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# Key Considerations When Creating a Family Office

Though families with great wealth have many options for wealth management solutions, those with assets over $250 million often choose to build their own private wealth management firms, called “family offices.”

Family offices provide customized services and support for a single family. They are increasingly used by those seeking to create a cost-effective wealth management process that provides quality, transparency, privacy and control. Additionally, a family office can provide the structure to strengthen family bonds through the shared experience and responsibility of wealth stewardship.

When done properly, a family office can provide tremendous benefits. Establishing a family office should be approached the same way as creating any other successful business: start with a good plan.

## Laying the Foundation for Your Family Office

Well-prepared families set up their family office months in advance of a specific need, such as a liquidity event associated with selling a business or the need to transfer wealth between generations. In some cases, this means transferring a family office that was embedded in the operating company into a new entity. For most families, it means building a new office from scratch.

In either case, it is prudent for the office to start by overseeing core services and outsourcing as much as possible in the initial phases. Then, over time, the office can add services and take solutions in-house as the family completes their due diligence and cost-analysis studies.

When anticipating a significant liquidity event prior to creating a family office, it’s critical that you find a safe place for your wealth to be held, and determine by whom and how the wealth will be managed for at least the first 12 months.

Most large families use a master custodian to hold and protect all marketable securities and cash, settle manager-directed trades into custody accounts, and provide independent, consolidated accounting for all of the family’s assets. By selecting the family office’s master custodian early in the process, the assets can go straight into the accounts that the family office oversees.

Ownership of a family business is often spread across multiple trusts and legal entities and setting up new accounts to receive the proceeds can take weeks. As a result, families often end up using existing retail solutions to receive the proceeds rather than a preferred, secure master custodian. After the liquidity event, the retail providers exert tremendous pressure to keep and manage the assets. Unraveling this situation can be time consuming, involve unnecessary meetings, and result in overall confusion as the family office begins to assume their responsibilities.

If the transaction proceeds are cash, it may be wise to have a short-duration fixed income manager in place to conservatively invest the assets while a long-term asset allocation plan is being developed. If the transaction proceeds are stock in a new company, this may mean exploring hedging strategies to manage market-volatility risks while decisions related to diversification and taxes are evaluated.

## Five Key Questions When Creating a Family Office

When embarking on the creation of a family office, you and your family should work together to answer these five key questions to ensure things start off on the right foot:

### Why Is the Family Office Being Created?

The answer to this question should serve as a mission statement that guides how all future decisions regarding the family office will be made.

We always ask our clients why they created their family office. While every story is different, most focus on the desire for a process that their family can trust and control and that keeps the family working together toward a common purpose.

When asked for greater details about the office's mission, responses typically include:

- To identify and manage an array of risks from investment risk to reputational risk
- To access and process investment, tax and family information more effectively than any family member could do on his or her own
- To control costs while delivering quality and value to the family
- To protect family members from untrustworthy individuals, organizations and, if necessary, from themselves

### Who Will Be Involved in the Family Office?

For wealth creators, this question is often easy to answer, as the family office is usually intended to serve them and their children.

If the family office is established for the long run, however, future participants should be identified as well. Many family offices define their clients as the wealth-creation generation, their children, their grandchildren and so on.

While simplicity is often the right approach, many offices must contend with the reality of managing expectations related to spouses, adopted family members, stepsiblings, former spouses, and, in some cases, in-laws and other non-family members (although this may trigger additional regulatory filings). Having clear guidelines related to who can be a client of the family office will help to navigate these issues.

There is no wrong answer when defining a family office client base. What is important is to understand your needs and to build a mix of services that address them.

### What Services Will the Family Office Provide?

The most common services provided by family offices are based on collective access to professional advisors. When it comes to investment, legal or tax advice, the family office can leverage its collective assets to find and retain the best providers through a thoughtful due diligence process. Those providers will be able to offer tailored advice in a cost-effective fashion though their immersion in the unique situations and needs that span across all family members.

The next most common service is related to information management. Wealthy families have complex investments, trusts and estate plans. Providing timely data and analysis to family members and family office executives becomes an important function of the office.

In general, family offices offer some mix of the following:

- Investment management and/or investment oversight
- Financial reporting to family members and investment committees
- Coordinating tax filings and tax planning
- Portfolio accounting and the processing of cash transfers
- Coordinating estate planning, administration and fiduciary matters
- Family foundation and philanthropic oversight
- Managing family properties, such as aircraft, boats and households
- Overseeing the family's insurance coverage
- Lifestyle services such as paying bills, travel, assistance buying a house, etc.
- Leading family governance initiatives

The family office may need to add new services or deliver existing services differently as generations age, the client base changes, technology evolves and the investment landscape shifts.

