White Paper

CREDIT SUISSE

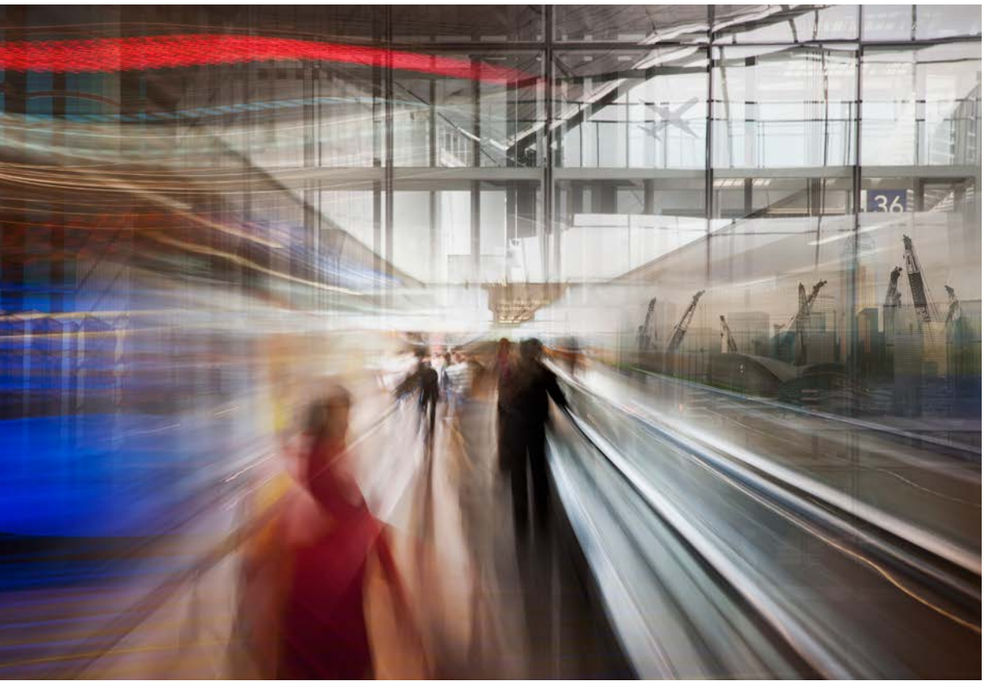
The way forward for family offices

In partnership with the University of St. Gallen

Center for Family Business

University of St.Gallen

Contents



Executive summary

Given the significant rise in the number of wealthy families around the world, it is no surprise that the family office has come into its own. The exponential growth of family offices has only heightened the demand for reliable information on the topic and best practices. In response, we have updated our 2016 white paper to reflect the diverse challenges and opportunities for family offices today.

The way forward for family offices provides a comprehensive, yet practical, overview designed to be as useful to an established family office as it is to a family thinking about setting one up. This paper covers the entire family office journey: from the initial vision and set-up to operation and long-term planning that takes key trends into account.

With research, insight, and fresh findings from a 2021 Credit Suisse global family office survey, this paper offers answers to the following questions:

- What are the main types of family office?
- Which range of services can a family office provide?
- What are the potential benefits and drawbacks of setting up a family office?
- Which decisions are vital in the set-up phase?
- How much does it cost to run and staff a family office?
- How does a family office plan for the future?
- Which investment strategies are being or can be considered for long-term planning and positive societal impact?
- What are the priorities of family offices today?
- Which external factors will shape the family office of tomorrow?

Importantly, every family office is as unique as the family it serves. The intent here is to present the many considerations and options available to family offices today.

We hope you find this paper both enlightening and useful.

Family office basics

Once the domain of royalty, the family office has evolved into a multifaceted offering that provides valuable, even vital services to wealthy families all over the world.

Evolution

Family offices date back to the sixth century, when the responsibility for managing royal wealth fell to the king's steward. In the modern era, the stewardship concept evolved into the family office as we know it today. In 1882, John D. Rockefeller Sr. established the Rockefeller Family Office, which was the first family office in the US and still exists, now serving other families as well.

A family office generally provides services tailored to the needs and objectives of the family for which it is established. While there are different kinds of family offices, they tend to be family-owned organizations that manage the family's private wealth and affairs. With the progressive growth of the family tree – upon the birth of children and grandchildren, and the addition of in-laws – and an increase in the complexity of the family's asset base, families usually professionalize their private wealth management by setting up single family offices (SFOs).

As subsequent generations evolve, the number of family members served by the SFO increases. This may lead to challenges in managing the breadth of services required and the eventual creation of yet another SFO for certain family members. By contrast, the multi-family office (MFO) typically originates as a commercial concept with the aim of supporting multiple families who are likely unrelated. They tend to offer bundled services to clients and operate as a profit-oriented financial service provider.

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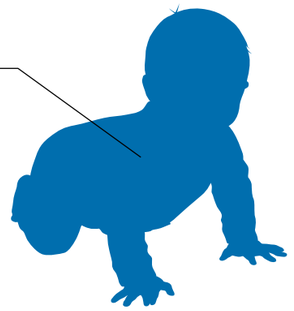
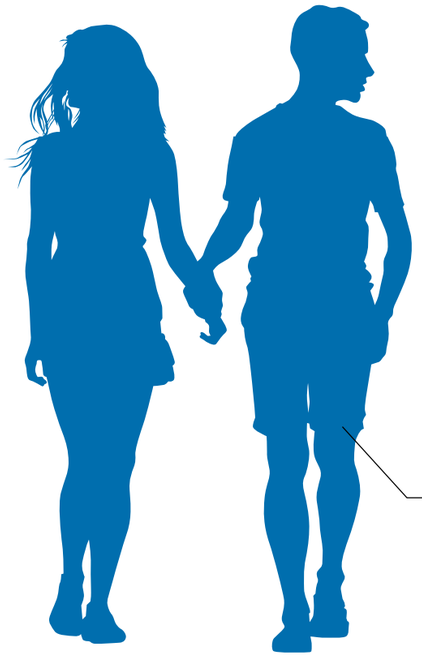
Average number of generations of the family supported by a single family office





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Average number of family members supported by a single family office

While there is no exact figure that captures the prevalence of family offices in the world today, the number of SFOs alone was estimated at more than 7,300 in 2019[1]. The exponential growth of the past few years can be attributed to an explosion in global wealth, which is increasingly concentrated among very wealthy families who need to plan for the transfer of wealth to the next generation.

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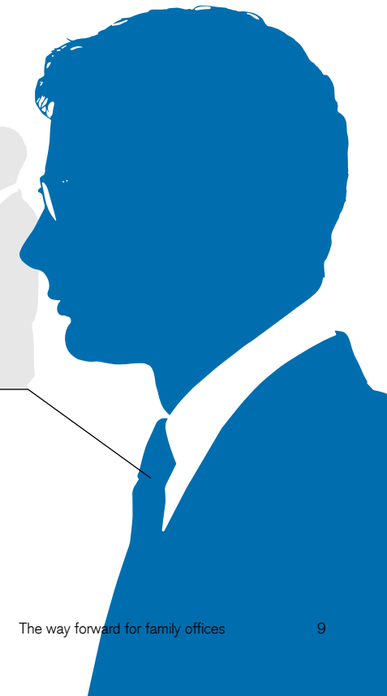
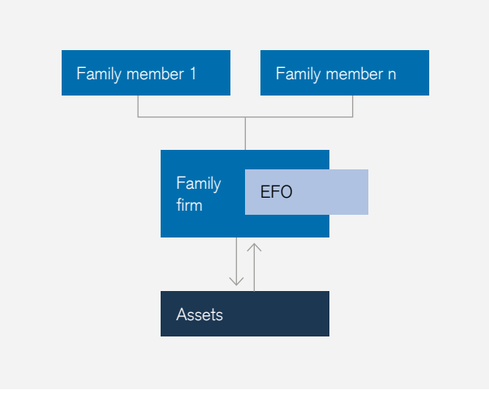
Average number of people working in a single family office

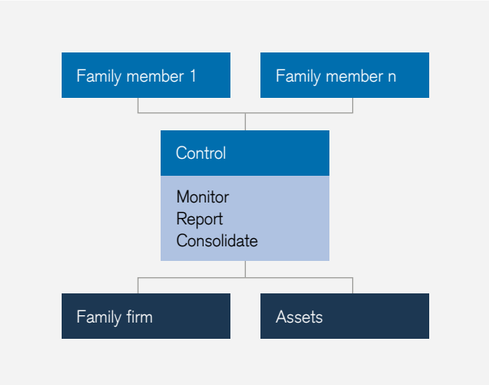


1 UBS & Campden Research. (2019). The Global Family Office Report 2019.

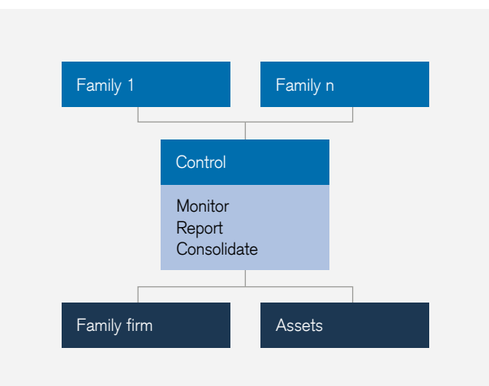
Three family office models



Embedded family office (EFO)
An EFO is usually an informal structure that exists within the family-owned business. As the family considers private assets to be part of the family business, they entrust their private wealth management to reliable and loyal employees of the family business. In many cases, the chief financial officer (CFO) of the family business and other finance team members manage family office duties. They report to the chief executive officer (CEO), who operates the family business, and the family owners of the private assets.



Single family office (SFO)
An SFO is a separate legal entity serving one family only. The family owns and controls the office, which provides dedicated, tailored services in line with the needs of the family members. Typically, a fully functional SFO will be involved in all or part of the investments, fiduciary trusts, and estate management of a family. Many will also have a concierge function to take care of the family's private needs, such as conflict mediation, education, and philanthropy.



Multi-family office (MFO)
An MFO manages the financial affairs of multiple families that are usually not related to each other. Like a single family office, an MFO may also manage the fiduciary trusts 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. Very few are private MFOs, which are exclusive to several families and not open to others. While there are exceptions, it is rare for an SFO to evolve into an MFO over time. This is due to their differing fundamental objectives: to provide tailored services exclusively to one family (as an SFO) or to offer bundled services to several families in a scalable, commercially oriented way (as an MFO).

In the following pages, we will focus on SFOs unless otherwise noted.

A full-service offering

Although the core service of many family offices is investment management, a fully developed family office can provide a number of other services, ranging from training and education to ensuring best practices in family governance.

