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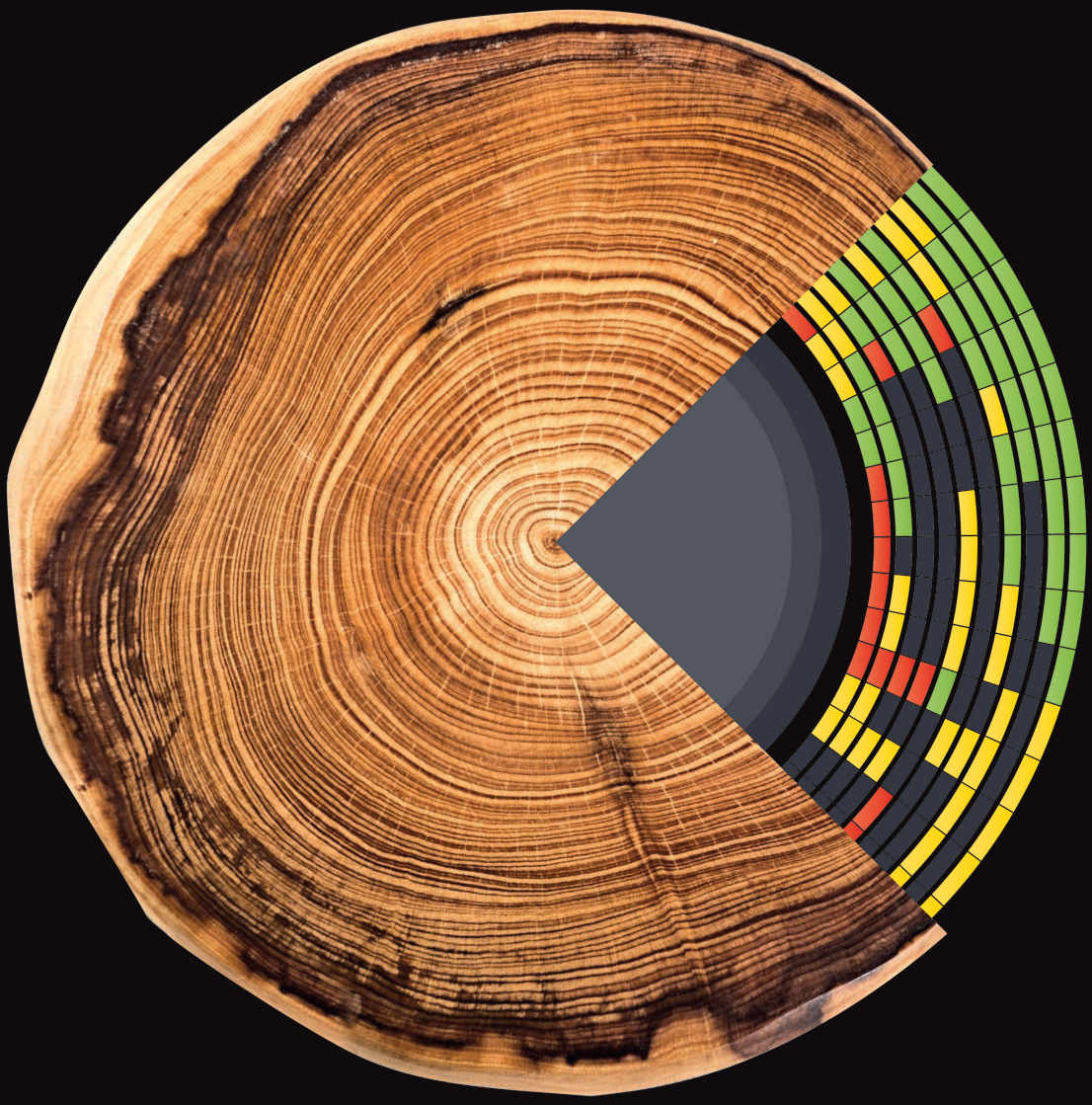

The Family Office Handbook

Achieving ambition. Managing risk. Leaving a rich legacy

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Introduction

With the creation of significant wealth, new worlds often open for high net worth individuals and their families. Exciting opportunities as well as new challenges can arise as the family acclimatises to the increased complexities of wealth. One important decision may be establishing a family office* to oversee the financial affairs of the family rather than relying on financial institutions to provide those services.

