BUILDING AND MANAGING A FAMILY OFFICE

hubbis

wealtra

SUMMARY

Whilst we see a proliferation of Family Offices being established in key financial centers, the quality of "construction" appears to be somewhat questionable. Often the "Family Office" is more an "Investment Office" and under strict scrutiny, lacks the holistic characteristics that would truly define a "Family Office".

To this end, in this article, my aim is to highlight, for both the families concerned and their key advisors, some of the critical factors to consider when building and managing a Family Office. My aim is to provide factors in the form of an aide-memoire which can be utilized to assess the direction and make up of the Family Office and identify areas of improvement.

GET IN TOUCH
[View Mark Smallwood's LinkedIn Profile]
[Find out more about Hubbis]

Whilst we see a proliferation of Family Offices being established in key financial centers, the quality of "construction" appears to be somewhat questionable. Often the "Family Office" is more an "Investment Office" and under strict scrutiny, lacks the holistic characteristics that would truly define a "Family Office".

To this end, in this article, my aim is to highlight, for both the families concerned and their key advisors, some of the critical factors to consider when building and managing a Family Office. My aim is to provide factors in the form of an aide-memoire which can be utilized to assess the direction and make up of the Family Office and identify areas of improvement.

Family Objectives and Values

The principal starting point for a Family Office is to clearly define objectives that will enable a family to focus on achievable goals in a structured manner.

It is important that the family establish a well written and defined set of objectives and values.

- **Key objectives and values would include:**

» Estate and Succession Planning – formalizing the structure of the family wealth with clear, legal mechanisms for the management and transfer of that wealth, in multiple jurisdictions, are required.

» Wealth Preservation – a primary objective for UHNW families is to preserve and protect the family's wealth for future generations. Minimization of taxes and the effective management of business and non-business assets are key focal points in this process.

» Business Continuity – ensuring the smooth continuity of the business, the grooming of capable successors to manage the business and the transition to their involvement.

» Family Unity and Harmony – through effective planning and communication, strong relationships and a sense of purpose can be developed amongst the family whilst reducing the potential for disputes.

» Successor Development – The identification and development of competent successors within the family and if necessary, the possible conclusion that outside professionals need to be brought in.

» Legacy and Values – Many families wish to pass down their values, traditions and philanthropic aspirations to future generations. This needs to be articulated and recorded.

Often the optimum manner in which to define the Family Objectives and Values is through a formally written Family Constitution.

Governance Structure

Family objective setting should lead to the implementation of a structured family governance structure. Key elements for this would be:

» Family Constitution – This provides a foundational document to outline the family's mission, values and principles – laying out their objectives and values. This leads to a shared understanding amongst family members, and provides a framework for decision making, conflict resolution and family involvement in business matters.

» Family Council – A representative body of the family, designed to provide a platform for open communication, collaboration and the exchange of ideas. Regular meetings with structured agendas promote effective decision making and family participation.

» Family Office – A dedicated entity for the purpose of managing the family's financial affairs, investments, and other administrative functions. The family office may take varying forms dependent on the family's structure, size and wealth.

» Board of Directors – For the family's business, tailoring and evolving the board with a view to long-term succession is essential, combining both family members and professional independent directors to monitor and hold accountable the executive management.

» Family Education and Development – Continuous education and development of family members are essential components of an effective governance structure. Seminars and mentorship opportunities can enhance understanding of wealth management, governance and leadership.

Wealth and Asset Management

To determine the best course of action to affect the management of the family's wealth, a number of specific factors need to be considered. These factors will include:

- Size – the size of the family's wealth will have a major determining factor on the family office structure and investment in the family office team. Costs must be understood and managed relative to the size of assets involved – expectations need to be managed.
- Diversification of Wealth – Some families may have assets concentrated predominantly in their businesses, whereas others may be more diversified, or the family may even have liquidated the original core business source of wealth.
- Complexity – Some families may have businesses located internationally across different geographies, real estate investments in multiple countries, and private markets investments and banking relationships in multiple jurisdictions. The level of complexity the family faces must be understood in order to focus on solutions which best suit the size and complexity involved.
- Sophistication – a family that has built substantial wealth in their core business and real estate, may be very unsophisticated when it comes to portfolio management of listed companies and bonds. Alternatively, some families may have within the family members with sufficient competence to be responsible for the management of non-core business elements of the asset base. Understanding the competences and skillsets of the family will help evaluate what is available within the family and what will need to be obtained externally or independently.
- Alignment with Objectives – if the Objectives and Values have been clearly laid out, then the correct approach to the management of the separate buckets of wealth should be clear. The result may be a Family Office which is focused on co-ordination and administration, whilst in substantial families, the Family Office may have executive functions in nearly all of the aspects of the management of the family's wealth and affairs.

