WHITE PAPER

WHAT IS A FAMILY OFFICE?

Answers to Ten Key Questions

NORTHWOOD FAMILY OFFICE

Northwood Family Office is Canada's leading independent, privately-owned boutique family office which provides comprehensive Net Worth Management™ for wealthy Canadian and global families.

Tom McCullough
Chairman & CEO

Tom McCullough is Chairman and CEO of Northwood Family Office, one of Canada's leading multi-family offices.

In this white paper, Tom answers some of the key questions about family offices, including:

1. What is the history of the family office concept?
2. What are the differences between single-family and multi-family offices?
3. How are family offices regulated?
4. What are the range of services provided by a family office?
5. How does a family office interact with other professional advisors?
6. Do other professional advisors view family offices as competitors?
7. What benefits does a family office provide?
8. What role does a family office play in the sale or transition of a family business?
9. How many clients can a family office effectively service?
10. What is the typical background and experience of a family office principal?

Q. What is the history of the 'family office' concept?

A. You can probably go back to the 6th century to find the conceptual roots of the family office. At that time, the majordomo (or highest level domestic staff) was a person who would represent, make arrangements for, or take charge of the affairs of a noble family and its wealth as a family manager or administrator. The modern concept and understanding of family offices was developed in the 19th century. In 1838, the family of J.P. Morgan founded the House of Morgan, which managed the family's assets, and in 1882, the Rockefellers founded their family office, which continues today.

As families become wealthier, their affairs become more complex and require dedicated management services, provided by a family office

Family offices have really come into their own in the last 30 years. As families became wealthier – through business growth or investments – and as they grew in size – through marriage and childbirth – their affairs often became more complex and required dedicated management. What was easy to manage, with just a nuclear family and modest wealth, became a full-time job when there were multiple generations and substantial non-business wealth. So they brought in a trusted advisor – often the family lawyer or accountant, or perhaps a banker or investment manager – to help them manage and coordinate the various components of their family and financial lives. These included investments, trusts, tax planning, family education, wealth transition and financial administration. In some cases, as the workload grew, this person would bring on other staff to assist them in looking after the family. Thus, the family office was formed.

Another catalyst for the formation or engagement of a family office is a major life event, such as the sale of some or all of the family business, which vaults the family into a different league of financial liquidity and requires an entirely different set of skills than they needed when they were simply running an operating company.

No one really knows how many family offices there are, but estimates have ranged from 3,000 – 10,000 in the U.S. alone.

Q. What is the difference between a single-family office and a multi-family office? What types of families find a multi-family office an attractive service provider to them?

A. A dedicated family office or single-family office (SFO) looks after the affairs of one family or a small group of related families and gives 100% of their attention to the family they serve. They also are paid for by that one family. Most experts agree that families setting up a single family office can expect to pay a minimum of $1 million per year in expenses and often much more. If a family is large enough – at least $500 million in family net worth – and has enough complexity to require the full-time services of a single-family office, it can make sense.

The difference is comparable to owning a private jet. You can have your own and cover all of the costs, or you can own a fractional interest and share both the access and the ongoing expense

But if the family is smaller (i.e. between $10 million to $500 million), they may choose an option like a multi-family office (MFO). In this case, the family essentially shares the family office resources with other families, under the assumption that they don't need the full set of resources all the time and would like to share the costs. Of course, all of the information is kept completely confidential. It is like owning a private jet. You can have your own jet and cover all of the costs, or you can own a fractional interest in a jet and share both the access to it and the ongoing expenses.

Families who choose a multi-family office are usually looking to them for some or all of the following things:

1. Proactive objective financial advice
2. Creative solutions to their financial issues from a professional team with diverse backgrounds
3. Integration of the family's estate planning, income taxes, investments, philanthropic goals and family governance
4. Having them act as a clearinghouse for financial, investment, tax and estate planning ideas
5. Providing access to 'best-in-class' investment managers, banking and insurance solutions
6. Coordination of other advisors
7. Cross-fertilization of ideas resulting from working with multiple families
8. Negotiated cost savings with other financial providers (e.g. investment management, custody, trading costs).

