

## CHAPTER 1

# Introduction to the Family Office

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In today's wealth management marketplace, there is a keen interest in the family office, especially now that celebrities and business moguls are establishing their own family offices. Once a relatively unknown term accessible only to the *über*-affluent, the family office has increasingly become more mainstream—yet it remains an enigma. What is a family office, and what are the typical paths that lead a family to either start their own single family office or join a multi-family office?

The definition of family office varies depending upon whom you ask; generally, they are designed to prepare family members to collectively manage, sustain, and grow their wealth across multiple generations. Family offices can aid families in managing the numerous risks that affluence exposes families too. In addition to offering a potentially wide array of services, such as tax, fiduciary, and compliance needs; investment management, risk management, estate planning, and trust administration; philanthropic advisement, financial education programs for family members; and family governance and wealth-transfer planning, the family office ideally has a higher purpose to bridge generations in order to create continuity and cohesion for families around their wealth. Those who may be familiar with the concept of the family office may not know how to identify whether it is right for their families or their client families.

This book demystifies the concept of the family office and clarifies who should consider joining a multi-family office or start their own single family office. The book also explains the importance to define and discover the

overarching purpose and vision of a family office. It clarifies what services may be rendered by the office and what the expense to the family may be. This guide will serve as a useful tool for affluent families, individuals, and philanthropists, as well as for practitioners and industry professionals, as it educates them about the important functions that the family office may render today and for generations of family yet to be born.

We begin with an overview of macro trends in global wealth and then segue to a discussion of the historical roots of the family office in Western economies, which is rooted in the growth and proliferation of family enterprise.

## **A Macro View of Global Wealth**

There is an art and a science to assess affluence, which starts with defining how much you have to have to be considered wealthy. We all have our own individual definitions; however, most industry research firms classify those individuals with a minimum of \$1 million as a high-net-worth individual (HNWI). For most individuals at this level of wealth, the option of a family office is not on their radar screen as a wealth management solution. And one industry research report estimates that the total population of HNWIs is estimated at 10 million individuals globally, an increase of 2.9 million individuals since 2001.<sup>1</sup>

Wealth-X, a prominent research firm, has concentrated solely on understanding the demographics and wealth profile of the ultra-high-net-worth (UHNW) individual, who has a net worth greater than \$30 million.<sup>2</sup> Wealth-X's research reveals that there are 199,235 UHNW individuals across the globe whose combined wealth is \$27.8 trillion<sup>3</sup> (all amounts are in U.S. dollars). There was a growth of 6.3 percent in the global population of UHNW individuals over the last year.

The concentration of wealth in the hands of UHNW individuals is further evidenced by the fact that the world's top 20 wealthiest individuals represent a combined fortune of more than \$700 billion.<sup>4</sup> Yet, when we look at the various strata of the affluent, it is clear that the largest tier in terms of population are those with \$30 to \$49 million. This group comprises 43.1 percent of the total UHNW population and its overall wealth increased by 6.9 percent (see Table 1.1).

Wealth-X found that the UHNW population is predominantly populated by men, who make-up 88 percent of the group. The typical profile is a gentleman who is married (95 percent), educated with a minimum of



a bachelors (87 percent), in his later 50s (58 on average), is self-made (70 percent) and holds a title of chairman (21.9 percent) or CEO (14.2 percent). These men have an average net worth of \$138M and most often made their wealth in finance, investments, banking (20 percent), and/or industrial conglomerates (6.3 percent). Women, on the other hand, made up only 12 percent of the global population of UHNW individuals. However, they had a higher average net worth than men (\$150M). More than half (53 percent) of these women reported attaining their wealth through inheritance, and only a third (33 percent) reported being self-made. Women also tend to be married (89 percent), educated with at least a bachelors degree (82 percent) and most frequently indicated titles such as shareholder (14.6 percent) or director (12.2 percent). Interestingly, women were most likely to identify the most significant industry they work in as “non-profit and social organizations” (15.2 percent) followed by finance, investments, and banking (14.2 percent).<sup>5</sup>

The UHNW market is highly important to global luxury brands, private banks, and top global non-profit organizations (NPOs) because of diversification of revenues, and, as David Friedman, cofounder of Wealth-X, states, “the ultra-wealthy market for consumption and investment is less susceptible psychologically and economically to the vagaries of macroeconomic turmoil.”<sup>6</sup> Thus, the affluent are more immune to global shifts in the economic markets and able to continue their lifestyles, discretionary spending, and long-term focus on capital appreciation.

Although 2012–2013 experienced a reduction of 1.8 percent in wealth of the global UHNW population, 2013–2014 saw signs of growth and recovery as this population grew by 6.3 percent. The slowdown in 2012–2013 was mostly attributable to the ongoing financial crisis in the Eurozone as well as the slowing down of emerging economies. However, the recovery of the United States economy in 2013–2014, was inspired by growing confidence due to the quantitative easing by the Federal Reserve, declining unemployment and resilience in the housing industry. Although the International Monetary Fund lowered its expectation for global growth in 2012, changing its forecast to 3.5 percent for 2012 and to 3.9 percent for 2013, predictions based on Eurozone policy action allowing financial conditions to ease gradually as well as the policy action in emerging market economies. There is a cycle in the Eurozone whereby financial market distress leads to sovereign distress and bailout packages. However, these provide only temporary relief and in fact increase the possibility of default and countries exiting the Eurozone. It is predicted that Europe will require several more years to recover from the sovereign debt issues it continues to face. All of this affects economic growth and wealth growth around the world. UHNW individuals have moved

their wealth away from peripheral economies and into those of Germany, Switzerland, United Kingdom, United States, Hong Kong, and Singapore.