In this section, we will look at the full range of services that a mature family office could potentially provide. These include:

Financial planning

- Investment management services
- Portfolio management services
- Strategic asset allocation and investment guidelines
- Environmental, social, and governance (ESG) impacts and philanthropy
- Life management and budgeting

Strategy

- Training and education
- Estate and wealth transfer to the next generation
- Business and financial advisory

Governance

- Family governance
- Administrative services
- Reporting and record-keeping
- Succession planning

Advisory

- Risk management
- Compliance and regulatory assistance
- Tax and legal advisory
- Insurance and healthcare solutions

Financial planning

Investment management services
Investment management is still the main reason to set up a family office as it is central to ensuring wealth preservation. Services can include:

- Evaluating the overall financial situation
- Determining the investment objectives and philosophy of the family
- Supporting banking relationships
- Managing liquidity for the family
- Providing due diligence on investments

Portfolio management services
Services can include:

- Providing practical support in managing a large, complex investment portfolio to help grow the family's wealth (e.g. researching diverse investment targets)
- Evaluating the performance of each investment periodically
- Optimizing the rate of return from the overall investment portfolio by increasing/decreasing investment in specific asset classes

Strategic asset allocation services and investment guidelines
In the management of the family's wealth, family officers can also suggest guidelines for investing in different strategic assets to ensure consistent growth over time. Services can include:

- Defining risk profiles (e.g. liquidity requirement), investment goals, and time horizons
- Allocating assets with a mix of capital market and non-capital market investments
- Evaluating the weights of different asset classes, such as equities, fixed income, alternative investments, and cash

Environmental, social, and governance (ESG) impacts and philanthropy
An increasingly important role of the family office is to support the sustainability goals of the family. These would include the family's efforts to address ESG issues, make positive societal impact, and engage in philanthropic activities. Services can include:

- Evaluating ESG risks that may undermine family wealth
- Incorporating ESG considerations in investment decisions
- Investing in targets with direct and measurable societal impact
- Philanthropic planning
- Assisting in the establishment and administration of charitable entities (e.g. foundations and trusts)
- Providing guidance on donation strategy
- Organizing ESG, sustainable, and impact investing, as well as charitable activities (including due diligence)

Life management and budgeting
While some of these are typical concierge services, they tend to be broader in scope and can also include financial planning services, such as:

- Organizing club memberships (e.g. golf, private)
- Management of vacation properties, private jets, and yachts
- Budget services, including wealth reviews, analysis of short- and medium-term liquidity requirements, and long-term objectives

Strategy

Training and education
This area largely revolves around the education of the next generation in wealth management, financial literacy, and broader economic matters. Services can include:

- Ensuring commitments to family education
- Coordinating educational and training programs with outside advisors

Estate and wealth transfer to the next generation
Family offices are often involved in business succession and legacy planning to enable the transfer of wealth to the next generation. Services can include:

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

Business and financial advisory
Beyond asset management advisory, family offices also provide advisory services on the financing and promotion of the family business. Services can include:

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

Governance

Family governance
Family offices often need to take on the role of mediating family relationships and ensuring cohesion across different family branches. Services can include:

- Continuity planning for unanticipated disruptions in family leadership
- Evaluation of the strengths, weaknesses, opportunities, and threats (SWOT analysis) related to key decision-makers, both inside and outside the family
- Coordination of the family council and meetings
- Adoption of a family charter or constitution to:
  i. Formalize the agreed decision-making structure and mission of the family
  ii. Define roles and responsibilities
  iii. Develop policies and procedures in line with family values and goals
  iv. Determine processes to resolve potential conflicts between family members

Administrative services
Administrative and back-office services are essential to the smooth running of a family office. Services can include:

- Support on legal issues and compliance
- Employee management and benefits
- Public relations referrals and the management of public relations firms
- Technology system referrals and the management of vendors

Reporting and record-keeping
Another core service involves maintaining records and ensuring transparent communication. Services can include:

- Consolidating and reporting on all family assets
- Consolidating performance reporting and benchmark analysis
- Maintaining an online reporting system
- Tax preparation and reporting
- Coordinating the exchanges with banking partners

Succession planning[2]
This is one of the most important services. Family offices can help the family prepare for the transfer not only of family wealth, but also of family values to the next generation, who will lead the family and the family business (if any) in the coming decades. Services can include:

- Setting up criteria for successor selection
- Providing training for successor candidates
- Supporting the transfer of wealth, ownership, knowledge, and responsibility between the incumbents and successors
- Adjusting the role of retired members in the family and defining the role of the next generation
- Mediating the relationships between successors and non-successors

2 Le Breton–Miller, I., Miller, D., & Steier, L. P. (2004). Toward an Integrative Model of Effective FOB Succession. Entrepreneurship Theory and Practice, 28(4), 305–328.

Advisory

Risk management
This area has also proven to be critical to helping family offices protect family wealth from possible risks. Services can include:

- Risk analysis, measurement, and reporting
- Evaluation of security options for clients and property
- Formulation of disaster recovery options and plans
- Protection of assets and data security
- Review of social media policy and reputation management support

Compliance and regulatory assistance
Family offices need to ensure strict compliance with regulations related to investments, assets, and business operations. Services can include:

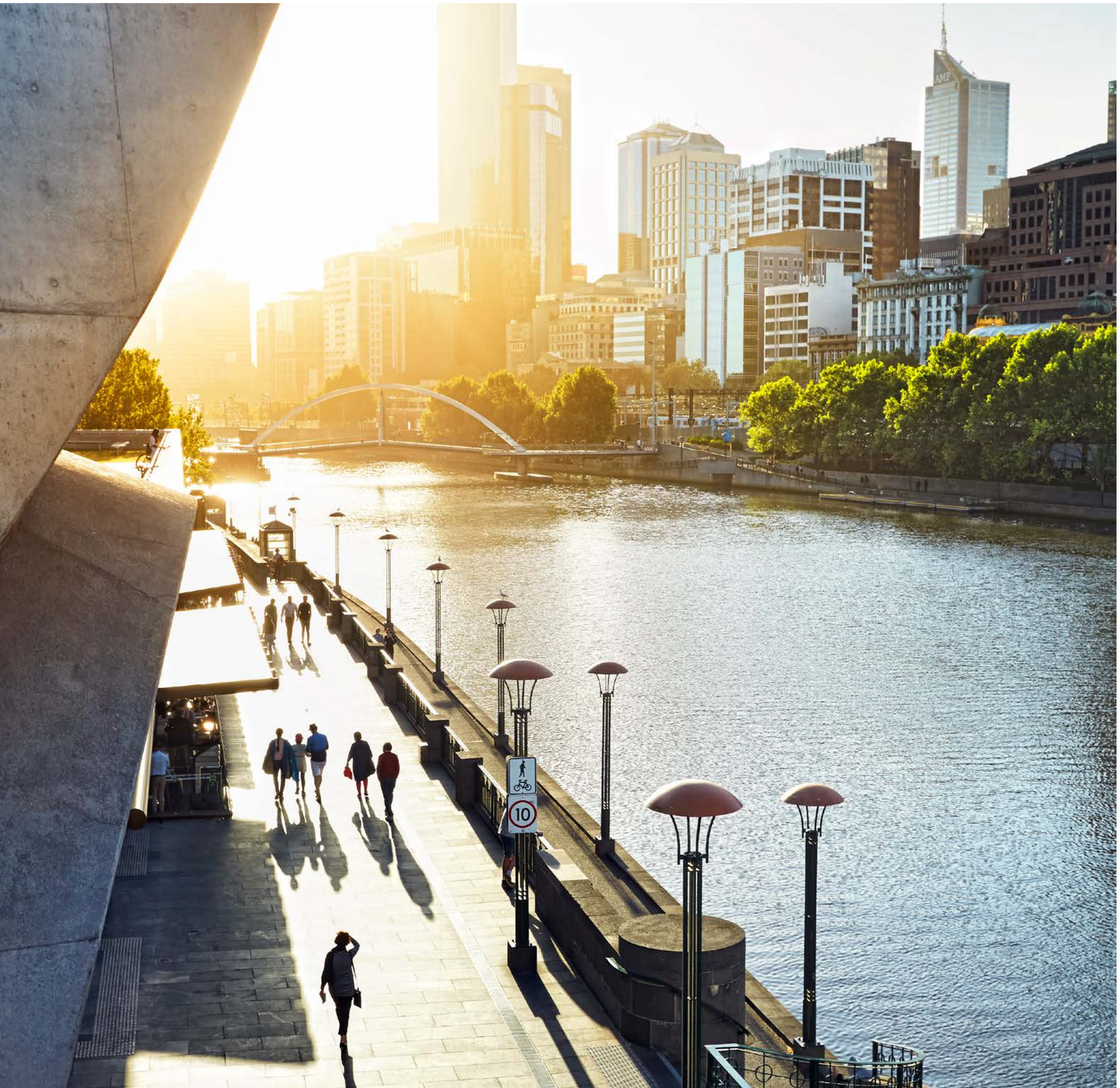
- Establishing a corporate governance mechanism, such as forming an independent advisory board
- Monitoring performance and providing internal auditing services
- Strengthening the regulatory investment process

Tax and legal advisory
This is one of the major functions of a family office. Typically, these services involve a general counsel and/or chartered accountant, or several accountants and tax experts. Services can include:

- Constructing a tax plan that best suits the family
- Planning investment and estate strategies that take into account both investment and non-investment income sources, and their tax implications
- Ensuring that all parts of the family office are tax-compliant

Insurance and healthcare solutions
Family officers can also advise family members on health-related issues, both physical and psychological, and related costs. Services can include:

- Organizing periodic health check-ups for family members
- Assessing insurance requirements, policies, and monitoring



Setting up a family office

The shift from planning to implementation requires a close look at family office needs. A clear, practical framework for decision-making can facilitate the set-up of the family office and reinforce it for the future.

Why it makes sense

After identifying the three main types of family office and their potential services, a family can start to think about why setting up a family office could be the right decision.

The following list explores nine reasons why the establishment of a family office might make sense.

1 Intergenerational transfer of wealth

The most fundamental reason is the wish to ensure a smooth intergenerational transfer of wealth and reduce intra-family disputes. This wish will inevitably intensify from one generation to the next, as the complexity of managing the family's wealth grows.

2 Separation of business, family, and investments

Family offices allow for a separation, or at least distinction, between the family business and the family's wealth or surplus holdings.

3 Privacy and confidentiality

Families may prefer using an investment vehicle, such as a special-purpose vehicle or their own investment fund (also called a private label fund), for certain activities. This way, family members do not need to perform all investment activities as natural persons and can delegate these activities to the vehicle and its directors, providing them with more privacy and confidentiality. As is the case with all investors, family offices need to document the beneficial ownership with their banking partners. Having a family office in effect increases visibility and is not a means of obscuring the identities of the investors.

4 Governance and management structure

An independent family office can provide governance and management structures that deal with the complexities of the family's wealth, helping the family mitigate or even avoid future conflicts.

5 Alignment of interests and mission

A family office structure also ensures that there is a better alignment of interests among family members and between financial advisors and the family. Such alignment is questionable in a non-family office structure where multiple advisors work with different family members.

6 Centralization of other services

Family offices can coordinate several professional services pertaining to ESG, sustainability, and impact investing, as well as philanthropy, tax and estate planning, family governance, communications, and education – all in the aim of realizing the family's mission and goals.

7 Potential higher returns

Through the pooling and professionalization of asset management activities, family offices may be more likely to achieve higher returns with lower risk from their investment decisions. Family offices can also help to formalize and optimize the investment process.

8 Risk management

Family offices allow for the operational consolidation of risk, performance management, and reporting. This helps the advisor and principals make more effective decisions with the aim of meeting the family's investment objectives.

9 Focal point for the family

In cases where the main family business has been sold, a family office can offer a new focal point for family members. One example would be the use of the family office to manage the financial investments and real estate properties, or the family's philanthropic activities.

Considerations

Despite these potentially motivating reasons, establishing a family office is a major undertaking that may not live up to the family's expectations. This is why it is important to factor in potential doubts and shared areas of concern.

1 Cost

The cost of running a family office and carrying out regulatory and compliance reporting remains high. Before a family office can viably offset its fixed costs, a higher level of assets under management will be required.

2 Trust in outside managers

To set up a family office, a family must have a certain level of trust in working with non-family asset managers and advisors. As trust is typically built through long-standing relationships, the next generation of family members may need time to develop the same level of trust. If new advisors are introduced, trust will need to be established with old and new organizational members as well as non-family employees.

3 Expectations around returns

Ultimately, family offices rely on their longevity to ensure wealth preservation. There may be doubt about the family office's ability to manage wealth "better" than other providers in the wealth and asset management industry.

4 Market, legal, and tax infrastructure

Family offices tend to function better when they operate in liquid and sophisticated markets within stable legal and tax systems. The absence of such systems in many emerging markets may have undermined the development of family offices and led to the growth of family offices in nearby markets. This could explain why an immense level of wealth in some emerging markets does not always correspond to the number of family offices present in the market.

After weighing the potential benefits and drawbacks of setting up a family office, the family can begin preparing the family office's strategic plan to avoid operating on a deficit basis in the long term, i.e. purely as a cost center. A strategic plan requires diligence and a vision for implementation that will take the family office well into the future.

The impact of jurisdiction

The legal set-up
It is vital to understand how the jurisdiction can shape the business environment. Internationally active families may need to consider not only the country in which the office will be based, but also the exact location. This is because in certain countries, such as the US and Switzerland, the tax, legal, and judicial structures vary greatly by state (or canton).

As a starting point, it is helpful to establish if the family office will:

- Own the family wealth
- Administer the family wealth by acting on behalf of family members, or
- Only advise family members on their joint investments and possibly other areas

Depending on the framework provided by the jurisdiction, other aspects should be considered to optimize the individual situation within the given legal, tax, and regulatory framework. Changing global tax laws are already a concern, according to a 2021 Credit Suisse survey of family offices: 29% of family officers cite them as a key challenge in the coming year.

