

Private Bank



Organizational Design, Strategic Leadership, and Governance Insights for Family Offices

A blueprint for families, senior executives,
and practitioners

Citi Private Capital Group

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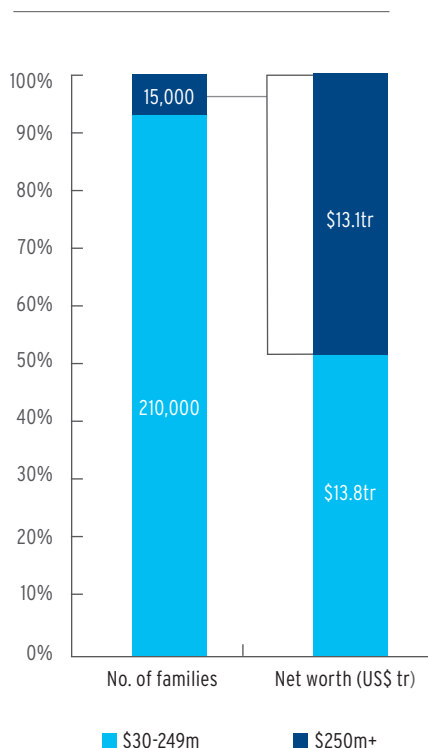
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Introduction

The family office industry has grown tremendously over the last twenty years as the amount of wealth accumulated by this sub-set of the ultra high net worth population has expanded.

Figure 1: The world's wealthiest families



Source: Wealth X

It is estimated that there are approximately 15,000 families globally at or above \$250m in net worth (a reliable threshold for a level of wealth where the issues that warrant a family office are commonly present).¹ While not all of these families will have formal family offices, it is fair to assume that most are currently, or will in the future, be structured in a way such that professionals are helping them manage their personal and financial affairs.² Furthermore, these families control a disproportionate amount of wealth. Families with a net worth at or above \$250m control approximately \$13tr in wealth which represents approximately half of all the wealth controlled by ultra high net worth (UHNW) individuals globally³ - **figure 1**.

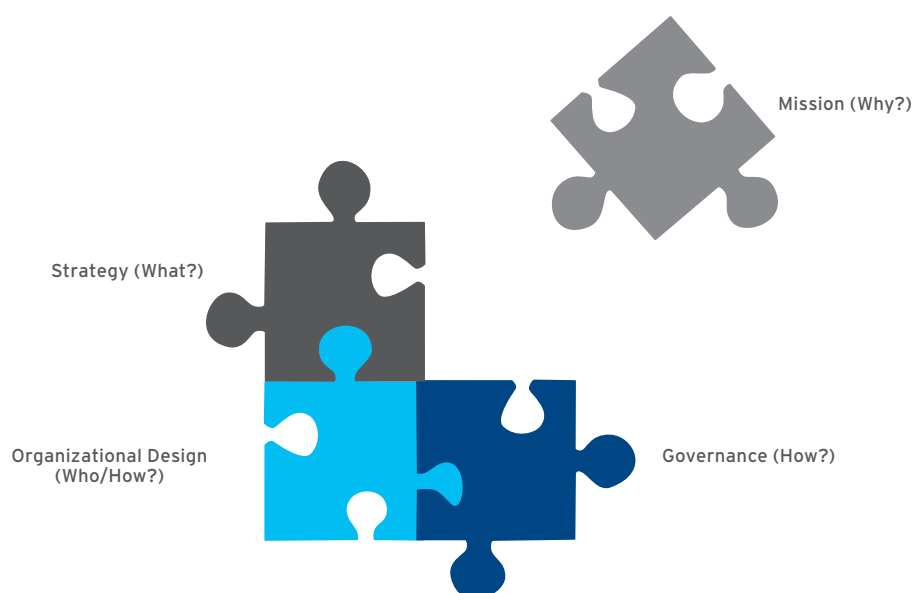
This growth and a resulting maturation of the family office industry have had a number of beneficial consequences for families. First, an industry has developed around serving family offices and their executives to provide information about best practices, industry research, benchmarking, and opportunities for collaboration. Second, many professional services firms that serve family offices for legal, tax, insurance, wealth management, and other advice and services have developed dedicated family office specialty practices. And third, a number of companies have emerged that provide outsourced solutions for family offices in areas such as consolidated reporting, information technology, human resources, cyber and personal security, bill payment, travel, and concierge, etc.

¹ Wealth-X 2017 World Ultra Wealth Report.

² It is also true that these issues exist for families below this net worth level and that they too might have family offices or an informal network of professionals helping them manage their personal and financial affairs.

³ Wealth-X 2017 World Ultra Wealth Report (defined as those families with \$30m or more in net worth).

Figure 2: The key components of a family office plan



The rise of the family office industry has also led to an increase in the breadth and sophistication of professionals who are interested in working for these institutions, particularly at the senior leadership level. It is not uncommon to see former hedge fund managers, private equity professionals, investment bankers, and heads of wealth management firms or businesses joining family offices. These new entrants to the family office industry complement the traditional sources for family office professionals such as former legal and tax professionals, chief financial officers (CFOs)/controllers of operating companies, and private bankers. As a result, family offices are professionalizing at a faster rate than before. This shift in the pace of professional evolution is a direct result of the specialized industry that has grown up to serve and advise wealthy families and the greater involvement of more senior and broadly experienced professionals.

One will often hear the claim that: “If you have seen one family office, you have seen one family office.” While it is true that every family is different, the challenges facing all substantially wealthy families are broadly similar and therefore require similar solutions. It is also true that the

challenges that come with substantial wealth are predictable and, as a result, many of the solutions to those challenges can be identified in advance.

Therefore, a successful family office must develop a professional strategy that anticipates and addresses these needs, coupled with an execution plan adapted to the unique attributes of a wealthy family. This white paper presents and discusses some of the professional practices we are seeing adopted increasingly by established family offices to provide senior family office executives and their principals with benchmarks in three key areas:

- Organizational design and key service areas of family offices as they pertain to the family office management company;
- Senior leadership positions with a focus on job responsibilities, skills required, success metrics, and experience needed; and
- Strategic, managerial, and governance insights that help senior executives navigate the unique dynamics that exist within every wealthy family.



Part 1: Organizational design and key service areas

Family offices typically organize their activities into three categories that represent their core service needs, goals and objectives, and managerial/operational requirements all within established legal, operational and asset ownership frameworks.

In general, the main areas include: the family office management company, the family's asset ownership structures, and the family's philanthropic activities. See **figure 3** for the three main areas.

The family office itself is usually housed within the separate management company that employs most of the staff. The management company serves the principals and their children, manages the assets, contracts with outside advisors and vendors, and acts as liaison with separate staff involved with the family's business or philanthropic activities. The management company's responsibilities will vary by family but in general will include some or all of the services listed in **figure 4**. In addition, the size, staffing needs, and governance mechanisms of the family office will depend on which services are conducted in-house versus what is outsourced.

