
Tackling the single family office conundrum

When does an SFO make sense, and when does it not?

The tax, legal, business and regulatory environment for entrepreneurial families and family offices is constantly changing and not always favorably, which presents both obstacles and opportunities for families around the world.

Because family offices are, by definition, unique, involving complex and often idiosyncratic structures, critical decisions reached in one area of importance for the family will invariably lead to consequences – intended or otherwise – in another. With affluent families now facing an ever-growing array of complicated issues affecting every facet of their global business endeavors, it has become mission critical for them to develop a comprehensive strategy deeply grounded in their stated values, and fully aligned with their cross-generational vision.

The modern SFO exists primarily to centralize, preserve and transfer significant family wealth across generations while at the same time acting as an effective inter-generational safeguard and touchstone for the family’s collective values, aspirations, heritage and legacy. While the SFO may not appear officially on an organization chart detailing the family’s business holdings, it will frequently operate as the strategic catalyst for the family’s various enterprises. An SFO is often structured as a formalized independent business entity – or, alternatively, a cost center embedded within a private operating company – with the goal of centralizing services for a single family. Typically, an SFO will supply a comprehensive solution to managing a family’s wealth and financial affairs, handling myriad issues including wealth advisory and investment services, data aggregation and performance reporting,
corporate and family governance, accounting, tax and legal issues, estate planning, philanthropy, risk mitigation, IT security, family education, as well as integrated personal financial planning. An SFO may also specialize in managing the wealth of multiple generations within a family and advising on inter-generational wealth transfers and the financial security of family members.

While select SFOs function as independent wealth management institutions with experienced teams of investment and business professionals, the majority of SFOs currently operate with limited personnel and a business model that relies heavily on outsourcing critical family office functions to a cadre of trusted advisors. Reliable estimates indicate that more than 50,000 individuals and families with a net worth of at least U.S. $100 million and 10,000 SFOs exist globally. The overwhelming majority of SFOs are located in the United States.

During the next decade approximately U.S. $4.0 trillion of global wealth will be transferred to the next generation¹. The United States will see the greatest level of wealth transfer, with U.S. $1.6 trillion changing hands over the next 10 years, accounting for nearly 40% of the global total. This tectonic transfer represents 14,000 ultra-high net worth families and individuals with an average net worth of U.S. $272 million, and will result in an entirely new breed of ultra-high net worth individuals and affluent families around the world.

These projections contained in the Family Wealth Transfers Report not only underscore the importance of early and proactive planning to ensure a successful transfer of assets, but also flag the related issue as to how entrepreneurial families should best execute this historically unprecedented transfer of global wealth.

For a select handful of global families, creating an SFO may make sense in planning for the future. However, for the overwhelming majority, the administrative expenses, management concerns and compliance requirements swirling around the day-to-day operations of an SFO are astonishingly complex and utterly cost prohibitive.

**MOVING UP TO AN SFO**

Designing and implementing an SFO to custom-fit a family’s unique circumstances and strategic requirements will certainly involve thoughtful discussion, careful preparation and nuanced execution, including consideration of key threshold questions that should ultimately help to frame an earnest and honest conversation amongst members of the family:

- Where is the family in the life cycle of wealth (i.e., first-generation entrepreneurial wealth versus multi-generation established family fortune)?
- What is the family’s collective vision and game plan for the next 5, 10, 15 years and what is the family prepared to sacrifice in order to achieve success?
- What are the family’s specific financial and personal goals and how do they align with one another?
- Is the strategic objective to preserve family values or family assets or both?
- Is the family genuinely aligned in its desire to institutionalize an SFO structure?

Experience reveals that a number of discreet indicators (perhaps better stated as “pain points”) may often

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prompt a family to take deliberate and immediate action towards adopting some variety of family office model, whether it be to form a stand-alone SFO or to join with other like-minded and value-oriented families on a Multi-Family Office (MFO) platform.

Alignment
The family's immediate financial horizon has become increasingly murky and uncertain, and family leaders have become overwhelmed with the details and financial minutiae required to manage increasingly tangled family matters and business operations, spurring a strong desire to achieve superior alignment between family advisors and family members.

Framework
The family wealth creator is considering alternative goals and benchmarks for the family business and requires a formal roadmap and aligned team in order to pivot successfully to the next stage.

Strategy
The family has multi-generational intentions and objectives, however it can no longer clearly and cogently articulate its long-term vision. Moreover, certain family members have moved in different and often incompatible directions from the strategic goals and aspirations originally embraced by the family.

Family Cohesion
Following a liquidity event or anticipated transfer of family wealth, an SFO model can serve as a focal point of identification and cohesion for family members regarding any number of critical issues, including business exit planning and value acceleration considerations.

Privacy and Confidentiality
The overarching priority for the family has become to ensure absolute privacy and preserve strict confidentiality on all levels.

Succession Planning
The family has not selected a qualified successor and no clearly defined succession plan has yet to be considered.