The number of multi-family offices has grown very quickly in the past decade alongside the growth in the number of ultra-high net worth families. Some other advisors (accounting firms, financial planning firms, and investment advisors) are converting themselves to multi-family offices, or are at least trying to use the multi-family office term to attract larger clients. Since there is no real definition of a family office or regulation in most jurisdictions (yet), it's often hard to tell if an advisor really is a multi-family office. You've really got to dig to figure out what the firm is offering and how objective and client-oriented it is.

Q. Are multi-family offices governed or regulated in the conduct of their respective practices by any third party institute, association, or other agency?

A. At the firm level, family offices are typically not regulated unless they provide investment advice. In Canada, for instance, firms that provide financial planning advice or family management are not regulated, but those that provide investment management are. Most often, those family offices that offer investment advice to multiple families are regulated by the relevant provincial securities commissions.

At the firm level, the provision of financial planning advice or family management are not regulated activities, but investment management is

At the employee level, many professionals who work in family offices carry professional designations, subjecting them to the authority of their own professional organizations such as accountants, lawyers, CFA charterholders, CFPs, etc. and therefore must comply with their relevant profession's standards of care.

In the US, single family offices often operate just like a corporation (a limited liability company [LLC] or possibly a private trust company). They are generally exempted from the SEC's investment advisor regulations, if they comply with certain criteria, primarily related to working for and being owned by one single family. Multi-family offices tend to be registered investment advisors (RIAs).

Q. What specific services does a multi-family office provide to its clients?

A. Every family office is different. In fact, it is often said: "If you've seen one family office... you've seen one family office." But most family offices provide five broad categories of service to their family members. In some cases, they provide the services themselves internally and in other cases they outsource them to specialists and simply play a supervisory and coordination role.

1. **Holistic financial management:** This includes goal-setting, financial planning, cash flow planning, estate planning, business succession and wealth transition planning. In this context, family offices often play a key coordination role with the family's other advisors to provide simplification, integration and to balance competing interests.

2. **Investment management:** This includes determining investment goals, developing an investment policy, making asset mix decisions, and selecting and supervising investment managers. Again, sometimes this will be done internally and sometimes it will be outsourced, often depending on the skills within the family office and the complexity of the family investment strategy.

3. **Administration and management:** This can include a wide array of services such as keeping minutes of meetings, making tax installment payments, reviewing insurance policies, writing trust resolutions, bill payment, accounting, cash flow management, and identifying trustees, executors and powers of attorney, just to mention a few.

4. **Consolidated reporting:** This typically includes comprehensive reporting across all entities (such as individuals, trust, hold-cos, foundations, etc.), as well as specific investment reporting.

5. **Family development:** Family offices are usually involved in many non-financial components of the lives of their families as well, including family meetings, governance, education, communication and conflict management.

Q. Is there any standard or commonality with respect to how different multi-family offices interact with their clients' other professional advisors?

A. A good family office works closely with the family's other advisors. Typically the other advisors (e.g. legal, tax, accounting, investment, insurance, business valuation, M&A etc.) are 'deep' in their own area of expertise whereas as the family office is 'broad'. The advisors' most important contribution is bringing specialized expertise that will benefit the family in a particular area. The family office's expertise is the family and their overall goals and fitting all the various pieces together to make sure the goals get accomplished effectively and efficiently.

The family office's expertise is client family knowledge and fitting all of the various pieces together to make sure family goals are accomplished

In many cases the family office plays a lead, proactive role for the family, bringing in their existing advisors at the right time or additional new advisors when there is a need. The family office also has an eye to the family itself and how the technical issues might impact the family relationships or succession plans. For complex wealthy families, it is hard to imagine a successful outcome without both 'best in class' specialist advisors and a coordinator or family office.

A family office manager has been likened to a general practitioner (GP) physician or a general contractor in a home renovation. For instance, in the case of a GP, their focus is on the health of the patient and they work with the patient's existing specialists or bring others in as needed.

Similarly, a general contractor provides the overall leadership and direction to a building project to ensure the owners get what they want. To accomplish the end goal, they use the expert trades (e.g. drywall, plumbing, electrical etc.) to manage specific technical components of the work. Otherwise, without a contractor the family would have to manage and coordinate all the trades themselves.