Figure 3: The three core family office service needs

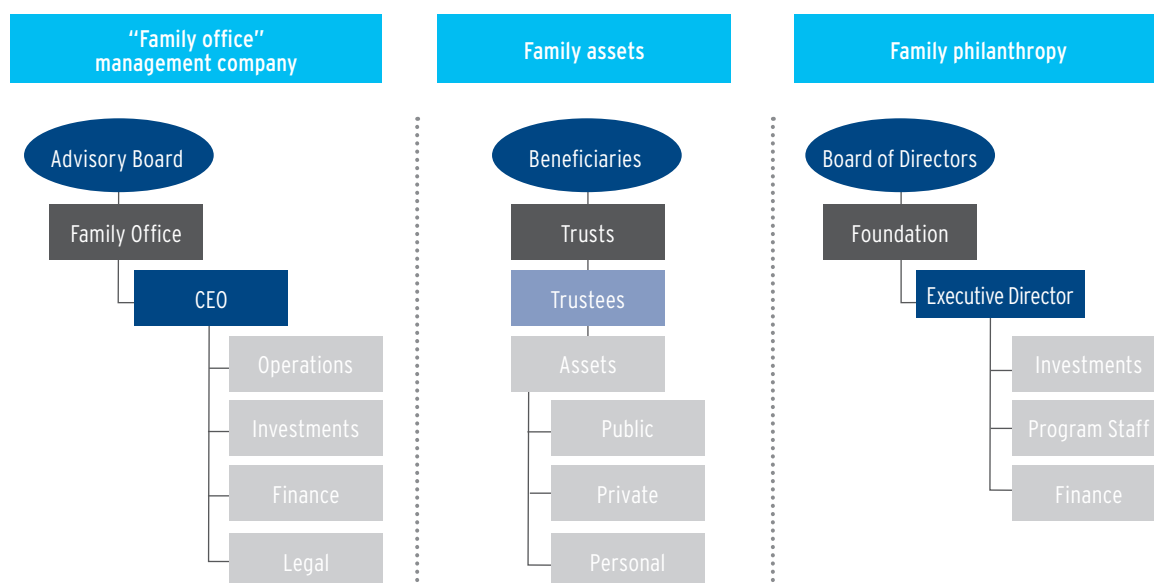


Figure 4: Comprehensive family office services

Administration, accounting, and tax

- Accounting and bill payment
- Cash flow analyses
- Tax planning and compliance
- Development and coordination of estate plans
- Trust administration
- Regulatory matters and reporting
- Oversee information technology needs

Investment management

- Development, implementation, and rebalancing of portfolio asset allocation
- Creation of an investment policy statement (IPS)
- Investment strategy execution (in-house or outsourced)
- Overseeing trading and execution
- Sourcing and due diligence for direct investments
- Aggregation and reporting of investment portfolio

Complex assets

- Residential and commercial real estate
- Operating businesses
- Collections
- Sports teams
- Private aviation and yachts

Philanthropy

- Develop philanthropic strategic plans
- Governance
- Socially responsible investing (SRI)

Family services

- Family bank
- Family mission, constitution, and governance
- Next generation education and engagement
- Family meetings
- Concierge services

Risk management

- Insurance
- Background checks
- Reputation management
- Personal and cyber security
- Medical concierge
- Legal

In-house versus outsourcing

Family offices must decide which services they want to focus on in-house rather than outsourcing to a third party. As a general rule, it is prudent for family offices to retain services that are the most important or of greatest interest to the family (e.g. investing or philanthropy), those that are difficult to outsource efficiently (e.g. bill payment), or where they have legacy expertise (e.g. direct investing).

Historically, family offices tended to bring a majority of services in-house out of necessity or fear of giving up control over the service delivery, potential conflicts of interest, or the release of personal and financial information. However, this approach comes at a high cost from a managerial time, complexity, scalability, and expense perspective.

Successful family offices now use a “value-add” and “core competency” approach to decide which functions should be handled in-house to manage their personal and financial affairs. Ideally, this is done during a strategic planning process where the family and senior executives decide on the services that the family office should provide and how vertically integrated the family office should be.

(Historically, this level of foresight and strategic analysis was seldom done as families simply added staff to address challenges as they came up whether in accounting and reporting, managing an investment portfolio or overseeing personal assets.)

For families with the foresight to do strategic planning, or who are conducting a review of their current practices, services are typically evaluated based on six major considerations: level of wealth, complexity, control, privacy, costs, and interests.

Level of wealth: For obvious reasons, the magnitude of a family's wealth impacts the services they can reasonably afford to conduct in-house (e.g. direct investing, private aviation).

Complexity: Can the family office provide those services that require either or both a high level of expertise or staffing (e.g. active trading, direct investing, tax preparation)?

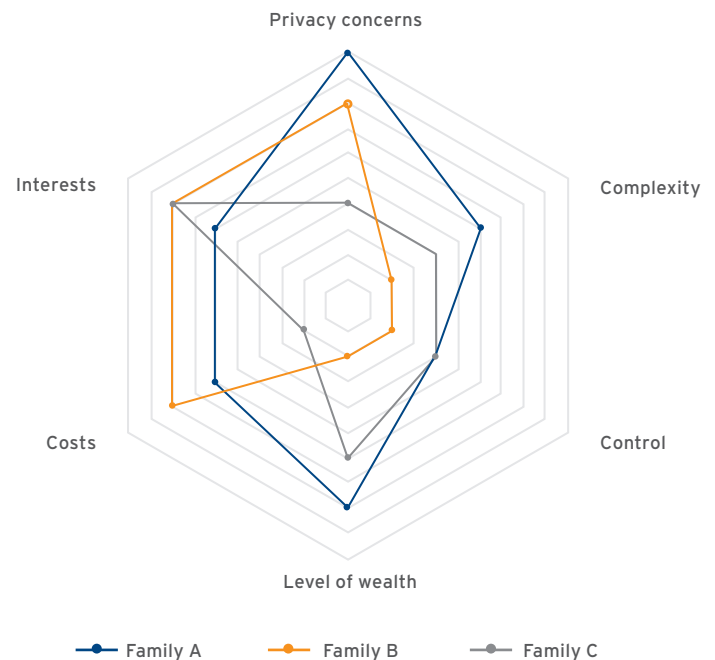
Control: Do the services require that the family office maintain control either because they are difficult to outsource or because the family is concerned about oversight, staffing or delivery (e.g. bill payment, personal security)?

Privacy: How comfortable is the family office with third parties having access to personal and financial information (e.g. consolidated financial reporting, HR, cybersecurity)?

Costs: In the absence of other considerations such as control, privacy, etc., is it less expensive to outsource a service or function (e.g. investment management, private aviation)?

Interests: Does the family or family office have a penchant for certain activities (e.g. direct investing, philanthropy)?

Figure 5: The six major considerations for family office services



Key service areas

The following discussion covers some of the key service areas within family offices including a review of those areas where outsourcing can be an effective option. There is no single best approach for any of these services, but rather family-specific considerations as well as the availability and sophistication of outsource service providers.



Investment management

One of the biggest areas of commitment of both time and resources for family offices is investment management. This is an almost universal responsibility for family offices although the approaches taken vary greatly by family. The decision on how best to structure an investment management function and whether to outsource it will be influenced by: a) the family itself and how they made their money; b) the size of the portfolio; c) the family's or family office's level of sophistication; d) the extent and experience with direct investing; and e) the family's investing philosophy.

For example, it is not uncommon for families who have a history in active management, such as former hedge fund managers or finance professionals, to conduct virtually all of their investing activities in-house. In these cases, the family has the experience, knowledge, reputation, and contacts to hire the right staff, develop appropriate strategies, and oversee a team of investment professionals.

In contrast, families who have limited experience in investing outside of core industries should be mindful of both the challenges and costs of building, executing, and managing a successful investment business. The asset management industry is significant and employs some of the best and most highly compensated people who have spent their careers managing money. This industry is readily available to help family offices achieve their goals for investment management.

This is particularly true in the area of direct or private investing. It is extremely difficult and costly for family offices to do this effectively and at a level that competes with the largest private equity firms, wealth managers, and other large and sophisticated family offices. Families who have a desire to invest privately should consider alternatives to building their own direct investing teams, such as going direct to financial sponsor firms, accessing opportunities through banks and brokerage firms, or co-investing with other families.

Although these alternative approaches have unique challenges, the benefits to doing so usually far outweigh the risks to a family of pursuing a direct investing strategy on its own when it is not properly set-up to do so.



Consolidated financial reporting

The bane of every family office's existence is consolidated financial reporting. This is because few outside of the family office industry can appreciate how time consuming and challenging it can be to prepare truly consolidated financial statements for a complex family that has dozens of entities, hundreds of individual accounts, wide-ranging asset classes, and multiple custodians. This challenge is made more difficult by the fact that traditional general ledger accounting systems cannot easily consolidate data electronically. Moreover, they are not set up to easily account for the complex asset ownership structures of wealthy families where differing pro-rata interests are held by multiple family members and entities. As a consequence, many family offices manage around these limitations through manual entry and by using Excel to modify, as needed, the system-generated reports.