Wealth Preservation
While the family has been traditionally focused on cost control, allocation, investment returns and dividend policy, wealth preservation is now becoming a rapidly growing priority owing to deep-seated concerns surrounding family cohesion and inevitable generational transitions.

Governance Architecture
Multi-generational family members are becoming increasingly alarmed that no formal governance architecture has been put into place to provide an effective and efficient operating structure by which to guide the family to the next level.

Information Overload
Critical family information has evolved into an eclectic amalgam of current and relevant—but also outdated and useless—information that is frequently impossible to decipher. The personal coordination of various investment managers, tax information and estate planning documentation has quite simply become overwhelming, chaotic and confused.

Regulatory Regime
The domestic and international tax, legal and regulatory regimes are constantly changing and more complex to manage, as the family's social and business relationships similarly evolve to include other like-minded families around the world.

EVALUATING THE FINANCIAL COMPONENT
A full-service SFO can easily cost as much as U.S. $1 million annually to operate, and in many instances may cost considerably more. The single largest components are consistently compensation and benefits, which together generally average around 60% of the total, followed by office overhead at 12-15%. From a benchmarking perspective, SFO costs are typically defined as a percentage of wealth (liquid and illiquid) and can vary widely depending on the nature of the wealth and the range of professional services required. A general rule of thumb is that annual SFO costs will typically range between 30 and 150 basis points. A smaller SFO will frequently come in at the higher end of the range because it has fewer economies of scale. Hence, when a family is considering the viability of an SFO, it should have a minimum net worth ranging between U.S. $250 million and $500 million.

Resources and related costs for an SFO are both internal and external:
• Internal costs include staff compensation and benefits, training and education, premises and infrastructure upkeep, office operations and overhead, technology and cybersecurity, and in-house regulatory costs.
• External costs include all the services and functions required by the family that are not otherwise covered internally.
• Whether to house a specific SFO function internally or externally will depend on a number of factors
MODEL FAMILY OFFICE FUNCTIONS

GOVERNANCE & LEGACY

- Business succession planning
- Family & corporate governance
- Long-term family vision & goals
- Next-gen education & leadership
- Multi-generational trusts
- Wealth stewardship
- Philanthropy

PLANNING & STRATEGY

- Manager due diligence
- Multi-generation wealth
- Goals and risk assessment
- Investment management
- Tax and estate planning

PERSONAL ADMINISTRATION

- Family office design & operation
- Talent & staff recruitment
- Paperwork management
- Comprehensive bill pay
- Aggregated reporting
- Document retention
- Personal concierge

COMPLIANCE & RISK MANAGEMENT

- Insurance
- Asset protection
- Regulatory compliance
- Family privacy & security
- Financial risk management
- Tax planning & preparation
- Cybersecurity & data privacy
including economies of scale, relative need for control, and the degree of active management required on components of wealth that may be unique to the family, amongst other factors.

A key additional consideration is the increased demand on free cash flow that an SFO will require, which is in addition to funds required to cover the personal needs of the family. While a family may be affluent in a macro sense, if a substantial amount of family wealth is tied up in illiquid and non-yielding investments, the amount of free cash available to design, launch and operate an SFO is considerably diminished. After deciding to establish an SFO, a family may discover that the composition of their assets needs to be adjusted to produce an increase in cash flow to cover the incremental costs. This is not necessarily a detriment, since the cost / benefit analysis behind establishing an SFO may well indicate that the reconstituted asset base will be managed with a heightened attention to value creation.

While an SFO can be established at a lower cost, its range will likely be limited to rudimentary services: SFO administration, control of assets, consolidation and risk management. For families on the cusp, where this narrower scope may be problematic, the tailored services of a multi-disciplinary MFO may make more sense than a stand-alone SFO.

Because an SFO by its nature is not as cost effective as an MFO (owing to its relative lack of scale), an SFO will consistently be called upon to revisit and re-evaluate its overall cost structure in order to maintain economically efficient operations. An MFO may negate a number of the economic disadvantages of an SFO, as an MFO is generally better positioned than an SFO to spread the cost of investments over a larger asset base and achieve higher cost efficiencies.

**FOR AN SFO TO BE VIABLE, A FAMILY SHOULD BE WORTH, MINIMALLY, BETWEEN $250 MILLION AND $500 MILLION.**

**REGARDING THE BROADER PICTURE**

The threshold question of whether to form an SFO or to join with other like-minded families on an MFO platform will inevitably hinge on a select group of highly specific and individualized family considerations.

**Wealth**

While family wealth coupled with projected growth are the first and obvious key factors to consider, a family also needs to take into account projected cash flow when considering whether to shoulder the financial responsibilities and implications of establishing and operating an SFO.

**Costs**

The cost of services will vary widely depending on which functions are provided within an SFO. Fees for an SFO will typically range higher than those for an MFO (owing to personnel and infrastructure costs). Regulatory and legal compliance are expensive SFO functions, which translates into the need to reserve sufficient cash flow to offset these fixed costs.

**Services**

Whether to create an SFO will depend directly on the range and types of professional services that the family will require to be delivered personally and exclusively. Certain families may wish to consider outsourcing a broad range of services that makes less economic sense to maintain in-house. Even a large and sophisticated SFO will want to assess whether or not to outsource certain services.