Structure
The structure refers to the kind of entity that will house the family office and ownership, both in the present and in future generations (assuming the office intends to support more than the first generation). If the family office is linked to a family business, clarity will be needed to determine if it will support the business, which may allow for the deduction of certain expenses against business income. As different structures are subject to different tax and regulations, it is essential for the family to understand the potential consequences of this decision.

In light of the more global orientation of families and investments today, the chosen location and structure need to be flexible yet also maintain the benefits of a traditional, centralized family office. It is helpful for the family to gather the following information:

- Location of each family member and presence in multiple jurisdictions
- Future migration and travel plans
- Location of substantial family wealth
- Future investment plans and goals in other jurisdictions
- Locations where family members are subject to various taxes

Criteria
Based on the diverse global interests of the family, the next step would be to investigate and weigh the particular benefits and drawbacks of various structures and jurisdictions. While the analysis will be unique for each family, the following items should be reviewed in each potential jurisdiction:

- Legal structures available
- Tax implications of structure
- Ease of hiring and retaining employees
- Cost of operation versus value received
- Ability to invest and manage the assets of a global family
- Risks, reputation, and volatility in light of economic and political climates
- Regulatory and informational filing requirements
- Immigration/visa requirements for family members
- Ability to efficiently coordinate with advisors in other jurisdictions
- Quality of communication and relationships with tax and regulatory authorities
- Streamlined exchange of information
- Flexibility to restructure in the future, including migration
- Opportunities for succession

Asking the right questions about location
In the end, the most crucial aspect in choosing a family office location may not only be the legal and tax environment, but also the jurisdictions (based on the migration of family members). Finding the location that is most suitable will depend on a thorough analysis of needs and scope.

In-house versus outsourced services

Given the wide range of possible services, family offices often need to consider outsourcing rather than providing certain services in-house.

The decision to "make or buy" services can be guided by the following questions, which may help to prioritize the services the family office will offer:

- Who will be the beneficiaries of the family office?
- What is the family's overall strategy to secure and expand its wealth over generations?
- Is the family's priority traditional asset management of liquid funds, with or without a portfolio of direct entrepreneurial investments? Where do ESG, sustainable, and impact investing and philanthropy fit into the mix?
- Will the family office act as the asset manager for all family members or as an advisor on specific services to select family members?
- What will be the family office's core role(s), e.g. financial advisor, risk and compliance manager, tax and legal advisor, educational facilitator for the next generation, mediator for potential family issues?

Once the family has set clear expectations for the family office, it is helpful to consider the potential drivers of the decision as well as the potential scope of in-house and outsourced services, based on a market analysis (see tables 1 and 2).

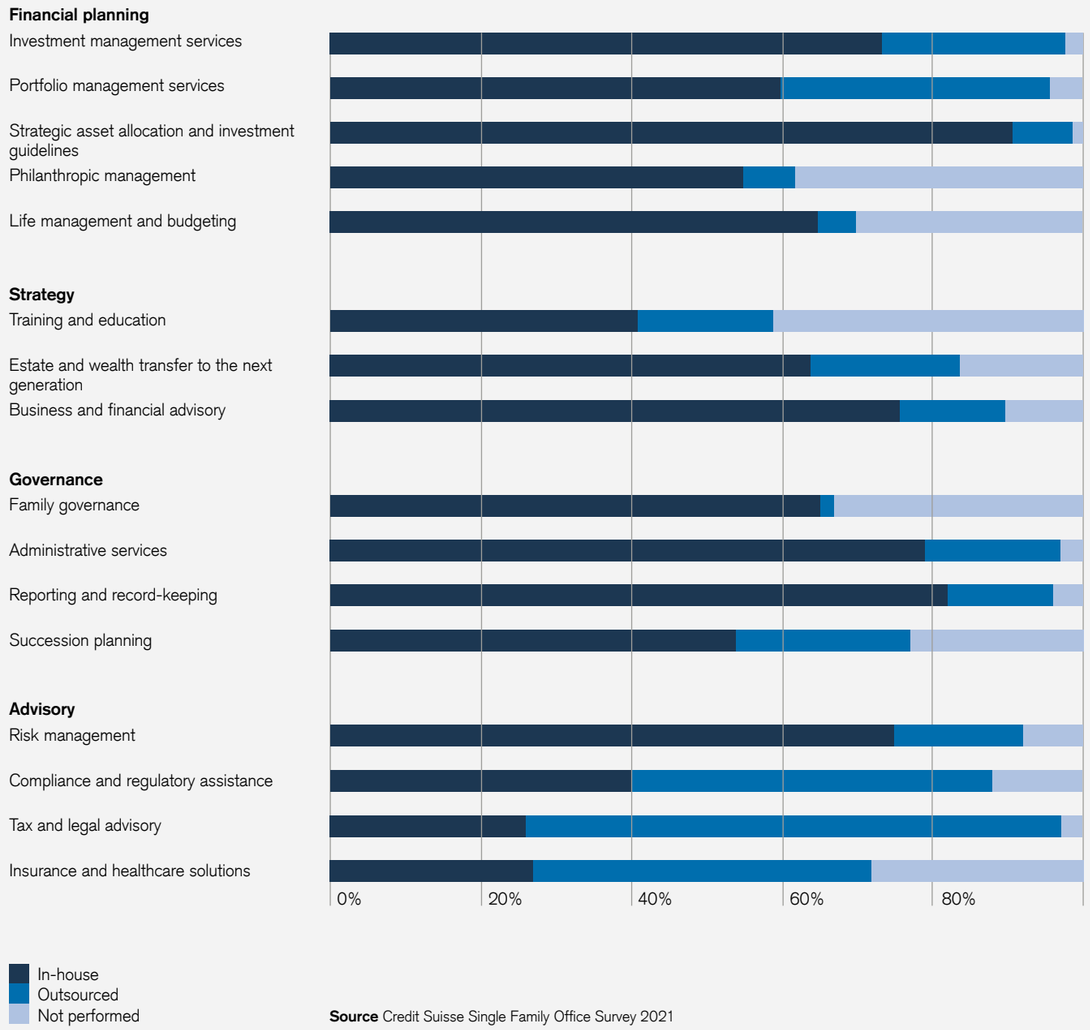
Table 1. Potential drivers: In-house versus outsourced services

Cost and budget	Expertise	Complexity	Regulatory restrictions	Technology, infrastructure, and data confidentiality
Potential cost reduction and overhead	Independent and trusted advice	Number and geographic spread of family member business connections	SFOs significantly less regulated (focused on family issues)	Confidentiality and privacy of in-house services
Staff productivity	Tailored knowledge within the family	Scale and complexity of family assets	MFOs often under distinct regulatory frameworks	Non-critical technology systems and infrastructure potentially outsourced
Economies of scale	Experienced professionals with specialized skills which family members lack	Decision-making process and potential conflicts of interest	In-house due diligence and continuous monitoring of performance and security against risks	
Cost versus profit center			External service defending the family office's regulatory independence in case of serious fallout from negative publicity	

Table 2. Potential scope: In-house versus outsourced services

Services	In-house	Outsourced
Investment management	Basic financial planning and asset allocation decisions	For more complex, specialized, and diverse assets
Portfolio management	Simple investment portfolio focusing on a few specific asset classes	More complex portfolio and advanced optimization with frequent adjustment of investment targets
Strategic asset allocation	Clear and stable investment preferences and guidelines	Consideration of more diverse but volatile asset classes
ESG, sustainable, and impact investing, and philanthropy	In-house expertise and assistance	Foundation set-up and related activities
Life management and budgeting	All in-house if confidentiality a primary factor	Less specialized services
Training and education	Identification and evaluation of suitable options	Expert input on training and development needs of next-generation family members to enter the family business
Estate and wealth transfer	Expertise required and dependent on need for data confidentiality	Legal advice on procedural and legal issues
Business and financial advisory	Family office set-up with family business general counsel or CFO	External expertise for competitive edge
Family governance	Mediation and conflict resolution with trusted family advisor (close and long-term connection to family members)	Professional family counselors for objective perspective and expertise
Administrative services	Daily monitoring	Outsourcing non-necessary and repetitive administrative tasks
Reporting and record-keeping	In-house for basic needs	Specialist reporting tools and software for more advanced reporting and higher degree of automation
Succession planning	Long-term dedication and relationships with family members to facilitate the transfer	Objective perspective to mediate the transfer and specialized training for the successor candidates
Risk management	Some in-house skills for peace of mind	Expert advice
Compliance and regulatory assistance	Potentially full-time legal and accounting expertise (if large family office)	If family office not large enough to warrant cost of full-time legal staff
Tax and legal advisory	In-house (selectively)	Often outsourced to trusted advisor to ensure superior service
Insurance services	Reminders about health check-ups and management of different insurance policies	Healthcare and more expanded policy coverage

Figure 1. In-house versus outsourced services



Source Credit Suisse Single Family Office Survey 2021

Selecting service partners

To implement the strategic plan of a family office, the family may want to select service partners to support the set-up and operations.

A fundamental choice is the selection of banking partners. Two to three financial institutions could be selected for risk-diversification purposes or to meet the specific needs of the family. The range of services (e.g. wealth planning, capital transaction, asset management) usually depends on the bank's size, business model, and international presence.

Other potential partners are law firms providing legal advice and assisting with the set-up, accountants advising on taxation and bookkeeping, and not-for-profit organizations focused on philanthropic activities and ESG investment.

Figure 2. Partner selection process

Assess the need
- Which external service is needed?
- How many resources does a family office have?

Search for partners
- Planned process based on a defined list
- Emerging process based on contact with potential partners

Evaluate potential partners based on the family's key criteria (e.g. past experience, location, cost, risk, chemistry/fit)

Decide on and set up contracts, with clear terms, requirements, and protections in case of breach

When selecting a partner (see figure 2), the family can first decide what the family office needs, given its size and the type of services it intends to provide. If the conclusion is that the family office lacks certain expertise or resources, it is a good time to start the search for potential partners. This can either be a planned process, based on a clearly defined list of candidates, or an emerging process, which determines potential partners after making contact and learning more about them[3].

Once the family has a list of potential partners in mind, they may use the following criteria[4] to decide which partner best fits with the needs of the family and the family office.

Past experience	◦ Does the partner have the professional qualifications and credentials to deliver the required service? ◦ Who are the current and previous clients of this partner?
Geographic proximity	◦ Is the partner located near the family and/or family office? ◦ Does the partner have a point of contact in the region where the family and/or family office can initiate activities?
Cost-effectiveness	◦ What is the cost structure for the partner's services? ◦ What is included and excluded in the given cost structure?
Risk assessment	◦ Does the partner comply with or even go beyond the regulations and/or industry standard for delivering the service? ◦ Is the service provided on a secure platform? ◦ Where is the data stored and how is it protected? ◦ Would this partnership potentially damage the reputation of the family?
Procedural clarity	◦ What is the timeframe for the partner to provide the service? Does the partner intend to deliver long-term services? ◦ Does the partner provide complete documentation and communication about its service as, for instance, a banking partner would by elaborating on its investment strategy for selecting targets and imposing limitations?
Personal chemistry	◦ Can this partner understand the family's values and dynamics? ◦ Does this partner share the vision of the family and/or family office? ◦ How trustworthy and dedicated does the family feel the partner would be?

3 Seitanidi, M. M., & Crane, A. (2009). Implementing CSR Through Partnerships: Understanding the Selection, Design and Institutionalisation of Nonprofit-Business Partnerships. Journal of Business Ethics, 85(2), 413–429.

4 Morgan Stanley. (2020). Single Family Office Best Practices Report.

After a careful evaluation of potential candidates based on the above criteria, the family can make a final selection of partner(s). The family and family office can then start negotiating contracts, being sure to specify the requirements of both parties as well as the protection clause in case of breach.

