COMMITTEE REPORT:
HIGH-NET-WORTH FAMILIES & FAMILY OFFICES

By **Patricia M. Soldano**

Lessons Learned After 25 Years of Family Office Management

The advisor's role has expanded to keep pace with changing demands and requirements

To many people in the financial services industry, it seems that the family office (FO) is a relatively new development in high-net-worth (HNW) wealth management. Yet, more than a century ago, in 1882, the Rockefeller family established one of the first FOs, choosing to consolidate their wealth management needs into one centralized organization.

Today, according to a survey done by Family Wealth Alliance, there are more than 2,500 single-family offices (SFOs) and more than 140 multi-family offices (MFOs) worldwide. Over the years, the FO has undergone changes necessary to keep current with market demands, tax legislation, financial requirements and other developments. Even as the FO business has changed, its core mission has remained the same: to help families tackle the challenges that come with a life of significant wealth.

I've been in the FO management business for 25 years. Here's what I've learned about the key services an FO can provide and the best ways to manage one.

Shift to MFOs

Since the 1990s, the FO marketplace has seen a shift from SFOs to MFOs, as SFOs have identified the expanded benefits that shared resources can provide to families. Industry professionals have become more sophisticated in their knowledge of various services, and there's been a noticeable increase in the specialization of service teams. Generalists are in decline, driving a greater need for a single resource capable of coordinating and managing specialist providers.

Some investment firms, banks and trust companies are recognizing that their HNW clients (that is, families with a net worth of $25 million or more) are in need of more services than they can provide and are trying to rebuild themselves as MFOs to better serve their most valuable clients.

In addition to HNW families, the market has seen a growth in families who want the benefits of an FO, but don't have the wealth level to justify the fee associated with an SFO. For example, I recently received a call from one family with $100 million-plus in assets that had determined that they couldn't continue to effectively and economically run their FO, so they outsourced the management to our MFO. In addition, smaller MFOs, as well as SFOs, are finding it increasingly more difficult to recruit the high level of talent they need to continue to operate, due to few career options for professionals within the firm. Firms of all types are looking to become FOs, some only to gather assets and increase assets under management.

Overall, the FO industry has become more structured, organized and formalized, with firms facing increased checks and balances and changes in regulation and government oversight at both the state and federal levels. Most recently, in the wake of the financial crisis that began in 2007, the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in 2010 as a means of increasing financial regulation to avoid another financial crisis and provide more transparency for investors, is driving FOs to reassess their operations.

As mentioned, there's been an increase in families desiring FO services, but there hasn't been an increase in understanding what the FO truly is and how it serves a family's needs. To gain a better understanding of the benefits FOs provide, it's important to identify

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why HNW families need a single-source wealth management agency.

Consider, for a moment, that the average HNW family has more than 25 different suppliers providing a range of financial services, as stated by the Family Office Exchange. From trust companies, foundations, banks, insurance and brokerage firms to attorneys, charities, hedge funds and money managers, among others, managing the many service providers required by HNW families can quickly become overwhelming, even for the most savvy family members. Add to the mix factors such as: younger generation family members in need of financial mentoring and education; the sale of family assets resulting in significant cash infusions; and ever-changing tax and estate laws, and the need for an all-in-one resource capable of managing every variable for the best interest of the family becomes even more pressing.

One hundred percent of the offices surveyed identified managing generational and family office transitions as their biggest challenge.

Ten Core Services

Just as each family is unique, so too are their wealth management needs. How do FOs personalize services to meet individual needs and maintain a sustainable business model? Even though each family has unique requirements, their needs can generally be categorized into 10 distinct, but interrelated, elements. Some families may find they need comprehensive services; others may find they need only the administrative, investment or legacy planning components. Ultimately, the greatest benefit of an FO is the ability to personalize services in the best interest of the family.

1. Estate planning. This is a vital service offered by the FO, one that has a direct influence on all other FO management components. The FO works to determine wealth transfer objectives, monitors the estate plan on an ongoing basis to ensure that family goals and financial management plans are aligned and makes recommendations that are in the best interest of the financial well-being of the family.

2. Lifestyle maintenance. Helping families assess whether they'll have sufficient capital to maintain or obtain a certain lifestyle is one of the primary services FOs provide. Through the use of tools, such as goals-based financial planning, risk assessment and customized financial reporting, FOs work with families to help them set realistic lifestyle goals for both the short- and long-term.

3. Managing investments. The FO provides a trustworthy resource for investment recommendations and management, including creating strategies and advising on strategic asset allocation, performing due diligence and selecting and monitoring investments.

4. Education. Without education about wealth management, the best planning in the world will have little long-term impact. FOs create customized programs unique to each family's requirements, so that family members can act thoughtfully when making any financial decision, no matter how big or small. Sustaining wealth across generations is possible only when family members have an overarching perspective created through mentoring and education. For years, families have asked for programs to educate the next generation, and now they're available. A very large, multi-generational FO recently retained our firm to build family governance and educate the fourth generation about family values and the family's assets. I believe this trend will continue to gain strength as families realize the inherent benefits of preparing heirs to be responsible stewards of wealth.

5. Expense management. Regardless of net worth, expense management is vital to financial success. For HNW families, expenses typically go far beyond balancing a budget and paying monthly household and credit card bills. The FO plays the important role of establishing internal controls, including expense approvals and archiving, categorizing and coding expense transactions, maintaining and managing cash balances and juggling the myriad of other details involved in properly managing expenses to help sustain and grow wealth.

