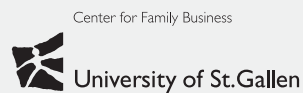


# FAMILY OFFICE WHITE PAPER



In Partnership with EY and University of St.Gallen

## **The Family Office Dynamic:** Pathway to Successful Family and Wealth Management Part I: Structural Considerations

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# CONTENTS

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Introduction and welcome	1
What is a family office?	2
Why set up a family office?	5
Family office services	7
The costs of running a family office	11
Constructing a business plan	14
Legal setup	17
IT, trading tools and platforms	19
Best practices from a professional point of view	22
Resources	25
About the contributors	27

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# INTRODUCTION AND WELCOME



**Francesco de Ferrari**  
Managing Director and Head of  
Private Banking Asia Pacific  
Credit Suisse

Dear Reader,

We are delighted to present this comprehensive guide to setting up a family office and best practices within the sector. Entitled *The Family Office Dynamic: Pathway to Successful Family and Wealth Management*, this report is published in two parts.

The First Part deals with issues concerning the structural aspects of a family office; the Second Part deals with issues that affect how well-run a family office can be. Collectively, they provide a framework for considering whether to establish, or restructure, a family office.

A large number of family offices have been set up over the last ten years all over the world. The common triggers for establishing a family office include: solving family conflicts; ensuring that wealth is transferred to future generations; preserving family wealth; consolidating assets; dealing with a sudden influx of liquidity; and increasing wealth management efficiency. Family offices have also gained prominence because of wealth-holding families' desires for greater control over their investments and fiduciary affairs, as well as lifestyle management.

Indeed, this desire for control has gained even more resonance since the financial crisis. More families are now taking control of their financial affairs in order to allay concerns about external providers of products and services. As wealth grows, particularly in the emerging markets, there is little doubt that family offices will play an even bigger role in the management of substantial wealth in the years ahead.

This paper is designed to provide guidance to families considering setting up a family office. Such families may include business families who wish to separate their family wealth and assets from the operating business. In Asia Pacific alone, the Credit Suisse Emerging Market Research Institute has found that business families have direct or indirect shareholdings of at least 20% of almost 1,500 listed companies with market capitalizations exceeding US\$500 million. We are mindful of the many more family businesses that are unlisted and private, and also the many successful entrepreneurs looking to structure liquidity gained from a profitable sale in order to further grow and preserve their wealth.

Family offices are complex organizations that require a deep knowledge – not just of investment variables, but a host of other factors.

Credit Suisse has had the privilege of serving many of the world's wealthiest families since 1856. Our considerable experience of advising and supporting our clients with their private banking needs is illustrated in this publication, together with the insights and expertise of the family office experts at Ernst & Young and the Center for Family Business HSG at the University of St. Gallen in Switzerland.

We hope that you will find this report helpful and illuminating as you plot your family's future path.

# WHAT IS A FAMILY OFFICE?

**Family offices have their roots in the sixth century, when a king's steward was responsible for managing royal wealth. Later on, the aristocracy also called on this service from the steward, creating the concept of stewardship that still exists today. The modern concept of the family office developed in the 19th century. In 1838, the family of financier and art collector J.P. Morgan founded the House of Morgan to manage the family assets. In 1882, the Rockefellers founded their own family office, which is still in existence and provides services to other families.<sup>1</sup> The expression family office covers all forms of organizations and services involved in managing large private fortunes.**

These can be organized either as family-owned companies, in which the family wealth is pooled, or as companies or bank departments that provide financial services for these clients while the family retains decision-making powers. Many family offices were originally a single-family office. In these cases, the family is the owner of the organization and uses its services exclusively for itself. In order to avoid one family having to bear the very high operational costs of a single-family office, families often decide to offer the services of their family office to other families. When a family office opens up its services to other families it becomes a multi-family office.

Since the individual services of a family office are tailored to the family, and are correspondingly costly, the amount of family wealth under management is generally at least USD 100 million. It is more revealing, however, to calculate the minimum wealth under management in the light of return expectations and targets, and the resulting costs of the family office. This shows that there is no clear lower limit for a family office. The costs of the family office, plus the return target, must be achievable with the chosen asset allocation and structure.

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<sup>1</sup> [www.rockefellerfinancial.com](http://www.rockefellerfinancial.com)

Family offices are arguably the fastest growing investment vehicles in the world today, as families with substantial wealth are increasingly seeing the virtue of setting one up. It is difficult to estimate how many family offices there are because of the various definitions of what constitutes a family office, however there are believed to be at least 3,000 single family offices in existence globally, at least half of which were set up in the last 15 years.

The increasing concentration of wealth held by very wealthy families and rising globalization are fueling their growth. Particularly important in the years ahead will be the strong growth of family offices in emerging markets, where for the most part they have yet to take hold – despite the plethora of large family businesses in these economies.



## Types of family offices

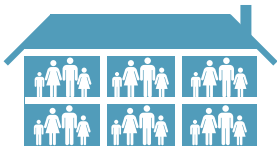
### Single family office



# SFO

In its purest sense, a single family office is a private company that manages the financial affairs of a single family. Typically, a fully functional SFO will engage in all, or part of the investments, fiduciary, trusts and estate management of a family; many will also have a concierge function.

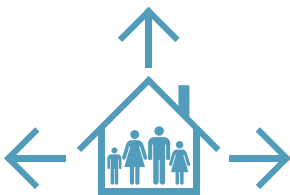
### Multi-family office



# MFO

A multi-family office will manage the financial affairs of multiple families, who are not necessarily connected to each other. Like a single family office, an MFO might also manage the fiduciary, trust and estate business of multiple families, as well as their investments. Some will also provide concierge services. Most MFOs are commercial, as they sell their services to other families. A very few are private MFOs, whereby they are exclusive to a few families, but not open to others. Over time, SFOs often become MFOs. This transition is often due to the success of the SFO, prompting other families to push for access. Economies of scale are also often easier to achieve through an MFO structure, promoting some families to accept others into their family office structure.

### Virtual family office



# VFO

Families looking to achieve the benefits of a family office managing their financial and other affairs, but who do not wish to set up an actual company to do so, can opt for a virtual family office. This can be achieved by outsourcing all services to external providers of services and consultants.