Fortunately, as the family office industry has grown, a number of technology vendors have emerged that provide family offices with consolidated financial reports. Family offices are increasingly looking to outsource the preparation of these reports to a specialty software provider. One caveat that must be made however is that even the best reporting service for family offices cannot capture all of the data electronically. There will always be non-marketable, personal and business assets that require manual set-up, data entry, periodic asset revaluation, and quality control. Given the high visibility and limited tolerance for errors in these reports, someone familiar with the family is required to complete the consolidated reporting function. Therefore a family office cannot expect to outsource the entire financial reporting service and must expect to have some internal staff working on this as well.



Concierge services

Wealthy families tend to travel frequently, own multiple homes, enjoy going to premier sporting, social and artistic events, and often collect wine, artwork, and automobiles. If the family office is responsible for executing these services, it is crucial to properly staff for this need with experts on each of the areas, or to know where to get the expertise.

With few exceptions, it is best to outsource these responsibilities to qualified service providers. As with consolidated financial reporting, an industry has developed around helping wealthy families with concierge needs. However, outsourcing the duties does not take away the family office's responsibility to oversee, coordinate, and periodically reassess how and with whom the services are being provided.

Although, despite the fact that there are now numerous third-party service providers, providing concierge services can be challenging and therefore warrants a great deal of attention by both staff and senior management. Problems will always surface in the delivery of these services and because they touch the principals and their families directly, and are very important to them, they become important to the family office. It is often the case that family offices will dedicate a number of staff to managing these functions and that the chief executive officer (CEO) will personally oversee the service delivery. We have included a detailed overview of the Operations Manager (OM) as one of the four senior managerial and service verticals to reflect this.



Philanthropy

Wealthy families often care strongly about philanthropy and spend a good amount of their time on it.

However, as with most new significant endeavors, there is a learning curve when it comes to significant philanthropic pursuits particularly if the family wishes to do something unique or actively manage grant making. Family office professionals should focus on this desire early and solicit the advice of other philanthropists, charitable organizations, and dedicated philanthropic consultants.

For families who are mostly passive with their giving, a number of outsourced solutions exist including donor advised funds (DAFs), community foundations, and existing foundations or public charities. For those who wish to develop their own philanthropic mission which is managed in-house, it is important to focus on this as a 'business.'

Andrew Carnegie famously said: "It is more difficult to give money away intelligently than to earn it in the first place." Families looking to manage their philanthropy in-house should take this advice to heart, and make sure that they do so in a measured way, focusing on the areas they care the most about, and considering all the issues that come with active philanthropy, including: strategy development, staffing, funding, sourcing, monitoring, and reporting.





Private aviation

For families who fly privately, there is a fairly steep learning curve in terms of options to access aircraft, costs, appropriate plane types, managing pilots and staff, tax considerations, etc. Generally, families enter this market over time choosing first to charter aircraft and then to consider purchase options, whether through a fractional ownership program or outright.

In general, families find that outsourcing to charter or fractional ownership companies makes the most sense unless they fly a considerable number of hours each year (e.g., over 200), have unique service needs in terms of the types of aircraft they need or airports they fly into, or have developed a hobbyist interest in the industry. The same approach is often taken with respect to hiring and managing flight departments. A number of service providers can offer pilots for those who own private planes, without the family having to include them as part of the family office.



IT and cybersecurity

Many family offices have the “wealth” commensurate with small and medium-sized enterprises but often do not have the same levels of information security. This lack of preparation often makes them a lucrative target when compared to other institutions or businesses. In addition, family offices face complex cybersecurity challenges because of six additional differentiating factors:

- Informal governance structures;
- Heavy reliance on small staff with outsized access to critical data;
- A higher value placed on efficient service over effective security;
- Supply-chain risks from external vendors and partners;
- The public nature of their activities; and
- The relatively modest investment family offices make in data protection.

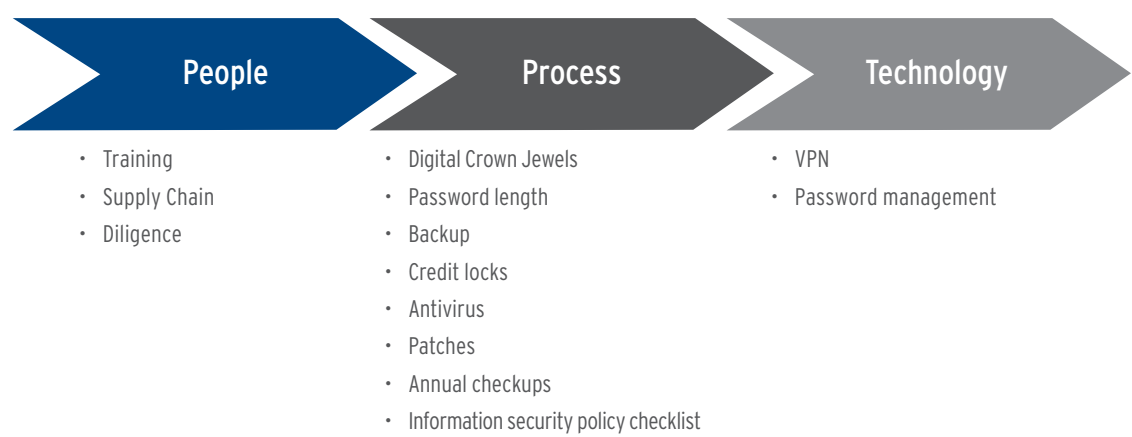
The most common information security threats family offices face are ransomware, business e-mail compromise, and threats from social networking sites. Through a combination of external experts and internal information technology expertise, family offices should build a regularly reviewed strategy that puts professionals and principals on the same page when it comes to what to do before and after a cyberattack. Ensuring the use of cybersecurity technologies, social media protocols and employee training is of paramount importance. This will become even more important in the future as the family grows, the number of devices over which information is shared increases, and the family office starts to manage the affairs of the children.

Regardless of how prepared the family office is for cybersecurity threats, they should start developing a comprehensive information security program that is flexible, and can incorporate lessons learned, and adapt to new threats.

Figure 6 provides a framework that family offices can explore as they establish a comprehensive cybersecurity strategy. For more details, please see our “Cybersecurity and Family Offices” white paper.⁴

Currently, the majority of family offices outsource or share operating company resources to help them address these issues. However, a growing number of IT professionals are being hired directly into family offices. In addition, a cottage industry has emerged that provides comprehensive cybersecurity training, consulting, and technology enhancements to wealthy families.

Figure 6: A cybersecurity strategy framework



⁴ The Citi Private Bank “Cybersecurity and Family Offices” white paper can be found at: www.privatebank.citibank.com/home/fresh-insight/the-cybersecurity-threat-to-family-offices.html



Wealth education

Wealthy families often struggle with how and when to introduce the topic of wealth to younger children. The availability of information about a family's wealth and the lifestyle of wealthy families require them to deal with this issue at an early age. Understanding these issues, and developing an education and communications strategy for young children around what being wealthy means for them, the opportunities and challenges it presents, and how they should behave is a critical ingredient of successful families who are able to raise well-adjusted and financially literate children.

Family offices are increasingly being asked by their principals to help them with this issue, although usually around the time the children become young adults and have the capacity to understand financial issues and interact with professionals. Generally, this assistance takes the form of preparing the young adult and adult children for the responsibilities that come with managing the significant wealth they will inherit. Families view this education as an important step in helping the children prepare for their future obligations regarding legacy and stewardship of the wealth for themselves and possibly others in the family.

There are a number of things family office professionals can do to help families in this area. The primary contribution is to engage the principals in a discussion about this topic and, if possible, to make it an important part of the family office's strategic plans. While some principals may decide not to focus on this for various reasons, or may only support it rhetorically, it is incumbent on the family office to raise the issue and to offer support when and if the principals decide to take them up on it. Typical areas of support provided by the family office include:

- Hosting and involving the children in family meetings;
- Developing and teaching a curriculum on various wealth topics;
- Facilitating employment in the family business, family office or family foundation;
- Involving children with the investment committee often around social impact investing; and
- Establishing and overseeing a process by which business opportunities presented by adult children can be assessed and money provided.