### What Is the Appropriate Legal Entity for the Family Office and Where Will It Be Located?

The legal entity you create is driven by the family's unique jurisdictional, regulatory and tax considerations. Legal and practical considerations can influence where the family office is headquartered. Restrictions on foreign currency exchange or the sharing of client information in some jurisdictions can pose challenges for multinational families.

When starting a family office, the natural tendency is to locate it where the family business was and/or where the matriarch and/or patriarch live. Over time, however, as family members relocate, it may be necessary to move the office or add satellite offices in other jurisdictions. The cost of running one or more offices must be weighed against the benefit of serving clients in their local jurisdiction and time zone, as well as gaining access to legal and investment opportunities unique to specific areas. Outside the U.S. and Canada, private investment companies (PICs) are a common structure for family offices. These PICs are typically owned by a trust, often a family trust that could also be managed by the family's private trust company.

When selecting a location, it's important to consider whether the jurisdiction:

– Enjoys political stability and adheres to the rule of law
– Has specific privacy regulations that may impact you
– Has access to quality staff and professional advisors
– Provides access to desired legal structures (such as an LLC, FLP, PTC,purpose trust, non-charitable foundation, etc.)

## Models for Investment Oversight

In order of popularity, the three most common models for investment oversight are the institutional model, the family office chief investment officer (FO CIO) model, and the distributed management model.

The institutional model adopts the same checks-and-balances approach used by large endowments and foundations. In this model, the family office outsources investment oversight to:

– An *advisor*, to establish asset allocation policy and conduct manager due diligence. The advisor is responsible for overall investment strategy. The advisor's mandate may be discretionary or non-discretionary (also referred to as an "Outsourced CIO"). The difference between discretionary and non-discretionary mandates determines the level of accountability an advisor has for performance and investment manager selection.
– *Investment managers*, to buy and sell stocks, bonds, etc., based on their fit within the asset allocation policy. Investment managers are responsible for managing assets within established risk metrics and for achieving performance results that are in line with appropriate benchmarks.
– A *master custodian*, to protect the family's assets. The custodian holds all marketable securities and cash, settles manager-directed trades into custody accounts, and provides an independent, consolidated accounting report for all of the family's assets.

The FO CIO model is similar to the institutional model, except the advisor is replaced by staff at the family office. In this model, the family office staff sets asset allocation policy and evaluates investment managers. The other checks and balances of the institutional model remain in place.

When using the Outsourced CIO model, some family offices choose to split their assets across multiple outsourced providers. In this distributed model, the family office monitors and reports on the results of each advisor and collects and consolidates the advisor reports. While this approach seeks to improve investment results through competition, it also creates an environment that delegates away significant control of the assets and may result in higher fees and investment risks through redundant investments across advisors.

Many other models exist, particularly if part of the office's mission is to leverage the family's unique advantages in certain markets, such as becoming direct investors in the real estate, energy or private equity sectors.

## Best Practices for Family Office Management

A successful family office requires more than just a good plan. It also requires effective management that is flexible enough to adapt to changes in the family's needs. Best practices for family office management typically include:

- A *mission statement* in the family's own voice that captures the business goals, family goals, and important family values that will guide decision-making for current and future family members. The mission statement should also include a clear set of priorities, one of which should be an annual measure of the performance of the office with respect to its execution of the mission statement. (Note: This is different than measuring investment performance.)
- A *governance process* that clearly outlines ownership vs. management responsibilities, defines the boards and committees to be created and how they will function, details policy and procedures for each major function of the family office in writing, and discusses how family members are to be supported by and possibly included in the decision-making process. Successful families typically have processes to involve future family leaders in graduated levels of decision-making, such as being junior board members or serving on a committee. Clear bylaws, shareholder agreements, family meetings and succession plans are important parts of any governance process.
- *Ongoing education for rising generations* and activities promoting understanding among and between generations. Mission statements and formal processes are important but are no substitute for paying attention to family dynamics. Family office personnel and/or external coaches facilitate communications exercises and intergenerational activities that provide the foundation for the collaborative spirit that binds the family and supports having a family office.
- A *detailed outline of the services offered* (by whom and for whom) and an *operating budget*. The service offerings are often a mix of outsourced solutions and services provided in-house. The office should have clear due diligence requirements for every solution and regularly validate that current operating models are cost effective and delivering quality service.
- *Policies that define the roles and responsibilities of each staff person*, along with compensation and benefit considerations. Family offices are small businesses that are empowered with tremendous authority and control over the family's assets. Hiring and retaining intelligent and trustworthy staff is critical to success. Every office should also have a written code of conduct, perform ongoing background checks and provide regular performance reviews. Policies also need to be clear about whether family members can be employees of the office.
- A *technology road map*, as technology can become a significant expense for the family over time. Proper due diligence needs to be conducted around accounting and portfolio management solutions purchased by the office. The office's hardware and operating systems must be secure, email solutions need to be updated with the best available protection, and data backup and disaster recovery policies must be in place and regularly tested.