# WHY SET UP A FAMILY OFFICE?

**As concerns about wealth preservation and succession planning within family businesses continue to rise, wealthy families are increasingly evaluating the benefits of setting up a family office.**

## **Good reasons to set up a family office**

There are many reasons why setting up a family office makes sense, but at the root of these is the desire to facilitate the inter-generational transfer of wealth and reduce intra-family disputes. This desire inevitably increases from one generation to the next, as the complexity of managing the family's wealth grows. Without being exhaustive, the following points set out the reasons why a family office makes sense:

- **Governance and management structure**  
A family office can provide governance and management structures that can deal with the complexities of the family's wealth transparently, helping the family to avoid future conflicts. At the same time, confidentiality is ensured under the family office structure, as wealth management and other advisory services for the family members are under a single entity owned by the family.
- **Alignment of interest**  
A family office structure also ensures that there is a much better alignment of interest between financial advisers and the family. Such an alignment is questionable in a non-family office structure where multiple advisers work with multiple family members.
- **Potential higher returns**  
Through the centralization and professionalization of asset management activities, family offices may be more likely to achieve higher returns, or lower risk, for their investment decisions. Family offices can also help to formalize the investment process, which may help to maximize investment returns for all family members.
- **Separation**  
Family offices allow for separation, or at least a distinction, between the family business and the family's wealth or surplus holdings.
- **Centralization of risk**  
Family offices allow for operational consolidation of risk, performance management and reporting. This can help the adviser and principals to make more effective decisions to meet the family's investment objectives.
- **Centralization of other services**  
Family offices can also coordinate other professional services including philanthropy, tax and estate planning, family governance, communications, and education to meet the family's mission and goals.

## Concerns about setting up a family office

The establishment of a family office is a major undertaking and there have been cases when family offices have not met the family's expectations. Some potential concerns about setting up a family office are:

- **Cost**  
This is something every family needs to be aware of. The cost of regulatory and compliance reporting remains high, which means that the level of assets under management by a family office needs to be high enough to offset its fixed costs.
- **Market, legal and tax infrastructure**  
Family offices function better when operating from centers where there are sophisticated markets and legal and tax structures. The absence of these in emerging markets has undermined the development of family offices there.
- **The multi-family office offering**  
To address the problem of the high operating costs of a family office, families often set up multi-family offices (MFOs) in which several families pool their wealth. These MFOs will often be directed by the lead family that initiated the office. In MFOs, all assets are managed under one umbrella. However, MFOs typically cater to a range of family sizes, wealth and maturity levels. This means that families can run the risk of not receiving the same level of personalized advice as in a dedicated single family office set up.

When considering establishing a family office, some people see potential positives as negatives. This tends to be particularly prevalent in the following areas:

- **The preference for privacy**  
Some families may be hesitant about consolidating their wealth information through a centralized family office structure.
- **Trust of external managers**  
Setting up a family office is typically contingent on the level of trust and comfort families have with external asset managers. However, trust typically stems from long-standing relationships with external managers.
- **Expectations on returns**  
Ultimately, family offices rely on their longevity through ensuring wealth preservation. The difficulty of securing market returns in recent years has led to some tension in this respect. Furthermore, during generational transitions, family office structures can be tested, often to the point of destruction, as the next generation presses for different goals and objectives to manage the family's wealth.



# FAMILY OFFICE SERVICES

**At the heart of any family office is investment management. However, a fully developed family office can provide a number of other services, which range from training and education to ensuring that best practices are followed in family governance. This section looks at the full range of services a mature family office could potentially provide (see figure 1). These include:**

## A. Financial planning

### Investment management services

Typically, this will be the main reason for setting up a family office, as it is central to ensuring wealth preservation. These services include:

- Evaluation of the overall financial situation.
- Determining the investment objectives and philosophy of the family.
- Determining risk profiles and investment horizons.
- Asset allocation – deciding on the mix between capital market and non-capital market investments.
- Supporting banking relationships.
- Managing liquidity for the family.
- Providing due diligence on investments and external managers.

### Philanthropic management

An increasingly important part of the role of a family office is managing its philanthropic efforts. This might include the establishment and management of a foundation, and advice on donating to charitable causes. These services would typically involve:

- Philanthropic planning.
- Assistance with the establishment and administration of charitable institutions.
- Guidance in planning a donation strategy.

- Advice on the technical and operational management of charities.
- Formation of grant-making foundations and trusts.
- Organizing charitable activities and related due diligence.

### Life management and budgeting

Some of these services are typically defined as concierge in nature, but they are broader in scope inasmuch as they also include budgeting services. Services under this heading include:

- Club (golf, private, etc.) memberships.
- Management of holiday properties, private jets and yachts.
- Budget services, including wealth reviews, analysis of short- and medium-term liquidity requirements, and long-term objectives.

## B. Strategy

### Training and education

Much of this revolves around the education of the next generation on issues including wealth management and financial literacy, as well as wider economic matters. These services include:

- Organizing family meetings.
- Ensuring family education commitments.
- Coordination of generational education with outside advisers.

Figure 1. Family office service

Source: EY Family Office Services, 2013



### **Estate and wealth transfer**

Family offices will be involved in business succession and legacy planning, enabling the transfer of wealth to the next generation. These services include:

- Wealth protection, transfer analysis, and planning related to the management of all types of assets and income sources.
- Customized services for estate settlement and administration.
- Professional guidance on family governance.
- Professional guidance regarding wealth transfer to succeeding generations.

### **Business and financial advisory**

Beyond asset management advisory, family offices will also provide advisory services on financing and business promotion. These include:

- Debt syndication.
- Promoter financing.
- Bridge financing.
- Structured financing.
- Private equity.
- Mergers and acquisitions.
- Management buyouts.
- Business development.

## **C. Governance**

### **Administrative services**

Administrative services, or back-office services, are essential to the smooth running of a family office. These services include:

- Support on general legal issues.
- Payment of invoices and taxes, and arranging tax compliance.

- Bill payment and review of expenses for authorization.
- Opening bank accounts.
- Bank statement reconciliation.
- Employee management and benefits.
- Legal referrals and management of legal firms.
- Public relations referral and management of public relations firms.
- Technology systems referrals and management of these vendors.
- Compliance and control management.