A trend among UHNW individuals is their use of multiple service providers rather than one individual private banking firm. While UHNW individuals are confident in allocating and managing their own risk capital, they are relying on wealth advisors on the risk management of their liquid capital. UHNW individuals seek less volatility, for example, how the bond markets have tended to perform, with the return benefits of the equity markets. Private banking professionals and organizations must respond by seeking deep understanding of their clients' needs and the needs of potential clients. New wealthy entrepreneurs want flexible, customizable investment platforms, a desire that does not make economic sense for investors with wealth in the \$50 to \$100 million range. There is a growing market for financial advisors who can provide family office-like service at this level.

Related trends, especially notable among self-made UHNW individuals in Asia, are their proactive participation in their wealth management, and their expectation of higher returns. Among this population, there is a confidence in wealth creation and a greater appetite for risk. Currently there is a large amount of private wealth in privately owned and family-owned businesses, and an avoidance of public markets. Single family offices are thus looking for such enterprises for investment opportunities, and those enterprises are seeking entrepreneurs and families that have had success in building businesses to invest in them. They prefer this investment to private equity or venture capital. Wealth-X predicts an increase in liquidity in privately owned businesses, not from IPOs or private equity fund investments but from family to family. Despite a decline in the global population of UHNW individuals in Asia in 2013, Wealth-X predicts this region will experience the greatest growth. It is predicted to overtake Europe's wealth by 2017 and its population of UHNW individuals will be greater than that of Europe's by 2021.

In terms of reduction in tax exposure, UHNW individuals seek locations with favorable tax structures. This is particularly desired as U.S. authorities' ramp up the fight against offshore tax havens and increase taxes. In response, American UHNW individuals are searching for new avenues to protect wealth and reduce tax exposure. In particular, they are searching for less visible markets that do not have tax treaties with the United States.

After more conservative spending trends post-2008, the UHNW individuals are increasing their discretionary spending. Specifically, UHNW individuals are spending more on luxury items at an increased pace. From paying for private aviation and yachts, to purchasing more luxury real estate, spending behaviors appear to be normalizing to pre-2008 with their lifestyle

primarily driving their consumption and spending habits. As a result, increased spending by UHNW individuals could buoy many economies around the globe.

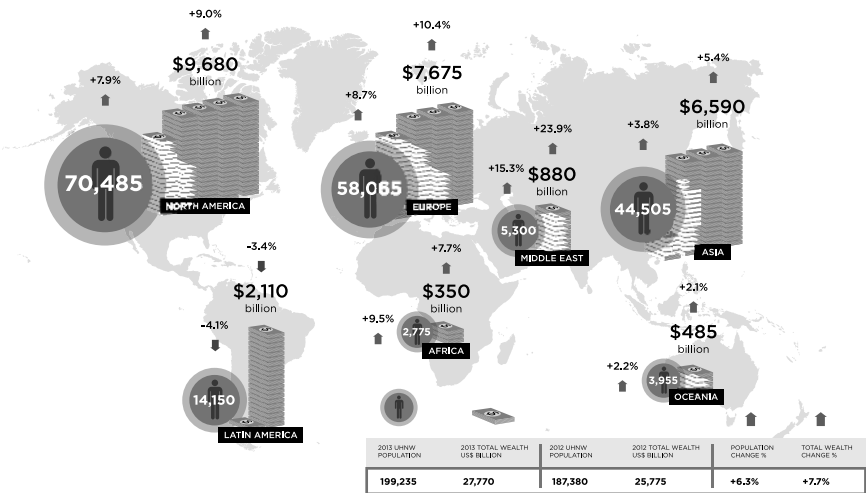
After so many experienced a dramatic loss of capital in the United States in 2008, more than ever the U.S. wealth management industry is focused on preserving wealth and preparing the upcoming generation of beneficiaries. Wealth managers have noted that the recent generation has a growing interest to align investment interests with their philanthropic values. Thus, wealthy families are using philanthropy to pass along their core values to the next generation. Increasingly, areas such as impact investing and socially responsible investing are more mainstream as metrics such as Return on Impact (ROI) and Return on Mission (ROM) interest UHNW individuals. Further, ultra-wealthy business individuals are applying their knowledge of performance and returns on the management of non-profit organizations and family foundations. The lines between growing wealth and doing good deeds with that wealth are no longer two separate agendas.

## **Billionaire Update**

The growth of billionaires is the slowest of all the wealth tiers by population; yet, this group still increased its wealth by \$326 billion. Wealth-X attributes the slower growth of the billionaire population to a marginally small number of net new entrants to the billionaire club. Staggeringly, billionaires account for 23 percent of the world's UHNW total wealth yet make up only 1 percent of the UHNW population. Comparatively, those in the two bottom wealth tiers, with a net worth between \$30 million and \$99 million, make up nearly three quarters of the world's UHNW population. UHNW individuals who have \$30 million to \$49 million are 43.1 percent of the UHNW population making them the largest segment of the UHNW population, although their combined fortune is \$3.5 trillion, which amounts to 12.6 percent of the total wealth of all the UHNW individuals in the world. The fastest growing wealth tier, the \$100 million to \$199 million group, increased their wealth by over 13 percent, \$445 billion. See Figure 1.1 for further details of the dispersion of wealth across the globe.

