The International Family Offices Journal

Editor: Barbara R Hauser

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STEP ADVISING FAMILIES ACROSS GENERATIONS

Globe Law and Business

The International Family Offices Journal

Contents

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Welcome to the March 2021 issue of The International Family Offices Journal

Barbara R Hauser, Editor-in-Chief

Again, continuing thanks for all the positive feedback on our Journal. Remember this is for the entire family office community – we solicit contributions and comments! As the word continues to spread, we enjoy receiving offers to write for us. We are already starting to fill the June 2021 issue.

The focus of the Journal

We feature articles from leading experts in the field, on a range of topics including the variety of family office models and structures, governance, investment approaches, succession planning, charity projects, family communication and consensus, and next generation issues among others. A key feature of the Journal is its international approach. We value our independence and our commitment to offering content without any conflicts of interest.

In addition to heavyweight substantive articles, we regularly feature in-depth country reports, profiles of family offices, interviews with industry leaders, a luxury corner, technology tips, book or film reviews, relevant news alerts from the Society of Trust and Estate Practitioners (STEP), and reflections by those who have grown up with wealth or advise those who have done so and what it has meant to them or their clients.

In this issue we are proud to include another fascinating variety of in-depth articles. We hope you enjoy them! This year, yet another with the pandemic, is already proving difficult for so many – we are hoping for brighter times ahead.

We begin with some intriguing predictions for the future of family offices by Tom Handler of the Handler Thayer law firm in Chicago, Illinois. Tom predicts that family offices will continue to restructure and reorganise – see our included articles on this very issue. See also his additional predictions.

We are very pleased to present another Country Report by Julia Booth and Kirit Javali of the University of Sydney, Australia, on the intriguing topic of the Hindu undivided family. Their comprehensive detailed article explains the many unusual and beneficial aspects of this tradition.

Next we have a practical article by Guillermo Barandalla of the INJAT private investment office in Burgos and Bilbao, Spain, describing the process followed for a Spanish new family office. The focus of the project was to establish a robust and reliable investment function. The process they followed should be helpful to a number of family offices.

"The role of elders" is based on continuing reflections by James E (Jay) Hughes of Aspen Colorado about the role of elders in family governance. The first part, identifying elders, was in the June 2019 issue. Here, in his inimitable, thoughtful style he proposes that the elders can play substantial roles – as mediators, as trustees, as 'elders' in a family. We thank Jay for this thoughtful addition to the literature.

The next article, by Iraj Ispahani, CEO of Ispahani Advisory, London and Dr Carl Sjöström, Stockholm, Sweden, highlights the necessity for single family offices in the 21st century to "remain fit for purpose". Their advice ties in with the opening predictions in this issue by Tom Handler.

Dr Alon Kaplan and Meytal Liberman of Tel Aviv, Israel share some of their extensive knowledge on the use of trusts in Israel. They offer a variety of planning tools. As they note: "In the past 10 years, there has been a positive development in the use of trusts under Israeli law, by both Israeli and foreign residents". They draw from some of Alon's insights in his book, *Trusts in Israel*. In our opinion there is no more knowledgeable lawyer on this subject.

With a focus on family offices, Peter Lorange, of the Lorange Network Investment in Zurich, Switzerland, addresses the dilemma of how small companies – such as a family office – can achieve good strategy formulation without the same resource base as that which larger corporations might have. He offers a step-by-step process to follow, which is "a speedier, more 'democratic' process, where most/all relevant family members might be participating".

Dr Alexander Bove of Boston, Massachusetts focuses on an intriguing role of the trust protector, "the new bodyguard for the family office". A recognised expert on the role of protectors (and the author of the book *Trust Protectors – a practice manual*), Alexander reviews the history of protectors, and adds the use of a protector on an as-needed basis, known as a ‘springing protector’. Then if a problem does arise, “the trustee, instead of preparing for court action, can simply call upon the trust bodyguard to deal quickly and privately with the issue”.

Christian Stewart, of Family Legacy Asia, based in Hong Kong, contributes a comprehensive study of family meetings and facilitators. Based on his many years of working with families, Christian gives extensive examples of why family meetings are the cornerstone of good family governance. Critical to successful family meetings is the role of a skilled facilitator. Again, Christian offers numerous practical examples of the characteristics of an effective facilitator. His comprehensive report includes a very helpful checklist. We thank Christian for his extensive report.

