

Family Office 101

Managing Family Wealth and Legacy

If the needs of families gave birth to family office concept, the changing business environment has made it a business opportunity today and Financial Planners in India can take a lead in utilizing this opportunity.

Family offices, as a concept, are credited to have begun with the Rockefellers, when John D Rockefeller created his family office in 1882. It operated more as a business office than an investment office, dealing with his personal and philanthropic financial activities. Over time, as the family's business investments became more liquid and diversified, the family office began handling family investments as well. In the 1930s, John D Rockefeller Jr. separated the family office from operating companies and it became a separate entity so that it could more effectively handle the financial, legal and investment affairs of the increasingly disparate and numerous active and inactive shareholders, spread all over the world.

Today, Rockefeller & Co operates as a full-fledged family office for the descendents of John D Rockefeller and other high networth individuals, making it one of the over 3,500

HUNTINGTON HARTFORD was heir to a vast grocery store fortune (A&P Supermarket, created by his grandfather and uncles) but squandered it away and filed for bankruptcy.

family offices that exist in the United States currently. The concept is popular also in Europe, where the wealth is older - as opposed to the entrepreneurial wealth created in the USA in the 19th and 20th centuries.

Why Have a Family Office?

“Shirtsleeves to shirtsleeves in three generations” is a familiar story of so many once-great fortunes. Even if a family's second generation is successful at preserving the estate, the third and fourth generations seldom are: primarily due to their inherently different interests or capabilities.

Michael Dell does not want his heirs “to drive a cab 50 years from now” and is also worried about tying his family's

long-term future to a single company in a single industry. He has invested an estimated USD 1 billion of his fortune in MSD Capital: giving managers a broad mandate to spread the money among private equity deals, public stocks and venture capital. What Dell wants to protect against is the fact it is hard to say a priori how a child or grandchild will turn out to be. For example, Huntington Hartford was heir to a vast grocery store fortune (A&P Supermarket, created by his grandfather and uncles) but squandered it away and filed for bankruptcy.

On the other hand, there is the example of the Pitcairn family in the USA, which derives its affluent status from the bequeathed wealth of the founder of Pittsburg Plate Glass Company, John Pitcairn (1841-1916). Currently 200 members of his extended family enjoy the benefits of the wealth, which is managed by a family office. So is the case

with the Rockefellers, the Mellons and the Grace family. Interestingly, all these family offices have started offering their services to other wealthy families also.

Triggers for Forming a Family Office:

What triggers the formation of a family office differs across families but most common reasons are:

1. **To transfer assets across generations:** The most common example for the establishment of an office is the retirement of the original founder(s). Family offices can be established on behalf of heirs so as to have the structures necessary to manage the inherited assets in common, rather than liquidating the assets and dividing the proceeds. This involves creating flawless legal documents so that the wealth transfer is easy and is not challenged.

2. **To manage cash flows from liquidation of family business:** The source of funds is the sale of, at least, a portion of the family business, leading to a sudden increase in overall



Akhilesh Tilotia, CFP®

Director, PARK Financial Advisors Pvt. Ltd

liquidity. This requires immaculate understanding of the reasons for selling and defining right avenues for investing the liquid portfolio. All too often, the sudden liquidity can be invested in too many (small?) investments which may not fit in the portfolio. Investing is a different skill from creating and managing a business and the cashed-out entrepreneur may

when the family has expanded beyond the first or second generation entrepreneurs. In order to provide every member of the family an equitable forum for ensuring the best use of wealth, according to their individual needs, a family office is created. The role of a facilitator (someone who can help create various forums for the family members) is



not be able to do justice to the same. Sound independent advice becomes the bed-rock of the relationship here.

Liquid wealth brings with it many contenders. Defining who gets what and ensuring that the transition is hassle-free is important for the family from a harmony perspective. Legal advice and help are of critical importance.

3. To improve governance of family wealth: A family office could be a strategic decision by family members to create a formal distinction between family wealth and the assets of the family business. Financial risk diversification is a primary motivation. Also, separation can be done in the spirit of improving transparency and corporate governance of the family business.

Typically, this is seen in multi-generation family offices,

of importance. Similarly, defining the legal rights of each member mutually is required.

How to Evaluate a Family Office Provider?

Finance is matter of trust. The most important element in your relationship with your financial advisors is the trust that he can build with you. Trust is built either through a long association or with confidence in the ability of the office to service your needs. One of the elements that create and foster trust is the ability to listen and understand your unique situation and to offer solutions and insights designed specifically for you.