### **Succession planning**

Ensuring a smooth succession and planning for future generations is integral to the long-term viability of the family office and the family it serves. These services include:

- Continuity planning relating to unanticipated disruptions in family leadership.
- Evaluation of the strengths, weaknesses, opportunities and threats (SWOT analysis) of senior executives both within and outside the family.
- Re-evaluation of the family board regarding the roles of non-family directors.
- Structuring corporate social responsibility platforms and programs.
- Development of formal knowledge-sharing and training programs.
- Implementation of intergenerational estate transfer plans.
- Adoption of a family charter or constitution, specifically aiming to:
  - i. Formalize the agreed structure and mission of the family business.
  - ii. Define roles and responsibilities of family and non-family members.

- iii. Develop policies and procedures in line with family values and goals.
- iv. Determine processes to resolve critical business-related family disputes.

### **Reporting and record keeping**

The maintenance of records and ensuring there is a strong reporting culture is another core element of a family office's services. Key to these services are:

- Consolidating and reporting all family assets.
- Consolidating performance reporting.
- Benchmark analysis.
- Annual performance reporting.
- Maintaining an online reporting system.
- Tax preparation and reporting.

## **D. Advisory**

### **Risk management and insurance services**

This is a service that has assumed a more important role in recent years because of the financial crisis of 2008-09 and the subsequent fallout. It will be a crucial service for family offices in the future as well. These services include:

- Risk analysis, measurement and reporting.
- Assessment of insurance requirements, policy acquisition and monitoring.
- Evaluation of existing policies and titling of assets.
- Evaluation of security options for clients and property.
- Formulation of disaster recovery options and plans.
- Protection of assets, which could involve the use of offshore accounts.

- Development of strategies to ensure hedging of concentrated investment positions.
- Physical security of the family.
- Data security and confidentiality.
- Review of social media policy and the development of a reputation management strategy.

### **Compliance and regulatory assistance**

Family offices need to ensure strict compliance with regulations pertaining to investments, assets and business operations. Necessary services may include:

- Providing auditing services for internal issues.
- Establishing a corporate governance mechanism.
- Ensuring a high level of staff hiring.
- Group performance monitoring and compliance.
- Offering recommendations on independent and board advisory formation.
- Strengthening the regulatory investment process.

### **Tax and legal advisory**

Tax, in particular, has become a much more important issue for family offices in recent years and as such has assumed a larger role among the functions of a family office. Legal matters are also important. A family office will typically employ a general counsel and/or chartered accountant, or several accountants and tax experts. These professionals may be able to provide the following services:

- Construct a tax plan to best suit the family.
- Design investment and estate planning strategies that take into account both investment and non-investment income sources and their tax implications.
- Ensure that all parts of the family office are tax compliant.

# THE COSTS OF RUNNING A FAMILY OFFICE

Family offices are unique to the family that sets them up. As such, to define what an average family office should look like is not meaningful. Their size may vary from one employee to up to 50 or more, depending on the services provided, the number of family members served, and how the services are to be delivered.

Despite there being no standard definition of a family office, anecdotal evidence suggests that a full-service family office will cost a minimum of USD 1 million a year to run, and in many cases, much more. This would suggest that for a family office to be viable, a family should be worth between USD 100 million and USD 500 million. Of course, a family office can be set up with USD 100 million or even less, but the service range will probably be limited to administration, control of assets, consolidation and risk management. A fully integrated family office will require a great deal more wealth. Figure 2 breaks this down in more detail.

**Figure 2. Family office types based on assets and costs**

Source: Cap Gemini, *The Global State of Family Offices*, 2012

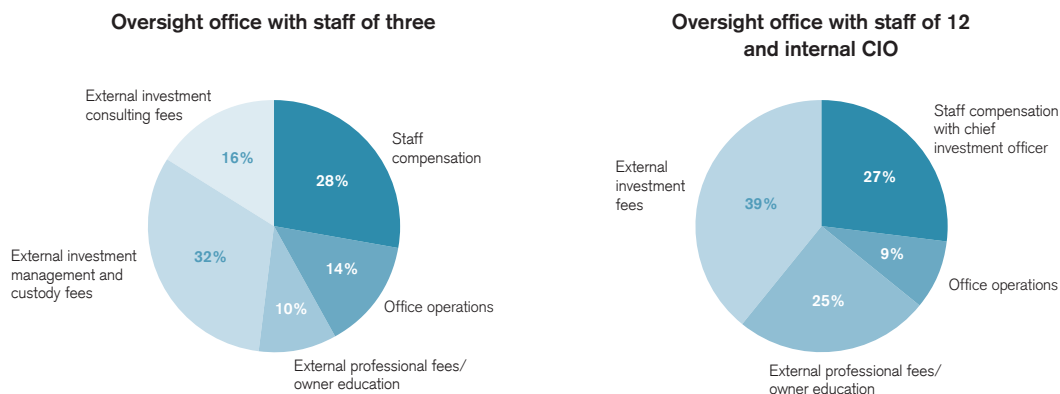
Family office type	Assets	Overhead cost per year
Administrative	USD 50 million to USD 100 million	USD 0.1 million to USD 0.5 million
Hybrid	USD 100 million to USD 1 billion	USD 0.5 million to USD 2 million
Fully integrated	> USD 1 billion	USD 1 million to USD 10 million

## Staff costs

Research from the consultancy Family Office Exchange, which supports over 350 business-owning and financial families, family offices, and trusted advisors in 22 countries, has found at least 60% of the total costs of a family office are allocated to staff compensation and benefits.<sup>2</sup>

**Figure 3. US family office costs**

Source: Family Office Exchange, *The Cost of Complexity, Understanding Family Office Costs*, 2011