For a visit to the art world and our Luxury Corner, we have another entertaining piece by our frequent contributor and art consultant, Ronald Varney of New York. This time the intriguing title is “Nakashima living rooms – the revenge of brown wood”.

In our Book Review, Dennis Jaffe, San Francisco, California, reviews the new innovative book on family philanthropy, the *Family Philanthropy Navigator: The Inspirational Guide for Philanthropic Families on their Giving Journey*. The authors, Peter Vogel, Etienne Eichenberger and Malgorata Kurak, of IMD, Lausanne, Switzerland engage family members on an active level. Jaffe comments: “The book is not intended simply to be read, it is to be used. The pages provoke you and ask you to then reach out to family and community and become an active learner.”

Lastly, we continue to express our gratitude to STEP for their list of news alerts.

We thank all the wonderful contributors and hope that our readers find value, comfort and inspiration during these unusual times!

Barbara Hauser

Single-family offices in the 21st century – remaining fit for purpose

Iraj Ispahani and Carl Sjöström

Often the comment is made glibly that no single-family office is the same because each is built around a single family and all families are inherently different. However, there are many things that owner families can learn from each other as they build, structure and manage family offices. Those contemplating setting up a dedicated single-family office today can also learn valuable lessons about issues and challenges, costs and benefits of privacy and control from precedent. With Covid-19 having changed the global socio-economic landscape, including reframing the dialogue around responsible wealth ownership, this is an opportune time to review one's family office operations and adapt its structure and remit as required to ensure it is resilient and fit for purpose for the remainder of the 21st century.

The linkage between business and society has been reinvigorated. Profit maximisation needs to be balanced with a corporate purpose; with businesses actively considering the needs of their wider stakeholders and not just their shareholders. Trust needs to be restored. With significant ownership of many listed entities now held through funds and passive vehicles, the ability of shareholders to influence corporate agenda change will be an important feature of this evolving landscape. While a heightened focus on sustainability by businesses is necessary, it raises many questions. Some of the changes that have taken place early in this century are positive and essential to our societies. Some of the changes are, and will be, destructive of family businesses and wealth. Disruption is likely to increase, partly driven by technological advances. Positive reputations for families and their businesses in this fast-evolving environment will likely be more difficult to maintain. What are the implications for family offices today?

The evolution of a family office

In the early days of a family business, the owner-operator typically uses the company's staff and his or her own personal advisers to manage all tax, legal and banking matters. This is the 'embedded family office' and it evolves using existing resources to address the family's needs. It often relies on the CFO and the company secretary who are already fully occupied with their corporate responsibilities. Little distinction is made between the family and the business at this stage until the capacity and skills to serve the family's interests clearly need to be added to. This leads to the adoption of a more proactive approach with which a host of pertinent questions arise: What do we need? How is it best delivered? What expertise should we bring in-house and what should we outsource? Who do we need to hire? How arm's length will it be? What oversight is required?

As families and their advisers come to understand the importance of separating the functions of the 'three circles'[1] – business, ownership and family – it becomes clear that while the business circle has a structure of management and support services and the owners have boards of directors, the family circle often has no organisational support.[2] Many families respond by creating, first, a family council to handle the interpersonal aspects of family ownership and, second, a family office to handle the financial and technical tasks. In these owner-investor family businesses the family council and the family office become the primary coordinating structures linking all aspects of the operation: wealth generation, wealth management, continuity, philanthropy and the family legacy. Where a family office has been created with no linkage to an operating business the role and structure will most likely be less complex.

A family office that serves a single family can be an integral part of family governance through which a decision-making framework is created encompassing leadership and family communication. The aim of the framework is to create cohesion in a family and support succession planning. Core to this is a family constitution[3] that captures the objectives and the essence of the family. The constitution formulates and formalises the family objectives into a strategy. Many families create a constitution as a good hygiene factor but don't implement it since embedding governance often requires behavioural change. Some constitutions also include a family office mission statement. Such a definition is a good starting point for a new family office as it helps align family members to the purpose which has been defined as well as providing the basis for its creation.