Table 3. Top SFO criteria for banking partners

Products and services	Partners
Level of fees	Expertise
Direct access to specialists and trading desks	Solution-oriented mindset
Market information and research	Responsiveness
"One-stop shop" approach and access to investment banking services	Can-do attitude
Online and mobile solutions for better connectivity	Strong personal relationship
Access to senior management	Trust
Large range of products and services	Efficiency
Due diligence on and access to alternative investment funds (e.g. private equity, private debt, hedge funds)	Proactive approach
Access to other single family offices	Integrity
Access to private investment opportunities including club deals/co-investments (single companies or single assets such as real estate)	Attention to personal needs

Source Credit Suisse Single Family Office Survey 2021

Figure 3. From vision to reality: Implementation and operations

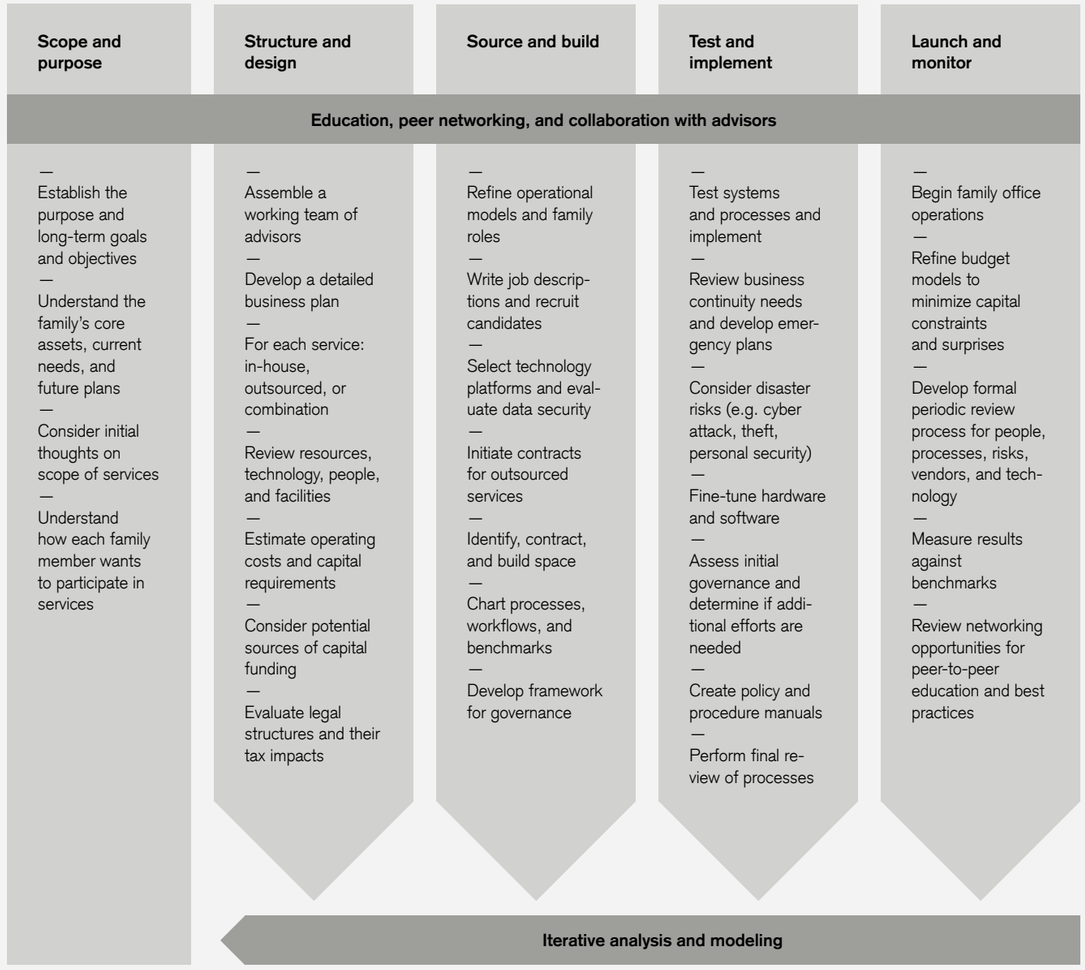


Figure 3 provides an overview of the steps for setting up a family office. Notably, certain steps may be repeated once the family office is operating (please see the next section).

Running a family office

The success of the family office depends on how well it is managed. Finding the right people, structure, and business plan is as important as the investment process and long-term vision.

Governance structure

After setting up a family office, the application of good governance practices is crucial to ensuring competent management of the family's financial assets and investments.

As mentioned, it is vital to develop a long-term vision and strategy for future generations. In the initial planning phase, however, a family office should consider the practicalities of good governance.

Board of directors
As family offices usually evolve from the founders' wish to safeguard family wealth and protect the next generation, they tend to rely on known and trusted advisors who have been working with the family for at least a few years. When the wealth is transferred to the next generation, however, there may be a need to elect a strong and active board that will take all family members, even those with conflicting interests, into account.

Although it is common for family members to serve as directors, independent non-family directors may offer experience and independent advice that will enhance, strengthen, and diversify the family office's investments and operations. In many cases, especially in the Middle East, families are reluctant to include independent directors, or open their books to outsiders at all, because of privacy issues. Such families may choose to appoint an interim advisory board without voting rights to help strengthen the board and provide advice on specific topics. An advisory board can help the family get more comfortable with the prospect of including independent board members and, in the future, create a fully functional and more diverse board.

Accountability and conflict resolution
If family members take on the responsibility of governance, they also need to understand their accountability to the rest of the family. To successfully steward the family wealth, family offices need to create the process and opportunity for family members to grow and develop their skills and talent, as well as manage their affairs responsibly.

As the family grows in size in later generations, they may have conflicts resulting in different perceptions of justice within the family.

1

Distributive justice

Distributive justice concerns the outcome related to allocation. It is not only about the absolute outcome, but also the ratio between family members' input and relative output. In a family, the distribution may not necessarily be based on each member's merit or performance but on other factors, such as the equality principle, with equal distribution to all family members, or the subjective evaluation of a few decision-makers, based on loyalty and personal relationships.

2

Procedural justice

Procedural justice refers to how family members feel treated during the process, resulting in a certain outcome. For instance, family members may question whether the same decision-making criteria are applied consistently to people over time. Other questions may arise, for example: Is the decision-making process free from the bias of a few family members? Is accurate information used in decision-making? Does the decision conform to the prevailing ethical standard? Does the process consider the opinions of various family members affected by the decision?

3

Interactional justice

Interactional justice reflects the extent to which decision-makers are sensitive to how people feel about a possibly unfavorable outcome. Do the decision-makers provide trustworthy information and a timely explanation of the decision to other family members? Does the communication process treat family members with dignity and respect?

Conflicts stemming from the allocation, process, and/or personal interactions may lead to feuds or even the discontinuation of the business(es). Family offices can support the family by mediating potential conflicts through different services. One example would be to help draft a family constitution to establish a fair decision-making structure and protocol. Holding a family council meeting can also encourage decisions that ensure fair distribution. In addition, organized family meetings can take the opinions of all family members into account and enable an open decision-making process.

Ultimately, family offices can assist the family in developing an effective conflict management style as opposed to avoidance or the domination of a few family members in decision-making. Family offices can serve as the mediator, helping the family find a way to accommodate their differences, reach a compromise, or even use an integrative solution to navigate family conflicts.

Dilemma between family and non-family members
Conflicts may go beyond the family and involve non-family members, depending on how the family office is staffed. A common dilemma revolves around the choice of family officer: either employing a non-family member who is well-versed in financial matters or relying on a family member who might not have that particular competence but is trustworthy, and most likely shares the family interest.

Non-family members tend to professionalize the operation of family offices and bring in an objective view when mediating conflicts. However, such a delegation of control risks the loss of family control. In light of this dilemma between professional management and total control, families are often tasked to find a way to combine the best of both worlds.

To help tackle challenges and conflicts effectively, family offices may call on boards, investment advisory committees, the personal involvement of other family members in select areas, incentive systems for non-family managers, and/or other monitoring systems.

Staffing

Although more than half of family offices are led by family members[5], a family office may decide to professionalize its operation by hiring non-family officers.

According to the Credit Suisse Single Family Office Survey 2021, family offices hire eight non-family officers on average. While recruiting, developing, and incentivizing staff are critical for success, identifying, attracting, and retaining the best talent is often a major challenge. The survey confirms this, with 29% of the respondents citing talent recruitment and retention as challenge in the coming year, and 51% in the next five years.

In this section, we will focus on the recruitment of non-family professionals, which involves structuring the recruitment process, formulating incentive packages, and maintaining strong relationships with the non-family employees. In big corporations, these processes are usually undertaken by the human resources department, but family offices may not have such a function. By default, recruitment often becomes the responsibility of the wealth owners and their trusted advisors, neither of whom may be trained to manage these processes or make such decisions.

Despite the lack of formal recruitment structures, families may have an advantage when it comes to attracting talent. They are often able to offer more flexibility in compensation and incentive packages for senior recruits. For candidates looking for an alternative to big-company culture, a family office can offer a more appealing work environment. Below we highlight some of the key elements of successful talent management.

5 Family Office Exchange. (2017). Family Office Study 2017.

1

Recruitment

Job description
The content can vary but must capture the key responsibilities and essence of the role. As family office executives are often involved in multiple projects, this should be clearly communicated to potential candidates in the job description. The family can also describe its mission and values to help attract the right kind of talent.

Recruitment committee
The responsibility for hiring for executive positions, such as the CEO and CIO, should not be assumed by a single person. It is advisable to share the work and the risks involved. Family members may be involved in the committee to ensure that the new hire fits with the family's mission and values.

Checking references
The recommendation of a trusted advisor or family member is valuable, but more extensive checks should be carried out. The process should be rigorous in order to ensure objectivity.

2

Onboarding and retention

Compensation
The family office should design a consistent compensation system. In addition to the base salary, incentives can be performance-based and include long-term compensation. For instance, options can include phantom stock (future cash payment based on the market value of shares), co-investment opportunities, transaction bonuses, and, in some cases, business partnership. As incentives often reflect the standards of the industry behind the family's wealth, packages may vary.

Benchmarks for compensation
A CEO's base salary may vary by the scale of wealth under management. In the US, it can range from USD 175,000 to USD 740,000[6]. By comparison, a CIO's base salary can range from USD 180,000 to USD 367,000.

Feedback on performance
A family office may not have a performance measurement system that is as structured as that of a large corporation. Due to the absence of meaningful feedback, executives may feel uncertain about their performance and the family's satisfaction with their role. Although family members may not be used to the need for feedback, they should attempt to provide a fair and thorough assessment of executive performance where possible. Otherwise, family office executives may perceive the lack of feedback as unfair treatment and be concerned about their long-term employment.

A culture of openness
Another major staffing challenge concerns the need for family office executives and family members to maintain a sense of partnership without undermining the executives' sense of impartiality. It is recommended that family offices create a culture of honesty and openness to enable executives to openly give and receive feedback. The degree of open communication and engagement also depends on the executives' long-term commitment to the family, often shaped and cultivated by appropriate incentive planning and personal chemistry, which cannot be underestimated.

6 Citi Private Capital Group. (2018). A Guide to Establishing A Family Office. Rosplock, K. (2014). The Complete Family Office Handbook: A Guide for Affluent Families and The Advisers Who Serve Them. John Wiley & Sons, Inc.

Cost structure

There is a significant variation in the cost structures across family offices because the size of the offices can vary from one employee to 50 or more. The assets under management can also range from millions to over USD 1 billion.

In effect, the cost structure will depend on the services provided, the number of family members served, and how the services are delivered. Of note, 37% of family offices consider cost efficiency as one of the main challenges in the year ahead (Credit Suisse Single Family Office Survey 2021).

Although no public data is available, anecdotal evidence suggests that a full-service family office will annually cost a minimum of USD 1.5 million to run, and in many cases much more[7]. To set up a viable family office, a family should have assets worth between USD 100 million and USD 500 million. Of course, a family office can be established with less, but the service range – related to administration, control of assets, consolidation, and risk management – will likely be limited. A fully integrated family office will require greater wealth to be run cost-effectively, as detailed in table 4.

Table 4. Family office types based on assets and costs[8]

Family office type	Assets	Full-time staff	Annual cost
Administrative	USD 50 million to USD 100 million	2 to 4	USD 0.75 million to USD 2 million
Hybrid	USD 100 million to USD 1 billion	4 to 11	USD 1.5 million to USD 20 million
Fully integrated	> USD 1 billion	8 to 16	> USD 15 million

7 Citi Private Capital Group. (2018). A Guide to Establishing A Family Office.

8 Citi Private Capital Group. (2018). A Guide to Establishing A Family Office. The cost ratio is estimated to be around 1.5–2% of total asset under management.