As a way to augment the efforts by wealthy families and family offices, consultants, banks, and brokerage firms have created next gen "boot-camps" that provide structured wealth education programs that typically cover financial literacy, succession planning, wealth transfer, family governance, and legacy building.⁵ These programs not only provide the academic and skills training needed but also a unique "peer learning" environment by including children from other wealthy families. Attendees at these sessions not only learn from others but also are able to share and discuss sensitive matters with peers who face similar issues.

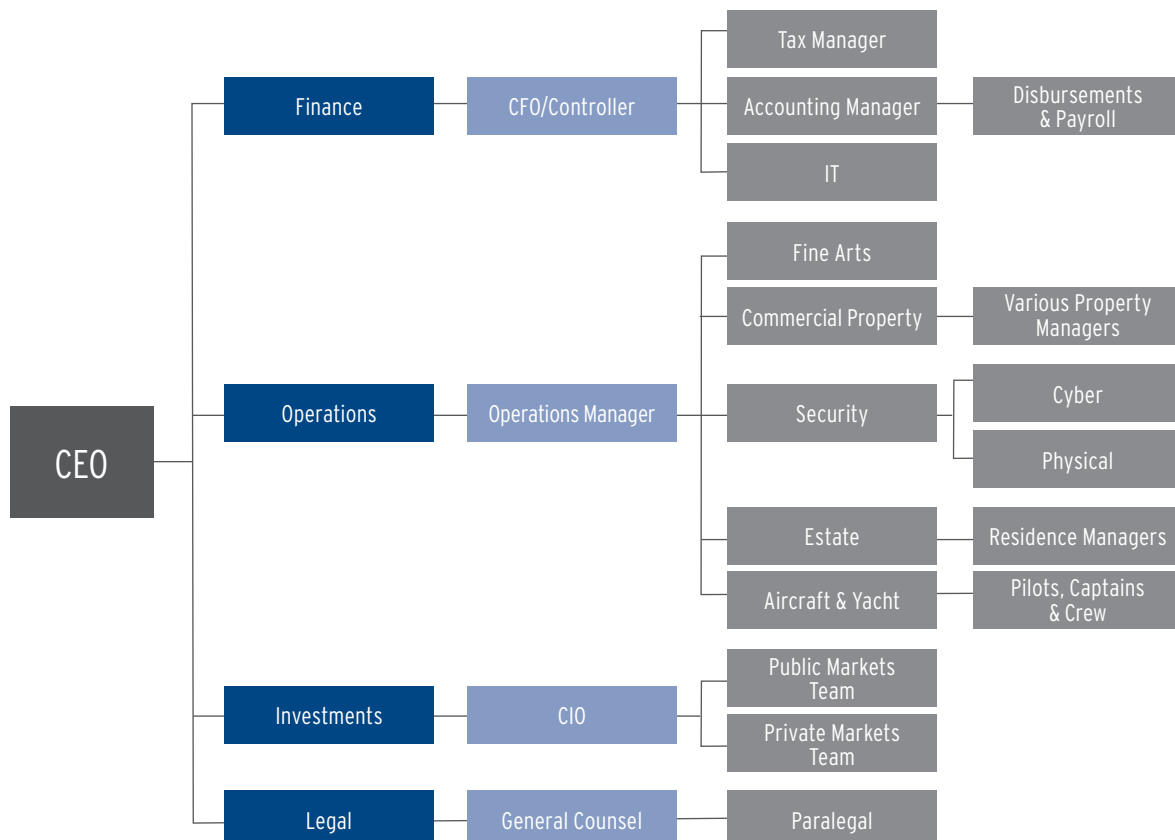
⁵Details about Citi Private Bank's Next Gen programs can be found here: www.privatebank.citibank.com/home/next-gen.html

Part 2: Strategic leadership

While the actual organizational structure for the management company (“family office”) will vary, the general outline for mid-to-large size family offices is illustrated below.

This organizational chart shows all the senior leadership roles required as well as functional roles within each service vertical. Obviously, the actual structures and positions for an individual family will differ based on wealth and complexity, number of assets owned (both personal and business), investment offering, level of outsourcing, etc. However, **figure 7** should serve as a useful template for families creating their family office or who are interested in seeing how other family offices organize themselves.

Figure 7: A family office structure





Questions to ask

To aid in organizational design, the following questions should be considered and where appropriate discussed with the principals to determine the number and size of each service vertical, staffing needs, managerial hierarchy, and modes of communication. Many of these are questions for which answers may not initially be known or will change over time. However, considering the answers to these and similar questions will help family office senior executives better design and manage their organizations.

- ? What is the purpose of the family office and what are the stated (and unstated) priorities of the principals?
- ? What specific services are required to be performed by the family office versus by individual family members themselves?
- ? Are the principals hands-on or delegatory and is this dependent on the principal?
- ? What capabilities and services should be provided in-house versus outsourced?
- ? How is performance determined and systematically evaluated for the family office as a whole and for individual employees?
- ? How do you identify, recruit, incentivize, and retain the necessary individuals needed to manage the various operational and service responsibilities? Is the family comfortable using recruiters to find and help assess candidates?
- ? Who are the current key employees of the family office, what services do they provide, and what is the nature of their relationships with the principals?
- ? What will be the form and frequency of communication for the principals, family members, employees, and external advisors?
- ? In what manner and with what frequency will principals interact with various professionals, especially around personal assets?
- ? How much authority will the family office executive have over assets, spending, and personnel?
- ? What are the investment responsibilities of the family office? Will the investing activities be managed out of the family office, outsourced, or a combination of the two, and how substantial are they?
- ? Is there an interest in direct investing and, if so, how involved will the family office be? Do they want to develop and manage their own “deal teams” or outsource to financial sponsor or wealth management firms?
- ? Is there a need for the family office to manage the affairs of children and other extended family members?
- ? Will family members be involved with the family office now or in the future?
- ? Are there location issues in terms of the principals, family members or staff that will impact the design of the organization, managerial oversight, and services provided?
- ? What is the annual budget for the family office and what is the funding mechanism by which the family office is provided required financial resources?
- ? Should independent professionals or extended family members be involved via formal or informal advisory boards?
- ? How will the various family office expenses be treated for income tax purposes and what structures should be considered to help improve their tax treatment?

Key executive positions in a family office

As an emerging industry, family offices have developed roles and responsibilities at the C-suite level that are becoming better defined. Below are several profiles of C-suite level family office positions that both executives and principals will benefit from understanding in detail. Included in these profiles are detailed descriptions of job responsibilities, success metrics, skills required, and experience needed.