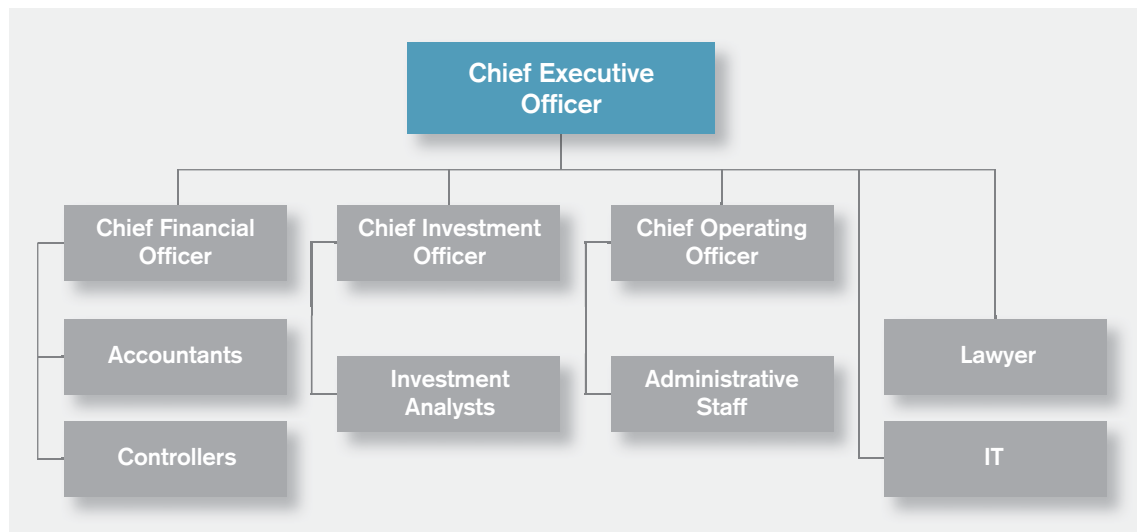


<sup>2</sup> Family Office Exchange, 2013

A fully integrated family office – providing most, if not all, of the services mentioned in the section on determining servicing priorities: the make-or-buy dilemma– would have a typical staff structure represented in Figure 4.

**Figure 4. Family office staff**

Source: Family Office Exchange, *A Guide to the Professional Family Office*, 2013



### Setup costs

Setup costs would also include the employment of head-hunters for recruitment, compensation specialists, relocation costs, legal setup costs, and the search for infrastructure such as office space and technology solutions.

### Overall costs

Family offices typically have operating costs between 30 basis points and 120 basis points. Offices with the lowest running costs focus primarily on a limited number of wealth management services, such as handling real estate holdings. However, there seems to be no strong correlation between the size of assets under management and the operating costs.

# Keeping it in the family

WHATEVER THE COSTS, A WELL-RUN FAMILY OFFICE PROVIDES HUGE BENEFITS – BOTH QUANTITATIVE AND QUALITATIVE

BY BERNARD FUNG

A FAMILY office is an organisation that manages the wealth and personal affairs of a wealthy family or several branches of that family. It also plans for that family's future in a multi-generational sense, deals with tax, legal and estate planning, preparation of the next generation, philanthropic activities, book-keeping and may even go as far as providing supporting services such as the management of art collections, planes, boats, properties and other assets.

Wealthy families invariably already have arrangements of one form or another to look after their wealth and personal affairs, usually made up of an informal grouping of some family members and staff that operate within the family business management office. However, such informal organisations create several challenges over time.

First, business staff also involved in the private matters may be distracted or not always be able to prioritise between family and business duties. Second, dividing or segregating information to make sure no one person "knows everything" still requires at least one person to be able to manage the complexity. This may potentially create disparate information silos that are less than desirable ("keeping track of who knows what"), and the risk of something unforeseen happening to the person with the "full picture". Lastly, families usually find that such organisations react to changes rather than pro-actively anticipate them, and may not readily keep pace with the increasing complexity as the family and its wealth grows, or as the business or family circumstances change with the family's lifecycle.

## Ensuring better management

Families that begin to experience some of these challenges consider a more dedicated and distinct arrangement. As the family extends into the next generation and beyond, the family may grow disproportionately relative to its wealth increase. By default or design, if the family has to stay together, for instance, because the family assets have not or cannot be distributed, a family office is often one of the options explored to ensure better management of this shared pool of assets, to meet the individual financial requirements and other needs of the family. This is where it may make sense to consider a more formal family office.

Particularly in Asia, where many family businesses continue to grow vibrantly, business owners may find it hard to manage family financial assets and run the business at the same time. The family's wealth may also become the business – for example, when the family no longer fully controls management or ownership because of new private or public investors; the family office can enable the family to interact with the business in a manner that strengthens the perception of good governance.

The family office may also provide a focal point for the family to continue to work together on other new business or non-business enterprises. A family office may relieve the administrative burden for the family, providing the wealth owner with a systematic way of organising the family's increasingly complicated lifestyle and freeing up time to pursue personal interests and passions. The current generation may wish to prepare the next one – a family office serves as a "safe pair of hands" to manage things and help prepare the next generation for the responsibility of stewardship.

The family should carefully consider the degree to which it wishes to "do everything" itself with its own family



## KEY INDIVIDUAL

Besides the necessary professional prerequisites, the person leading the family office should also have an attention to good processes and the eye for details necessary to deal with legal and financial issues and service providers

office. There are family offices that have, in the interest of maintaining utmost secrecy, set up full infrastructure and staff to manage every function in-house. Unless managed very well, such family offices do not pass the test of time – the next generation usually ends up dismantling them as the costs compound over the years. Conversely, hiring relatively low-cost administrative staff to merely act on directions and instructions from the family may not always be an appropriate solution – the office does not generally rise beyond the level of its staff, and the family never realises its full potential.

## Finding the right person

One of the most crucial tasks the family has to fulfil is finding the right person (family or non-family) to lead its family office. Several qualities are important. That person needs to know how to strike the right balance between growth and preservation of long-term wealth. Besides the necessary professional prerequisites, he or she should also have an attention to good processes and the eye for details necessary to deal with legal and financial issues and service providers. The person must be able to build on trust and be trustworthy, for instance being able to represent a wealthy and powerful family without abusing that status. He or she should be able to gain the confidence and trust of both the current and the next generation and be capable of "speaking truth to power", for example to present the family an opposite view in a way that builds a positive outcome rather than destroys cohesion and unity. The exceptional person will be able to draw the family into a wholesome level of involvement with the professional family office, and help nurture the right sort of independence in the next generation.

Family offices with stewardship over wealth pools of

similar magnitude and complexity can have staff sizes ranging from a few persons to over a hundred. Published statistics suggest that family offices manage median investable assets of around US\$100 to US\$125 million, with an average of around US\$250 million. Annual operating costs average from about 40 up to 100 basis points of investable assets. However, Asian families considering family offices should view these published statistics as rules of thumb, rather than industry norms or operational standards, as they sample mostly from family offices based in America and Europe.