That is a big step, one that involves many logistical, operational, and even emotional considerations. Yet it is a bold move that many others have made in recent decades. Wealthy families have been taking more hands-on control over investment policy decisions as a result of continued capital market uncertainty and their desire to commit resources to making an impact in the world now and in the future. Also, in this era of increasing risk, investment fraud, and cybercrime, more families have been adopting an institutional approach to family risk management. This process is aided by the advancement of and growing reliance on technology in family financial affairs.

In such an environment, establishing and operating a family office, or expanding the services of an existing family office, requires careful analysis and planning to properly manage, protect, and grow a family's wealth. Deloitte can help at each step along the way so that the legacy a family has built sustains its interests in the future.

This publication is a starting point. It is designed to help wealthy families build on their current understanding of what a family office is, consider factors that have contributed to the success of other family offices, and formulate a plan that leads to the creation, transformation or expansion of their own family office. While not intended to address every question arising, it should serve as food for thought and discussion. We invite readers to join us for that conversation soon.

A family office is:

- An increasingly popular concept albeit the original roots extend back to the 1800s when they were established to manage the significant fortunes of successful early entrepreneurs
- A private organisation established by a family to oversee, directly or indirectly, the financial affairs of the family
- Often the result, like wealth accumulation in general, of owning a successful family business
- In certain instances, formed by a principal of a hedge fund or private equity fund who decides to no longer advise on funds with third-party assets, instead evolving into a standalone family or private office to solely manage his or her family's wealth
- An organisation that offers many of the same services as top-tier private banks and investment firms, but devoted to the needs of a single family
- A highly tailored organisation, often reflecting the characteristics and aspirations of the family it serves

*This publication focuses on single family offices: private organisations established by families to oversee, directly and indirectly, their financial affairs. References to a "family office" throughout this publication refer to a single family office unless otherwise stated. In contrast, a multi-family office is an organisation that serves multiple non-related families. Sometimes, these are former single family offices that have broadened their client base to serve other non-related wealthy families. More often, multi-family offices are third-party wealth management firms that provide outsourced services to wealthy families.

Family office fundamentals
Characteristics of a family office

While each family office is as unique as the DNA of its individual founders, there are some common goals that most family offices strive to achieve:

- To provide formal structure for the management and governance of the family's wealth
- To promote the family's legacy, vision, and values
- To co-ordinate, integrate, and consolidate customised services for the family
- To manage economic and personal risks for the family
- To capitalise on economies of scale gained from consolidated family wealth accumulation, such as preferential investment access and lower fee rates
- To maintain confidentiality and privacy of family affairs

Traditional paths of the family office
One of several scenarios often results in the formation of a family office

Scenario 1: Separation

A successful family business has grown significantly and profits from the business have been diversified into new active or passive investments. The management and administration of those investments has become highly demanding for family business personnel. To mitigate conflicts of interest and other risks, the family's non-business operations embedded within the company are separated into a newly established family office.

Scenario 2: Liquidity event

A successful family business or entrepreneur-owned business is monetised through, for example, a minority interest sale, majority interest sale, or recapitalisation. A family office is established following the liquidity event to provide a formal structure to promote family governance and decision making around the resulting wealth.

Scenario 3: Fund redemption

A hedge fund or private equity fund manager redeems out third-party investors of the fund. Subsequently, the fund manager evolves into a family office, now serving the principal and family members.

Family office fundamentals
When is it time?

While opinions vary widely about the amount of wealth necessary to form a family office, a traditional threshold is at least US$250million of investable assets. In general, it is believed that this amount of wealth is necessary for dedicated resources to provide favourable economies of scale from both a time and money perspective.

But the amount of wealth involved is not the only important consideration. There are a number of key integrated, qualitative factors that also should be considered. As more of the factors become relevant, so does the value proposition for the formation of a family office.

This due diligence process is an important step in assessing when and how to initiate the formation of a family office. With the guidance of trusted advisers, the diligence process provides a structure for weighing these important factors, which will help a family determine whether and when a family office makes sense.