What can we learn today from families who are already dealing with scale and complexity in their family offices? With Ispahani Advisory's longstanding experience in the family arena and supplemented by a range of recent conversations held over lockdown with families of significant wealth, we want to share some perspectives which may be timely and helpful as we all look ahead.

The conversations
The conversations held were open-ended discussions with representative members from a dozen families and sought to highlight the issues around existing family offices and how families see them evolving in the future. Those we spoke to were members of a broad mix of families who carefully coordinate their affairs, including:

- Families based across Europe and Africa (we also had additional input from Asian and North American perspectives).
- Wealth created in the 18th, 19th, 20th and 21st centuries, represented by first through to eighth generation wealth owners.
- Wealth originating in manufacturing, distribution, retail and services businesses. Some families still own the original operating businesses, some have moved into different sectors and some have divested.
- Families using a single-family office structure (the majority of those we spoke to) and those using a shared multi-family office structure or no formal shared office structure.
- The number of family members whose affairs are coordinated range from six to over 1,000.
- The family offices have been in place in their current form between less than three years and more than 50 years.

What does the family office do?
A family office is an organisation, the main activity of which is to assist family members with their personal affairs in a coordinated manner, in particular around tax, legal and investment matters. For the families that we spoke to:

- A common feature is for the family office to provide advice on professional service providers, such as banks, insurance companies, law firms and accountants and to maintain relationships and negotiate rates with them.
- Many people think of family offices as private fund management firms and most of them do invest funds on behalf of the family and/or family members. However, there is a clear trend away from the family office providing discretionary investment services in traded securities, for example stock picking, towards providing advice on fund management services, acting as a fund of funds and/or advising on the selection and evaluation of third-party fund managers.
- Investment management remains a key activity in supporting the family in illiquid investments, in particular property and private equity investments. It is noteworthy that a number of families were explicit in favouring investments aligned with the family's values and fields of interest. If the family has deep expertise in a sector there is a tendency to double down with a less diversified portfolio and where a family has environmental or social objectives these tend to have a strong influence on investment choices too.
- Most of the families we spoke to no longer or never offered family members a concierge service coordinating travel, holidays or other personal matters. Most were strongly against such service coordination, with several having experienced it as divisive and conflict creating. Some family offices assist in the management of family properties, but again the potential for internal conflict was noted for those families too.

The Red family decided against a concierge service. "We don't want those tasked to make money to also be in charge of spending it. Cost control is difficult when you are also spending the money. If we want to travel or need something booked we do it ourselves."

Family inclusion and values
All the families we spoke to have a clear view of what the family is, but that view varies from case to case. For some the family is defined by the person who created the fortune and all subsequent generations are included, regardless of the financial situation. For others, only those who have a financial stake in the family business are included, perhaps extended to their heirs and possibly a further generation. Clear tensions arise when the family grows and dilution of wealth occurs. Sharing a name, blood and heritage becomes more difficult to coalesce around. The

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definition of the family is therefore critical to how the family office operates and aligned with this are the values that the family espouses and adheres to.

How the family's wealth should be protected and grown depends on a multitude of factors but for many it is the core values of the family that are central. Most families found the definition and articulation of values to be quite difficult so they remain relevant from generation to generation. A common problem is that words may be adopted but are not clearly defined and so the values do not get embedded. For some families a dominant patriarch or matriarch have at times slowed work on developing common values, which need broad buy-in, but several of the families we spoke to have addressed this by tasking the next generation to deliver a solution.

The Purple family have agreed and adopted a set of statements over time that they see as the guiding values. "You can't say we all share the same fundamental values as people. However, we do have shared values for the assets we own together as a family."

Helping to hold the family together

Several family offices were originally set up at a point where two family members shared ownership of the operating business and many others were set up to protect the interests of the family when it grew. Avoidance of conflict within the family and conflict resolution are important considerations for most of the families we spoke to. Wealth suffers when conflicts arise and family cohesion is therefore paramount. Hence, one of the most important features of a family office is its role in facilitating education and communication as a neutral, trusted and confidential nexus. The family office is typically governed by a family board set up by the family council, with external trusted advisers providing input either directly or indirectly, and all family members meet with the family office representatives on a regular basis.