Whatever the costs, a family office's benefits are both quantitative and qualitative, and the family should assess these in light of the original motivations for setting up the office. Quantifiable benefits include higher sustainable real investment growth due to more rigorous investment process and due diligence, risk management, or access to "institutional" deal flow. Savings from aggregating resources to negotiate with service providers also contribute to the bottom line.

Benefits not be easily quantifiable but arguably of equal, if not greater value, include strengthening the family unity, a fuss-free generational transfer of stewardship over business and wealth, as well as preservation of the family's legacy and enhancement of its reputation.

There are as many organisational variations of family offices as there are families, their respective needs, wants and preferences. Whatever form the organisation assumes, it should be always able to draw its inspiration, identity and vitality from the family it serves. It is, after all, the family's office. ■

Bernard Fung is Head of Family Office Services Singapore, Credit Suisse Private Banking division

# CONSTRUCTING A BUSINESS PLAN

**After the family has determined its vision of the family office, the next phase can be described as the design phase, during which a detailed business plan is developed. This should include the choice of the most suitable jurisdiction, services provided, staff requirements, office location and infrastructure, anticipated capital, breakdown of operating costs, measurable benchmarks, and funding to be used.**

One of the underlying determinants of the business plan and the family office is the question of whether the family office will be run as a profit center or as a cost center. It is equally important to determine whether there is any intention to open up the family office to other families as a multi-family office at a later stage, or if it is clearly intended to continue delivering services just for the founding family.

Other important factors to take into consideration when creating the business plan of a family office include:

- **Family skills**

An important question is: do some family members have the right skills and qualifications to run the family office, or will external management be hired? When this decision has been made, the right level of family governance must be implemented to deal with the tension between principals and agents in the appropriate way (we discuss this in Part 2 of the Family Office White Paper). An investment committee or a supervisory board with family representation is usually part of the envisaged governance structure.

- **Family business**

Families that still own the family business and may be active managers in that business face distinctly different issues to those that have sold the business and are managing their private family wealth. In some cases, the company's chief finance officer, legal counsel or controller advises the family on estate and investment issues; in others there may be an internal department in the family business that functions like a family office.

- **The entrepreneur and the family business**

Entrepreneurial risk-taking in the family business should not be confused or combined with the approach to risk for the separate private assets of the family. While a comprehensive approach to wealth management across both private and business assets is required, personal affairs should best be dealt with in a discrete entity

separate from the business, in order to meet the distinct ownership needs of individual family members. The investment and risk profiles of the family and individual family members should not be overwhelmed by larger corporate priorities, although clearly a holistic approach to risk levels on both the business and private sides needs to be ensured.

- **Operational model**

The business plan should define the operating model of the family office, its functional setup and infrastructure, reporting and control systems, and the governance structure – including setting up relevant boards, such as the investment committee or the family council.

- **Jurisdiction**

Another factor to be considered is the optimal jurisdiction and tax regime for the family office, based principally on the home jurisdiction of the family and the majority of its assets. The choice of jurisdiction, legal, regulatory and tax issues is addressed in the appendix.

The most important make-or-buy decisions need to be made by looking at the potential savings if certain services are outsourced, and judging the opportunity costs of outsourcing as against sourcing in-house (see section on determining servicing priorities: the make-or-buy dilemma). A detailed staffing plan must be created, and a salary structure put in place that provides sufficient motivation for talented staff to work in the family office. Key positions, such as CEO (unless held by a family member), CIO or tax adviser must be filled by knowledgeable and trustworthy individuals. Another major area requiring decisions is infrastructure, including the office and IT infrastructure (see section IT, trading, tools and platforms).

The result of the design phase, in which the business plan is prepared, should be a concrete action plan to build and set up the family office. All the relevant family members should be asked to commit in writing to the establishment of the office.



Alongside financial projections, the business plan also needs to provide short-term and long-term timelines, and detailed job descriptions and performance goals for employees.

The business plan should also outline qualitative goals such as:

- Details of the current wealth structure and intended asset allocation.
- A review process for evaluating the achievement of the family office's goals.
- An employee hiring plan and compensation model (employee stock option plan or other).

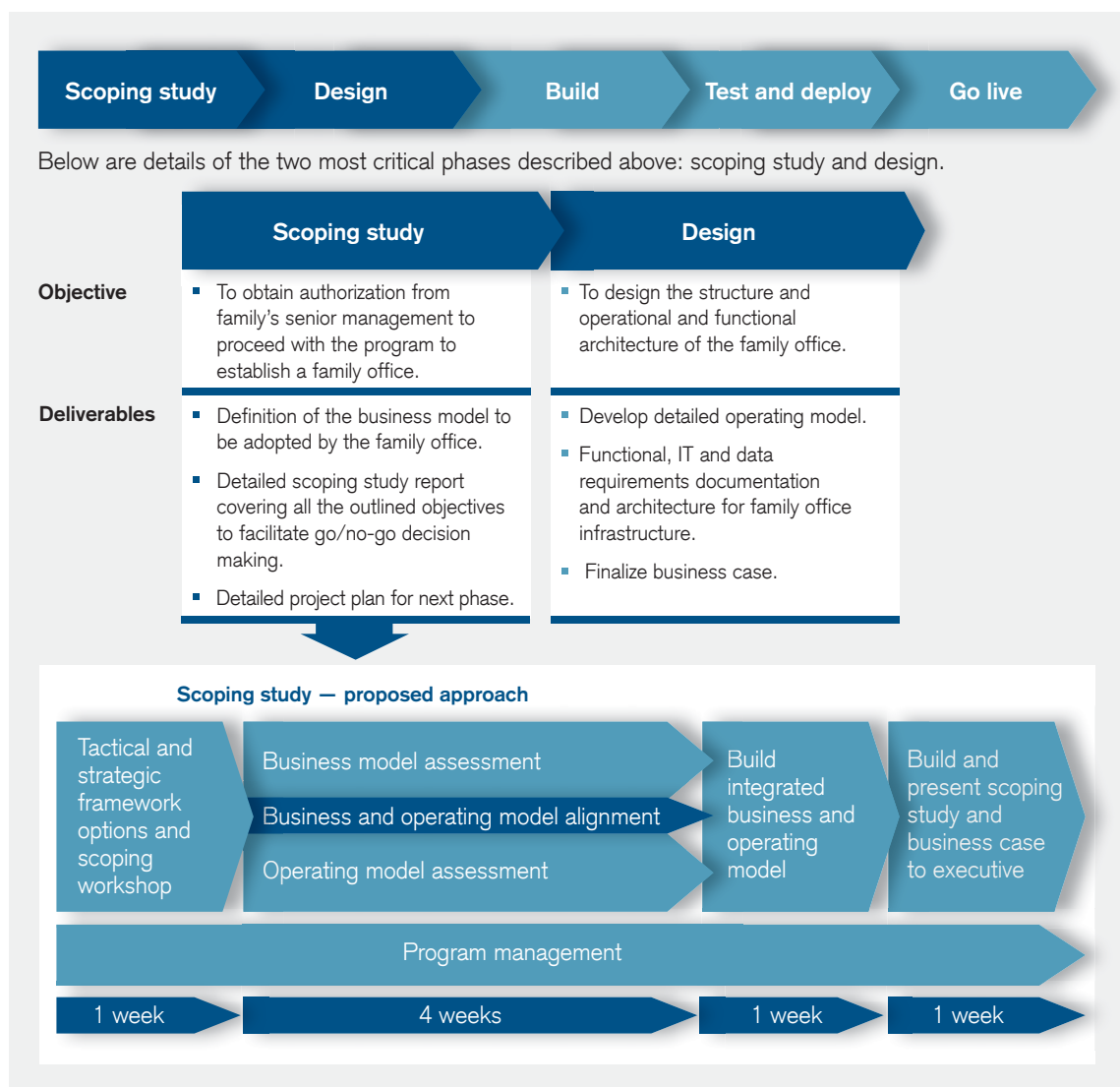
- Contingency plans.
- Investment guidelines, with the expectations regarding investment returns and benchmarks once the CIO is on board.