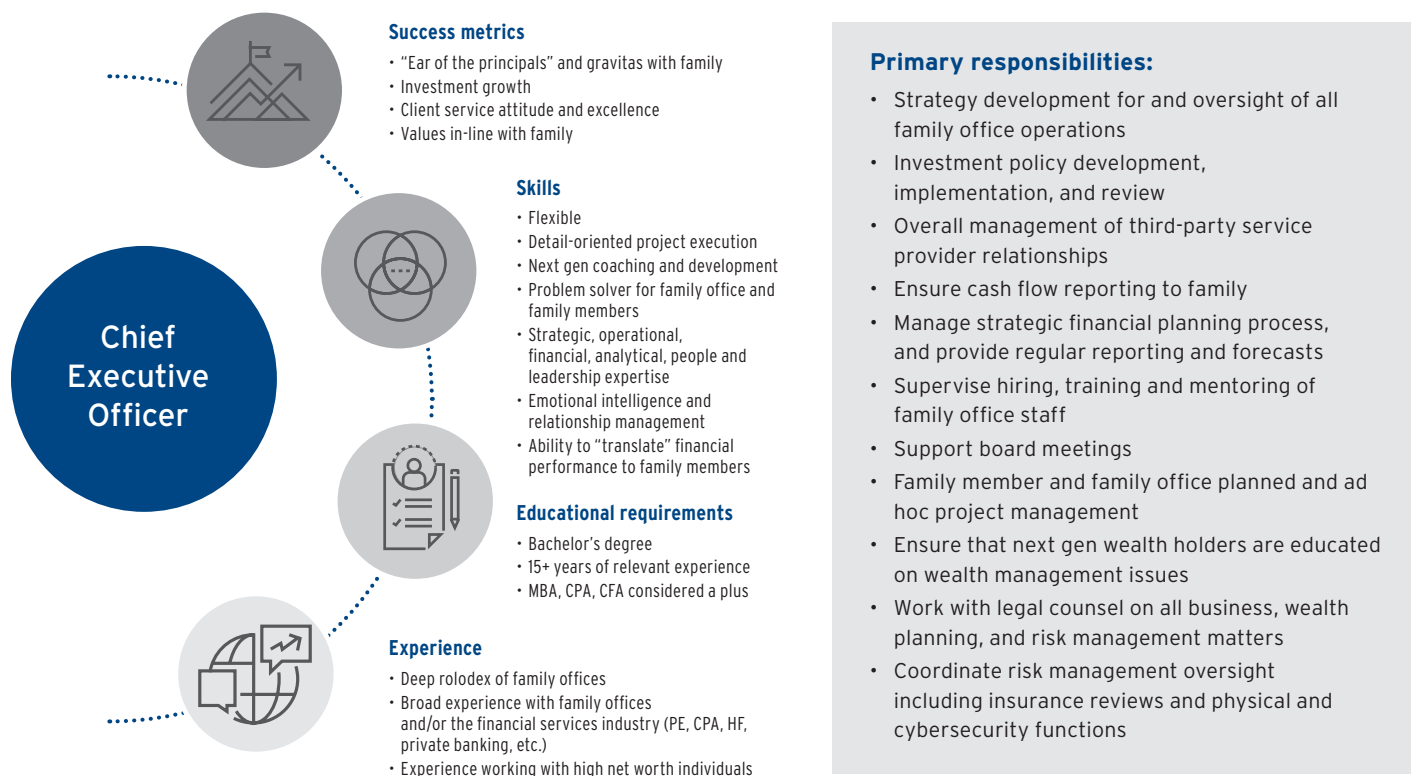
As expressed in the sample organizational chart, the four key areas of responsibility, or managerial verticals, are: chief executive (CEO), investments (CIO), finance (CFO), and personal assets (Operations Manager). While in many ways this management company is like other for-profit management companies that serve individual clients or oversee assets, there are some significant differences

in terms of staffing, job responsibilities, and governance practices. Understanding and being able to adapt to these differences is one of the most important skills required of senior executives who work within a family office.

Chief Executive Officer (CEO)

The CEO position in a family office is a challenging position to hire for because of the unique strategic, operational and interpersonal requirements of the job. Few new CEOs have experience running a family office and fewer still with a deep understanding of the family and their unique needs. Having said this, professionals who help families hire for this top job have identified a number of important qualifications that can help a family find the right CEO and help that executive understand what is required and how success will be measured.

Figure 8



An important orientation for a family office CEO is that of a “servant leader.” The CEO is indeed in charge of the family office and, as with other for-profit organizations, has the responsibility and authority to develop strategy, design the organization, hire and fire employees, establish managerial roles, and determine how required services are to be delivered. However, the CEO reports to the principals who will have their own views as to the proper make-up of the family office, its operations, and employees.

An effective family office CEO must be able to “educate while they lead” in discussions with their principals regarding strategy and organizational structure. They must also be able to modify their strategy when it does not align with that of the principals, sometimes for reasons the CEO believes are unnecessary or impractical. This is often the case for newer family offices with very active principals who are used to managing their own affairs. This issue however can diminish over time if the CEO is effective in balancing this need such that the family office is viewed as successful and/or as the family office matures over time to serving a less active and growing base of family members.

Another important consideration for both newer and experienced CEOs is to “know what they don’t know” in terms of the myriad of new issues that come with running a family office. For newer CEOs this is an issue largely because the requirements for leading and managing a family office are new to them as are sometimes the needs of wealthy families and their behavioral biases. In these cases, it will be important for the new CEO to engage with their peers who manage similar family offices as well as seek out the advice of a growing industry of professionals who advise wealthy families.

For established CEOs who have been working with the family and/or managing the family office for some time, this is also an issue because it is easy to become isolated and myopic

when running a family office. In these cases, the CEO, principals and employees only know what they have been doing (and how) over the many years. They are often further assured of the merits of their approach given the success they feel they have achieved by being able to do it successfully for a long time for the same family members. This is often the case for family offices that were created due to an ever increasing level of complexity in the principals’ lives and where the initial needs of the family were operational, namely “keeping the trains running on time.” In these cases the family office may not evolve and grow to help the family anticipate, address, and resolve/avoid the issues that come with substantial wealth over many years and sometimes generations. Examples of these issues include:

- More efficient ways to manage the office through the use of advisors, technologies, and outside vendors;
- Upgrading the quality of employees and outside advisors;
- Staffing for expanding areas of needs such as direct investing or philanthropy;
- Adopting more institutional approaches for managing investment assets;
- Assessing and protecting the family from a growing number of risks including social media and cyber;
- Establishing important and necessary governance mechanisms;
- Acclimating and educating children to growing up with wealth (and potentially a future role in the family office); and
- Preparing for succession at both the principal and family office leadership level.

As with the newer CEOs, staying connected with other family office executives and developments in the industry will be of great value to the executive and the family.

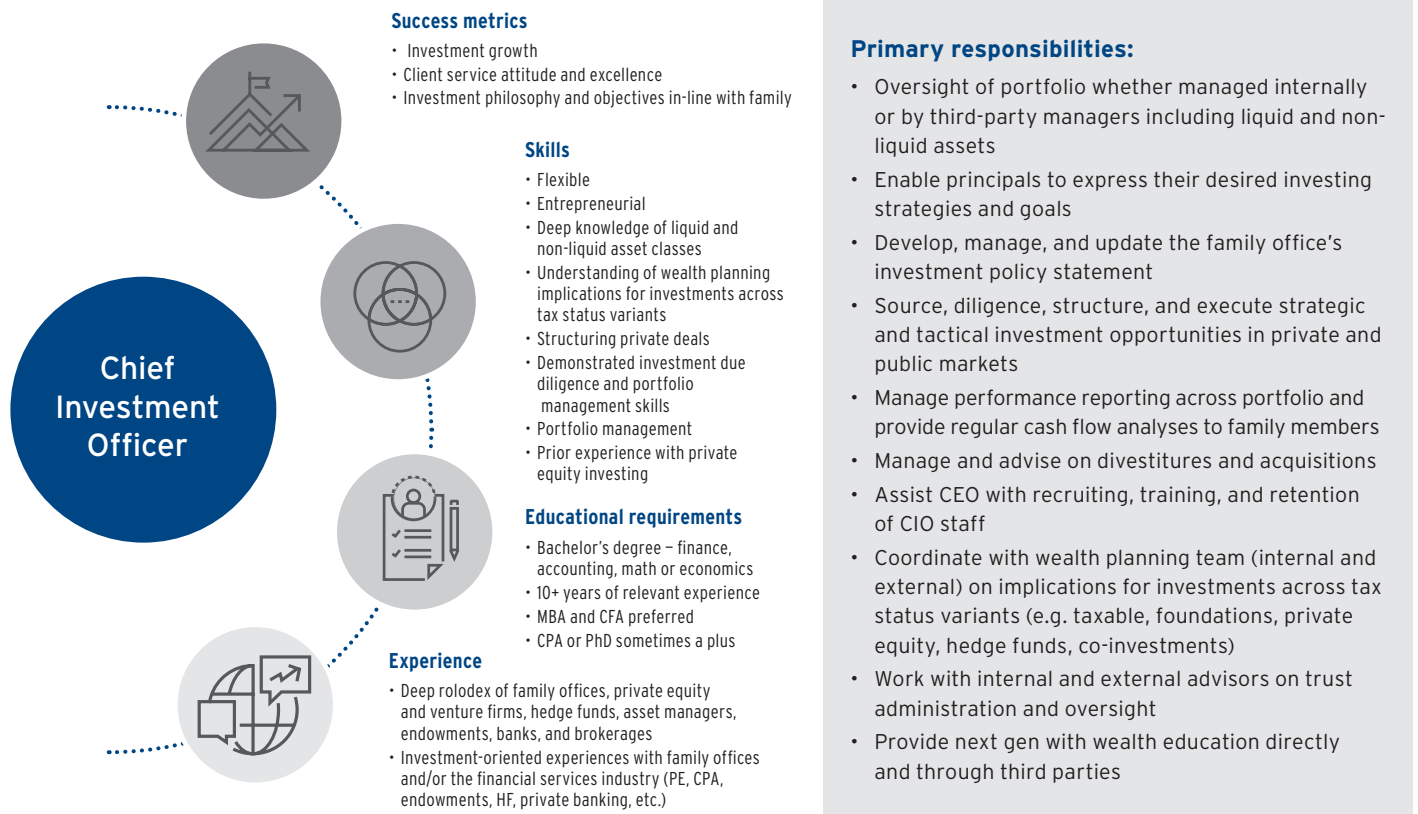
An effective family office CEO must be able to “educate while they lead” in discussions with its principals regarding strategy and organizational structure.