The White family addressed discontent within the family by overhauling the operations of the family office, increasing the frequency of contact with all family members, introducing a customer satisfaction survey and stressing the value of services being competitive by introducing an annual charge for membership of the family office.

Education is also critical in addressing a key concern raised by most families – to make sure that wealth does not become a disabler for the younger generations. Several families ensure that younger family members are educated in both understanding the key operating businesses but also, and more importantly, in financial matters to help them become 'better owners'. Most do not rely on the future generations' abilities to run operating businesses but they do need them to be able to make the right investment and divestment decisions to maintain and grow the family's wealth.

The natural tensions within a family of factors such as increased size, diverse interests, different risk appetites and geographic spread have also led most of the families to expect their family office structures to be relatively short-lived, even where they have a long history. All were very alert to the reality that even a large fortune can disappear quickly and that nothing can be taken for granted in an increasingly unpredictable world. All the families therefore wanted the family office to have a role in keeping the family's interests together but for it to be seen to earn its keep while being under constant review for continued relevance.

Single-family office or not?

A family office, in particular a single-family office, costs money to run and most of the families we spoke to had reviewed or were reviewing the costs and benefits as well as the services provided. Most hold that the family office must pay for itself but does so in different ways, such as through:

- Putting a value on owning and controlling the information.
- Closing down unprofitable areas, such as active stock picking and concierge services.
- Spinning off non-core services that have become less relevant for the family to maintain but that have a commercial future outside the family office.
- Charging participating family members fees for membership and/or services.
- Charging operating companies fees for services.
- Using family wealth as leverage to reduce third-party fees.
- A combination of the above, assessed against the external market on both quality and cost.

A significant majority of the families we spoke to have a single-family office in place to coordinate the affairs of a defined group of family members. When different family office structures were considered most elected not to share with other families in a multi-family office due to concerns over trust and privacy, wanting to own their own information, perceiving their needs to be sufficiently unique, in combination with funds being sizeable enough, to justify setting up their own family office. However, some of the families we spoke to had decided not to use the single-family office model for reasons other than costs, though they had the very same concerns.

The Orange family decided against a family office, concluding from the experience of surviving several geopolitical events where family members found themselves located in different countries that such a structure would not work for them over the long term. The family wanted each branch of the family to have independence and to use the operating company as the focal point for the extended family.

The Blue family knew a multi-family office well and decided against a single-family office model. To address the trust and privacy issues they set up a board of family members and trusted advisers to instruct the multi-family office as well as instructing other service providers and advisers, thus ensuring independence and confidentiality as well as competitive service levels and rates.

Using external advisers

All the families we spoke to make use of external trusted advisers to provide a combination of impartial views, technical expertise and outside perspective. Trust and discretion are paramount and advisers are often tested over long periods of time by either having been professional advisers to the family, such as lawyers, bankers and accountants, business associates of the older generations or former senior executives in either a family operating business or the family office. The trusted advisers typically sit on the family's operating company boards or the family office board but may have no formal role as such.

Attracting and rewarding talent

The people employed in family offices are typically recruited from professional services firms, banks or other family offices. The key attributes that families tend to look for are, first and foremost, trust and discretion, followed by technical competence. Many families are grappling with wanting trust, discretion and loyalty while also requiring a measure of staff turnover to ensure that competence and innovation keeps the family office prepared for future challenges.

Roles within family offices are distinctive from other similar roles. They tend to have more limited career trajectories but they also tend to have more autonomy and direct influence on the business. That said, family offices are often quite hierarchical in nature. The most senior employees, such as the chief executive and the chief investment officer, typically have personal interactions with and privileged access to the family, thereby separating them from the rest of the team to a greater extent than if they were at an independent firm of a similar size.

To attract and retain staff most families wish to pay well but don't always do so. As part of our research, we held a number of discussions with Botoff Consulting in the United States.[4] Botoff Consulting specialise in compensation studies of US family offices, where this is a relatively well-defined employment market. Interestingly, we found that when speaking to non-US families there was no consistent definition of the market for talent, the type of remuneration plans offered or what performance is most important to reward. Remuneration packages range from fixed salaries only to salary plus a discretionary bonus to salaries in combination with formal bonus, long-term incentive and a carried interest structure. Performance requirements similarly range from discretionary assessment of the quality of executing the family's wishes to value of funds under management to business strategy success.

