capital account value – often quite substantial discounts - and the process of determining redemption value can be a flashpoint for conflict among family members. The redemption process will be most successful when the process for requesting redemptions and determining redemption values is set forth in writing and agreed to by all the clients of the SFO at the outset.

Recognizing that family members will periodically need access to liquidity, and that unplanned-for redemptions and dissolutions can be extremely difficult and time-consuming to navigate, many SFOs have created family banks. A family bank offers SFO clients the opportunity to borrow against their interests in SFO investments or to take partial redemptions. Family banks have several advantages: they provide clients with access to liquidity at affordable rates and reduce clients' need or desire for redemptions. They also make liquidity available to all clients on the same terms, unlike handling requests for liquidity on an ad hoc basis, with certain family members potentially getting preferential treatment.

Conclusions

For families with substantial financial resources, an SFO provides the ultimate in control, privacy and customization for optimizing the family's wealth, legacy and resources. The prevalence of conflict-ridden investment advice from third party service providers make it imperative for high net worth families to consider creating an SFO to control the family's destiny and build upon a legacy of sustainability. The SFO should be viewed as a way for the family to build a talented, skilled and experienced team to manage its wealth in all its forms.

An effective SFO is a highly valuable asset that preserves and creates wealth for the family. As with any business, it requires a clear mission, a fully thought-through business plan and an understanding of the resources available internally and on an outsourced basis in the SFO marketplace. The ability to create a custom SFO has never been easier. An entire eco-system of SFO organizations and consultants has developed to service families of wealth in establishing and running their SFO. New technology, selective outsourcing, and a vast pool of talented individuals is available in the marketplace to create and run an SFO more efficiently and effectively than ever before.

Generations from now, after business interests have been liquidated and/or greatly dispersed and individual investments have been eclipsed, the SFO stands as the family's unifying entity, signaling a healthy and productive path for those that follow. The family SFO embodies the legacy of the values established and nurtured by the family for the world to see and for generations to come.

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The Family Office Association is a global peer network that serves as the world's leading single family office community. Our group is for education, networking, selective co-investment, and a resource for single family offices to share ideas, deal flow and best practices. Members are not actively marketing products or services to other members and no contact information or email lists will ever be shared. Since our founding in 2007, TFOA has led the global single family office community by delivering world-class educational content, unique networking opportunities, and exceptional thought leadership to our highly curated network of the world's largest and wealthiest families. If you'd like to access our free library of whitepapers or receive event updates and more timely information please visit: www.tfoa.info



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