**Legacy**

Preserving vision, values and culture across generations through an SFO will appeal to those families for whom maintaining and safeguarding the family’s unique legacy is paramount. An SFO may also serve as the logical vehicle through which to channel the family’s educational, philanthropic and charitable programs.

**Priorities**

A standout function of the modern SFO is to address the immediate needs and requirements of the family across a host of correlated and independent disciplines. As an adjunct to its principal investment...
management purpose, an SFO may also consider employing certain qualified family members in appropriate leadership and management roles.

**Privacy and Confidentiality**
Privacy and confidentiality are amongst the most compelling drivers in deciding whether to form an SFO. Along with its other key functions, an SFO should operate as the exclusive vessel to maintain confidential financial and personal information and to vouchsafe the privacy of family members.

**Command and Control**
While many families will not wish to deal with the challenges inherent in employing independent staff, others may elect to employ dedicated personnel that they can control and direct. An SFO will typically employ a Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Chief Investment Officer (CIO), amongst others. However, with fewer family members now working in SFOs, staff recruitment has become an ever-increasing challenge. Families

While many factors argue in favor of establishing an SFO, there are equally compelling countervailing arguments, and some arguments can be found in both the “pro” and “anti” camps.

**REGULATORY CONSIDERATIONS**
An SFO will function most efficiently when operating in a jurisdiction that has adopted an appropriate tax, legal and regulatory framework. A full-service SFO is more likely to be in a better position to comply fully with applicable laws and regulations governing family offices, while a smaller SFO will be more challenged to maintain compliance and at the same time keep its associated costs in line. The absence of a sophisticated legal and regulatory environment for an SFO tends to explain the relative absence of SFOs in many emerging markets.

**PROJECTED COSTS**
The establishment and operation of an SFO is tremendously complicated and time-consuming. Regardless of jurisdiction, the cost of regulatory and compliance reporting is generally high, which means that there must be sufficient cash flow to offset the SFO’s fixed costs. Accordingly, families need to factor in their overall liquidity needs extremely carefully during the SFO planning process.

**MFO ALTERNATIVE**
An MFO will make sense when the high operating costs and administrative burdens of an SFO are simply too high. Instead of venturing alone, a family may either join an existing MFO or partner with like-minded families to pool their wealth in order to create an MFO that operates in alignment with their shared goals and values.

**PERILS OF GROUP THINK**
Too readily when a family elects to form an SFO, a certain amount of insularity may begin to settle in, and a “group think” mindset can emerge. Consistently reaching out to solicit advice and new ideas should help to mitigate this risk.

**DESIRE FOR FLEXIBILITY**
The SFO journey requires a sustained commitment of time, energy and resources to the mission, which may reduce the family’s capability and bandwidth to pursue new business ventures or other opportunities. The family’s desire to maintain maximum flexibility may argue against pursuing an SFO strategy.

**CONFIDENTIALITY AND TRUST**
Families forge long-term relationships with their business and personal advisors over decades. These relationships are premised on deep-seated trust and respect and are not easily jettisoned or altered. Exposing one’s personal financial and family issues to a new individual may leave certain family members feeling uneasy. Naturally, some may believe that it would be challenging for an outsider to appreciate fully the nuances of working closely with the family.

**STICKER SHOCK**
The reality of paying seasoned family office executives a generous salary and bonus may leave many families questioning the economics of pursuing the SFO track. An SFO can indeed be an expensive venture on many levels.
will frequently encounter a dearth of qualified or available SFO executives based upon issues including compensation, roles and responsibilities, and geographical preferences.

CONCLUSIONS
Highly successful families and family businesses the world over face an increasingly diverse and distinctly challenging array of risks and opportunities in today’s hyper-connected global business environment. Entrepreneurial families clearly have unique needs and requirements in comparison to corporate business operations. Similar challenges confront SFOs around the world.

The breadth, scope and focus of an SFO are as unique and personal as the family that creates it. While the primary functions of an SFO are to centralize the management and preservation of the family fortune and to effect over time a financially astute and tax-efficient transfer of the family’s wealth, additional critical SFO functions include family governance, estate planning, philanthropy, education and maintaining a critical complement to the core family business to the extent it continues to operate in family hands. Fashioning a successful SFO is a business process requiring a clear vision, a realistic business plan, a thorough understanding of the resources available internally and externally and a granular roadmap by which to design, launch and operate the SFO.

The decision whether to embed certain functions in your own SFO, or outsource all or part of the functions to an independent third party, can be as weighty as many of the decisions that led to creating the family’s wealth in the first place. It is always in the best interests of a family to seek out the broad experience and wise counsel of recognized experts and trusted advisors in the family office community as it evaluates the benefits and opportunities, as well as the challenges and drawbacks, of designing and implementing an SFO structure.

Your Fieldpoint Private team stands prepared to work closely with you at each step along the journey to consider all of the issues at hand and achieve the optimal result for your family.
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