There are two aspects to judging the family office: the

sophistication of their advisory tools and the quality of their research. Discuss with the office professional about your needs and observe whether they have or can develop a process for solving issues nearest to your heart. Quality of research distinguishes a world class office from their peers. Check if the firm runs an independent research or is into product selling. Increasingly the family office industry is moving towards an “open architecture” platform where the office is only advisory in nature and not a product-seller, like a bank. This ensures independent advice and you are protected from owning products produced by one entity.

What are the Responsibilities of a Family Office?

Family office is not a sub-set of a business: it is a vehicle for the wealthy entrepreneurs to manage their wealth independently and professionally from their businesses. What a family office seeks to achieve is a peace of mind and a concentration of efforts for managing wealth. Instead of different advisors managing different portfolios (investment, insurance, taxes, estate planning) a family office consolidates all the personal and family wealth solutions in one place.

One of the largest aspects of the wealth management is managing investments but that is only the beginning. A family office encompasses value-creation and support across various other important functions. We detail the avenues of responsibilities for a family office.

Understand Family Context

A. Financial Planning for the Family:

- i. Define a clear current financial picture: Give the family a clear picture of the wealth that they have. This will include providing them with sophisticated portfolio analytics, analyzing complex structures in the portfolio (options, converts, concentrated positions, etc.) and helping understand and appreciate holding structure complexities.
- ii. Financial planning and projections: Helping the family set the financial milestones, defining the risk that they are willing to take, helping them project return expectations. Based on this, providing the family - and its individual entities – with projections and risk-proofing.

B. Documenting Current Legal Position:

- i. Document the holding structure of the business and family assets.
- ii. Understand and document the current and required compliances with regulations.

C. Understanding Family Governance / Objectives:

- i. Defining the family value / mission statement, laying down clearly the non-financial goals of the family (social, personal, legacy, etc.)
- ii. Defining what the individual goals of the family members are and how they are expected to conflict with the goals of

the family, or of other members.

- iii. Understanding the family structure and personalities (claimants to the wealth, their advisors, etc). This will include developing an index of potential conflict situations and means/process of resolving foreseeable disputes.

D. Evaluating and Consolidating Current Service Providers:

- i. Evaluate and consolidate the various current service providers across services that are / can be provided via the family office. This will include providers of services for accounting, tax, legal guidance, investment management, insurance planning and concierge services.

Financial Risk-Return Management

E. Risk management:

- i. Define financial risks in the current and future situations: This will include analysis of concentrated positions (for example, one business which creates wealth).
- ii. Creation of financial-decision support tools: for understanding/evaluating uncertain situations. Examples include Monte Carlo analysis, scenario planning, etc
- iii. Defining insurance / asset protection strategies.

F. Return management:

- i. Strategic asset allocation: defining right asset classes (including right currencies) to be in, in right proportions. The family office determines this allocation in the light of the goals and constraints of the family and defines an investment policy statement.
- ii. Research across asset classes: equity, debt, real estate, art, commodities, international investments, etc. The family office either develops research expertise in-house or outsources the same to product providers or brokerage companies for fees and/or commissions.
- iii. Evaluating investment managers: The office can now directly take an active role in identifying the assets suitable for the family or it can identify the right set of asset managers that are required to execute the right set of transactions.
- iv. Co-ordination across various service providers: Choosing the best for execution and coordinating across various investment professionals, will be required of the office.

Investment management is typically the initial touch point, as the concern of managing wealth is what draws the wealth owner to a family office. What the wealth owner requires is deep skill set of analytical ability to research, identify and retain the right set of managers.

Coordinated Tax, Trust and Estate Planning

G. Offering tax-optimization strategies:

- i. Tax minimization: Advice on creation of entities (tax-shelters, trusts, etc) to deflect taxes.
- ii. Tax deferring: Creation of structures to defer taxes to

Choose the right place to build
a great career.

Join Bajaj Capital



Bajaj Capital, the pioneer of Financial Planning in India, requires dynamic financial planning professionals for its various branches across India. So just move ahead to be a part of the team that brings success in life.

We're looking for Relationship Managers (Across India)

CFPs/AFPs, preferably with an MBA, having 2-3 years' experience. You must be thoroughly conversant with Mutual Funds, Insurance and other financial products. Exceptionally strong communication skills and a pleasing personality are essential pre-requisites.