6. Tax planning. For HNW families, tax planning carries with it a host of challenges, including trust and estate planning, charitable tax planning and structuring, as well as ensuring compliance with federal, state and local tax requirements. FOs manage all aspects of tax-related issues to position families in favorable tax structures.

7. Fiduciary accounting and support. This, as well as management of trusts and trust-related issues, are common services of the FO. Trust administration and management and liability support and advice for all trustees also fall under the FO's fiduciary service offerings.

8. Philanthropy. Families fortunate enough to amass significant wealth recognize the importance of philanthropy. For HNW families, philanthropic efforts go far beyond annual donations. The creation of charitable trusts, strategic tax planning, next-generation involvement and foundation governance are all considerations for which FOs provide guidance and education.

9. Governance. Sustaining wealth across generations is paramount for HNW families. Without governance, however, the ability for a family to transfer wealth beyond three generations drops significantly. FOs are adept at guiding families as they develop a family mission statement, implement a governance system and prepare succession-planning activities.

10. Documentation. From a strictly administrative perspective, tracking, coordinating and managing the documentation involved in family wealth management is a Herculean task. FOs are able to maintain the family's document inventory, including trust paperwork, tax documentation, summaries and ownership of major assets, family governance statements and any other documentation family wealth management generates.

In addition to these 10 core services, FOs often manage new business acquisitions and oversee the negotiation process; advise family business boards of directors; supervise the purchase of real estate; oversee attorneys and others involved with the families; and mediate family member conflicts. In short, the services an FO can provide are dictated by what the family needs.

Considerations

Just as there are 10 core elements today that summarize the services of most FOs, there are at least eight considerations families should address when selecting a suitable FO model:

1. What services do they provide? Do they address the 10 core elements in some way, or are they specialized, focusing more on investments or administrative responsibilities?
2. How large or small is the FO? Some families may be seeking very hands-on personalized service; others may be looking for an FO to provide general oversight through a more formal, hands-off approach.

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3. How does the FO communicate family business, updates, news, investment advice and so on? How frequent are communications from the FO?
4. What's the cost of service? How does the FO get paid? Is it a direct fee for service, or does the office collect fees based on trades, for example?
5. What's the management structure of the FO? What are its management challenges? Does the office attract and retain a wide range of professionals and resources? Does it coordinate and integrate activities for the benefit of its families? Has it built sustainable entities?
6. Who owns the FO? What's the mission statement of the FO? Are its goals and mission in alignment with the family's goals and mission?
7. Where's the FO located? Is it a small office with only a few locations? Or, is it a global company with offices around the world, offering personalized services to HNW families in a given region?
8. Is the objective in its approach? Is its operational focus in the best interest of the families it serves, or is its driving principle to generate revenue for its ownership?

FO Challenges

All businesses face challenges that force them to

examine and refine their business approaches to better serve their customers, and the FO is no different. In a 2011 Family Wealth Alliance Single Family Office Study,[1] FOs were surveyed to identify their biggest challenges. One hundred percent of the offices surveyed identified managing generational and FO transitions as their biggest challenge. Family cohesion and governance also scored high. Preserving wealth ranked relatively low, and liquidity and cash management ranked at the bottom of the list. It's becoming more common for large SFOs to reach out to other firms to assist in communicating the values of the family and transitioning the business or assets to the next generation.

Wealth management decisions carry an inherent risk for all investors, but especially for HNW families that require the services of a range of providers.

Wealth Advisory Firm Options

With a clear understanding of what services an FO can provide and considerations to ponder when choosing an appropriate FO model, investors must still analyze the business models of service providers and determine which best fits their needs and preferences. Three primary options are available: advisors, distributors and manufacturers.

Advisors. The role of an advisory firm is just that: to serve as an objective advisor. They agnostically source products from outside suppliers. The advice they provide is independent of products. Advisory firms are paid directly and only by the investors. Their value proposition hinges on objectivity, expense optimization, risk management, access and quality of advice. FOs follow an advisory business model.

Distributors. They are financial supermarkets. They exclusively distribute products for their institution and others. Their advice is bundled around the investment products they offer. Distributors are paid via wrap fees, asset management fees, trade fees and the like. Similar to advisory firms, they count quality of advice as part of their value proposition, as well as product variety, depth, access, brand and size.

Manufacturers. They offer investment management services and primarily distribute a proprietary product. Manufacturers receive payment from asset management fees and imbedded, product-based performance fees. They sell their services based on the quality of asset management capabilities, research, brand, size and performance.

Five Core Principles

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Regardless of the wealth management/advisory firm a family selects, it's in the family's best interest to ensure that, above all, the firm adheres to the five core fiduciary principles of wealth management:

1. The client's interests are put first.
2. The firm acts with prudence—with the skill, care, diligence and good judgment of a professional.
3. The clients aren't misled—they receive a full and fair disclosure of all important facts.
4. The firm makes every attempt to avoid conflicts of interest.
5. The firm fully discloses and fairly manages, in the client's favor, unavoidable conflicts.

Any family that follows these guiding principles when assessing wealth management options will be well positioned to objectively and carefully analyze services for the best interest of the family.

—The views expressed are those of the GenSpring representatives and are subject to change. They are shared for educational purposes only, and shouldn't be considered as investment advice or a recommendation for any particular security, strategy or investment product.

Endnote

1. *The Family Wealth Alliance Report* (2011).