While these statistics about UHNW individuals can help us put into perspective the general population of those wealthy enough to possibly have a family office, the question remains: How many affluent families are utilizing the services of a family office? The short answer is that we do not know precisely, due primarily to privacy, anonymity, and exclusivity requirements of the family office and how and if a family identifies as having a family office.

**FIGURE 1.1** State of the World's Ultra-High-Net-Worth Populations



Family Office Exchange (FOX) estimates that more than 3,000 families in the United States have family offices, and that there are at least twice that number embedded inside private operating companies.<sup>7</sup> This number is not grounded in any statistical research to my knowledge; thus, it is difficult to put too much weight or emphasis on it, since there are still issues around the true definition of a family office.

The Securities and Exchange Commission (SEC) is interested in better understanding the population of family offices, and the Family Office Rule has recently defined a single family office as “any type of qualifying entity that provides investment advice to a single family including traditional family offices and private trust companies.”<sup>8</sup> The definition is still broad, but the reality is regulatory bodies are also closing in on putting more definition around these organizations in order to monitor and track their advisory practices. What does this really mean? The increased scrutiny of Wall Street post-2008 has shredded the proverbial kimono for many family office outfits, requiring them to make a determination of the need to register. Further discussion on the legal, compliance, and regulatory environment will be covered in Chapter 7.

## How Much Do I Really Need to Fund a Family Office?

One of the greatest debates that continue in the family office space is the “How much does it take?” discussion to warrant starting a single family office. Fifteen years ago, an expert in the field might have said anywhere from \$50 to \$250 million. However, experts such as Kathryn McCarthy, a seasoned advisor who has spent more than two decades working for families including the Rockefeller family, shared that the operating costs to build out a fully functioning family office typically require a minimum in the range of \$500 million to \$1 billion. Why has the number gone up in just the last decade? Well the new reality of uncertainty coupled with periods of low-returns has seen investment returns stall or drop while overhead remains steady or increasing with new regulatory and compliance costs.

The broad dispersion of family office size does range considerably. A recent research conducted by the Family Wealth Alliance, a professional organization that serves the family office community, shows that of the 34 family offices surveyed, the financial size of the office ranged from \$42 million to well over \$1.5 billion, with a median of \$275 million assets under supervision and a mean of \$516 million.<sup>9</sup> The Family Wealth Alliance has conducted this study annually for the last three years and has found these figures to be relatively consistent. That said, there are some extremely large single family offices in the multiple billion range that were not captured in their survey as well as significantly smaller single family offices that may only manage \$20 to \$30 million as well. So as the old adage goes, “if you have seen one family office, you have seen one family office.” Like snowflakes, no two family offices are alike.

It is evident that there are still a large number of single family offices that serve families with far fewer than \$500 million, perhaps in the range of \$50 to \$200 million or more of investable assets. McCarthy coins most of these family offices as “coordinator family offices,” where most of the family office services are outsourced and perhaps one or more family members runs the family office operations with the support of a bookkeeper or accountant. Most of these families with smaller family offices identify as much, if not more, with the concept of being a family office, so again, scale of wealth does not translate to a hard and fast definition to whether you are or are not a family office. That is a decision up to you and how you register with the SEC.

Because this self-identification process as a family office is relatively new, the exact number of family offices is difficult to discern. And with greater regulatory scrutiny more family offices will have to comply and identifying to be one or not. This will be helpful for consumers and the industry in

order to surface those who are pure and simple single family offices and those who are actually advising on investments beyond immediate family members and are classified as Registered Investment Advisors (RIA).

So we now have a general understanding of how big in terms of assets under management and how many family offices in relation to the number of UHNW families, so what sum of wealth is required to justify setting up a family office? Once again, the debate continues in the field about what amount justifies the creation of a family office; generally, however, family wealth experts such as Barbara Hauser estimate that a family should have \$200 million to \$300 million in assets to warrant establishing a single family office. Remember, however, this is a general rule of thumb, not a hard and fast base range. Families with fewer assets or significantly more may opt to start a family office and/or join a multi-family office; it is an individual decision that depends on the family's overarching objectives, time, and energy.

## **Purpose and Definition of the Family Office**

What exactly is the purpose and definition of a family office? The purpose of the family office is to manage and oversee the wealth management affairs of highly affluent individuals and their families in regard to such issues as tax, wealth transfer, investment management, governance, estate planning, risk management, compliance, education, communication, financial education, and so on. How do those in the field define a family office? The wealth management industry generally defines a family office as, "an organization dedicated to serving wealthy individuals and/or families on a diverse range of financial, estate, tax, accounting, and personal family needs."<sup>10</sup> According to Family Office Exchange, the family office in its best form provides a structure that helps preserve the family enterprise by supporting four dimensions of the family:

1. Business Legacy—where the wealth originates, and for some, the cornerstone for the Family Enterprise.
2. Financial Legacy—where financial security and management of the wealth are maintained.
3. Family Legacy—where the family comes from and where they are heading together.
4. Philanthropic Legacy—where the lasting contribution for the family resides, by giving back in a meaningful manner.