Integrated factors in the decision to form a family office
The amount of wealth involved is only one of many factors that drive the decision to form a family office.

Family office fundamentals
Services to be provided

Wealthy families have numerous options for obtaining personal and financial services. A key success factor in forming a family office is to engage the right people to do the right work. For long-term success, it is therefore important to establish and periodically reassess the optimal balance between services performed in-house by competent family office employees and those outsourced to qualified service providers.

For those activities that the family office chooses to outsource, the family office executive must build the right advisory team and choose the right third-party providers to deliver those services. Developing a network of resources who are specialists in the respective service offerings is key to putting an effective team in place.

Scope of family office services

Strategic services	Technology	Tax and wealth planning	Investments	Risk management	Philanthropy	Legal	Family	Finance	Operations
Family education	Social media	Tax compliance	Investment policy	Insurance	Philanthropic mission	Monitoring & oversight of outside counsel	Concierge services	Bookkeeping & reporting	Talent
Governance	Technology platform & controls	Tax planning	Asset allocation	Reputational Risk	Family foundation & operations	Document preparation	Household help	Cash Management	Office policies & procedures
Succession planning	Cloud computing	Wealth transfer planning	Manager selection	Fraud prevention & detection	Family foundation oversight	Contractual review	Property management	Budgeting & forecasting analysis	
	Family & business information continuity	Investment structure design	Bench-marking	Physical security	Charitable bench- marking	Contract oversight	Collections management		
			Performance reporting	Cyber risk	Due diligence	Litigation oversight	Travel		
				Financial controls	Miscellaneous philanthropic activities	Regulatory compliance			

■ Most often done in house ■ Sometimes done in house ■ Most often outsourced

- Many in-house services (items shown in dark green) address daily activities at a granular level. Keeping these services in-house provides immediate access to and control over the information. It is also likely to be more cost-efficient and expedient than outsourcing.
- Other services (items shown in blue) may be performed by family office staff and at other times by outside providers or a combination of the two. This can offer the best of both worlds: cost savings on services that involve lower risk or is less complicated, and cutting-edge planning and quality assurance for more complicated services or projects.
- The most frequently outsourced services (items shown in light green) typically require highly specialised skills or significant infrastructure. Few family offices have the appropriate structure or resources to provide these services in house from a risk–return perspective.

Operational considerations

Governance

Establishing and operating a family office, or expanding the services of an existing family office, requires careful consideration and planning to properly manage and protect a family's wealth so it can flourish over time. As with any organisation, the relative success or failure of a family office relies on effective governance.

Important considerations include:
Balanced leadership and delegation. Although family offices often are established by the family's senior generation, effective governance hinges on both the experienced leadership of those senior family members and selective delegation to others. Vision and strategy should be set by the family, with tactical decisions and execution left to capable family office personnel and supported by outside advisers.

Effective communications
The family office often serves as the centre piece for communications to and among family members. The family office often hosts family meetings and organises retreats, and family office leadership is often tasked with communicating certain messages to the younger generations.

Board oversight
A leading practice among family offices is to establish a board of directors to provide oversight and direction. Careful consideration of board composition is imperative. In most cases, the board should include both senior family members and objective outsiders who can offer contrasting perspectives.

Succession and contingency planning
Another leading practice is to safeguard the long-term prospects of the family and family office through succession and contingency planning. For example, developing a plan and educating family members on what will happen after the family patriarch or matriarch passes away is an important factor in reducing confusion and averting disagreements and misunderstandings over the direction of the family wealth.

Continuous operational improvement
Faced with continually evolving operational challenges, successful family offices and the families they serve thrive on continuous process improvement and innovation. Whether it is an existing organisation or newly formed, and whether executives have been in place for years or are newly appointed.

Attributes of effective family office governance
Family offices should create a governance infrastructure that encompasses all activities from the operational to the strategic.

While death and taxes are inevitable, their consequences don't need to be a surprise. Family offices are in a unique position to prepare their organisation and the families they serve to plan for the inevitable, such as the death of a principal or key family members. Preparedness exercises can put the family office, the family advisers, and most importantly, the family in a significantly better position to address the personal and business implications of the death of a principal.