Internal costs
Research from the Family Office Exchange consultancy – which supports over 380 business-owning and financial families, family offices, and advisors in 20 countries – revealed that 55% of a family office's total costs are allocated to internal operations, in particular staff compensation and benefits.

A fully integrated family office, which provides most if not all of the services mentioned in the previous section (if not outsourced), would likely have the staffing structure represented in figure 5.

Set-up costs
The internal cost encompasses the set-up costs, which may include the employment of head-hunters for recruitment, compensation specialists, relocation costs, legal set-up costs, and the search for infrastructure, such as office space and technology solutions.

Overall costs
Family offices typically have operating costs of around 150–200 basis points (i.e. 1.5–2%)[11]. The Family Office Exchange research cited above looked at more than 100 family offices around the world and compared the cost structure between 2014 and 2017. Although the average total cost remained stable, the internal office cost increased by 6% while the external investment cost decreased by 10%. In effect, the cost of running a family office has risen as a percentage of assets under management in recent years, especially if the family office hires more talent to develop in-house services. Offices with the lowest running costs tend to focus primarily on a limited number of wealth management services, such as handling real estate holdings.

Figure 4. Family office cost allocation[9]

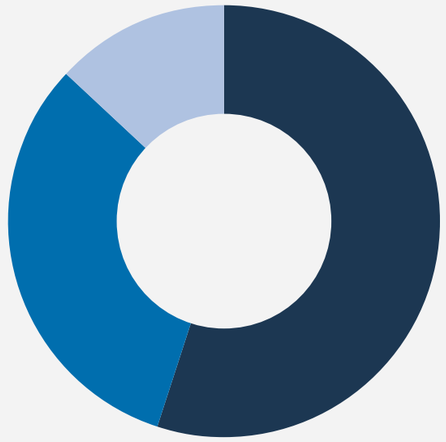
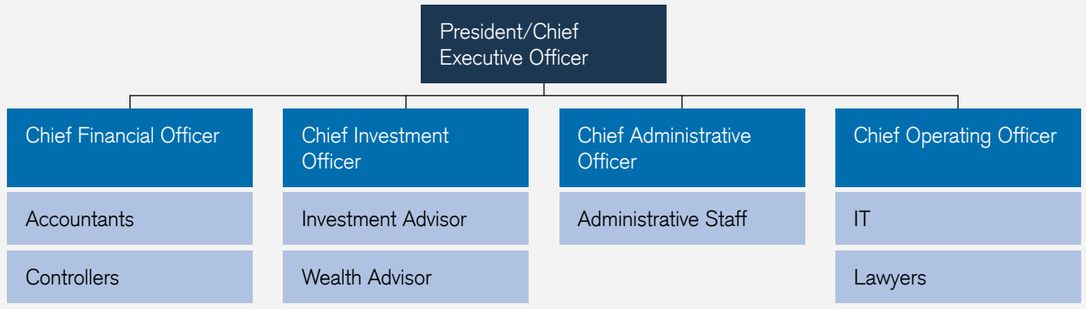


Figure 5. Family office staff[10]



9 Family Office Exchange Research, 2017

10 Rosplock, K. (2014). The Complete Family Office Handbook: A Guide for Affluent Families and The Advisers Who Serve Them. John Wiley & Sons, Inc.

11 Rosplock, K. (2014). The Complete Family Office Handbook: A Guide for Affluent Families and The Advisers Who Serve Them. John Wiley & Sons, Inc.

Strategic planning

Once a family office is operating under the initial plan (i.e. family charter), the strategy may require an annual evaluation. Family offices that have existed for generations may also create five- or ten-year strategic plans.

As family offices must often respond to a wide variety of demands from many family members, it is easy to take a more passive stance on planning. For that reason, executives may need to take the initiative to ensure continuous planning of the family office strategy.

Ten-year strategic plan
Family offices that have existed for a long time and support multiple generations tend to formulate a five- or ten-year strategic plan. These plans are designed to develop the building blocks that will be needed to realize the vision, as defined in the family charter (sometimes considered as a 100-year plan). By taking the time to articulate the goals of the next ten years, the family office may think differently than it would in annual planning, when the focus is on the short-term horizon. The family may find it beneficial to engage an outside advisor to lead and facilitate the planning efforts and bring in new perspective. There are three major elements often considered in such a plan.

1

Succession planning
Preparing family members for leadership takes many years, whether that involves leading the business, governance committees, or the family office itself. Families may establish a development program for an entire generation, including training, mentorship, and business internship programs to give the next generation leadership experience.

2

Business or investment growth
Families may consider starting a new business or a large real estate development plan. They may also shift into private equity investing, which could require years to mature as both an investment and a foundation for the new business.

3

ESG, sustainability, and impact investing, and philanthropy
Some families set ESG goals that center on the avoidance of controversial sectors. Others aim for more direct societal impact through, for example, the support of a particular community by providing higher education or solving health issues. These tend to be long-term goals that may be better served through a ten-year plan.

Annual strategic planning
In contrast to the other kinds of planning, annual planning involves the evaluation of the previous year's activities. It also covers the setting of goals for the coming year and an action plan to achieve them. The planning process can be extensive and present an opportunity to address different topics.

Reflection
An honest look at the past year will involve asking certain questions. How have the family and the office performed against the current annual plan? What are the strengths and weaknesses of the family office? What major changes have occurred since the last plan was devised? Is the family successfully moving toward the long-term vision detailed in the family charter, and in line with the ten-year plan, or are there major gaps between the stated goals and actual activities?

Feedback for improvement
It is valuable to find out what family members think about the office, staff, and the support provided. The older generation might be satisfied with the office, for example, while the younger generation would prefer to make changes.

Risks
This is an opportunity to reflect on succession planning, risks related to staff or operations, and potential economic, ESG, legal, or tax matters. How might these business risks impact the family, and how might family risks impact the business? This discussion can help to identify the major risks facing both the family and the family office and determine how they could be mitigated.

Family office operations
The annual evaluation is a good time to assess the family office and its current operations because priorities often change. In addition, as some services may be better delivered by an outside provider, the process allows for a discussion of potential choices. Family offices may also have a need for additional staff or wish to plan for upcoming retirements and other changes.

Technology
Family offices can use the annual evaluation to compare current offerings against the rapidly changing marketplace, also assessing how the various technologies work together to meet their needs. In addition, it is crucial to consider cybersecurity given its potential impact on family finances as well as on the family's privacy and physical safety. The social media behavior of family members can also be monitored to evaluate the digital presence of the family.

Family initiatives
New initiatives and the potential role of the family office could also be considered. Initiatives might range from business ventures and real estate development to new philanthropic initiatives, an upcoming family meeting, or even the planning of a major family anniversary.

Budgeting
The evaluation of the above will help determine the budget for the coming year and the plan for funding it. If the family agrees with the plan and future initiatives, they will be much more likely to agree on the required funding.

Investment process

With 91% of family offices keeping the strategic asset allocation and investment guidelines in-house (Credit Suisse Single Family Office Survey 2021), the investment process is clearly a major topic for family offices.

The investment process describes the steps needed to create a set of guidelines for all parties involved in the family office's investment decisions. Ultimately, a solid investment process can be effective in maximizing investment returns.

Creating the investment road map
The first step is to establish clear investment objectives and risk profiles. This part of the process may also help to resolve any issues around business shareholdings and their distribution in the family.

It is essential to establish a common understanding of the purpose of the family wealth. What does the family want to achieve with its wealth in the medium to long-term? There can be a combination of very different answers to this crucial question, such as:

- Securing the wealth for the current and future generations
- Financing new business ideas of family members
- Securing the future of the family business (e.g. by being a long-term controlling shareholder)
- Funding philanthropic ideas that are important to the family
- Investing in innovation and deploying capital to companies that foster change
- Providing the funding for a very active and entrepreneurial investment style; this is relevant when investing is the main professional activity of (select) family members

Questionnaires and the examination of previous investment styles can aid in the discussion. Scenario testing is also an effective way of drawing out concerns about risk and portfolio drawdowns. While the family office CIO often leads the discussion, family members may get involved, especially if there is interest in setting up a charity or engaging in philanthropic initiatives.

Of note, family offices often place a greater yet less regular call on the investment portfolio. Family members may, for example, request funds for business-related or private equity stakes, philanthropic and impact investments, or ongoing expenses. For that reason, families should examine their overall liquidity needs in the portfolio construction process.

An investment time-horizon should be also defined. Family offices often think and invest on a long-term basis as they primarily pursue wealth preservation to pass on assets to the next generations[12].

As a final step, the family office should choose a performance benchmark and risk measures.

Structuring the asset allocation
Once there is agreement on the road map, the next step is to structure a portfolio and determine the right investment tools to move forward. The process integrates:

- Capital market assumptions, which provide long-term return and risk forecasts for a broad set of asset classes, taking quantitative and qualitative criteria into account (and possibly cross-checking long-term historical trends for context)
- Strategic asset allocation to establish the optimal mix of asset classes which meets the objective while respecting the risk tolerance (derived with a long-term investment horizon in mind)
- Tactical asset allocation to anticipate market movements and reactions to market dislocation, and to provide guidance on temporary over- or underweight asset classes and markets that may go against the strategic asset allocation
- Currency allocation to set a reference currency for reporting purposes and decide on currency allocations and hedging strategies
- Tax considerations to ensure a realistic view of the expected portfolio return or to prompt adjustments

12 Credit Suisse. (2012). Family Business Survey.

Figure 6. Investment process

Choosing the investment strategies
Once the investment road map and policy statement are in place, family offices can begin thinking about the deployment and management of capital. The selected investment strategy should reflect the sourcing capabilities, desired degree of control, liquidity needs, investing experience, and family office infrastructure.

Family office investment strategies fall into three broad categories: (i) third-party managed, (ii) public direct, and (iii) private direct. Family offices often use a mix of these strategies to diversify investment exposure and improve risk-adjusted returns.

i. **Third-party managed investing** – With this strategy, the family office uses asset management funds to invest capital. This allows the family to make high-level decisions around capital allocation by industry sector and asset class at the fund selection level. Beyond the fund selection level, however, the family will have limited influence over investment decisions.

In the case of direct investing – public or private – the family office decides which asset or security to invest in. This requires research and due diligence.

ii. **Public direct investing** – This strategy is centered on liquid debt, equity securities, and derivatives that trade over a public exchange. Investments are made through the use of public information and are subject to regulatory requirements. In general terms, public direct investing allows for limited influence over the underlying asset's management and strategic decisions.

iii. **Private direct investing** – This strategy allows the investor to take a more active role in the deal process and underlying investment. The investment can be structured as debt, equity, or as a specific asset purchase (e.g. real estate). In this case, regulatory requirements tend to be looser.

Investment process practicalities
The drafting process will depend on the level of family involvement in the business as well as the investment experience of the family office CIO. These factors are likely to produce a strong behavioral bias when it comes to investment strategy and portfolio diversification decisions. The origins of the family office itself could also play a role as an office set up by a first-generation entrepreneur may well have different aims than one established by a fourth-generation family.

Once the recommended asset allocation has been reviewed and agreed on, the family can formalize their investment plan in an investment policy statement. This statement should be shared with all parties in the client relationship (e.g. investment advisors, investment managers, trustees). It provides a clear course of action, especially in periods of market volatility when high emotion could lead to imprudent decisions.

Portfolio modeling
Once the portfolio takes shape, stress-testing and modeling are challenging but essential steps for projecting how the portfolio might behave during periods of volatility. It is sensible to examine all family wealth, not just the investment portfolio. One example would be to model the core business holding of a family as a form of private equity or direct equity holding, and then analyze and optimize the other components of the family's wealth.