Chief Investment Officer (CIO)

The CIO role varies widely based on the size, complexity, investment philosophy, and objectives of the family. Variations range from family offices that manage much of their assets in-house to those who delegate entirely to third-party consultants, banks or brokerage firms. Regardless of the type of family office, CIOs spend a significant amount of time helping the family develop their overall strategy for the family's assets, executing this strategy, and evaluating performance. There are numerous ways that families conduct their investment activities and therefore the type of CIO they need will vary greatly. While the title CIO is conferred

on the senior person in a family office who is responsible for investments, the type of investment professional and what they can contribute will depend on their background and experience. For example, the term "investment professional" includes all of the following: private banker, stockbroker, portfolio manager, trader, chief strategist, etc. It is therefore important for the family to match as best they can the investment professional with their investment strategy. Following is a summary of two broadly different types of family office investors and some considerations regarding the professionals best suited to serve them.

Figure 9



Asset allocators

A number of family offices, regardless of size, that do not have a preference for managing their money in-house, often hire a CIO to oversee strategy, assist in manager or advisor selection, provide reporting, evaluate performance, and recommend rebalancing. These families tend to develop their asset allocation in-house, with or without the assistance of outside advisors, and delegate the execution of that strategy to banks, brokerage firms or asset managers (and often a combination of the three).

For these families, hiring a CIO who has a broad background in portfolio management, capital markets and/or experience working on the “sell-side” of the financial services industry is helpful. These professionals bring with them a perspective about how other wealthy clients or institutions manage their money and understand the strengths and weaknesses of financial services firms. As such they can help the family identify appropriate partners, assess their strengths and weaknesses, know what is reasonable to pay for services, and leverage their resources. Indeed, a growing trend and best practice for these types of family offices is to access and use the tremendous resources that exist within banks, brokerage firms, and asset managers to obtain services and expertise the family office does not have and should not invest to obtain.

Portfolio managers/Active traders

Many family offices have a preference for managing their money in-house whether because they come from that world (e.g., a former hedge fund manager or asset manager) or because they believe they can do a better job than the financial services industry. For these families understanding staffing requirements, managerial responsibilities, and the costs for doing so is very important. CIOs who can develop and oversee active trading programs or broad asset class portfolios are expensive and the costs to support them significant. Furthermore, these family offices must recruit CIOs from a very competitive and well-paid industry that includes hedge funds, institutional investors, and asset managers. That said, while family offices will monitor their portfolios and measure individual risk factors, including geographic, currency, sector or counter-party exposures, the family office staff or its principals must also be mindful to evaluate “competency risk” – a fundamental mismatch between the family principal's

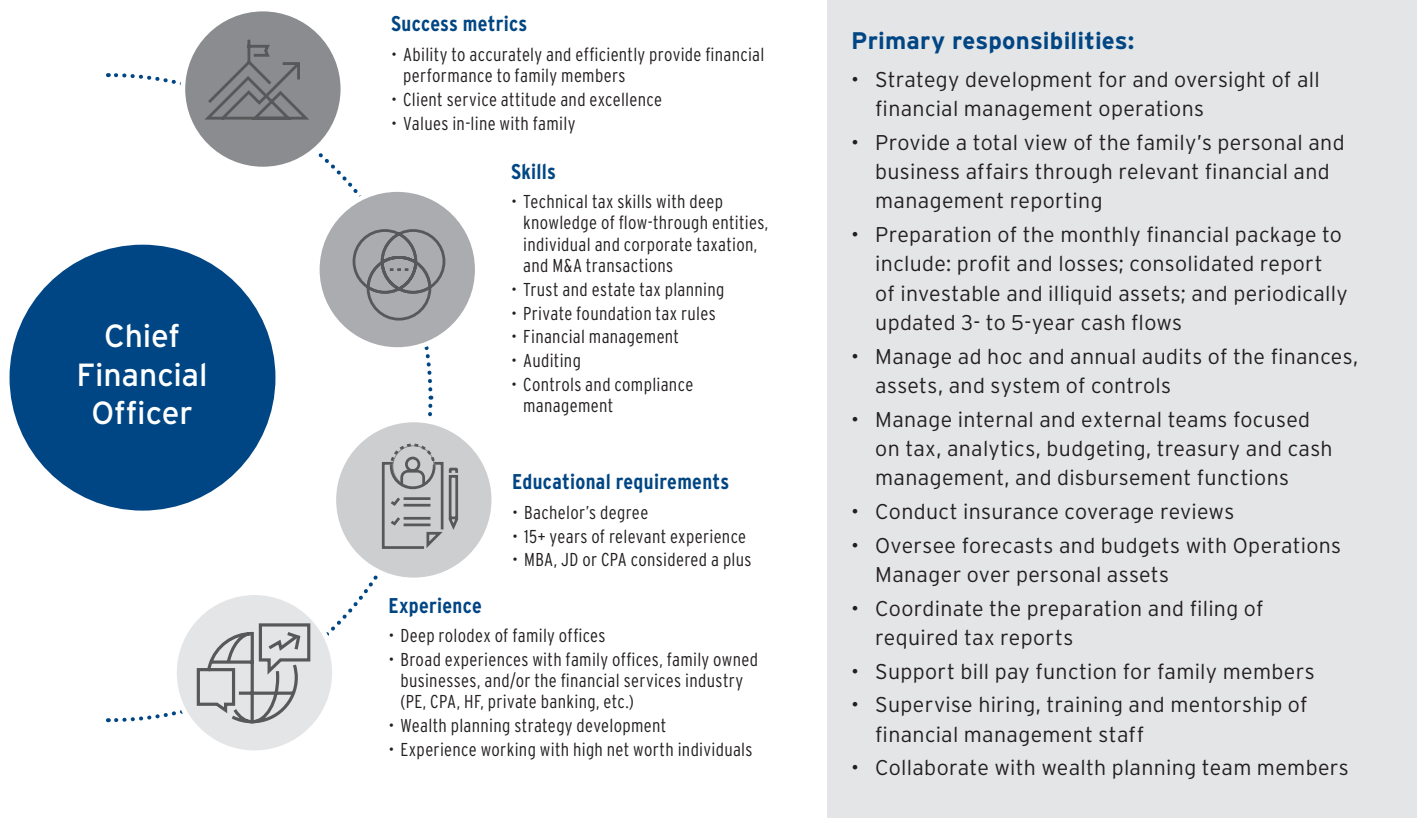
expectations for the portfolio and the investment process, skill and experience of the family office professionals available to consistently satisfy those expectations.