The average high net worth family often has at least 7-8 advisors whose activities need to be coordinated by the family office

In the same way, a family office works with the family's accountant, tax advisors, lawyers, investment and insurance advisors and family business consultants to ensure the key tasks are accomplished and things don't fall through the cracks, because most activities for families are integrated and can't be looked after by one silo of expertise. The average high net worth family often has at least 7-8 advisors whose activities need to be coordinated. For instance, the purchase of a vacation property in another country will typically involve:

- Investment / financial issues: Where will the funds come from to pay for it?
- Tax and legal issues: How will it be structured to protect it from estate tax and liability risks? Who will be the trustees of the trust that will hold the property?
- Insurance: How will it be insured?
- Family communication: Who will have access to it? Will there be a schedule?

Q. Does a well-run multi-family office typically function as an intermediary between its clients and their other professional service providers? Do these advisors view multi-family offices as competitors, interferers, or complementary services providers?

A. It depends on the situation. A good family office plays an overall coordination role, but most successful families also have a number of well-qualified, competent, and often longstanding advisors. When the issue at hand relates to just that advisor, clients may deal with that advisor directly. When the issue is more complex and multi-faceted, the family office is more likely to be actively involved. In all cases, it is usually helpful to ensure that the family office is copied on all activities and transactions so they can keep track of the big picture for the family.

A good family office plays an overall coordination role

Good advisors typically see the role of the family office as additive, even advisors who have been working with the client for a long time.

Most advisors will agree that there are often things in a family's financial life that fall through the cracks and that there is often no one with the knowledge, time or mandate to play the 'general contractor' role for the family. Family offices are not normally specialists in any one specific area, so they rely on and work closely with the family's other trusted specialist advisors.

In our practice, when we start to work with a new family we typically develop a strong working relationship with the family's existing advisors, such as lawyers and accountants, and often have the opportunity to refer them to other families who are looking for new advisors. Family offices often play a proactive role within the family helping to move the ball forward on areas that are deemed to be a priority, particularly where there is complexity and multiple people and issues are involved.

Q. What are the specific benefits to clients of a multi-family office of the approach you have suggested?

A. There are five main benefits of using a multi-family office:

1. **One-stop shop:** A family office provides coordination, simplification and ongoing management of complex financial affairs. It allows the family to go to one place to deal with pretty much any financial issue. If it is something the family office can't look after itself, it will bring in and coordinate with the relevant advisor. More often than not, big issues will require the input of multiple advisors, which the family office will facilitate.

2. **Unbiased advice:** True family offices are 100% focused on the best interests of the family and are completely objective in their recommendations and advice. A true family office is paid only by the family and doesn't sell any products. Families can be fully confident that the counsel they are getting is balanced and trustworthy.

3. **Organization and management:** Family office clients benefit from the confidence that comes from developing clear goals and strategic direction for the family, implementing good governance, deciding and documenting the critical issues, having regular consolidated reporting, putting contingency plans in place, and ensuring proper communication with all key stakeholders. Most families can't say they have this confidence, but it is achievable.

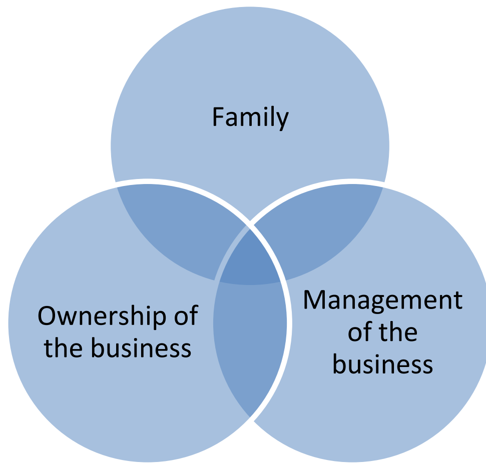
4. **Economies of scale and cost saving:** One of the other benefits of a multi-family office in particular is the economies of scale that result from combining the buying power of multiple families. This can apply to investment management fees, custody charges, research, and professional fees, as well as access to investment managers and services.

5. **Continuity and institutional memory:** A multi-family office also provides a stable advisory team who can work with a family over the long term, often across generations, and keep consistent records of key information and decisions the family makes over time. A multi-family office also reduces the risk of losing a key long term member of a single-family office and the disruption that could cause.

Business transitions can generate large amounts of liquid wealth, which the family office then helps to structure, invest, and manage

Q. What role does a well-run multi-family office typically play in its clients' business transition strategizing, planning and execution?