Operational considerations

Cost structure

Family offices can provide significant benefits to the family, but not without an adequate annual operating budget. A general rule of thumb is for the annual operating costs to be approximately 1% of assets under management. However, the actual range can vary widely, from 30 to 200 basis points depending upon the amount and type of assets under management, the complexity of the family office operations, scope of services provided, and even whether external management fees are included in the calculation.

Once annual costs for the family office have been determined, an equally important decision is how the family office will charge the family for the services provided. The charges for services provided should be sufficient to cover the family office's operating costs and ensure that it can operate as a going concern. Although no industry standard for such charges exists, leading industry practices include:

- Variable fees based on hourly rates
- Variable fees based on a percentage of assets under management
- Fixed fees based on an agreed-upon scope of services
- A flat rate designed as a reimbursement for costs allocated
- A hybrid or combination of any of the above

Whatever method is chosen, the charges should be fair and reasonable on a comparative basis, transparent to the family client incurring the charge, accounted for accurately, and documented contemporaneously.

Some family offices undertake a transfer pricing study to determine a comparable market rate for services. Market-rate pricing analyses can avert potential tax issues, and provide comfort to fiduciaries that services are provided at a fair rate.

Operational considerations

Talent

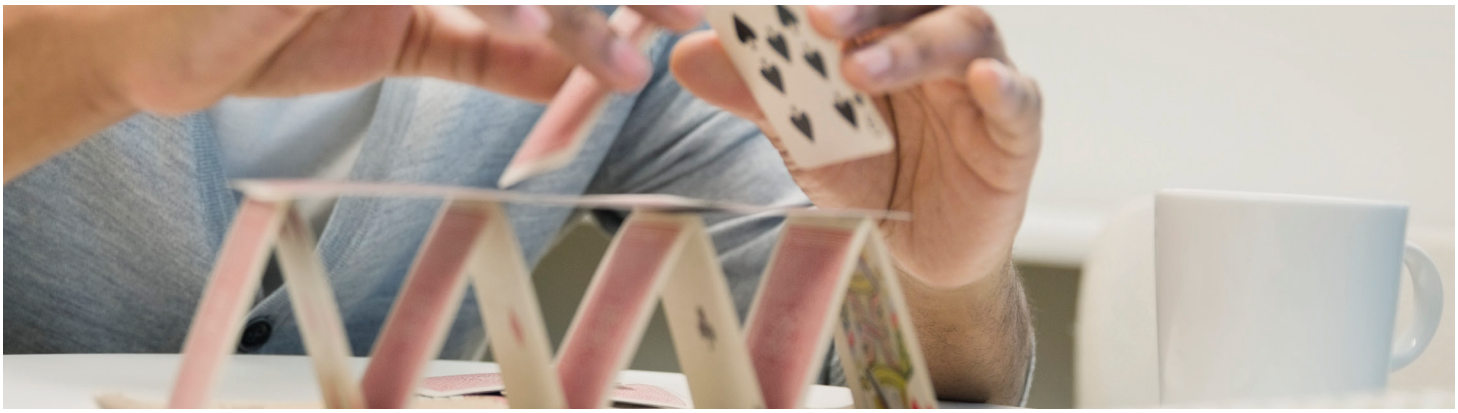
A cornerstone and significant success factor of any family office is the talent it employs. Attracting and retaining effective talent enables a family office to create the appropriate culture, maintain high morale and retention, and adeptly evolve as family needs and dynamics change.

Not surprisingly, compensation and benefits are by far the family office's largest annual costs, representing between 50 and 75 percent of the annual budget. This is why the family should invest significant time in attracting, retaining, and incentivising its workforce.

- Family office staff size can range from as few as one or two people up to more than 100, depending upon the size of the family, the type and extent of services provided, and relative financial holdings and activity.
- The most common family office leadership positions include a chief executive officer (CEO), chief financial officer (CFO), and chief investment officer (CIO). Recently, many family offices have added a chief technology officer (CTO) due to the expanded role and integration of technology.
- As the business demands of the family office have changed over time, so have the expectations of new generations of employees. It is important for family members and family office employers to recognise these changes and consider how they will respond to them to attract and retain talent.