Others in the field have discussed that the family office “has a deep understanding of the planning, generational, and tax issues so important to wealthy investors.”<sup>11</sup>

The role of the family office as integrator and coordinator of all the wealth affairs of the family truly makes the family office different from other financial institutions because it is uniquely positioned to execute long-term strategic planning on multiple fronts. Putting the family office in the context of a football team, it becomes the quarterback and “coach” for the management of the family’s financial and wealth affairs, providing a centralized point for the family to unify around their wealth. The office can collaborate with the family’s professional team members—lawyers, accountants, tax advisors, family business advisors, among others—to derive the family’s strategic plan and decide when to move forward and execute on certain goals—that is, to pass or rush—and when to opt out or refrain following through in certain objectives—or to kneel down, as it may be in football terms. Keeping our football metaphor in mind, the family office is not only about ongoing maintenance and monitoring of wealth, it is about deriving the strategy to sustain and grow the wealth across generations. Like the coach of the football team, the primary purpose of the family office is to coordinate, organize, plan, and aid in the implementation of wealth management goals for a family yet to be born.

Another critical function of the family office is to discern a multitude of risks that are often interconnected and interrelated among individuals, their assets, and their entities. The family office is also uniquely positioned to help individuals understand the context of their family wealth, a progressive point of interest adopted by leading wealth experts such as Jay Hughes, Charlie Collier, Dennis Jaffe, and Sam Lane among others. Jay Hughes explains that a “family’s wealth consists primarily of its human capital (defined as all individuals who make up the family) and its intellectual capital (defined as everything that each individual family member knows), and secondarily of its financial capital.”<sup>12</sup> Collier, on the other hand, identifies family wealth as having four components: human capital, intellectual capital, social capital, and financial capital. Collier noted:

*Human capital refers to who individual family members are, and what they are called to do; intellectual capital refers to how family members learn, communicate, and make joint decisions; social capital denotes how family members engage with society at large; and financial capital stands for the property of the family.*<sup>13</sup>

Although each wealth expert has a slight variation on how they define family wealth, both emphasize that wealth is not simply material. Rather,

family wealth considers the broader aspects of wealth as it relates to the individual (human and intellectual) and as it relates to community and society (social). This derivation in the concept of wealth has been influenced by inter-generational wealth transfer as the increase in assets being transferred to the next generation rapidly expands on a global level. Family wealth is as old as time and is a significant driving force in perpetuating the need and ongoing interest to the creation of family offices.

## **Historical Background of the Family Office**

Although the exact origin of the first family offices is not well documented, the literature suggests that the first family offices emerged in Europe after large, land-owning families liquidated their assets.<sup>14</sup> European family offices were often embedded in the estate offices of French, British, and German nobility in the nineteenth century or earlier and land ownership played a much greater role in wealth preservation in the United Kingdom and Europe than in the United States.<sup>15</sup> While the roots of the family office began in Europe following the Crusades approximately in the 1400s to 1500s, the U.S. family office originated shortly after the Industrial Revolution (1712–1942) and the incredible fortunes that were generated during this booming era.<sup>16</sup> In North America, the family enterprise is the bedrock that supports the domestic economy, contributing approximately 64 percent of the gross domestic product in the United States and 45 percent in Canada.<sup>17</sup> As a result, much of the wealth in North America is the direct result of the success of the family enterprise. The impact of the family enterprise as it relates to private equity transactions is significant—three of every four private equity deals involving private companies are family companies.<sup>18</sup> Thus, the vast majority of concentrated wealth in families is linked to the family enterprise and the ways in which their resources are managed.<sup>19</sup>

## **Family Wealth and the Family Office from the Industrial Age**

The Rockefellers are perhaps the most well-known ultra-wealthy American family who created one of the first—if not the first—family offices in the United States. John D. Rockefeller amassed an enormous fortune as a result of the success of his Standard Oil Trust Company. By 1900, Standard Oil dominated the domestic oil refinery business and controlled 80 percent of all oil refinery capacity in the United States.<sup>20</sup> After a number of years of litigation, the Supreme Court ruled that Standard Oil was a monopoly that had to be dissolved. Standard Oil was dissolved into six sub-oil companies, and

John D. Rockefeller became the largest single stockholder in these companies—the predecessors of Exxon, Mobil, Amoco, and Chevron.<sup>21</sup> By 1913, it was estimated that Rockefeller's holdings in these companies were valued at \$900 million.

In 1882, prior to the dissolution of Standard Oil Trust, John D. Rockefeller Sr. started the Rockefeller family office in what is now one room of 30 Rockefeller Plaza. As of 2002, the Rockefeller family office had expanded to take over three floors of the building, with approximately 145 employees serving the Rockefeller clan and an estimated 200 non-family clients.<sup>22</sup> In 2003, the Rockefeller family office had an estimated \$8 billion under management and by 2004 it had grown 22 percent, to \$11 billion.<sup>23</sup>

Recognized as one of the greatest philanthropists of his era, Rockefeller donated an estimated \$530 million to various charities during his lifetime. In addition to his generosity to the public good, Rockefeller understood the opportunity that centralizing his family's wealth afforded his immediate family and generations to come. Although John D. Rockefeller, Sr. had three daughters and one son, he passed the vast majority of his wealth (\$250 million of \$274 million in oil stock) to his son, John D. Rockefeller, Jr., leaving just \$24 million to be divided among his remaining daughters.<sup>24</sup> This application of primogenitor, or the passing of the wealth to the oldest male in the family, was a common practice in the early twentieth century. The goal was to keep the wealth aligned with the bloodline and family namesake.