Services and Expertise

After evaluating the family's objectives, the size and complexity of their asset base and the sophistication of the family, and where their strengths and weaknesses arise, the family will be in a position to determine the expertise required in the Family Office. This might include:

- Investment Management – An evaluation will need to be undertaken as to how hands on is the Family office. This will often be determined by the size of liquid assets and real estate. Does the Family Office build an in-house Investment Management team, or does it outsource some or all functions?
- Estate and Succession Planning – This will be a pre-requisite for all families. Is the family able to attract talent with the right skillset in-house, or should it identify and nominate a key advisor such as a lawyer or other estate and succession planning professional to ensure that the family's affairs are in order?
- Tax Planning – This will cover both personal and business aspects and determine business related activities and investments and how best to legally optimize investment returns. Consideration will also need to be given as part of the estate and succession planning process to the tax issues involved in transferring assets to future generations.
- Legal Services – Similar to tax planning requirements, legal service providers will need to be identified, and for simplification purposes, often international firms will be necessary in order to enable co-ordination within the firm's global resources to provide a coordinated cross border approach.
- Business Advisory – Some families may not have natural successors to the business within the family. Independent and trusted advisors to the family may be needed, in addition to which professional advisors may be needed to ensure continuity and co-ordination between ownership structures as they relate to businesses and how this interacts with the family's estate and succession arrangements.
- Philanthropy – Expertise may need to be engaged to advise and guide the family on philanthropic endeavors.
- Family Education – The family may wish to have a focus on engaging and developing the younger family members. This may involve education and possible involvement in the family's objectives and values, the family council, and aspects of how the family's wealth is being managed.
- Concierge Services – The family may require services to simplify

the administration of their lifestyle. From maintaining properties, to paying household bills, arranging travel and other requirements, internal or selected external resources may be required.

Resource Allocation and Family Office Team

A realistic assessment of the family's objectives and requirements will lead to an examination of the budget anticipated and what resources and infrastructure can be met within the budget. In so doing the family will be able to assess what services are handled in-house (more expensive) and what services will need to be allocated to external parties (typically less expensive). Considerations will include:

- Likely office rents and operating costs.
- Staff costs (salaries, bonus, pensions, insurance and healthcare, taxes and recruitment).
- Technology costs – this will not only include standard computers and data storage, but will also include specialized software, data and information services such as investment management, portfolio management, accounting, account aggregation and consolidation software etc.
- Chief Executive and Chief Investment Officer function – Is this the same person? Is the family large enough to engage both functions? Is this undertaken internally or does a key banking relationship manager or a multi-family office provide the CIO function to the family?
- Single Family Office focus, or does the family consider contracting out some or all investment related services to a multi-family office, or their cornerstone banker.
- Asset Administration and Data Management Services – this will include corporate and trust administrators for the administration of both corporate and trust structures as well as technology, data management and storage service providers.
- Trusts and Trustee services as determined by the family's estate and succession plan.
- Compliance and Regulatory Services - to ensure the operation of the family office meets all external regulatory requirements and internal risk controls are managed effectively.
- Identification of key legal, tax, estate and succession planning advisors.
- Concierge service providers – this could range from a high-end credit card related service to the employment of a full-time family administrative assistant.

Regulatory and Compliance Considerations

The family should understand the need to consider both regulatory and compliance aspects to ensure that legal compliance is maintained, and potential risks, both external and internal, are mitigated.

Aspects would include:

- Regulatory Registrations and Exemptions – jurisdictional requirements must be understood and adhered to, registration and certification should be obtained if necessary, and if necessary, tax exemptions obtained.
- Anti-Money Laundering (AML) and Know Your Client (KYC) – the family should fully understand the global operating environment of today's markets as they apply both to personal and corporate assets. This will enable them to make correct decisions in developing structures and maintaining family wealth in a manner which is acceptable to the financial and regulatory institutions with which they will engage as well as their respective tax authorities.
- Privacy and Data Protection – families will need to understand and adopt measures to ensure that their data is maintained in secure storage locations and what their expectations and rights should be.
- Investment Regulations – The family will need to understand how appropriate laws may impact the way their family office is run. Securities laws (for example insider trading), reporting requirements (for example holding percentage stakes in listed companies above a limit), and other laws and rules need to be complied with and where necessary legal advice obtained.
- Tax compliance – this will incorporate all aspects of taxation, from income tax, capital gains tax, estate and inheritance tax, withholding taxes, corporate taxes, etc. This element can become exceedingly complex with cross-border assets and family

members and often requires appropriate professional advice.