However, there are a number of family offices that have the means and technical expertise to do so, and for them managing their money in-house provides the greatest level of flexibility, and becomes an important part of who they are. In some cases, family offices who start out managing their money internally ultimately decide to open up their investment management services to other wealthy families and institutions. There is a growing trend, for example, of former hedge fund and asset management professionals joining family offices in order to establish a track record. These traders/managers are in effect “seeded” by the family office that in return takes an equity stake in the business if and when it gets launched.

Some family offices are also comfortable taking a hybrid approach to investing whereby they actively trade or manage a portion of their portfolio and outsource the balance. These families tend to invest using their internal staff in those asset classes or strategies where they have a background or interest. They invest outside of these areas of core competencies through third-party managers, banks or brokerage firms.



Figure 10



Chief Financial Officer (CFO)

The CFO (or at times the "Controller") is a specialized role that supports the CIO and CEO with reporting critical to the decision-making process of the family office. The CFO traditionally focuses on preparation of the monthly financial package; the audit of the finances, assets, and system of controls; oversight of forecasts and budgets; and coordination of the preparation and filing of required tax reports.

The CFO for a family office can be a challenging job in part because the finance and reporting functions within family offices are often far more complex than principals and at times CEOs believe. This is because the complexity for wealthy families builds over time as the family acquires numerous personal assets, engages in tax and estate planning, and employs outside investment managers. This complexity is often not kept up

with in terms of personnel and systems. Family office finance professionals are often in the position of trying to catch up or modify legacy accounting and reporting systems to accommodate an ever-increasing volume of transactions over an increasing number of entities and accounts, and ensuring proper control measures are in place.

In addition, the CFO is often responsible for a wide range of family office needs, not just accounting and reporting, for which they do not have prior experience. These may include working with pilots, captains, and property managers; assisting with IT and cyber security; reporting on both liquid and private assets; evaluating possible future investments; helping to manage commercial real estate projects; and interfacing with numerous tax, legal and financial advisors.

Operations Manager (OM)

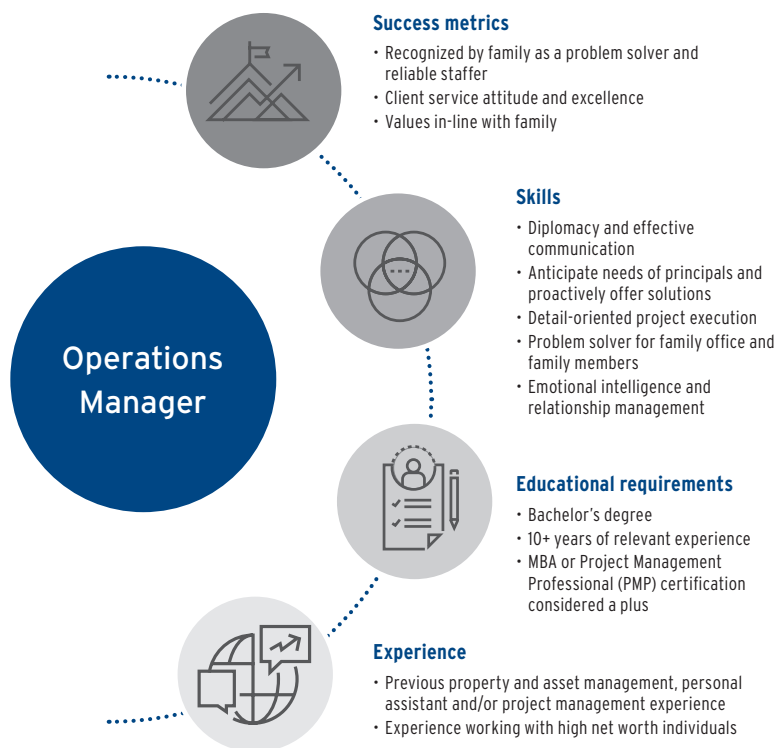
The Operations Manager position within a family office is sometimes bundled into other executive positions; however, as the complexity of the family office increases this position tends to stand on its own. For complex families with many personal assets this can be one of the most important positions to fill. Often staffed by individuals with commercial property management, personal assistant, and/or project management experience, this position typically requires individuals with a positive attitude, flexible schedule, and limited outside commitments.

Of all the duties of a family office, managing the personal assets of the family is one of the most difficult. This is because these services touch each of the family members frequently and disruptions or poor service are readily noticed. In addition, many of the services have an impact on important intangibles for family members including enjoyment and

quality of life, a sense of privacy and security, reputation, and standing among friends, etc. The Operations Manager must be available, flexible, and knowledgeable in all the areas of service. They must also be able to multi-task and manage with grace both reasonable, and sometimes unreasonable, demands placed on them. As a result, the right person for this role as well as those who work for them must be carefully selected, developed, and supported.

This is also a service area that may require frequent involvement by the CEO. Principals are quick to involve the CEO on family operational matters particularly if things are not going well. In addition, because of the need for both lower level family office staff and outside service providers to interact with the family directly, the CEO must stay abreast of issues and manage communications in order to get in front of and resolve issues.

Figure 11



Primary responsibilities:

- Coordination of non-financial family office operations
- Management of private assets including art, commercial property, security, personal estates, aircraft, and yachts
- Supervise hiring, management, training, and mentorship of operations management staff
- Manage communication protocols with principals and family office CEO to identify, discuss, track, and resolve open project items
- Coordinate with CEO on family member and family office planned and ad hoc project management
- Oversee specialty asset class vendor (e.g. pilots, captains, residence managers) relationships including the preparation of regular budgets and cash flow statements
- Develop robust physical and information security policies and conduct periodic training of family members and staff
- Oversee lifestyle enhancements for family such as travel arrangements, scheduling, correspondence, coordinating activities for children, etc.
- Hire and coordinate personal estate activities and relationships including: butlers, chauffeurs, chefs, personal assistants, managers, housekeepers, and nannies

A conceptual diagram with a blue background. A hand's index finger points directly at a light blue box labeled 'Governance'. Other boxes labeled 'Mission', 'Ethics', 'Policy', and 'Rules' are visible in the background, connected by faint lines, suggesting a network or hierarchy of organizational concepts.

Governance

Part 3: Managerial and governance insights

Understand the true priorities of the principals, many of which may be non-financial, and devote an appropriate amount of managerial time and staffing resources to these.

It is different working for or managing a family office. Those who work with private families commonly share this experience and it is the basis for the refrain mentioned earlier: “If you have seen one family office, you have seen one family office.” However, the actual organizational structures and staffing needs of a family office are quite similar in as much as the advisory and service needs of wealthy families are similar and predictable.

It is in the execution of strategy, managerial practices, and governance where senior executives must account for those differences that manifest themselves because, indeed, every family is different. These differences take many forms but typically result from differences in the personalities of the principals, amount of wealth, level of sophistication, desire for control, extent of personal activities, etc. Senior executives of family offices need to understand this and should plan, manage, and govern in a way that takes these idiosyncratic

family differences into account. Following are a number of insights we have gleaned from working for and with family offices over many years.

One of the greatest challenges new senior executives face when they join a family office is to understand and, as needed, recalibrate their assessment of what matters to the principals. Often these executives come out of an industry where revenue, growth rates and profit margins are the metrics by which they are judged. However, family offices are different from commercial businesses in that non-financial concerns often take precedent. Even though they have many of the same requirements in terms of reporting, staffing, managing the needs of multiple stakeholders, etc., there is no profit margin. Rather “success” is often evaluated based on a different set of criteria, including: quality of life, investment returns, acclimating children to growing up with wealth, philanthropy, etc.

Family office executives should take the time to recognize this new reality and work hard to understand and assess what the true motivations and objectives are for both the principals and each member of the family they serve. Some of the ways to do this include observing how decisions are made, assessing prior behaviors, speaking with outside advisers, and discussing these issues directly with the principals and their children.