Continuing his father's wealth transfer intentions and planning, John D. Rockefeller, Jr. was able to protect the vast amount of the family wealth prior to President Roosevelt's 1934 proposed tax wealth increase—the gift tax. Through elaborate estate planning and gifting, Rockefeller, Jr. created a number of substantial generational-skipping trusts, each worth \$20 million for his wife and six children.<sup>25</sup> In this manner, the Rockefeller clan was able to perpetuate their family's tremendous fortune from generation to generation. In 1987, it was estimated that the Rockefeller's collective family fortune was over \$1.7 billion, an increase of over \$1 billion from 1974. This 1987 figure did not include the family's holding company that owns the family real estate and broadcasting properties.<sup>26</sup> Through John Rockefeller Sr. and Jr.'s keen insights into aggregating and leveraging the amassed fortune, and their strategic planning of transferring wealth to future generations, the Rockefeller family established the model for transgenerational wealth transfer.

The wealth of other legendary affluent families, such as the Mellons, Scripps, Phipps, Lairds, Nortons, Pitcairns, and DuPonts, became the foundation for many of the larger U.S. private investment companies, family offices and/or trust companies.<sup>27</sup> Some of the families' wealth was converted into

private investment companies that are known today as U.S. Trust, Fiduciary Trust, Glenmede Trust, Laird Norton Tyee, Whittier Trust Company, Northern Trust, Wilmington Trust, Atlantic Trust Pell Rudman, Bessemer Trust, and Pitcairn Family Office. Again, the aggregation and concentration of these families' wealth gave them an enormous advantage and opportunity to grow and perpetuate their family wealth for generations to come. This is another strategic advantage of the family office that continues to be an important advantage for families today.

The story of the creation of Bessemer Trust provides another example of an historic, renowned family who understood the value of aggregating their collective wealth. Henry Phipps, a partner of Andrew Carnegie, established Bessemer Trust Company in 1907 as a family office.<sup>28</sup> Phipps requested that \$50 million, a portion of the amount he received from the sale of Carnegie Steel to J.P. Morgan, be invested by the family office.<sup>29</sup> Managed by the family office, the initial \$50 million investment grew to an estimated \$1 billion that was divided among 100 of Phipps' descendants in 2004.<sup>30</sup>

In the early 1970s, with a staff of 200, Bessemer struggled to remain cost-efficient as a single family office, paying out an estimated 2 percent of assets under management annually.<sup>31</sup> In 1975, Phipps family members hired new management and opened their doors to other affluent individuals and families to become a multi-client family office. As of 2003, Bessemer Trust had \$40.1 billion of assets under management, a 14.2 percent increase over one year from 2002.<sup>32</sup> The Phipps family recognized that, in order to grow and maintain the success of their family's wealth, they needed to shift their model of wealth management. At the time, the concept of bringing in outside clients was a novel and progressive idea. The idea paid off—Bessemer Trust is recognized as one of the largest wealth advisors in North America, providing advisement to over 2,000 clients with \$57.5 billion under supervision.<sup>33</sup>

Another well-conceived family office was started by the Pitcairn family. John Pitcairn (1841–1916) was a Scottish immigrant who became one of the 1883 co-founders of Pittsburgh Plate Glass Company, known today as PPG Industries (PPG). The company was quite successful; by the twentieth century, the company manufactured 65 percent of all plate glass made in the United States.<sup>34</sup> Following the death of John Pitcairn, his three sons formed the Pitcairn Company, a family holding office that managed the financial and estate planning affairs and maintained the family's voting control of PPG. The three sons, Raymond, Theodore, and Harold, had a total of nine children, and by 1951, there were 61 descendants of John Pitcairn. The success of PPG is evidenced by its incredible dividend payout as, "between 1938 and 1985 alone, the [PPG] corporation paid over \$320 million in dividends to their holding company."<sup>35</sup>

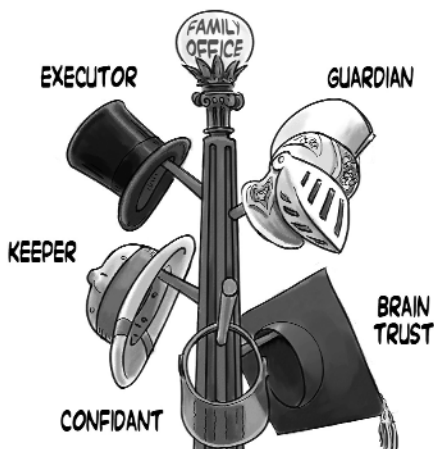
In 1973, Pitcairn Company celebrated its fiftieth anniversary as a family office and had grown to more than \$200 million in assets under management, after paying over \$750 million in dividends.<sup>36</sup> In the late 1980s, the Pitcairn family decided to liquidate their personal holding company by selling nearly all their assets, including their PPG stock. In 1987, the family reconstituted the family office as a private trust company, Pitcairn Trust Company, located in Jenkintown, Pennsylvania and began a new chapter as a multi-client family office.<sup>37</sup> Each family member was given the choice to opt out of maintaining their assets at the family's office; no family member moved any assets from the family office. Pitcairn's departure from a single family office model was similar to other large family offices, such as Bessemer Trust and Rockefeller Family Office that made the transition to a multi-family office. In 2003, Pitcairn Trust Company had \$2 billion under management, a 14.3 percent increase over 2002.<sup>38</sup> After speaking with Dirk Junge, the great grandson of John Pitcairn, and chairman of Pitcairn Family Offices, Dirk shared the weight of his family's powerful heritage and their tremendous pride, but also his deep sense of stewardship to the wealth generated over a hundred years prior. Dirk has dedicated most of his entire professional career to leading his family office and has invested tremendously in the family capital to fortify generations to come.