Botoff Consulting has found that in the United States there is a clear correlation between family office AUM and the levels of compensation. There is also a lot of commonality in remuneration approaches. For larger family offices, with assets under management in excess of $1 billion, some 90% provide annual incentives, 95% review and adjust base salaries on an annual basis against peer benchmarks and approximately two-thirds use long-term incentive plans (deferred incentives, co-investment and carried interest being the most common).

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The family office as part of the family governance
The families we spoke to all have family governance high on their agenda. They all have or are working on a family constitution and all have some sort of family board representing family members' interests. The position of the family office within the governance structure varies from sitting within, above or completely separate from the operating businesses. The role of the family office tends to be impacted by its position versus the operating businesses, in particular in terms of oversight role, separation of interests and how advice is used.

A key differentiator is whether the family is still involved in an operating business or not. The views on the importance of the operating business and the family office's involvement differ significantly. Some see the operating business as synonymous with the history and core of the family, others see it as a chapter in the history of the family. Some believe that the family office should have minimal links to the operating business, whereas others consider it difficult to draw exact lines between where the operating business ends and the family office begins. It appeared to us from our conversations, however, that the existence of an operating business created a stronger emphasis on family cohesion and that this often impacted the family's commercial decisions, in particular around very mature assets seen as iconic for the family. There is also some distinction in approach between entrepreneurs and longer-established business-owning families that have a family office. Entrepreneurs will typically create a family office after a liquidity event so have a greater focus on investment governance while business owners will also have ongoing business governance to factor into their thinking.

Protecting and growing wealth
Linked to the importance of the operating business is what a couple of families articulated as the need to differentiate between the part of their wealth which must be protected for longevity and the part that can be risked to create a new fortune. Most people were very alert to the real risk of the family's wealth being eroded within one or two generations, whether through the family growing, family ties weakening or wealth being poorly managed or spent. For some the operating business has the role of risking capital to create new wealth and the family office's role is to protect for longevity. For others the family office should do both and is seen as a natural source of investment capital when a member of the family is looking to set up or invest in a business. This can be described as the 'family bank'[5] though the families we spoke to differ in their approach to this, such as:

- Not allowing investments in family members' businesses, thus also avoiding conflicts of interest issues.
- Supporting investments only by helping the family member negotiate with banks and other advisers.
- Guaranteeing loans up to a capped value if the investment idea passes scrutiny.
- Making loans and investments at commercial rates with formal, planned exit strategies.
- Insisting on governance of a set standard, imposing family office chosen board members if performance is not meeting the business plan.

When acting as a family bank, the family values dilemma becomes even more critical for the family office. Where families have worked extensively on their common values, they typically translate these for investment purposes and give them a significant role in all investment evaluations. Most families recognise the growing importance of this, not only for internal reasons but also to navigate the increasingly complex areas of environmental, social and governance requirements and expectations from different stakeholders.

The Green family have evaluated all investments against ethical criteria for over 40 years. "We test investments against risk and moral appetite first, before we even consider the ROI, and we set KPIs accordingly for those who work in the family office."

The Brown family has two social and environmental areas that they want to prioritise and test all investment decisions and actions against. They see this as essential for the culture within the family office and the businesses they own. "Culture is essential – it is not bling."

One of the most unexpected findings from our conversations is the doubt many share as to the longevity of the family office.

Conclusions from our conversations

Single-family offices are built for different reasons, in different ways and the organisational structures that support a family will vary. These offices may be created purely to support one generational transition with a planned winding down of the organisation and distribution to beneficiaries after the founder's death. Other family offices are created specifically to support family longevity and cohesion across several generations. In some cases, family office capabilities are created which, while integral to family governance, do not require a dedicated standalone family office organisation. The success of any family office, however, starts with clarity on the family's objectives. These objectives are centred around the purpose of the family's wealth and need to be articulated clearly. This is important for the family now and for future generations, as well as for those employed by the family office.

Our conversations showed that there are many versions of a family office, indeed a few family representatives noted their dislike of the term as they associate it with something different to what they have created and wish to achieve. That said, there are a number of interesting points raised in our conversations indicating the general future of the family office and learning opportunities for those setting one up or reviewing their structures and choices.