A related reality in family offices is that the principals tend to care about and focus on certain services or activities more than others. While this might seem obvious and of little consequence, often a family office executive will make the mistake of focusing more on what they believe “should be” important to a principal versus what “actually is” important to a principal. For example, new business pursuits, philanthropy, and addressing challenging family dynamics are often areas of greater interest or need by principals than, for example, investment performance, accounting or tax planning. As a result, family office executives should devote more time than they otherwise might to leading, managing or assisting in those areas that matter the most to the principals.

Be flexible with responsibilities but, where possible, try to clearly define and delineate responsibility and communication protocols over the various service verticals

Within every family office there is a reality regarding the nature of the duties performed by the executive versus those he or she was hired to do. Many senior family office executives are surprised when they find themselves spending time on relatively mundane and menial tasks. This blurring-

of-the-lines is commonplace and for most family offices will continue in one form or another. Senior executives, in particular, must accept this and be willing to accommodate this facet of working in a family office.

The chain of command is not always observed within a family office and is something senior professionals should anticipate and accept, at some level, for certain service verticals. It is not uncommon for family offices to be staffed by legacy employees who have much longer relationships with the principals. As a result, the principals are comfortable and through habit willingly go direct to subordinate employees to solve problems or ask questions. This may take the leadership of the family office out of the communication loop, and not allow them to be aware of and get in front of issues.

While this sometimes cannot be avoided, it is something that should be mitigated to the extent possible and managed so that proper protocols for communication and decision-making are developed and respected, usually around specific service verticals. For example, in finance and accounting it is possible for a Controller or CFO to be the point person for communication around issues or needs, whereas with personal assets, direct communication to the actual service provider is a requirement. Recognizing this reality, setting clear guidelines around communication and managing staff more closely can help mitigate these issues. While it might seem counterintuitive, formality, and bureaucracy are sometimes helpful within family offices to promote a more professional approach to managing the office.

The chain of command is not always observed within a family office.

Establish mechanisms for the timely and accurate reporting of financial information so that the leadership of the family office is kept informed and aware of issues but not mired in unnecessary details

Financial, operational and reporting requirements of a family office are mission critical functions that on occasion are not given the resources they need. While the principals may not focus time and effort on these, they do care about timely and accurate reporting, budgeting, bill payment, and data privacy. When mistakes or delays in the delivery of these services become apparent and are recurring, principals can quickly lose confidence in the family office and call into question the oversight of other responsibilities. Therefore it is imperative that family offices properly staff for the preparation of financial reports, payment of bills, reporting of assets, etc., to ensure they are done accurately and timely, and do not require the unnecessary involvement by senior management.

There is a related risk when the family office executive spends an inordinate amount of time on the operational and reporting needs of the family. In these cases, senior leadership of the family office is not able to focus on other more important matters which might include investment strategy, risk management, philanthropy, educating the next generation, etc. This is particularly true and a risk for newer family offices where initial staffing and/or the use of vendors or third parties is not sufficient to address basic financial and reporting needs given the size and complexity of the organization. For most family offices the leadership must operate both with a focus on operational matters and also strategy. In order to do so they must have the right organizational structure including an appropriate level of staffing, the right people in clearly defined roles, and an effective use of external resources.

Emphasize fit and function when hiring for certain critical family office positions

Working within a family office is different than most other professions and many of the professionals who join family offices have no prior experience with them. As a result, both senior executives and more junior staff are surprised by the differences between working in industry and working for a wealthy family. These differences might include the lack of well-defined roles, the level of involvement in the family's personal affairs, or the significance of family dynamics on decision-making. These realities and challenges often motivate family office executives to look for professionals who are familiar with and can deal with the unique challenges of working with families, in essence, hiring for "fit" as a primary criterion.

However, many experienced family office executives have found that hiring for job experience, i.e., "function," is just as important as hiring for "fit" given the complex needs of the family office. As a result, focusing on both is important. Fortunately, as the family office industry has matured it is now easier to find qualified candidates who can both do the job and navigate the unique realities of working within a family office. However, in order to do so, the family office executive should engage with and incorporate the advice of outside human resource professionals such as recruiters who focus on the space and who can help assess "fit" as well as technical competency.

Develop appropriate governance mechanisms, both formal and informal, and professionally adhere to these

Organizational formalities are not normally an area in which newer family offices anticipate needing to spend a great deal of time. Many family offices start out small and are staffed by the founding principal's close advisors or former employees from a family or operating business. As a result, they tend to be managed in an informal manner, and without traditional organizational designs and protocols. However as these family offices grow, add staff, and manage an increasing level of complexity, it is important for them to adopt more conventional organizational governance structures. These structures help define areas of responsibility, clarify lines of communication, and establish protocols for addressing and resolving issues. They also help mitigate many of the issues mentioned here regarding the unique dynamics of family offices and how they differ from industry.

Another reason to include formal governance mechanisms is to help develop and train the next generation of family members for when it is their responsibility to oversee the assets and employees. Often this is accomplished by inviting young adult children of the family to participate in meetings or join committees. Through this mechanism the children learn by watching and will emulate those behaviors once they are in charge. It also provides the principals with a way to evaluate the competency, interest, and future potential roles for their children.

Identify, maintain, and work with a small group of outside tax, legal, investment and specialty service professionals on an inclusive and collaborative basis

Many of the most successful family offices are those that over the years have developed longstanding relationships with trusted advisors who are appropriately experienced to advise them and with whom they share information on a robust and collaborative basis. To the extent the family office executive can help foster these relationships, they will greatly serve themselves, the family office, and the principals. To do so, senior executives should identify those outside advisors who should be included as well as recognize where service providers need to be changed or upgraded. The family office executive should include them as part of a core group of senior advisers and develop protocols for recurring communication and collaboration.

Determine the appropriate annual budget for the family office and ensure a proper funding mechanism

Proper budgeting and funding for a family office is critical for its long-term success. It is not uncommon for newer family offices to be underfunded and understaffed because the depth and breadth of the family's needs are not initially understood. Or the family office does not properly add staff, or change the make-up of their staff, to accommodate changes in the family's complexity, sophistication or service needs. Therefore spending time up-front and on a recurring basis to determine and re-evaluate appropriate staffing and funding needs is critical.

At a minimum, the family office should develop an informal "business plan" that identifies its areas of responsibilities, designs an organizational structure to address these needs, determines the level of required staffing and funding, and proposes a mechanism to pay for these needs. In these cases it is often helpful for the family office executive to seek advice from other family offices or outside resources to help establish benchmarks against which they can both compare their organization and communicate to the principals what is needed.



Conclusion

As long as families have had substantial wealth they have needed others to help them oversee their personal and financial affairs. This need dates back centuries and is in part the basis for the role of stewards who provided these services to royal families. It is only recently that the “business” of helping families manage their wealth took on the term “family office” with the creation of formal family offices by JP Morgan and later the Rockefeller family. Today the term family office is ubiquitous, as an industry has emerged to serve ultra-wealthy families with dedicated service providers, technologies, and industry professionals.

Although there is a myriad of challenges that comes with managing significant wealth, families and the senior executives who are dedicated to serving them should take comfort in knowing that these challenges are not new. They have existed as long as families have had wealth and as a result there are a number of established approaches and solutions that can serve as a guide. These solutions can be found by understanding how other families have structured their family offices as well as seeking the advice of those professionals and organizations who work with similar families.

This white paper provided a look at some of these solutions as they apply to the organizational structures, staffing, and governance of mid-to-large size family offices. The paper identified that, with respect to organizational structures and staffing, there are broad similarities in terms of best practices and approaches. This serves as a guide to families and senior executives who are creating a new family office or assessing their existing family office. The paper also identified those areas where family offices are indeed different and warrant unique, family-specific approaches in the governance of the family office. Understanding these areas and managing for and around the preferences and proclivities of the principals and their family members is how family office executives can truly distinguish themselves and help the family be successful.

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