### The process for setting up a family office

The typical process for establishing a family office includes the following phases: **scoping, design, build, test** and **deploy**. Stringent and professional project management is key, and should involve external advisers with the appropriate know-how to assist the family throughout the entire process (see figure 5).

**Figure 5. The phases of business planning**

Source: EY Family Office Services, 2013



## STEP

# 1

### Scoping study

What are the family's vision and expectations? Who are the beneficiaries of the family office? What does the family want to do with its wealth, family business, philanthropy, talents and children? Which part of the family wealth shall be allocated to the family office? Which services are needed and for whom?

Key priority functions of the family office to be considered:

- Investment strategy: will the family office take on a purely advisory function or act as an asset manager?
  - Confidentiality, assets in a family office or held by individuals, liquid versus illiquid assets.
  - Develop investment regulations and define benchmarks.
  - Consider dividend levels and payout ratios.
  - Controlling function in-house versus external.
- Administration of wealth: separation of private from business assets.
  - Strategic and tactical asset allocation: day-to-day wealth management.
  - Governance issues (investment committee and other boards).
- Tax at individual family member level: level of service for beneficiaries.
- Holistic accounting and tax advisory for all assets, whether or not managed by the family office.
- Acquisition and management of private assets.
- Should the family office cover philanthropic issues and family education?

## STEP

# 2

### Design

Development of a detailed business plan, including the most suitable jurisdiction, services provided (i.e., wealth management, estate planning, philanthropic, personal services, etc.), employee skills required, space needed, anticipated capital, operating costs, measurable benchmarks and funding.

- Define operating model: functional setup, reporting, board structure, governance.
  - Separation of private assets from business assets.
  - Consider level of operational versus investment risks.
- What is the optimal jurisdiction and tax regime in which to set up the family office?
  - Which tax, legal, regulatory framework.
  - Depending on the level of services offered.
- Draft detailed business plan:
  - Level of in-house services – consider make-or-buy, opportunity costs, potential savings if outsourced.
  - Staffing and recruiting: which roles are required in the family office? CIO, tax adviser, controller, bookkeeper?
  - Outline necessary infrastructure: IT, security, office space.
- Result of this step: concrete action plan to build family office (e.g., family information document – to be signed by all family members) – obtain commitment of all family members to go ahead.

Source: EY, Family Office Services

# LEGAL SETUP

**Since a family office is a business, the question of which jurisdiction provides the best environment for such activities often arises. Legal and tax structures will have a big impact on the structure and operational performance of the family office and as such need to be given substantial consideration.**

**Given that the family is at the center of the family office, choosing a location close to the family, or at least to the central members, would appear to be much more important than a tax-optimized choice of location. Nevertheless, legal, tax and regulatory aspects relevant for the setup, as well as for the operations of a family office, have to be checked carefully. Depending on the framework provided by the jurisdiction, there are normally many aspects that must be considered in order to optimize the individual situation within the given legal or tax frameworks.**

## **Asking the right questions on location**

As outlined above, the most crucial aspect of choosing a location for a family office is not the legal and tax environment. Nevertheless, there are a few jurisdictions that stand out as centers of family office excellence. There are many other relevant aspects of location choice beyond legal and tax, and it is important to establish which questions have to be asked – and answered – in the process of setting up a family office.

## **Regulatory environment**

The regulatory environment of the jurisdiction must be carefully checked, as does the level of services provided by the jurisdiction. The requirements that need to be met in order for the office to perform services under the laws of the location must also be verified. In many countries, special registrations or permits are required in order to give investment advice or to act as an attorney or trustee on behalf of the principal family or certain family members.



# IT, TRADING TOOLS AND PLATFORMS

**Technology plays an important role in creating an efficient family office. Furthermore, finding the right individuals to manage these platforms is crucial. It is important that a family office identifies its core technology needs before choosing or creating solutions. Automation is an excellent way to keep costs under control and to mitigate risk. The IT tools and platforms that a family office should consider are:**

- Custody platform (bank, brokerage or trust company).
- Consolidated reporting.
- Trading and portfolio management tools.
- Risk management tools.
- General ledger and accounting software.
- Client Relationship Management (CRM) tools.
- Tax preparation software.

The selection of IT should be focused on finding ways to provide efficient reporting, trading, portfolio management, and accounting. The technology can range from off-the-shelf products to highly sophisticated, customized solutions. Much of this can be outsourced or provided by service providers, freeing up family office resources to focus on growing wealth. The following sections examine some of the various platforms in more detail.