To us there are three key take-aways for single-family offices. First, a core reason for having a single-family office is to retain control over information while benefiting from economies of scale in handling family members' affairs. Second, the success of a single-family office structure depends on how well it serves as a neutral nexus for communication and education to and between family members. Third, the family needs to keep the family office under constant review to ensure that it remains relevant and an enabler for future generations and further wealth creation.

Drawing on our experience and the experience of those we spoke to, other learning points can be summarised as:

- Family offices are mainly used to:
  - ensure best advice on technical services, such as legal, tax and investments;
  - identify and execute investments in illiquid assets; and
  - educate and communicate with family members.
- The key trends for single-family offices are:
  - investment in technology to support resilient family office infrastructure is likely to become increasingly important;
  - a move away from own discretionary investments in the trading markets towards the selection of third-party providers; and
  - as a consequence, a move away from hiring deep expertise, putting more emphasis on trust and confidentiality;
  - greater focus on formulating an effective risk management framework to identify risks, develop risk mitigation approach and proactive risk monitoring; and
  - paying more attention to the complexity of compliance around managing cross-border wealth.
- Key concerns are:
  - the need to develop explicit strategies for both protecting wealth and creating new fortunes by taking calculated risks;
  - that a family office can fuel the disabling aspect of wealth for the upcoming and future generations; and
  - how to articulate the family's values and make them implementable.
- Also worth noting is that:
  - investment strategies tend to follow a family bias;
  - the structure of the family office tends to follow purpose; but
  - the positioning of the family office versus operating businesses may have a significant impact on how those businesses evolve and how the family office works; and
  - family offices which embrace a learning and digitally enabled culture are more likely to survive and thrive.

The future of the single-family office

One of the most unexpected findings from our conversations is the doubt many share as to the longevity of the family office. If the family office is seen as a temporary solution to a changing situation it begs the question whether the exercise is worthwhile? We note that families have been generally pleased with the value to date, but if a family office is going to have a future one needs to define the direction of travel. To us there are three particular areas that should be considered, where we see opportunities to make family offices more 'evergreen' organisations.

From disabler to enabler

As we have noted, wealth becoming a disabler is a key concern that most of the families we spoke to share. Currently, family offices mainly address this through education and communication, providing younger generations with the tools to be owners and insights to make investment decisions. To do this and to recognise the need is very important but we also see a developing role for family offices through first redefining family wealth and then protecting and developing it as encompassing human, social and intellectual capital in addition to financial capital.

The family office as an organisation

To be sustainable and to be able to evolve the scope of its activities, a family office must be recognised as an organisation but without sacrificing its representation of the 'family circle'. Much of this is standard for an operating business but for a family office it is often overlooked due to size and control, with the family office seen as an extension of the family. However, since the family office is not staffed just by family members it is harder for it to survive the changes that the family more easily adapts to, such as geographic moves, political risk, management changes and new values. Family offices increasingly need to build their platforms with careful use of technology and digital data management to remain agile and relevant but also so that the family office can as part of contingency planning replicate itself in a fallback jurisdiction if circumstances require.

The family office as a business

One of the greatest risks we see with family offices is when they pursue areas that are better met by other providers or that are not relevant to the family. However, having broadened the scope and structured the organisation, there are opportunities for a family office to develop its own commercial value that should at least be considered. Family offices, as extensions of the family, can present interesting opportunities to disrupt and challenge established operating models. For example, one of the recent noteworthy developments is the emergence of the family office as a competitive force in private equity. Previously mainly a key source of capital, family offices increasingly do their own deals. What makes family offices interesting in this space is that they can compete with strengths that are difficult to match for private equity firms. Family offices can turn family ownership into competitive advantages by, for instance, working with much longer time horizons and drawing on deeper and more current expertise. Family offices can also trade financial returns for strategic advantages and draw on reputation in ways that private equity firms struggle to do as they are bound to the limited life of each fund.

If family offices are to remain relevant for the remainder of the 21st century they will have to stick to their knitting and remain cost-conscious but also be open-minded, agile and prepared to consider new ways of working. The question of what is best done in-house versus outsourced or via partnerships should be asked with increasing frequency in a business world facing disruption.

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