Technology and Data Management

A number of factors need to be considered to ensure efficient and cost-effective operations and the security of sensitive information. These would include:

- Infrastructure and Systems – an evaluation of what current systems are being used by the family would need to be undertaken and then adapting these over time to the family office. Hardware, software, network and communications systems would need to be evaluated and adapted over time.
- Data Security and Cybersecurity – Robust data storage and security measures will need to be implemented, and measures put into place to prevent unauthorized access, data breaches and cyber threats taking place. Staff education and monitoring will be necessary.
- Data Integration and Centralization – Consolidation and aggregation of data will be necessary for a holistic view of the family's affairs.
- Scalability and Flexibility – future growth needs to be anticipated in the selection of technological solutions. The solutions chosen need to be able to adapt to the changing needs of the family office either through their own capabilities or through their ability to be connected to other software and hardware solutions.
- Reporting and Analytics – whilst software and hardware may work to capture data, is it optimized to deliver the data in a form that enables effective reporting and analysis? Performance reporting, risk management, compliance and regulatory reporting and customized reporting for different stakeholders will be necessary.
- Disaster Recovery and Business Continuity – this is vital to ensure that unexpected events do not impact on the ability to access information and records. Data, backups, offsite storage, redundancy measures, and contingency plans to ensure uninterrupted operations in the event of systems failures, natural disasters or other disruptions are necessary.

External Partnerships

A complete review of a family's existing partnerships is often required and there is usually a need to adapt the relationships once the family's objectives have been clearly defined. Areas that need to be considered will be:

- Custodian banks and brokers – an evaluation and often a consolidation of such relationships is nearly always required. This is particularly the case where the family office seeks to run most of the portfolio management functions internally.
- Trust and Corporate Services Administrators – over the years these functions can end up with a cluttered collection of service providers. The selection and consolidation of service providers is vital to reduce administrative costs, reduce opportunities for data leaks, and ensure proper co-ordination of the administration and reporting of entities.
- Tax and Legal Advisors – corporate advisors are not very good at advising on family related issues and vice versa. Furthermore, most UHNW families have assets in multiple jurisdictions so accessing the right advice and managing the associated costs is critical.
- Softer Issues – in addition to the objective nature of selecting partnerships, critical to the choice will be subjective compatibility. This will reflect factors such as the specific expertise and reputation of the partner, compatibility and cultural fit with the family and its senior family office employees and the depth of resources offered by the external partner.
- Fees and Transparency – critical to the effective management of the family office is the ability to manage costs. In many cases the overall operating cost of a family office can at least in part be financed by cost savings with external partners. Partners who are clear, transparent and fair in their fee disclosures and charging structure will benefit from a sustained relationship whilst the family office can benefit from a reallocation of costs to the more holistic family office functions.

Conclusion

Too many Family Offices are established in a haphazard and inefficient manner. The result is that costs overrun, expectations are not met, and the family fails to teach the optimum outcome.

Whether a family has established their family office or is in the process of establishing it, a thorough examination of these components and the drafting of a detailed implementation or remediation plan is usually vital to ensure that the benefits are achieved, and the pitfalls avoided.

A planning or remediation process will in summary require:

- Clearly defined objectives, typically found in a Family Constitution.
- An evaluation of the current allocation of family assets, control and wealth management processes, and the goal of coordinating both personal and business assets.
- A remediation or evolution plan to adapt the existing family structure, wealth ownership, succession, and asset management structure to the desired objectives.
- The implementation of this process can take several years and is often constantly evolving, requiring ongoing management.

It is vital for the UHNW families establishing a Family Office, or with an established Family Office, to invest time and money in developing and managing the overall plan. The utilization of key advisors who are able to add holistic, independent value to the existing team members is normally vital in this process.

We hope that the above provides a useful aide-memoire of factors to consider as you or your clients seek to build and manage their Family Office. ■