The benefits...

- ❖ A congenial and stimulating work atmosphere with emphasis on continuous learning
- ❖ Performance-based rewards and recognition
- ❖ Accelerated growth path for the deserving
- ❖ Best in the industry compensation package
- ❖ An opportunity to rub shoulders with some of the best brains in the Financial Planning industry

How to apply...

E-mail your updated resume to sonalbajaj@bajajcapital.com.

or, Call: **9811080065**



ALWAYS ACTING IN YOUR INTEREST (%)

Investments | Insurance | Financial Planning | Tax Saving | Retirement | Stock Broking*

* All Insurance products are sourced through Bajaj Capital Insurance Broking Ltd. an IRDA-licensed direct insurance broker. # Stock Broking products offered through Bajaj Capital Investor Services Ltd.

minimize current impact.

- iii. Transaction structuring in tax-optimum manner.
- iv. Asset location strategies: Determining which jurisdictions the assets should lie in so as to be tax efficient.

H. Routine activities:

- i. Preparation of returns for various entities in the family (including individuals, the office, trusts, etc.)
- ii. Representing before tax and compliance authorities.

I. Estate Planning:

More from an inter-generational transfer angle than the tax angle in India. Intelligent estate planning can help avoid many indirect taxes (like stamp duties) and/or liquidity events to satisfy the various claimants.

Legal Services

J. Intergenerational Transfers:

- i. Advice and coaching on precautions to be taken during the lifetime
- ii. Preparation and registration of the right set of documents
- iii. Execution of the will.

K. Creation of structures: for protecting wealth including legal advice on creation and structuring of holding companies, trusts, endowments, etc.

Family Governance/ Legacy Planning

L. Creation of various family forums: It is a rare family, wealthy or otherwise, that does not experience conflict (whether inter or intra-generational) at some point. For wealthy families, such conflicts can lead at best, to unwanted publicity and at worst, deep emotional trauma and dissipation of the asset base. A family office can help create various forums (family councils, family boards, etc) for the

A GREAT CHALLENGE for wealthy families is raising children to be productive adults, fully capable of stewarding the family's wealth during their turn.

discussions around such issues and actively seek to prevent, identify and resolve them.

M. Education of younger generations: A great challenge for wealthy families is raising children to be productive adults, fully capable of stewarding the family's wealth during their turn. A family office can play a highly positive role in helping educate younger generations about their future responsibilities and in offering opportunities to gain hands-on experience in dealing with those responsibilities.

N. Management of a closely-held business: Many families not only possess great liquid wealth, but also control an operating business. A family office can provide an ideal

forum for discussing how such a business will be managed and governed, for dealing with issues posed by the fact that some family members work in the business and some don't, for thinking about capitalizing and recapitalizing the business, and so on.

O. Legacy planning / philanthropy

- i. Clarifying family values and vision: why should an activity be taken up? What is the larger purpose it is serving?
- ii. Creation of legacy institutions: Either create charitable trusts or endowments in-house, or evaluate NGOs that can provide the services.

Administrative Convenience

P. Document management

- i. Retention of records
- ii. Upkeep and maintenance of records

Q. Performance monitoring and analytics

- i. Reporting on risk undertaken, returns delivered
- ii. Portfolio review in the light of strategic / tactical allocation
- iii. Rebalancing portfolio
- iv. Evaluating and reporting on various service providers (asset managers, lawyers, accountants, concierge service providers, etc)

R. Accounting and reporting

- i. Expense management - and advice on the same
- ii. Cash-flows, balance sheets for all entities in the office

S. Concierge services: A family office is a new way of life for the super-rich family. For example, the office will proactively insure all the family members. It will get you enrolled in the best - and relevant - clubs in the country and constantly keeps you and your family updated on the latest trends in your areas of interest. The office will manage access to the best in the class hospitals in the country and internationally. It will help you define and execute your long-desired vacations, get your family together, organize the event (book tickets, book hotels, etc.) and ensure a flawless delivery.

Note that the scope of the family office is significantly broader than a pure investment advisory company. The objective is not only return maximization but also preserving the family wealth and legacy. Also note that all the entities of the family office (different members or different tax entities like trusts, etc) will require the various services of the family office at different levels.

tilotia.akhilesh@parkfa.com



The author acknowledges the help of various family office documents, freely available on the internet, with special reference to GreyCourt, Inc.