NORTHWOOD FAMILY OFFICE

WHITE **PAPER**

The Shoemaker's Children:

Why smart, successful professionals can benefit from a family office

Introduction

A few years ago, I was talking to a lawyer who was lamenting the lack of time and attention she was able to devote to her own family's personal financial affairs. "My personal affairs never make it to the top of my in-basket," she said. While she clearly wanted to manage her own affairs well, client issues always seemed more important – and certainly more urgent.

It reminds me of the old Scottish proverb – and its variants in many other languages and cultures – "the shoemaker's children go barefoot." The moral of the story is that a busy cobbler is so busy making shoes for his customers that he has no time to make shoes for his own children.

The families of many senior executives, investment bankers, investment managers, consultants and other professionals (-- let's call them High Performance Professionals or HPPs) may be euphemistically 'barefoot' when it comes to thoughtful, strategic management of their family's financial affairs.

Some of us, like the cobbler, have the expertise to do it well, but simply lack the time. Some of us have the time, but lack the specific skills to put a coordinated plan in place and manage it consistently. Some of us, if we are honest, lack both the time and the requisite skills.

We may advise large corporations or even wealthy individuals on their financial, legal or management strategy, but on the home front we don't have an Investment Policy Statement for our total combined investment portfolios, we're not sure if we are over- or under-insured, and we don't know exactly how much capital we will need to finally 'hang up our skates'.

Take the test

The following self-assessment test is a good place to start. It will help you assess the degree to which you have a handle on your financial affairs, or where you need some help getting and keeping them in good order -- for your own sake and for your family.

Private Wealth Holder *Self-Assessment* Test

Yes	Not sure	No	
			ORGANIZATION AND PLANNING
❑	❑	❑	Our financial affairs are well-organized and in good order.
❑	❑	❑	I know what my family's long term goals are and can quantify them.
❑	❑	❑	I receive regular, easy-to-understand, consolidated reporting on all our family holdings across all of our entities and family members.
❑	❑	❑	Our personal financial situation is straightforward, I enjoy managing it and I feel I am doing a good job.
❑	❑	❑	We have a very good document records system that allows us (or our heirs) to quickly put our hands on whatever we need.
❑	❑	❑	I can safely say that very few financial details fall through the cracks in my life.
			INVESTMENTS
❑	❑	❑	I know what rate of return we need from our investments to ensure we meet our family's objectives over the long term.
❑	❑	❑	I am confident that our asset allocation is appropriate.

Private Wealth Holder *Self-Assessment* Test

Yes	Not sure	No	
❑	❑	❑	Our investment managers have been objectively reviewed recently and I am confident we have the right ones in place and in the right combinations.
❑	❑	❑	We have a written Investment Policy Statement for our overall investment portfolio that clearly lays out the objectives, limitations, review process and accountability.
			RISK MANAGEMENT
❑	❑	❑	I am comfortable that we have the appropriate level of risk in our portfolio.
❑	❑	❑	We have a regular, consistent review process in place to evaluate the success of our investments and other financial issues against relevant benchmarks.
❑	❑	❑	We are well-diversified and not overly reliant on one particular investment.
			TAX PLANNING AND STRUCTURING
❑	❑	❑	I am comfortable that we are taking advantage of all the tax efficiencies available to us.
❑	❑	❑	I am confident that the tax location of our investment assets is optimal.
❑	❑	❑	I understand how the use of a trust could decrease the amount of tax we pay.
❑	❑	❑	I fully understand the tax implications of any U.S. assets we own (eg. real estate, securities etc.) and have protected ourselves accordingly.
			ESTATE PLANNING AND SUCCESSION
❑	❑	❑	I have a clear idea of our estate objectives and how much our heirs will receive and when.
❑	❑	❑	Our wills have been updated in the past three years. We have properly-executed powers of attorney for financial and health care purposes.
❑	❑	❑	I feel comfortable that our children are financially well-educated and sufficiently responsible to inherit the assets that are likely to be left to them.
❑	❑	❑	I understand all our insurance policies and am confident that they are appropriate and up-to-date.
			CASH FLOW MANAGEMENT
❑	❑	❑	I know exactly how much capital I will need to be able to retire and to maintain our standard of living.
❑	❑	❑	I know what our family expenses are and feel confident that they are manageable over the long term.
❑	❑	❑	I have a game plan in place to prepare for a liquidity event, such as retirement, receiving my deferred compensation or cashing in my shares or partnership interests.
			FAMILY ISSUES
❑	❑	❑	Our family has frequent, open, healthy dialogue about money and financial issues.
❑	❑	❑	I'm comfortable that my spouse and children will be able to manage if something happened to me.
❑	❑	❑	I am comfortable that our family net worth is not likely to be at risk if one of my children gets divorced.
❑	❑	❑	If any of my family members is a U.S. citizen, resident or green card holder, I understand the tax and compliance risks facing the family and have addressed them.
			ADVISORS
❑	❑	❑	I have an advisor who is knowledgeable and objective regarding all of the issues listed above.
❑	❑	❑	My advisor is proactive and regularly anticipates the key issues that need attention in my life.
❑	❑	❑	I know all the fees we are paying to our advisors and understand the value we receive and the impact on our net worth.