Pitcairn's successful family office is due in part to the intention and effort the family has made in establishing a strong governance structure with their growing number of family members. The Pitcairn family maintains an advisory council that is comprised of family members. In addition, they have codified a number of generational rituals, such as family meetings and retreats that help build community and strengthen familial bonds. Giving members of the family a free choice to participate in the affairs of the family and the family office strengthens overall cohesiveness, as they typically choose to participate. Further, these rituals and governance practices provide clear guidelines and expectations for family members as they grow up in the family system. They also foster increased and open communication, clarity of family member roles and responsibilities, and greater family harmony. A more detailed discussion of the Pitcairn Family Office will be shared in Chapter 11 on the governance in a family office.

### **Three Key Roles of the Family Office**

Although the family office tends to wear many hats for the family, if we were to condense down the key roles that family office may serve a family, we would find there are typically three core functional areas.

## The Many Hats of the Family Office



Cartoonist: David Willson.

### The Keeper and Executor

The family office for many families is the primary keeper and executor of transactions and legal documents. Although the families make the decisions, there is a critical function that the family office plays in implementing and executing transactions based on those decisions, monitoring and complying with the industry rules and regulations, housing and storing critical documents related to strategy, and planning and building continuity and context to the wealth management efforts by the family. Thus the family office may have to manage or oversee a variety of different tasks and transactions such as:

- Liquidity of family units and various entities.
- Process for transaction approval.
- Impact a transaction may have on legal structures.
- Impact a transaction may have on tax expense or savings.
- Administrative tasks to be completed once the transaction is complete.
- Housing and archiving relevant legal, compliance, estate planning, business planning, and/or tax documents.

The keeper is a critical function of the family office regardless of the type of family office (discussed in the next section) or the stage of the family office, as discussed in Chapter 2. With the responsibility of being the keeper, confidence and trust in the family office professionals, the processes enacted, and the management of the family's wealth and business affairs is of the highest priority.

## The Guardian and Confidant

Perhaps the family office's most important role is to protect the family it serves. There is no doubt that families of tremendous wealth have much vulnerability. The family office can function as a protector and defender to the family when it comes to shoring up potential exposure. In 2006, Family Office Exchange (FOX) published a Thought Leaders Compendium, "Recasting the Central Role of the Family Office as Risk Manager," that deeply explored the important role for the family office as an advanced warning system. This important contribution to the field started a movement to energize the family office community to be even more proactive and forward thinking to foresee potential dangers prior to having them occur. For example, an investment advisor in charge of reviewing a family's asset allocation plan makes a recommendation that the family should shift its asset allocation from 80 percent equities and 20 percent fixed income to 60 percent equities and 40 percent fixed income. The investment advisor's analysis is sound, risk metrics meet the standards established in the family's investment policy statement, and the transaction execution plan is realistic. However, by not consulting the family's tax advisor, the simple change may trigger an unwelcomed tax on investment activity that could eliminate the benefit of the change in approach. The family office can mediate that risk by understanding both the investment advisor's objectives and the real tax consequences that may result based on the families over all wealth strategy. As the integrator and overseer the family office can best mitigate critical risks that would jeopardize the well-being of the family. What are some of the most critical risks that FOX's study revealed?<sup>39</sup> Those risks include:

- *Lack of shared vision for the future:* Wealth can empower and provide tremendous freedoms for family members, yet it can enable family members to separate more easily from the family. When a family does not have a shared vision of the future (see Chapter 4) it becomes increasingly more challenging to keep the family together particularly under the confines of a family office structure.
- *Lack of an effective decision-making process:* Families may or may not have an explicit decision-making process, yet every family has an implicit governance mechanism. In first generational wealth households, the wealth creator(s), typically the patriarch and/or matriarch, are the cornerstones for the familial decisions. In later generations, the key decision makers evolve and change. When a family lacks a governance process, building continuity, buy-in, and commitment can fractionalize the family group. Strategies

for effective governance in your family office are more broadly discussed in Chapter 11.