Leading practices for family office talent management:

- Identify near and long-term talent and leadership requirements to meet the family office strategy and mission.
- Inventory talent and identify any high potentials, high performers, and gaps in capabilities.
- Decide how to fill gaps by building, buying, or borrowing.
- Establish a formal process for hiring including due diligence and background investigations and onboarding.
- Execute appropriate legal documents, such as employment agreements, non-disclosures, and privacy commitments.
- Define clear roles, responsibilities, and lines of reporting.
- Create long-term succession and development plans.
- Develop an employee handbook with policies and procedures.
- Create a work environment that emphasises employee well-being and provides flexibility.
- Encourage employees to establish goals that directly tie to the family office's short and long-term objectives, then tie rewards directly to those goals.
- Institute compensation arrangements that include long-term incentives to promote retention of key employees.
- Set up a formal performance and review process that includes meaningful feedback.



Operational considerations

Technology

With technology continuing to transform businesses and governments around the world, and as the pace of change accelerates, family offices are increasingly adopting and embracing it through improvements that impact operational effectiveness, communication with clients, and data security.

Digital capabilities can help position a family office to capitalise on opportunities, address a variety of risks, increase efficiency, retain talent, and provide transparency to key stakeholders.

Cloud computing, mobile applications, robotic process automation (RPA), and other emerging technologies can significantly enhance the way the family office staff and stakeholders interact with each other, help contain IT costs, and facilitate efficient operations. At the same time, these technologies present risks and challenges that require specific skills and increased cybersecurity vigilance.

Another important and growing challenge for family offices is data aggregation—the ability to access, analyse, manipulate, consolidate, and report on data from multiple sources. Many families have moved to a global custodian to shift the burden of aggregation away from the family office. In other cases, third-party expertise and data aggregation solutions may be warranted.

Future technology investments
While thinking ahead for the next three to five years, family offices are placing their biggest technology bets on:

- IT security and infrastructure
- ERP/general ledger upgrades
- Collaboration sites: document management and storage systems, e-rooms, file transfer
- Data storage and retrieval optionality
- Mobile device applications

Family office technology needs
The modern family office relies on an integrated technology platform to effectively serve clients.

The sophistication and complexity of any technology platform should be weighed against the needs, expectations, and capabilities of family members. The resulting decisions should address those factors both for the near term and in the future as the family being served grows and expands its global footprint. Engaging appropriate third-party expertise in this process is a leading practice.

Management considerations

Risk management and controls

For family offices and the families they serve, the global risk environment is constantly changing. However, several risk areas continue to be top of mind:

- **Cyber risk** Areas of exposure include personal identities, reputations, public and private schedules, business and personal travel, investment accounts, business dealings, and many more.
- **Fraud risk** This is an infrequent, but important area of exposure due to family office proximity to cash and assets and the significant control a single employee may have over financial activities and family communications.
- **Organisational and operational risk** This includes family office employees, processes, systems, and external parties, as well as the physical security of family members themselves.

The family office is in a better position than any individual family member, adviser, or service provider to monitor and manage such risks for the family. A family office's approach to risk management depends on many factors, including the size of the office, the experience of its personnel, and the office's state of development. For family offices of all sizes, a sound risk management framework with effective internal controls is essential.

Many family offices are beginning to reframe how they think about risk management. The resulting projects are not viewed as necessary expenses, but rather as investments in the future of the family's reputation and well-being, as well as preservation of the family's assets. Family offices with strong risk management frameworks are often better prepared to withstand market disruptions, cyber attacks, internal fraud, and other relevant threats.

Risk management as investment vs. expense

Families may perform a risk assessment and develop controls to mitigate the risks identified, with the ultimate goal of preserving the family's wealth.

Common risks facing family offices

Financial

- Improper trade authorisation
- Deviation from investment policy

Technology

- Cybersecurity
- Data confidentiality/ privacy
- Business continuity

Employment

- Payroll fraud
- Internal data theft

Controls and risk mitigations

Authorisation/ limits/access

- Dual signatures for transactions
- Stringent assignment of access

Bookkeeping/ reconciliations

- Dual signatures for transactions
- Stringent assignment of access

Segregation of duties

- Up-to-date segregation policies with periodic spot checks

IT controls

- Stringent remove-access policy
- Comprehensive data encryption
- Enforcement of password policies

Consider this: Internal controls are the processes and procedures that a family office uses to build integrity and security into its critical functions. As with any successful business, the sooner internal controls are introduced, the better equipped the family office will be to manage risk and discourage inconsistency and unreliability in its management of the family's affairs.