## Custody platform

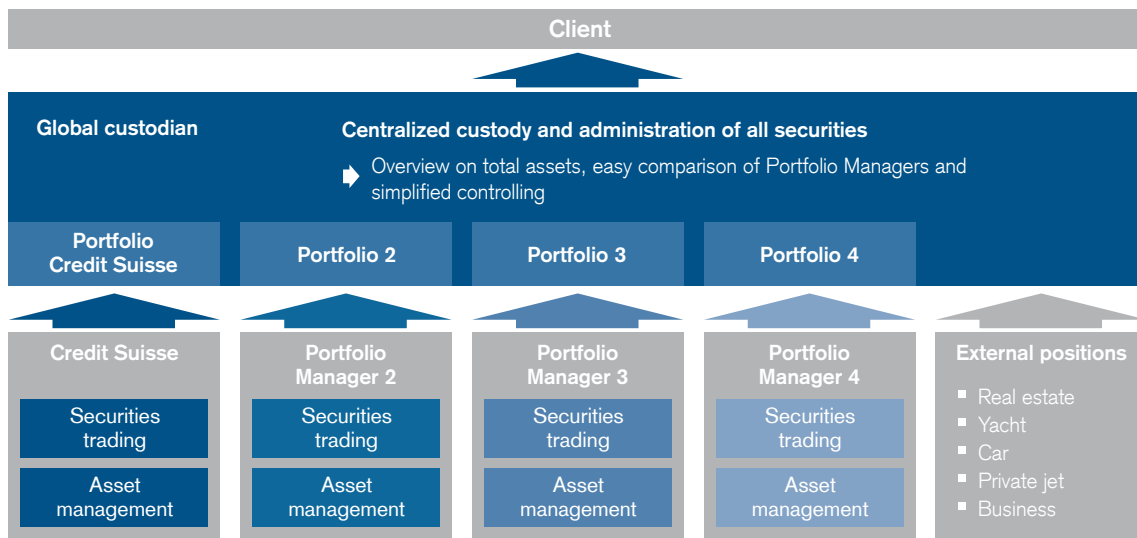
The use of multiple custodians creates the obligation to consolidate assets. This can be done for a fee by a third party vendor, in-house with the proper investment in systems, or through a global custodian.

The custody of bankable assets is the safekeeping and servicing of assets, either with one or multiple custodians or banks (see figure 6). Global custody refers to the custody and administration of assets with one custodian, which offers many advantages such as:

- The consolidation of all bankable securities, financial instruments, and liquid assets, so that the time-consuming work of consolidation resides with the global custodian and not the family office.
- The provision of a comprehensive, transparent overview of the performance of all the assets at all times via a consolidated investment report (providing a uniform format and standards for all assets).
- The assets can be managed either by the custodian bank, an external asset manager, or the family office (i.e. the family office selects its preferred asset manager with no restrictions, and the asset manager is free to select the brokers for securities trading).
- Some non-bankable assets, such as direct real estate investments, mortgages, third party derivatives, art collections, and yachts, can also be included.

**Figure 6. Structure with global custody**

Source: Credit Suisse, 2013



### Consolidated reporting

Good design of this process early on will allow families to understand their investments, identify risks, and strengthen their confidence in their family office. Consolidated reporting is known to be the most valuable tool for a family office, and is highly recommended.

### Trading and portfolio management tools

Some family offices employ an asset allocation model that they give to fund managers. Others make their investments in-house, in which case portfolio management and trading systems become more important.

Various modules can be added to the infrastructure to deal with the increased scale and complexity that this leads to. These can include:

- **A portfolio management system:**  
This provides the backbone of a fund's operational infrastructure and acts as the internal books and records. Functionality includes Profit and Loss, Net Asset Value views and reporting, cash and corporate actions management, reconciliation, and integration with key third parties.
- **An execution management system:**  
An electronic trading platform that provides Direct Market Access trading connectivity as well as direct connectivity to broker algorithms. It also includes level 2 data (market depth) and advanced pairs and program trading functionality.
- **An order management system:**  
This provides the main trading platform for the firm. Like an execution management system, it also provides Direct Market Access (DMA) trading and broker connectivity. Other functions include compliance (pre- and post-trade), rebalancing, order staging and allocations, and portfolio modeling.

## Risk management systems

This is usually split into two distinct systems: Real-time/Near-time and End of Day. Real-time/Near-time risk is provided by some portfolio management system providers and functionality includes real-time sensitivities (Greeks), theoretical valuations, risk shocking and scenario analysis. End of day risk system functionality includes Value at Risk calculations/reporting and more complex scenario analysis.

## Client relationship management (CRM) tool

A CRM tool is vital for a family office to manage critical information, such as that relating to family members, in one central location. Information retained in a CRM database should include: family contact information, family discussions regarding services or major family events, the structure of the family, and third party contacts such as legal counsel, accountants and insurance contacts. Some reporting and custody platforms will offer such a CRM tool in their overall solution.

## Human capital and technology

When choosing technology for a family office, it is imperative to have the right individual(s) in place to manage and operate the software. Such individuals, who may be in dual operational roles, should have an understanding of performance analysis and of accounting principles. They should be detail oriented,

have the ability to leverage technology for integration purposes, and have basic Excel skills. Depending on the size and technical complexity of the IT system, some family offices may hire a Chief Technology Officer. This person would be responsible for support, updates, communication and software training.

The implementation of IT in a new or existing family office may require additional resources. These resources might involve external consultants, who can provide advice and support with respect to integration, implementation and the verification of input and output data.

## Implementing technology

Once the core needs have been identified and the appropriate solutions chosen, it is vital to implement them effectively. Appropriate implementation may include the following:

- Writing a detailed project plan that sets out the responsibilities of each vendor.
- Agreeing the data import processes with each vendor.
- Creating data and functionality test scripts for each platform.
- Hiring an external consultant for data output testing.
- Holding frequent meetings with each vendor on progress and on project plan milestones.

# BEST PRACTICES FROM A PROFESSIONAL POINT OF VIEW

**Below are some best practices to consider when setting up or restructuring a family office.**

## Setting up a family office

- Establish a comprehensive overview of the family's current situation (wealth, structure, etc.), capabilities today, and goals for the future.
- Determine the expectations of and priorities for the family office, including the scope of services involved, beneficiaries, and use of its wealth.
- Do not simply copy what other family offices or wealthy families do. What works for one will not necessarily work for others. Families should always do their own due diligence and research.

## Family office services

- While investment management is usually at the heart of the family office, consider the inclusion of the full range of other services in the four main areas: financial planning, strategy, advisory and governance.