Table 5. Family office investment strategy

Benefits	Considerations	Examples
Third-party managed		
◦ Lowest infrastructure requirements ◦ Investment access is good, but customization is limited ◦ Third-party expertise can be valuable	◦ Management fees ◦ Limited control over how capital is allocated at fund level ◦ Transparency can be limited ◦ Potential conflicts of interest ◦ Redemption features can impact liquidity	"Fund investing" ◦ Mutual funds ◦ Private equity funds ◦ Infrastructure funds ◦ Hedge funds ◦ Funds of funds
Public direct		
◦ Liquid asset class ◦ Avoids management fees ◦ Highly customizable portfolios ◦ Large investment universe ◦ Ability to utilize family office expertise in investment selection	◦ Limited to public market opportunities ◦ Information must be public ◦ Generally has limited influence over underlying entity or asset ◦ Subject to public market volatility around valuation ◦ Moderate infrastructure requirements to manage portfolio	"Traditional investing" ◦ Money markets ◦ Fixed income ◦ Equities ◦ Commodities ◦ Options
Private direct		
◦ Avoids management fees ◦ Highest potential for "alpha" ◦ Structuring flexibility ◦ Ability to utilize family office expertise in investment selection ◦ Highly customizable portfolios ◦ Increased access to information, including non-public ◦ Ability to influence decision-making around underlying asset	◦ Investment sourcing can be challenging ◦ Illiquid asset class ◦ Investment process, including due diligence and documentation, can be burdensome ◦ High infrastructure requirements	"Alternative investing" ◦ Private equity ◦ Venture capital ◦ Mezzanine debt ◦ Real estate ◦ Infrastructure projects ◦ Natural resources ◦ Royalty streams

Source EY Family Office Services, 2015

Implementation and tracking
Portfolio implementation should be consistent with the investment objectives and portfolio structure laid out in the investment policy statement. The family office would be responsible for the tracking of asset performance and day-to-day management of the portfolio.

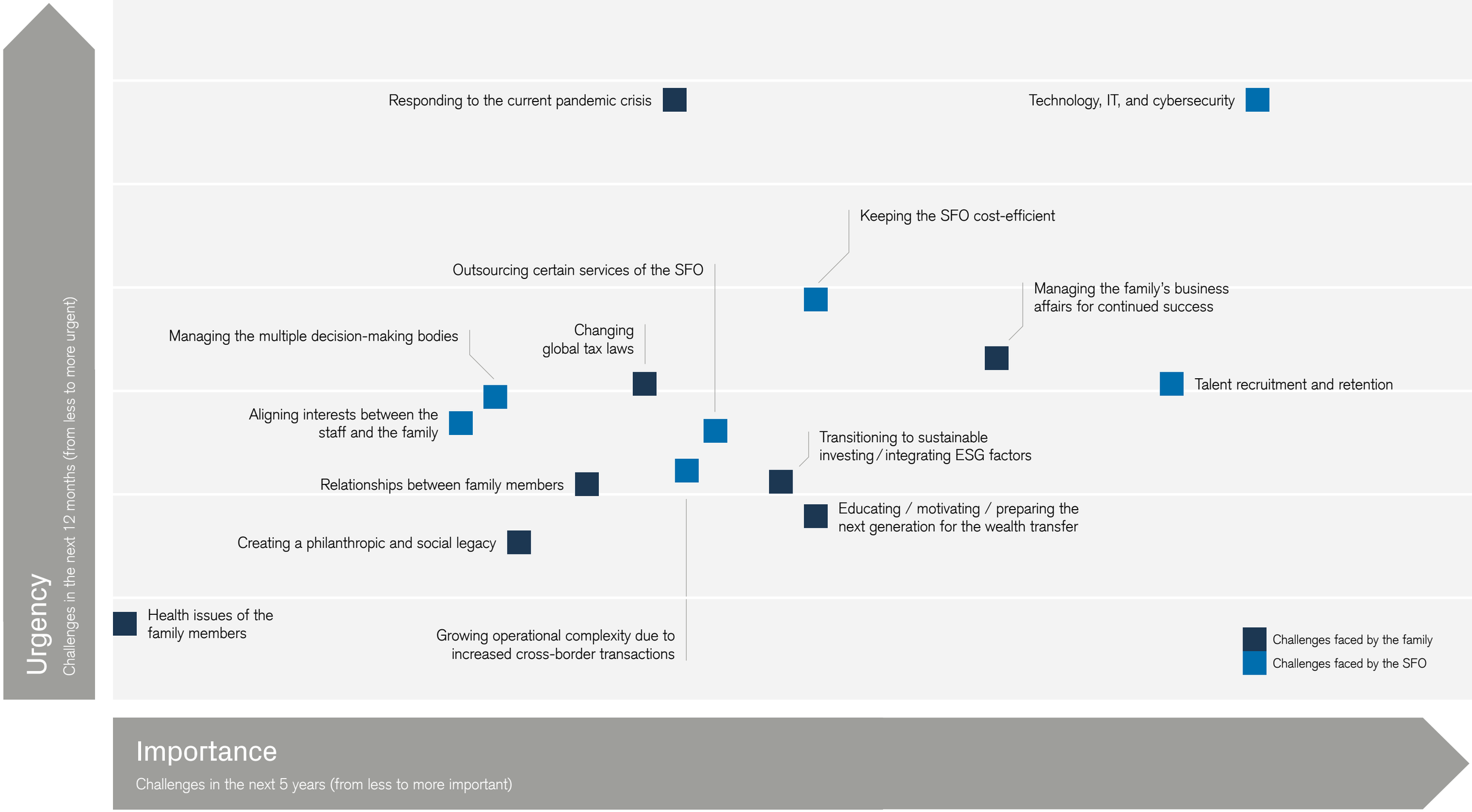
Portfolio reviews and governance
In addition to reviewing the family's goals and objectives, it is vital to revisit portfolio asset allocation at least once a year. As governance and transparency are also important, regular meetings and calls between principals, the family office staff, and external advisors will help to clarify any shifting views on strategy and implementation.

How single family offices see the future

Summary

The survey respondents were asked which challenges, if any, the SFO and the family currently face or will face in the future. Technology, IT, and cybersecurity emerged as the most pressing challenges facing SFOs, followed by cost efficiency and talent recruitment.

As for the families supported by the SFOs, they place high importance on sustainable investing and education/preparation of the next generation. Their current focus, however, is on managing the volatility related to the pandemic to ensure long-term prosperity.



Key trends

By design, the family office is focused on the next generation. Staying a step ahead means understanding and even acting on significant developments in the investment landscape and beyond.

Private markets

Overview
Private markets (PM) refer to investments in equity and/or debt of privately held companies which are not traded on an exchange, but are bought and sold through private transactions. Today, private equity (PE) investments include not only leveraged buyout and venture capital, but also real assets (real estate and infrastructure) and secondaries with possible access through fund-of-funds, single fund, and direct investments (see the section, "Investment process"). What unites them all is their complexity, illiquidity, and long-term investment horizon.

The value of PM assets is estimated less frequently than exchange-traded securities. As the valuation also relies on expert appraisal, rather than sale price, it tends to be less volatile, not fully reflecting fluctuations in capital markets at any point in time. While private market investors may experience less of an emotional roller coaster in the face of market volatility, it is essential to understand the benefits and drawbacks of these complex investments.

Private market strategies explained[13]

Portfolio companies	The end recipients of any private equity investment Note: General partners (private equity firms) carefully identify companies with growth potential through highly stringent due diligence processes.
Leveraged (buyout)	The purchase of a significant portion or majority share of a company with a mixture of debt and equity (leveraged buyout) or equity only (buyout)
Direct investments	Investors investing directly into private companies, with no intermediary Note: This strategy requires deep knowledge of the sector. Investors can be directly involved in the growth story of a company and realize returns on exit.
Direct lending	Non-bank lenders who lend to business in return for debt securities
Mezzanine	Refers to the "middle layer" of financing primarily utilized in buyout and later-stage growth investment
Secondaries	Secondary funds that purchase existing limited partnership interests in private equity funds after these funds have been partially or fully invested in underlying portfolio companies
Distressed debt	Distressed debt funds seeking to acquire controlling stakes in companies that are in financial difficulties (or even insolvent) through the purchase of debt, which is then converted into equity upon reorganization of the company
Infrastructure	Broadly defined as the permanent assets a society needs to facilitate the orderly operation of its economy
Growth capital	Equity investments in already established companies with the aim of expanding operations beyond the current capacity
Venture capital	The financing of start-up companies
Real estate	Investments in property assets of differing risk-return profiles

13 Credit Suisse. (2020). Private Market Investing Explained.
https://www.credit-suisse.com/about-us-news/en/articles/news-and-expertise/private-market-investing-explained-202010.html

A trend of direct investments in private markets
Recently, there has been a strong trend of family offices pursuing direct investments in private markets. The primary drivers have been (i) a search for better investment control, (ii) attractive risk-adjusted returns that have limited correlations with public markets, (iii) lower price volatility, and (iv) current low interest rate environment. This type of investment strategy, however, is based on a formal committee-driven investment process to identify, vet, and execute new opportunities as well as manage ongoing portfolio needs.

Some family offices have chosen to team up with other family offices to pursue a private direct investing strategy as a club. While this approach offers attractive synergies around infrastructure, deal sourcing, and idea sharing, it can create governance issues with investment selection and the ongoing management of investments. For small to mid-sized family offices, the club approach enhances the family offices' overall competitiveness in the marketplace by increasing the capital available for new opportunities – an important advantage in more competitive deals.

Family offices may also decide to pursue individual deals on a co-investment or standalone basis.

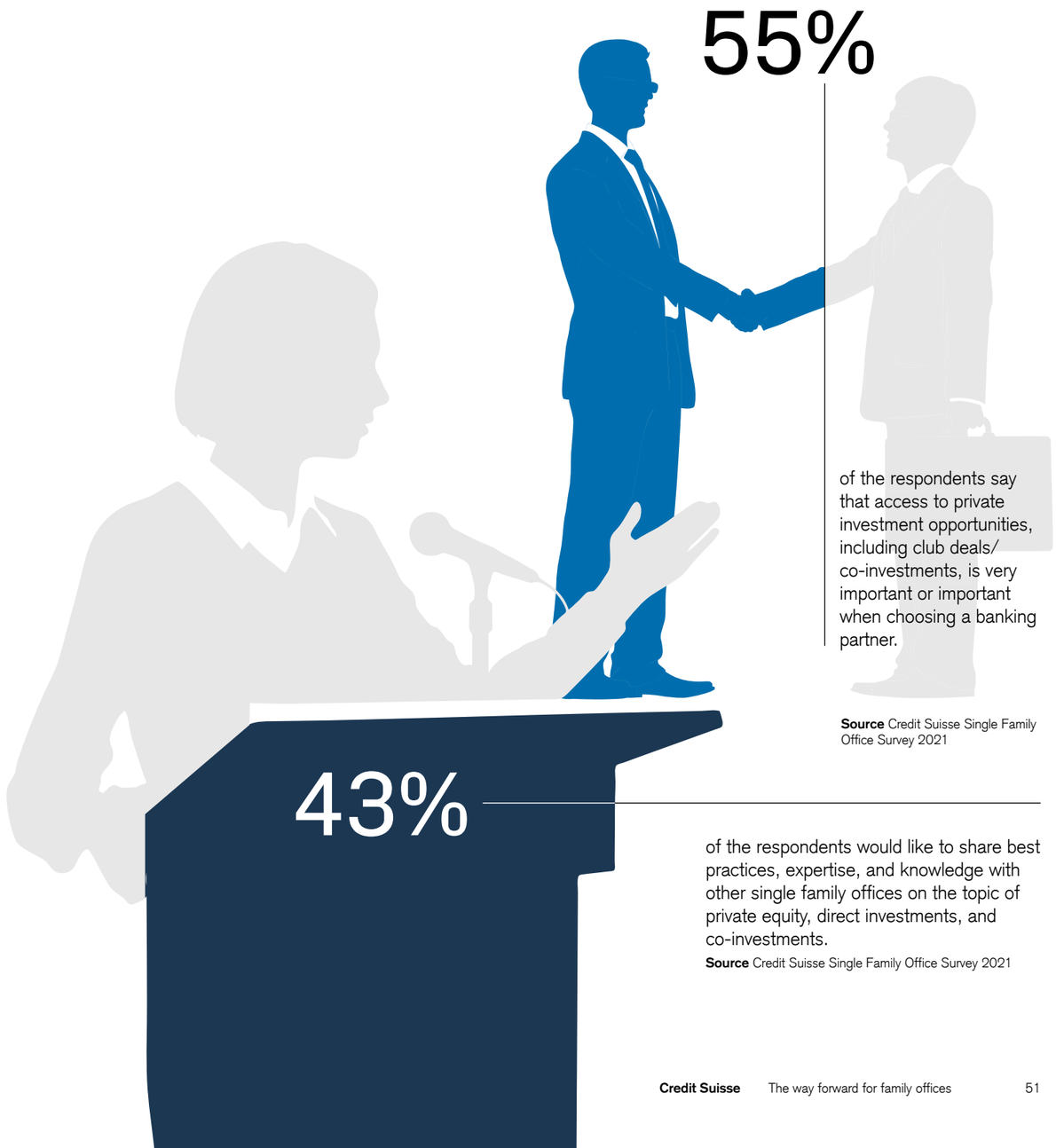
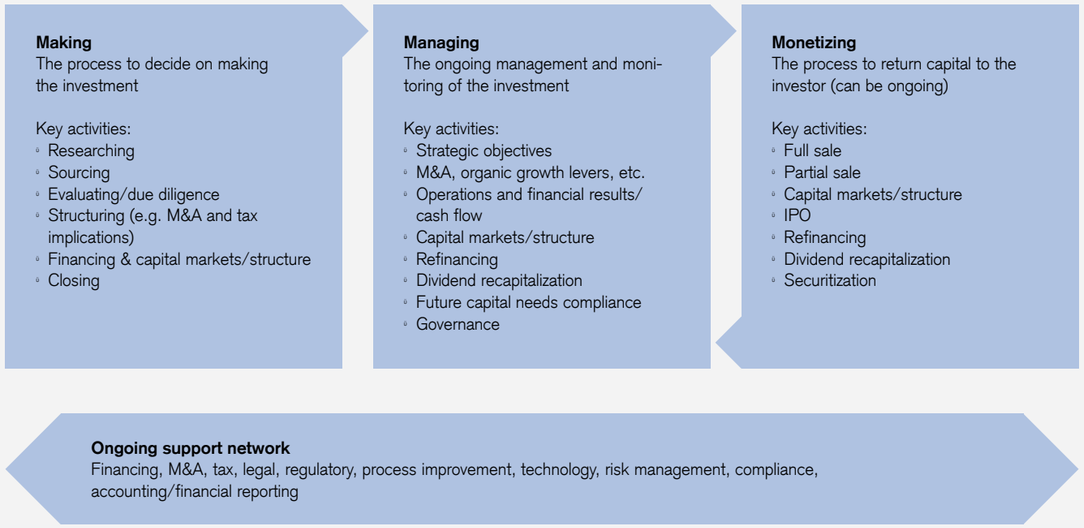