Risks evolve over time, particularly as the family itself and the family office's personnel and systems change. A leading practice is to conduct a periodic formal risk assessment to confirm that internal controls are effective and appropriately focused. Results should be presented to the board so the family stays informed and engaged.

Management considerations

Legal, tax and regulatory

The legal, tax and regulatory framework for family offices can be complicated, requiring the expertise of competent advisers. The following are common focus areas:

Legal considerations

- Should the family office be structured as a company, partnership, trust or something else?
- Who will own and control the family office?
- What is the appropriate legal jurisdiction for the family office?
- What other legal agreements are necessary, such as employment agreements and service agreements?

Tax considerations

- For tax purposes, how should the family office be structured?
- Will the family office activities rise to the level of a trade or business?
- Are there gift or estate tax issues concerning family office ownership and succession?
- Will there be a tax impact for family members?
- How will the role of the family office impact international family members and/or structures?
- Is there sufficient flexibility to cater for change in tax and regulatory rules as well as family circumstances?

Family offices can effectively prepare for enquiries/audits by tax authorities by conducting a periodic audit readiness assessment. This can range from a simple discussion with internal advisers to a detailed audit readiness assessment that includes document analysis, interviews, and other data gathering.

Note: The comments in this section only provide a cursory overview of the legal, tax, and regulatory environment applicable to family offices. Matters concerning the structure of family offices can become complex where multiple jurisdictions are involved and therefore it is important to seek tax advice before establishing a family office.

Bringing the family office vision to life

Investing and managing family wealth

How the family wealth is invested typically defines the family office. Investment services provided by or co-ordinated through family offices often include:

- Developing investment objectives, including drafting of investment policy statements, assessments of risk tolerance, and creation of appropriate target asset allocations
- Selecting appropriate investments based on the family's short and long-term needs, and periodically rebalancing or making adjustments to the portfolio
- Selecting, engaging, and managing relationships with investment advisers
- Reviewing asset holdings and investment performance
- Managing cash and liquidity
- Overseeing investment due diligence
- Providing periodic investment account statements and performance reporting

Common themes and trends for family office investing:

- A long-term investment horizon, perhaps spanning generations
- Unencumbered by regulatory constraints placed on institutional investors
- Diverse and non-traditional asset allocations
- Significant interest in private equity direct invest and co-invest opportunities
- Focus on wealth preservation vs. growth. The more generations served, the stronger the focus on preservation
- Liquidity preferences driven by the relative cash needs for the family
- Use of family pooled investment vehicles to promote co-investment
- A more recent emphasis on social impact investing and venture philanthropy

Bringing the family office vision to life

Philanthropy

Philanthropy often unifies a family behind a purpose, encouraging effective governance and collaboration while giving the family an opportunity to create a meaningful impact on social and environmental issues in their communities and around the world. It also engages younger generations in the family vision and succession. Similar to investing, philanthropy is often a cornerstone activity for the family office.

However, families today have more options than ever before to create social and environmental impact. Today's philanthropists can donate through an array of vehicles, ranging from private foundations and charitable gift funds to community foundations and online giving platforms. The abundance of charitable vehicles is further complicated by a new set of options that are emerging as ways for individuals to try to effect change, such as political contributions, socially responsible investing, and impact investments in social enterprises and social purpose businesses that produce both financial and social returns.

The family office can be a key player in helping family members navigate among and across these options. The family office executives coordinate with expert philanthropic advisers to assist the family in understanding issues and effective practices, establish clear charitable goals, and align those objectives with the strategies and tactics that can more effectively achieve the family's philanthropic vision.

Family offices can also be a critical aid in helping individuals make sense of the complex tax issues related to charitable giving.

For the family who desires to create a legacy and have greater control over its charitable giving, a private foundation may be an appropriate charitable giving vehicle.