## Determining servicing priorities: the make-or-buy decision

- Involve external experts by taking into account not only their capabilities but also cost factors, time-sensitivities and confidentiality issues.
- Follow the goal of obtaining the most effective services in the most efficient way, while avoiding potential operational risks.
- Consider having a generalist as the office's own legal counsel, who can manage and guide external legal partners; this can reduce legal fees substantially.
- Consider partnering with a universal bank that can provide services such as international booking and trading platforms, global custody, global research, prime brokerage, and innovative solutions and products.

## The costs of running a family office

- Remember that the level of assets under management by a family office needs to be high enough to offset its fixed costs.
- Take into consideration that family offices typically have operating costs between 30 and 120 basis points, depending on the type of services involved.

## The internal-external conflict

- Set up appropriate benchmarks, and monitoring and compensation mechanisms for asset managers (internal and external) to ensure that incentives are not misaligned to the detriment of the family office's long-term goals.



## Selection of family office professionals

- Seek professional assistance and guidance on structuring the recruitment process, formulating compensation and incentive packages, and maintaining a strong relationship with employees, particularly through good feedback.
- Select your family office employees very carefully. Trustworthiness is extremely important given the confidentiality needs of a very wealthy family. Avoid high staff turnover.

## Constructing a business plan

- Set up a business plan for the operating model of the family office, its functional setup and infrastructure, reporting and control systems, and governance – including boards such as the investment committee and family council.
- Write a detailed plan covering financial projections, short- and long-term timelines, detailed job descriptions, lists of employee qualifications, performance goals, and qualitative goals. Include growth projections for the family office to allow for strategic hiring of employees and expansion of infrastructure.
- Align the goals of the family with those of the family office management, and incentivize accordingly.

## Legal setup

- Consider engaging specialists to craft all legal, tax and regulatory aspects relevant for the set up and operation of the family office with enormous care.
- Since a crucial ingredient for a successful family office is getting the right people into the right positions, locating the family office close to the family, or to their representatives, may be more important than a tax-optimized choice of jurisdiction.
- Less is often more when it comes to legal structures. Consider whether the legal structure might prohibit the family's principal goal: wealth preservation and multi-generational wealth transfer.

## Risk management

- Establish an appropriate risk management system to review risk exposure regularly and manage day-to-day decisions.
- Consider responding to the new need for risk transparency by investing in direct investments and real assets rather than in complex financial capital market products.
- Pursue optimal diversification and asset allocation (often involving alternative investments and uncorrelated, niche asset classes) combined with active and highly flexible portfolio management, as cornerstones of solid risk management.
- Take steps to fully professionalize investment risk management, particularly relating to manager selection, due diligence on direct investments, and stringent control of portfolio managers.

- Separate entrepreneurial risk-taking in the family business from the risk approach applying to the private assets of the family.
- Remember that risk management involves more than investment risks. Equally important is a risk management setup for legal risks, reputational risks, fraud, etc.

## The investment process

- Establish formal processes to make investment decisions by setting clear boundaries and goals, and to avoid ad hoc investment decisions that are out of line with the broader mandate or long-term strategy.
- Ensure that the family office investment process includes: consideration of legacy, objective setting, mapping risk tolerances, building a portfolio structure across liquid and illiquid assets, the use of strategic and tactical investment tools to ensure that investment solutions fit the objectives and meet cash flow needs, and governance.
- Have a clear view of the strengths and weaknesses of your family office members in terms of investment knowledge, and decide on what to manage in-house (e.g. non-listed company stakes) and what to delegate to an investment manager (e.g. international real estate and hedge fund portfolios).

## IT, trading tools, and platforms

- Find suitable providers for IT trading tools and platforms to support the investment activities of the family office.
- Consider using the following IT tools and platforms: custody platform (bank, brokerage or trust company), consolidated reporting, trading and portfolio management tools, risk management tools, general ledger and accounting software, client relationship management (CRM) tools, and tax preparation software.
- Since consolidated reporting is known to be the most valuable tool for a family office, ensure that this is a priority.

## Family governance

- Ensure that all relevant family members commit in writing to the setup of the family office.
- Ensure that there are good lines of communication between the family office and the family, with one family member responsible for each topic or area.
- Provide appropriate education in all relevant fields to the next generation in order to ensure sound wealth transfer.
- Implement clear rules for family meetings, voting rights, the investment decision process, etc.
- Make use of international networking platforms to share best practices with other family offices.
- Consider an education plan for future generations so that they understand the role and responsibilities of the family office, and the reports provided to the family. The ambition should be to build a family office that can survive for generations.

# RESOURCES

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EY is a market leader in advising, guiding and recognizing family businesses. With almost a century of experience supporting the world's most entrepreneurial and innovative family firms, they understand the unique challenges they face and how to address them. Through their EY Global Family Business Center of Excellence, they offer a personalized range of services aimed at the specific needs of each individual family business helping them to grow and succeed for generations.

The Center, the first of its kind, is also a powerful resource that provides access to their knowledge, insights and experience through an unparalleled global network of partners dedicated to help family businesses succeed wherever they are. For further information, please visit [ey.com/familybusiness](http://ey.com/familybusiness).

## Ernst & Young (EY) Family Office Services

EY's services for families and family offices are a reflection of their broad range of expertise and a symbol of their commitment toward family businesses around the world. Their comprehensive and integrated approach helps families to structure their wealth and preserve it for future generations. Their goal is to unlock the development potential of the family through a multidisciplinary approach that scrutinizes operational, regulatory, tax, legal, strategic and family-related aspects. For more information about the full range of family office services, please visit [ey.com/familyoffice](http://ey.com/familyoffice).

## The Center for Family Business — University of St.Gallen

The Center for Family Business of the University of St.Gallen (CFB-HSG) focuses on research, teaching, and executive education in the context of family firms and at international level. The CFB-HSG's work involves initiating, managing, promoting and running training and transfer programs, research projects and courses.

At the St.Gallen Family Office Forum, representatives of German-speaking single family offices meet twice a year in a discrete and trustful setting. The aim is an intensive exchange of experiences, best practices, and ideas. Further information can be found at [www.cfb.unisg.ch](http://www.cfb.unisg.ch).

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Credit Suisse, EY, and the University of St.Gallen would like to thank the following individuals for generously sharing their time, expertise and insights:

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