Figure 7. Private direct investing process

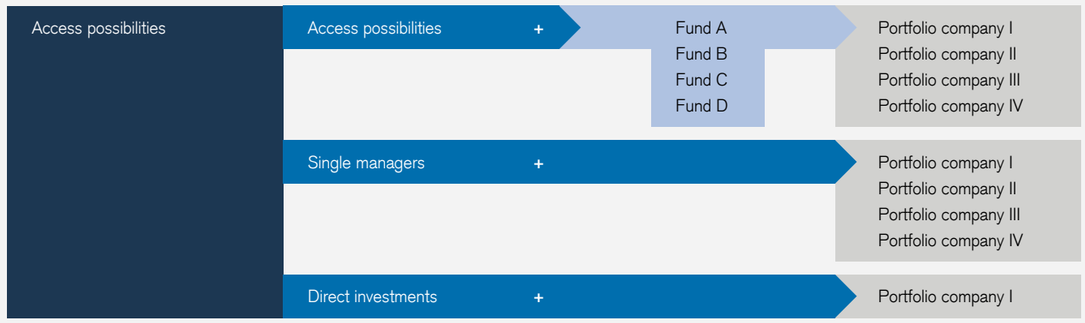


Private direct investing process
The private direct investment process can be broken down into three broad phases: (i) making, (ii) managing, and (iii) monetizing. It is critical to set up a formal investment committee process for implementation as well as the necessary infrastructure in the family office.

While family offices often possess the foundation needed to create a successful direct investing strategy, investment gaps can exist at each phase of the investment process. Family offices, like traditional asset managers, may rely on outside professionals to assist with the services not available in-house (e.g. advisory in M&A, capital markets, financial, legal and tax matters, due diligence, accounting). This is particularly true when the family office first adopts a private direct investing strategy. In some instances, the largest family offices, due to the build-up of experience and infrastructure over time, bring many of these professional services in-house.

A glance at private equity
Private equity (PE) investments represent the majority of investments in private markets. PE involves investing in private companies as opposed to publicly listed entities. In most cases, the owner takes a significant share to be able to wield influence in company decision-making, for example with a seat on the board. Fundamentally, the owner aims to increase the value of the company in order to sell it and get a return on the investment.

Figure 8. How to access private equity through private markets



PE sub-strategies
- Buyout: the most prominent and actively traded PE strategy, usually for larger, more established companies
- Venture and growth: a focus on companies in the start-up and expansion phases
- Secondaries: vehicles acquiring partially or fully invested private equity in the secondary market
- Real assets: investments in infrastructure and real estate
- Distressed, turnaround capital, and other niche strategies: an aim to invest in contrarian (turnaround capital) or other niche themes

Direct versus indirect investing
As noted, PE investing is complex. The main challenge for any investor, including family offices, is access to reliable information (about the deal, price, and risks) and potential opportunities. The inability to carry out proper due diligence may also be an obstacle. For that reason, the family office may want to assess the alternatives with competent partners who can advise them on choosing the right solution out of many.

Good to know
- Private companies outnumber listed companies, yet they tend to be less monitored and valued by the investment community. For that reason, investing in PE often requires time to research potential opportunities.
- As with PM investing in general, most investment is carried out via pooled vehicles, i.e. funds, often with a lifespan of 10–12 years.
- PE investing involves a considerable degree of financial and/or business risk. Investments in PE funds are neither principal-protected nor guaranteed.

Endowment-style investing

Endowment-style investing is a portfolio strategy inspired by the endowments of prestigious US institutions, notably that of Yale University.

Under the stewardship of David Swensen, Yale's chief investment officer since 1985, the endowment has generated a 12.6% annualized return over three decades[14]. For that reason, it has become a model for institutions that invest for the long term and depend on a steady stream of income from their endowments to fund ongoing operational needs.

Alternative asset classes

An endowment strategy allocates a significant part of the portfolio to less liquid alternative investments, such as private equity, private debt, private real estate, natural resources, and hedge funds. In the case of the Yale endowment, most of the portfolio lies in alternative asset classes (see figure 9).

Alternative investments tend to be harder to sell in a short timeframe and, in the case of private equity, can take multiple years to divest (see the previous section). This may be an advantage, however, and the source of an "illiquidity premium" compared with more liquid asset classes[15]. In a low-return environment, these extra return sources may appeal to investors that are able to tolerate some degree of illiquidity.

A key part of the endowment approach is the ability to source and select the top investment managers within each alternative sub-asset class (e.g. hedge funds, private equity). This capability is even more important for the alternative part of the portfolio because the variation in the track record between the bottom and top investment managers of alternatives is more pronounced than within equities and bonds, for example.

14 Yale Investments Office. (2020). The Yale Endowment 2019.

15 Franz, R. & Kranner, S. (2019). University Endowments: A Primer. CFA Institute Research Foundation.

Figure 9. Yale endowment: Asset allocation target

Alternative investments 75%
- Absolute return/hedge funds 23.2%
- Private equity 37.0%
- Natural resources/commodities 4.9%
- Real estate 10.1%

Traditional investments 25%
- Equities
- Fixed income

Source Yale Endowment Report 2019

Longer-term outlook

In addition to institutions, these investors include a growing number of individuals and family offices. They are drawn to the potential for higher returns, lower risk through portfolio diversification, and steady cash flow over time, even across generations.

Endowment-style investing may be part of a well-diversified strategic asset allocation (SAA). The SAA represents the target weights that the portfolio should hold in each asset class over the long term (see the "Investment process" section). In effect, the SAA is constructed to meet the investor's return target while exposing the portfolio to an acceptable level of risk, even during turbulent market periods.

In an endowment, the strategic asset allocation is characterized by a higher allocation to less liquid alternative assets than in traditional portfolios. More family offices are following suit in the hopes of generating a similar rate of return.

Endowment strategy

- Multi-generational perspective
- Long investment timeframe
- Potential for improved risk/returns with alternative asset classes

Focus on sustainable investing

A growing number of investors are turning their attention to sustainability issues.

The United Nations drafted the Sustainable Development Goals (UN SDGs) as part of its 2030 agenda to achieve a better and more sustainable future for all. Families and family offices are increasingly taking environmental and social issues into account when making investments or initiating new activities. As a result, opportunities are evaluated not only on their potential financial return, but also on the wider implications for society.

What is sustainable investing?
Sustainable investing refers to an investment strategy that considers environmental, social, and governance (ESG) aspects alongside traditional valuation criteria. There are different approaches to sustainable investing:

- Pursuing investment strategies that align with or do not go against the family's values
- Integrating material ESG factors into investment processes with the goal of delivering superior risk-adjusted returns
- Mobilizing capital into companies that offer solutions to societal challenges, through either thematic and impact-aligned investment in diverse sectors (e.g. education, healthcare, clean energy); or impact investing, a subset of sustainable investing, which aims to deliver measurable impact

Active ownership, which has become more prevalent, can involve the exercise of voting rights at a company's annual general shareholder meeting (proxy voting). The investor may also initiate and maintain a dialogue with the company's management team and/or board of directors on the topic of specific sustainability issues. This approach, known as engagement, is a way to drive positive change by actively exerting influence on a company.

For family offices, sustainability is an increasingly relevant challenge: how to create economic as well as societal and environmental value from family wealth. The family office can support the family's sustainable activities through different approaches, depending on their level of engagement, as seen in figure 10.

Of note, the Credit Suisse Single Family Office Survey 2021 revealed interest in the topic:
- 49% of the respondents plan to increase their sustainable investments (0% plan to decrease)
- Top three areas of interest: renewable energy (63%), health (61%), and education (48%)

What is philanthropy?
Unlike sustainable and impact investing, philanthropy usually involves financial contributions to a particular cause without an expectation of financial return. Traditional philanthropy tends to be short-term, with the targeted organization(s) supported through fund-raising and donations. More tailored philanthropic solutions include the establishment of a charitable structure, foundation, or longer-term partnership.

Figure 10. Sustainable investing spectrum

It is important to pursue sustainable investing with professionalism and commitment, and without underestimating the challenges and potential benefits. By engaging with sustainability, the family office can unite the family around shared values and involve the next generation (who have, according to our research, expressed strong interest in making a positive impact on society) in the investment strategy. Family offices can in effect help to align sustainability activities with the family's values and wealth requirements – and determine how the vision for sustainability fits with the family's long-term legacy.

Charting the course for a sustainable path
Every family office has unique motivations, operational contexts, and goals. As each family office has a different starting point, the path to sustainability will vary. The following framework provides guidelines to help customize the family office's sustainability engagement. Some may prefer to follow all the steps carefully while others will want to chart their own course, using these steps to guide the way.

1

Define the vision

Clarity of purpose can have a considerable benefit on the family's sense of cohesion, especially if the original shared goal of the family has faded over generations. It can be hard to find a mission that all family members stand behind, yet the lack of clear direction can be damaging to the individual family members' sense of self-worth, especially to the younger generation of a wealthy family.

2

Assess the level of engagement

Sustainable investing is not all-or-nothing. Family offices may adopt a gradual and iterative process after examining internal capabilities, available resources, and expertise. It is also important to determine who would be involved.

3

Identify time horizon

The family office should set a time horizon for its sustainability engagement. An effective strategy and clear communication of the family's commitment are essential to ensuring a positive outcome for the family and their stakeholders.

4

Choose an appropriate vehicle

The selection of a vehicle to manage the family office's sustainability engagement will depend on the level of personal engagement, financial resources available, timeframe, and tax and legal considerations. The family office may involve existing staff, hire designated managers, or set up a foundation to direct the sustainability engagement.