- *Lack of transparent family communications:* Communication is perhaps *the* most important component to continuity planning of wealth for multi-generational families, a key insight from the work of Roy Williams and Vic Presser, thought leaders of the Institute for Preparing Heirs.<sup>40</sup> Whether a family member is intentionally or inadvertently isolated from receiving communication or does not receive the depth of necessary information to make an informed decision, both scenarios put the family at tremendous risk. The flow of information is more broadly discussed in the operations section covered in Chapter 9.
- *Improper ownership structures:* How assets are structured, titled, and held are foundational to how a family's wealth management objectives are achieved. If improperly structured, a series of problems such as tax, legal, and compliance issues can arise. The process and approach to consider establishing your family office is covered in Chapter 5.
- *Lack of appropriate diversification of assets:* Concentration of a particular asset, such as a family business, or a type of investment, such as real estate, is often cited as the roots or source of great wealth. However, concentration or lack of diversification can have even more severe downside risks associated with them, and diversification is often cited as a means to preserve wealth. Creating an investment strategy informed by the risk tolerance of the family and its individual members can help shape an investment policy for the family's wealth. Chapter 7 provides a broader discussion on investment management in the family office and how to determine what investment approach is prudent based on the stage of the family, their risk profile, the time horizon, and their short- and long-term investment goals.
- *Lack of focus on key family risks:* There are a number of family risks that can be devastating to the well-being of a family. There are a myriad of complex risks that can entrap a family, from reputational risk, such as how a family member behaves in public, to information risk—what private or confidential information is disclosed about the family in the public domain—to risks associated with common events, such as marriage, death, birth, and divorce. Chapter 6 provides a process to undergo to assess the critical family issues that could be catastrophic to the family and organizes the information that needs to be known to family office advisors supporting the family.

Another risk that is not often discussed is the risk of isolation that often comes with amassing a tremendous fortune. Wealth can open a number of

exciting new doorways, yet it can also be incredibly isolating. No one really prepares most individuals for the isolation of having extraordinary wealth. Wealth can make you a target of the interest and affections of long lost relatives, charities, alma maters, old schoolmates, or neighbors from long ago. Further, wealth can create a whole new dynamic among the relationships in your family. These are deeply personal and sometimes challenge even the most even keeled and level headed of individuals. Thus, members of the family office may also act as sounding boards and trusted confidants to the family as they navigate a whole host of issues. As confidant, they provide objective, unbiased advice that helps develop and empower the family members to be their best with their wealth. The family office takes on the role of guardian by saying “no” to inquiries from friends and relatives, as well as others, in a way that protects the family’s financial assets while preserving these personal relationships. The role of confidant or consigliere is perhaps one of the most critical functions of the family office. In many respects it is akin to have a second set of eyes that can always see what you are seeing and help to validate or clarify the course at hand.

### **The Brain Trust**

Jay Hughes once told a story at an investment conference that best describes the family office as the Brain Trust of the family. Jay proceeded to ask the crowd whether anyone remembered anything about their dreams from the previous evening. Many raised their hands. He then asked if anyone remembered their dreams from a week ago. Far fewer hands were raised. He then asked about dreams from a month ago. Just a few hands were now raised. He then asked, for those who remembered their dreams from a month ago, how many of those dreams turned into tangible ideas. And, of those ideas, how many of them were successfully implemented such that they resulted in significant financial wealth. No hands were raised at this point from the audience.

And then Hughes reminded the audience, who consisted primarily of advisors, that we have the privilege to serve the few whose creativity and bright ideas have led to major business and financial success. Family offices can be a repository and a thinking partner to foster these seedling ideas and help launch family members into new careers, passions, and interests. Inspiring and fostering a collaborative dialogue between the family and the family office on “what could be” is perhaps one of the richest and most rewarding aspects of the profession. Chapters 12 and 13 more deeply explore how to support, educate, and advise future generation family members as they engage in an informed and purposeful life with wealth.

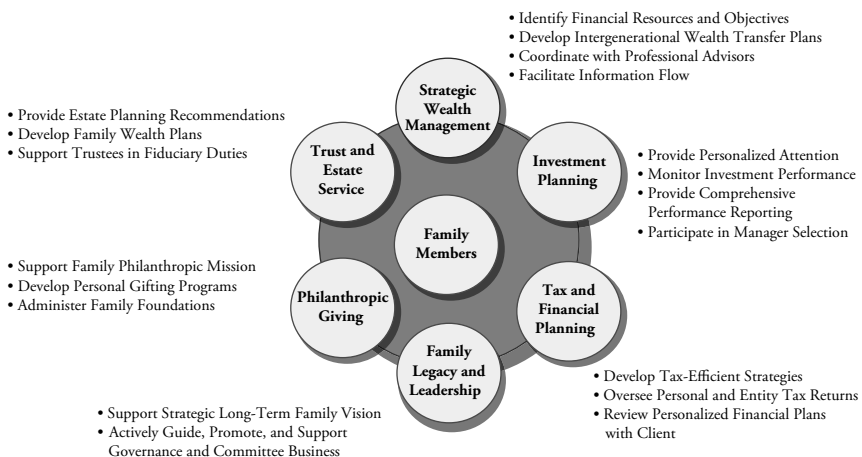
## Types of Family Office Services

To more fully understand the purpose and role of the family office, a broader understanding of how the family office functions and the diverse wealth management options available to affluent families is required. Similar to defining the family firm by behavior, one can begin to understand the role of the family office based upon how it operates in relation to affluent families.<sup>41</sup>

Family Office Exchange outlines six basic categories of service that family offices typically offer: strategic wealth management, investment planning, trusts and estate service, philanthropic giving, family legacy and leadership, and tax and financial planning. See Figure 1.2 for an overview of services that may be offered through a holistic, integrated family office.