A. The successful transition or sale of a business is one of the most significant financial and life events for that family. Family-owned businesses are often said to be made up of three intersecting circles – the management of the business, the ownership of the business, and the family itself:



Source: Renato Tagiuri and John Davis

In a business sale or other transition, the process is normally led by the management team with the assistance of an investment bank or mergers and acquisitions firm. The family office usually focuses on the other two circles – the owners and the family – helping them understand, agree to and prepare for the likely changes to come, including how to structure, invest and manage that wealth. The family office, with its deep knowledge of the family and its goals, as well as its experience in a wide variety of technical topics, plays an important role in providing the family with guidance and counsel in what is often completely new territory for them.

In many business transitions, the family ends up with more liquid wealth than they have ever had before and will need to prepare for this new life and the opportunities and challenges it will bring. The impact of that wealth can be overwhelming and even ruinous to families who have not been educated in the stewardship, responsibilities and management of financial wealth. It can also have an effect on inter-generational relationships. Communication between parents and children can be challenging at best, and a sensitive topic like money can make it even more difficult, unless it is handled well.

The ratio of family office principals to number of clients can vary depending on client family complexity

Q. Is there any typical ratio between the number of principals in a multi-family office and the number of clients those principals can effectively service?

A. No, it really depends on the number and complexity of client families. Because the family office looks after such a wide range of activities for each family and the families' assets are relatively large and often complex, there is typically a lot of detailed customized work for each family.

Most principals will have some highly qualified back-up staff (e.g. accounting managers, investment analysts, administration, etc.) that will help him or her handle the load, and provide services on a cost-effective basis to the family. In our multi-family office, the ratio of staff to families is about 1 to 5.

Family office professionals need to be integrated advisors with a broad and unique skill-set

Q. What specific academic backgrounds, business experience, etc. do you believe are best suited to working as a principal in a multi-family office?

A. Family office professionals need to be integrated advisors. They need to have a unique set of skills, experience and temperaments to deal with the complexity of both the financial and family issues they are called to advise on. Many of these integrated skills have to be developed 'on the job'. Principals usually come from one profession of origin (typically accounting, tax, legal, investment, or consulting) but then develop the other skills they need over time. The most common designations of family office professionals include:

- CPA (Chartered Professional Accountant)
- CFP (Certified Financial Planner)
- CFA (Chartered Financial Analyst)
- LL.B. (law degree)
- MBA (Master of Business Administration)

In addition to technical competency, family office professionals require a unique set of additional talents. They need superior organizational skills and detail orientation, natural curiosity, a desire to help people and solve their problems, excellent listening skills, a sense of objectivity and fairness, and a willingness to make thoughtful, often difficult decisions. It takes years to build up the skills, expertise and experience to become an effective, practicing integrated family officer advisor. And clearly, not everyone has the temperament, interest or skills to become this kind of advisor.

Conclusion

The family office concept has developed to meet the increasing complexities and growing size of the wealth held by multi-generational families. If the family's net worth is large enough, typically above $500 million, it can make sense to establish a single-family office which is dedicated exclusively to servicing that family's needs. For families with less than $500 million in net worth, multi-family offices typically make the most economic sense as both the costs and resources of the family office are shared across several families.

Since they are largely unregulated, family offices can vary greatly in terms of the scope of services provided and size. However, good family offices are generally multi-disciplinary, integrated advisors, working in concert with a family's existing specialist advisors to play an overall coordination role. Family offices typically provide five broad categories of service:

1. Holistic financial management
2. Investment management
3. Administration
4. Consolidated reporting
5. Family development

Most family office professionals come from an accounting, tax, legal, investment, or consulting background, with a similarly broad range of professional qualifications including the CPA, CFA, and CFP designations.

Multi-family offices can provide tremendous value to families, including:

1. A one-stop shop
2. Unbiased advice
3. Organization and focused management
4. Economies of scale and cost saving
5. Continuity and institutional memory

Overall, we believe that the family office is a compelling solution for successful families, providing a dedicated team of professionals who oversee and manage their complete financial affairs.

Northwood Family Office

Northwood Family Office is Canada's leading independent, privately-owned boutique family office which provides comprehensive Net Worth Management™ for wealthy Canadian and global families. Northwood also serves as a Chief Investment Officer (CIO) for client families, helping them assess their objectives, design an appropriate investment policy, select and manage investment managers and provide comprehensive reporting.

Northwood client families typically have $10 million or more in family net worth.