Bringing the family office vision to life

The impact of global reach

Advancements in technology and better access to information, resources, and markets continue to expand global opportunities. Wealthy families are at the forefront of this shift. Whether through geographic dispersion of family members, property ownership in foreign jurisdictions, or investments made in foreign companies, wealthy families are increasing their global footprint. A family office can provide the necessary support to address the wide variety of issues that can arise from the increased global reach of the family.

Global communication
The ability to connect in person becomes more limited when family members reside in different jurisdictions across the globe. Having a secure communication platform to share information among the family, family office, and trusted advisers in real time is critical. The family office can assess the appropriate technology to meet family members' needs, regardless of where they are and when they want to access information.

Global families
If the family resides in a foreign jurisdiction for all or a portion of the year, what are the financial, tax, and legal implications?

Global investing and informational reporting
Countries are demanding greater transparency regarding investments and their owners, and the family office can assist with addressing the rules, registration, and reporting requirements related to the family's foreign investments. For example, one far-reaching impact relates to investments in pass-through entities, including private equity funds, hedge funds, and private foreign investment corporations. These investments frequently generate detailed amounts of information that can prompt significant tax return disclosures. The penalties for non-compliance can be onerous, and the family office, working with its tax adviser, can assist the family with meeting these requirements. Understanding the costs associated with the incremental reporting and disclosures attributable to foreign investments is essential for taxpayers to evaluate their after tax investment returns. In addition, families must consider the implications of holding these foreign investments because personal information regarding the family members may be required to be shared with foreign authorities.

The implementation of the Foreign Account Tax Compliance Act (FATCA) by the IRS as well as the Common Reporting Standard (CRS), together with beneficial ownership registers has significantly increased the tax transparency for investors across the globe. Many family offices have committed resources within the organisation to complete the initial and recurring documentation required by foreign investments. As more families commit capital to these investments, family offices are assessing the risks associated with disclosing family members' personal information to tax authorities around the world.

Looking ahead

Family offices created today have many similarities to the family offices created over the past 150 years. However, several emerging trends are reshaping how family offices will operate and identify talent and resources in the future, including:

Philanthropy For decades, family offices have been created to oversee the financial affairs of the family and to implement planning to sustain and pass on wealth to future generations. Many families created family offices after a sale of a business that had been in their family for generations with the intent that future generations would be cared for financially. Today, an increasing number of individuals desire to pass a meaningful portion of the wealth generated by the sale of their businesses to philanthropic pursuits instead of perpetual trusts for the benefit of family members and future generations. This trend may necessitate different skills and experience among family office employees as the family's goals shift.

Technology The adoption of new technologies is impacting the skills required of family office personnel. Many repetitive tasks that previously required hours of an individual's attention, can now be completed by new technologies. Rather than hiring individuals to input large amounts of data, family offices can seek to hire individuals with enhanced data analytics skills and experience implementing and effectively leveraging technology.

Direct private equity As more families consider investing in direct private equity, family offices are tasked with evaluating how this will impact the family's overall investment allocations. In addition, families must evaluate whether they will acquire talent with a private equity background to source transactions aligned with the family's investment strategy. Direct private equity often requires more active involvement with respect to ongoing business decisions. Accordingly, it will be important for families to agree on the governance with respect to these business investments and whether family members will be allowed to actively participate in the acquired companies.

Global mobility As families become more globally mobile, the need for a statically located family office is changing. Alternatives include establishing multiple family office locations or an operating model where more employees work virtually. This may create new talent pool options since the family office no longer must rely primarily on its home market for recruiting purposes. However, technology must be evaluated to ensure that the data transferred between personnel is secure.