Strategic wealth management involves long-term strategic planning that takes into account wealth objectives for current and successive generations. Intergenerational wealth planning also encompasses building your governance strategy; developing family boards and/or family councils; and the governance protocols that will guide your family, such as a family constitution, family mission statement, and/or family investment policy statement. It also may include the coordination of multiple family members' assets that facilitates group purchasing power and access to alternative investment strategies. Investment planning is another core service offered by family offices and

**FIGURE 1.2** Family Office Services



Source: Family Office Exchange, "Family Office Primer," 2013.

may be conducted in-house or outsourced through an investment provider, such as an outsourced Chief Investment Officer. As part of investment advisory services, a family office may oversee asset allocation, portfolio construction, investment and manager due diligence, investment policy creation, and ongoing performance and reporting. The investment advisory function may also conduct money manager selection, as well as performance analytics and constant monitoring, reviewing, and rebalancing of portfolios.

A significant appeal of family offices is the service of investment record-keeping and financial reporting. Because the centralization of assets gives many family offices a unique perspective, it also gives them the opportunity to report in aggregate on family assets. Many family offices offer consolidated financial reporting, allowing individuals to see their asset holdings across various accounts and by various asset classes. This allows families to be more fluid and strategic in the coordination of their pooled assets. The Phipps and Pitcairn families utilized pooled asset strategies effectively as a tool for intergenerational wealth accumulation and transfer. Consolidated reporting also allows families to collectively understand inflows and outflows of the combined families' wealth, and to track whether they are meeting, exceeding, and/or not meeting their families' wealth goals. Many family offices, but not all, also provide a tax preparation service for their clients. If it is not performed in-house, tax preparation is an important function to manage by the family office. This can be a monumental task for families whose wealth is spread across hundreds of accounts, asset classes, and in different types of investments or vehicles. Most, if not all, affluent families file for an extension of their income tax as a result of the use of alternative investments, which typically have later reporting. The family office can be a centralized point and an instrumental vehicle to organize incoming K-1 documents and facilitate tax payments on behalf of its client family. Reporting, investment recordkeeping, tax preparation, and financial services will be discussed in more detail in Chapter 7, which explores the actual nuances of the family office service offering.

In addition to consolidated reporting, family offices will drill down and offer customized reporting per family member that may include performing a cash flow analysis to determine specific budgeting needs. It may also constitute addressing specific tax or compliance issues; risk management strategies; banking, credit, and/or mortgage needs; personal security; bill paying and/or concierge services, such as travel planning, housekeeper sourcing, or plane rentals. This micro-perspective of individual family members also creates greater clarity of how individual family members are contributing to, maintaining, or draining the family's collective wealth.

In addition, family offices often have fiduciary responsibilities and provide oversight and diligence on trusts held by their clients. As the trustees in many instances, they are cognizant that investment strategies are in line with the terms of the trust. From aiding in the administration of the trust to overseeing all tax, compliance, and recordkeeping, fiduciary oversight is an important component to successful intergenerational wealth transfer. Chapter 7 discusses the organizational, legal, and fiduciary considerations that a family needs to explore in the context of setting up a family office.

This type of advice-giving that family offices provide creates a transparent and conflict-free relationship with the clients, allowing the clients to know that their wealth advisors are working solely in the families' best interest and are not selling or pushing products for the interests of their employers. Investment policy creation helps the clients to anchor underlying objectives and goals for their portfolios and can ultimately help to create perspective on the long-term intentions for the wealth.<sup>42</sup> In addition to investment management, family offices will provide governance advice to help families build a framework to enhance how family decisions are made.

Family governance is a term more commonly associated with managing the family business; however, it has become increasingly instrumental in organizing families around their wealth.<sup>43</sup> Governance involves the decision-making in the family and how policies, agreements, boards, and councils are formed as related to the family wealth. The family office can be an effective facilitator to aid families as they devise a governance framework that suits their family's needs. A more expansive discussion of family governance practices is shared in Chapter 11. Other governance issues are whether to build or create a family office; the differences between starting a single family office and joining a multi-family office (Chapter 3); a working guideline to assess the estate, investment, financial, wealth transfer, and governance planning you have completed to date in your family (Chapter 6), and the legal and fiduciary requirements of setting up your family office (Chapter 7). Chapter 8 highlights investment management considerations for your family office while Chapter 9 overviews the advancements in information technology and operations; the human resource management requirements of successful family offices are covered in Chapter 10. Finally, Chapters 12 to 14 discuss the importance of family education in preparing succeeding generations for the responsibilities of wealth and building continuity in your family office: the role of entrepreneurship and the family bank (Chapter 13); the role of legacy and philanthropy in your family office (Chapter 14); the book closes with a discussion of the impact of the globalization of the family office and serving global families (Chapter 15).

## Conclusion and Final Thoughts

Now that we have established a foundational understanding of the definition, purpose, historical context, and basic services of a family office, Chapter 2 moves us into a broader discussion of the evolution and inception of the family office. By sharing common experiences and paths to the origination of a family office and/or to join a multi-family office, we provide you an opportunity to identify which context matches your current need or that of your client. Let the family office adventure truly begin!

## Notes

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