5

Align the family's values with the investment strategy

The family will need to decide how to invest its assets in the aim of both positive impact and financial returns. The responsible staff/entity can then invest the assets according to the family's values. For a family that cares deeply about social justice, for example, an ESG-exclusion investment strategy would adopt a more passive approach and avoid investment in controversial companies involved in bribery or child labor. On the scale (see figure 10), an ESG-integrated investment strategy uses ESG data to deliver superior investment returns and manage risks, whereas thematic and impact investing are strategies that seek to mobilize capital into investments that offer solutions to societal challenges.

6

Implement and regularly follow up

Defining clear impact goals upfront will facilitate the evaluation process, whether it is through third-party assessments or periodic internal reviews. Based on the evaluation, the family office can update its engagement strategy and impact goals.

Succession planning with a purpose

Family offices can help prepare and execute succession plans to ensure a smooth transition of wealth and maintain a sense of family unity.

Succession planning as an imperative
In the next two decades, it is estimated that an astounding USD 35+ trillion of family wealth will be transferred from one generation to another[16]. A recent survey[17], however, points to some of the challenges surrounding the transition of family wealth and businesses:

- 70% of families report not being on the best terms and failure in intergenerational wealth transfers
- 67% cite succession planning and inheritance issues as their biggest concerns

While more families and family offices are already thinking about succession planning – nearly 57% have drafted a formal or informal plan, according to the Credit Suisse Single Family Office Survey 2021 – the topic deserves considerably more attention.

Planning for generational change
Because succession planning is not a one-off event but a process, families often underestimate the potential problems and need for plans and procedures. In fact, 72% of failed wealth transfers are attributed to a breakdown in family communication and the failure to establish a family mission[18].

Whether families are handing over a business, investments, or both, family offices can play a role in managing the technical and emotional dimensions of succession planning. As with any important process, it is helpful to begin early, even years in advance.

Building on shared values
There are three specific areas where family offices can contribute:

- **Establishing a governance model**
  A clear and professional governance structure (see the "Governance structure" section) is the cornerstone of successful cross-generational families. A solid model will reinforce the strengths of the family business and help the family develop strategies together, based on a common set of values.
- **Fostering dialogue between family members and across generations**
  Effective communication about wealth, relationships, and family business ownership is essential to building and sustaining high-performing family businesses. Families often look for external support to improve their framework for communicating and put these ideas into practice.
- **Drafting a family investment philosophy**
  The purpose of a family's wealth should be discussed early, often, and across generations. This step entails establishing and regularly revisiting the overall goals for the family's wealth. The philosophy should reflect a balance between the best practices of institutional investment and the unique needs, values, and vision of the family and its business(es).

16 Wealth-X. (2020). World Ultra Wealth Report 2020.
17 Castoro, A. & Williams, R. (2017). Bridging Generations: Transitioning Family Wealth and Values for a Sustainable Legacy. Higherlife Development Serv.
18 Castoro, A. & Williams, R. (2017). Bridging Generations: Transitioning Family Wealth and Values for a Sustainable Legacy. Higherlife Development Serv.

Involving the next generation
We define the next generation as the family members who are positioned to take over a family business, family office, ancestral home, and/or family assets. At some point, they may find themselves at a crossroads, unsure if or to what extent they should get involved in the family business. If the trade-off between personal growth and continuing with the family tradition is not communicated or managed well, there could be consequences for the family legacy.

Research shows that when the next generation is (or feels) left out of the process, this can pose a key challenge to succession planning[19]. The reasons for potential exclusion range from a lack of qualifications to the family head's unwillingness to relinquish any degree of control.

A recent Credit Suisse survey[20] on the next generation revealed additional insights:

- 60% wish their families had more open discussions about their wealth
- 39% intend to take over the family business, 10% already have, and 30% don't know yet
- 97% are interested in actively managing their family's investments
- Nearly 50% play a passive role in their family wealth and wish they had more responsibility

To equip the next generation for their future roles and responsibilities, the family office can explore different approaches:

- **Educational programs** to help the next generation understand the basics of finance and wealth management, as well as more tailored programs to help multigenerational families strengthen their family bonds and explore different legacy and succession planning models
- **Curated networking platforms** to deliver customized content and access to peers, fellow entrepreneurs, and investors from other wealthy families
- **Early responsibility** to help the next generation learn about the business sooner rather than risk serious handover issues later, and enable a more seamless transition of wealth and know-how

19 Zellweger, T. (2017). Managing the Family Business: Theory and Practice. Edward Elgar Publishing.
20 Credit Suisse & YIO. (2019). Creating a World with the Next Generation.

Best practice example[21]

The entrepreneurial Tavares de Melo family from Brazil, with over 100 family members, was one of Brazil's leading producers of sugar, food products, footwear, and fruit drinks until they divested the business in 2007 and established a family office. They offer interesting suggestions for keeping family members involved, even if they are pursuing independent careers.

"I started working for the family business after I finished school. At the time, my only wish was to join the company. That said, some of my cousins didn't want to be part of the business. Today, there is no pressure on other relatives to join us, but we try to show them that family unity is good for everyone."
Marcos Tavares Costa Carvalho, 3rd generation, Member, Board of Directors, Grupo Tavares de Melo

"We formed a Next Generation Committee to formally define everyone's roles and create transparency on decision-making processes within the six branches of the family business."
André Tavares De Melo Nóbrega, 4th generation, Member, Board of Directors, Grupo Tavares de Melo

"Being part of the family office has helped me to understand what is truly important to run a successful business, how critical governance can be, and the need for the next generations to be part of it… We established our Legacy Program in 2017 to promote a joint understanding of technical and behavioral aspects of the family."
Giselle Tavares Costa Carvalho, 4th generation, Member, Family Board, Grupo Tavares de Melo; Next Generation Committee Member

"Every year, each family branch elects its representatives for the Family Board according to our protocol, which sets out rules governing minimum age limits and qualifications. Any eligible next generation family member can express an interest in taking a seat on the Family Board. They simply have to be aware that even though it is not a full-time position, it entails certain rules and responsibilities that have to be taken seriously."
Bruno Cavalcanti Tavares De Melo, 4th generation, Member, Family Board, Grupo Tavares de Melo; Next Generation Committee Member

21 Credit Suisse Global NextGen Report. (2018). Creating a world with the Next Generation and their families. https://www.credit-suisse.com/microsites/next-generation-and-families/en/next-gen/download-the-report.html

Technology at the forefront

The right choice of technology can help a family office effectively pursue its objectives, manage legacy changes, and adhere to industry updates.

56%

of the respondents in the Credit Suisse Single Family Office Survey 2021 cite technology, IT, and cybersecurity as key challenges in the coming year, and another…

28%

as key challenges in the next five years.

For core technology needs, a family office can decide to outsource to a third-party vendor (providing off-the-shelf or highly customized products) or develop an in-house platform. There are certain platforms a family office should consider.

Custody platform
The safekeeping of assets can be carried out by either one or multiple custodians or banks. If a family office chooses global custody, the administration of all assets will be carried out by one custodian, which could:

- Save time by consolidating all bankable securities, financial instruments, and liquid assets
- Provide a comprehensive and transparent overview of the performance of all assets via a consolidated investment report
- Allow the assets to be managed either by the custodial bank, an external asset manager, or the clients themselves (the clients would select their preferred asset manager with no restrictions and the asset manager would be free to select the brokers for securities trading)
- Potentially include non-bankable assets, such as direct real estate investments, mortgages, third-party derivatives, art collections, and yachts

Consolidated reporting
Consolidated reporting can help the family office gain an overview of various assets and the potential tax implications. This enables the family to understand their investments, identify risks, and strengthen their confidence in their family office.

Trading and portfolio management
Although some family offices employ fund managers, others may make their investments in-house. In the latter case, trading and portfolio management systems are more important. The system may need to have various modules to deal with the increasing scale and complexity of investment. A portfolio management system can report profits and losses as well as net asset values of the investments. The trading management system then provides direct market access and other functions, such as rebalancing, order staging, and allocations.

Risk management
Risk management systems can provide real-time sensitivity analyses, risk calculations, and scenario analyses to help families and family offices better understand the vulnerability of their assets.

Client relationship management (CRM)
The family office may wish to manage the information related to family members and other contacts in one central location. A CRM system often includes family contact information, the documentation of key family discussions around the family office's services and major family events, as well as contact information for lawyers, accountants, and other external resources.

Implementation of technology
Depending on the scale and complexity of the technology, some family offices may hire a chief technology officer (CTO). This person would be responsible for support, updates, communication, and software training, and may require additional resources and staff to help manage the different technologies. Tasks could include:

- Designing a detailed plan with the responsibilities of each vendor
- Performing tests on the data and functionality of each platform
- Organizing frequent meetings with each vendor to evaluate the systems

Cybersecurity
Another important task for the CTO or third-party vendor would be to ensure cybersecurity not only for the family office's technology systems, but also for the family members' devices at home.

Key risks include:

- Loss of money resulting from vulnerabilities in checking accounts, wire transfers, and credit and debit cards, as well as from phishing and other fraudulent means
- Loss of privacy resulting from vulnerabilities in networks, personal devices (phones, laptops, tablets), password hacking, and social media practices
- Physical safety issues resulting from vulnerabilities in personal devices (including connected home devices), as well as from viruses and other malware

Integrated risk management

The preservation of family wealth across generations is an extremely complex task. There are many risks that may potentially derail a family from achieving their long-term legacy. Families should develop an integrated risk management approach between the family business assets and private family assets to protect the family from risk.

Categories of risk
Asset diversification is a major task of family offices. Different investments are often combined to include long-term investments with lower volatility and a moderate expected return, and short- and medium-term investments with a higher risk profile and higher returns. Due to the increasing demand for risk transparency, direct investment and real estate have gained in popularity in recent years[22] compared to complex financial capital market products. Families and family offices tend to pursue investment products with a lower level of complexity, proximity to the investment, and the ability to have real influence on the investment.

To effectively manage the assets, there are seven risk categories (see table 6) that may help family offices develop a strong, coherent approach to risk management.

Table 6. Risk categories[23]

Risk categories	Description
Value and legacy	Changes in family vision or purpose, family governance, communication, education, and planning
Business	Any potential impact (e.g. financial, succession-related, reputational) from various businesses the family owns and manages
Investment	Investment policies and processes, including selecting managers and evaluating the risk specific to the portfolio
Operations	Transaction processing and controls
Estate/regulatory	Related to the type of entity and includes management and oversight, compliance, reporting, and office management
Technology	Evaluation of platforms used in the office, review of infrastructure, technology, and security (in particular cybersecurity, data privacy, and data protection)
Crisis	Planning and preparation for unexpected incidents related to health and physical safety, and evaluation of existing insurance coverage

22 McKinsey. (2020). Global Private Markets Review 2020.
23 Morgan Stanley. (2020). Single Family Office Best Practices Report. Rosplock, K. (2014). The Complete Family Office Handbook: A Guide for Affluent Families and The Advisers Who Serve Them. John Wiley & Sons, Inc.

Risk management systems
An appropriate risk management process assesses each risk category against the specific situation of the individual family/family office. The assessment of risks should factor in any mitigation practices as well as the existing control environment to evaluate the level of residual risk (measured, for example, on a scale from low, medium to high).

As shown in figure 11, the steps recommended for a typical risk management system consist of the diagnostic process (risk review, risk identification, and measurement), which objectively reports the risk and improves the control environment to ultimately mitigate the risks. Leading practices would also include a crisis management plan that would cover, for example, the recovery of technology and data, health support in an emergency, and physical protection against robbery and kidnapping.

Figure 11. A formalized risk management process

Risk review
- Establish risk threshold for the family and family office (what level of risk is acceptable?)
- Define a common understanding of the risk level among family members, the investment committee, and other relevant boards

Risk identification
- Identify and document the quantitative and qualitative risks
- Define the key drivers of volatility across the main asset classes/investments

Risk measurement
- Measure the impact of risks on assets
- Prioritize the risks according to impact level and likelihood of occurrence

Risk reporting
- Disclose relevant and adequate information
- Establish a governance structure to deal with risk management

Risk mitigation
- Define an action plan to mitigate the priority risks (at least)
- Identify possible opportunities to minimize risks
- Establish regular monitoring of the family's risk landscape

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