## Exiting the Family Office

As generations grow, offering the freedom for family members to leave is critical to the long-term viability of the family office. For some families, this means creating a formal process that helps facilitate a graceful and prudent exit.

Provisions for exiting can be housed within a family constitution or in a separate document. Details may include specific provisions for valuing the shares of a departing member if family office assets are held in a structure such as a family limited partnership, as well as a staged exit process whereby an outgoing family office client receives payouts over multiple years. This is particularly important for members of the family who may not have been given the choice to work with the family office, such as beneficiaries of trusts.

Over time, some families may find that the family office structure no longer serves their needs. Family members in the third and fourth generations may no longer have a shared sense of identity, family ties to a major investment may have weakened, or the scale of wealth may no longer justify a family office.

By collectively acknowledging the desire to collapse the structure, family members can unwind relationships with advisors, vendors and staff in an orderly and timely manner and find substitute solutions that better match their individual needs.

## BNY Mellon Wealth Management Can Help

For more than two centuries, we have helped families build, manage and preserve their wealth. We understand the unique and evolving challenges that families face, starting with the first liquidity event and creation of the family office and continuing through the transition of the office to future generations. Backed by the resources of BNY Mellon, our dedicated Family Office Services group is focused on delivering specialized advice and access to tailored solutions to help family offices and their advisors manage the complexities that exceptional wealth presents.

## About the Authors

**Philip G. Tedeschi**
Managing Director

Philip G. Tedeschi is a Managing Director for BNY Mellon Wealth Management with national responsibility for all new business activity for the firms Family Office and Charitable Solutions Groups.

Mr. Tedeschi oversees a team of Senior Wealth Directors focused on developing new business opportunities and assisting family offices, advisors, consultants and non-profit organizations with access to BNY Mellon's industry leading solutions including investment management, banking, fiduciary, custody, accounting, and performance measurement services.

Mr. Tedeschi has 25 years of experience in the financial service industry. Prior to joining BNY Mellon Wealth Management, he was a director at Investors Bank & Trust and a principal at CCC Alliance, LLC., a peer based consultative organization for successful families and family offices. Mr. Tedeschi previously worked at Mellon Financial Corporation from 1987–2000 where he held various roles working with institutional and private clients.

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Amantha T. Butler is the Head of Fiduciary for BNY Mellon Wealth Management Family Office. In this role, she oversees the provision of fiduciary services for BNY Mellon Family Office. She has over 15 years of experience in fiduciary oversight and administration, and advising clients on the intergenerational transfer of wealth and control.

Prior to joining BNY Mellon, she led the fiduciary team of a private trust company, where she was responsible for fiduciary oversight of various trusts as well as governance for the trust company and other entities. Prior to this, she spent 8 years in private practice, both in the private client group of Goulston & Storrs and the trusts and estates department at Patterson, Belknap, Webb & Tyler.

Amantha received her Bachelor's degree in Political Science from Amherst College and her Juris Doctor degree, magna cum laude, from Cornell University.

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As a senior director and global family wealth strategist, Joan works closely with families and their advisors to provide comprehensive wealth planning. She specializes in multinational planning, business succession, family governance and philanthropy.

With more than 25 years of experience working with large, multi-generational families, she is frequently invited to speak to clients and professional groups such as the American Bar Association, the Hong Kong American Chamber of Commerce and numerous estate planning councils throughout the United States, Canada, the Middle East and Asia. She has recently been featured in various publications and broadcast media including The Wall Street Journal, Trusts & Estates magazine, the American Journal of Family Law and CNBC-Asia. Joan received her MBA (Finance) from Rollins College, her Bachelor of Education from Queens University, and her Bachelor of Music from McGill University.

She holds the designations of Certified Financial Planner, Certified Trust & Financial Advisor and the international trust and estate designation TEP. She was named 2017 Industry Thought Leader by Global Finance magazine and was a founding contributor to The GCC Governance Code of the Family Business Council-Gulf.

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