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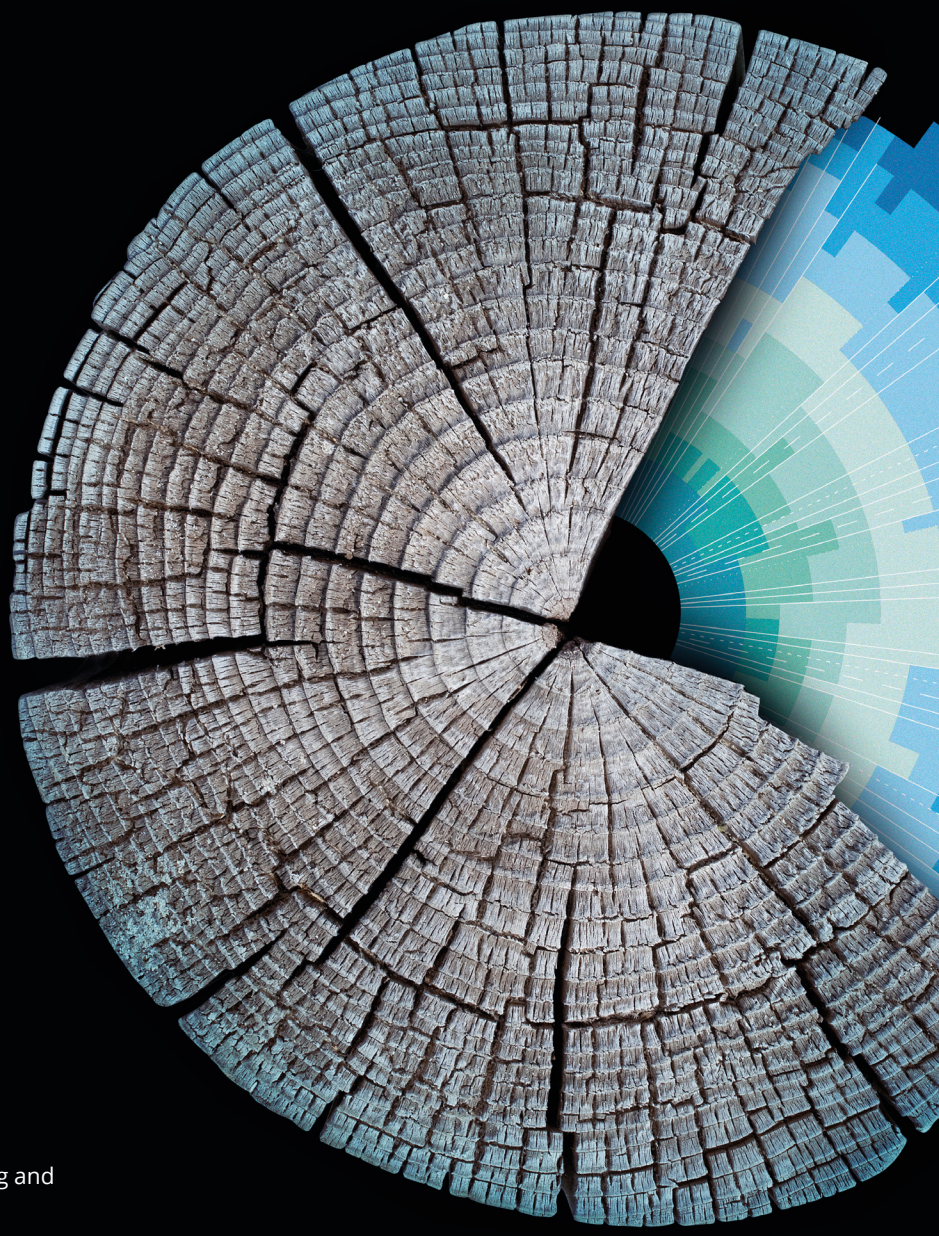

Family Office Community

For executives of Single Family Offices

Our Family Office Community provides executives leading and working in private, single family offices with exclusive opportunities to network and share common challenges, experiences and insights.

The programme includes access to our Family Office Executive Dinner series, which features talks by subject-matter and industry experts on the issues that matter most to family offices and those leading them. Our annual Family Office Symposium also provides a networking platform as well opportunities to hear about family office trends and other topical issues.

To find out more, email deloitteprivate@deloitte.co.uk

An experienced team

Deloitte has an experienced team dedicated to supporting the specialised needs of the ultra affluent, including families with multi-generational wealth and family offices. We provide the expertise and guidance to assist family offices through critical conversations while helping to preserve and enhance the family's legacy. Our advice spans a wide range of specialised areas – from tax technical to cyber risk management— with access to a global network and emerging markets

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