			TOTAL

Could you use some help?

If you answered 'no' or 'not sure' to **three or more** of the questions above, you are likely missing some significant opportunities to improve your financial situation, and your peace of mind as well.

Like many HPPs, you may feel that you *should* be able to take care of these issues yourself, but, for whatever reason, history shows that it doesn't happen.

Who are High Performance Professionals (HPPs)?

- Senior investment bankers
- Senior private equity managers
- Senior management consultants
- Senior lawyers and other professionals
- Senior hedge fund/ investment managers
- C-level executives (CEO, COO, CFO)
- Professional managers
- Entrepreneurs

And there is also the feeling of insecurity about who you might turn to for help. Do they have sufficient expertise and experience? Are they trustworthy? Will they handle our affairs with suitable care, attention and sensitivity?

All fair questions! And, until recently, it has been difficult to find a satisfactory solution to these issues due, among other things, to the structure, compensation and silo-nature of the financial industry and the lack of credible, integrated alternatives, focused on private wealth holders.

The family office has long been one of the solutions to this need for integrated unbiased advice. Unfortunately, they were only available to the privileged few. Dedicated (or single) family offices were originally conceived in the 1800s to look after the complex, personal affairs of the wealthiest families in the U.S. and Europe. And each *single*-family office served only one family.

However, over the past 30 years or so, *multi*-family offices have emerged in the U.S and are now seeing explosive growth. More recently, they are starting to spring up in Canada. Multi-family offices (MFOs) bring a similar customized and coordinated service to multiple families of more modest wealth -- typically $10 million or more in family net worth. High performance professionals are often well suited to this type of service.

The development of a family office 'industry' in Canada is particularly important for Canadians given the substantial differences between U.S. and Canadian taxation and family law, which must be understood and incorporated into family wealth planning.

The benefits of a family office

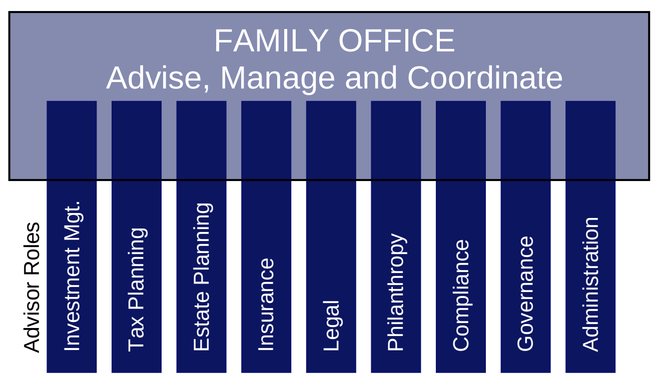
There are a number of reasons a family might consider engaging a family office, which are outlined below.

1. Coordinated, strategic approach to family wealth
2. Time saving and complexity management
3. Fee savings and tax savings
4. Proactive risk management
5. Objectivity, independence and confidentiality
6. Dedicated, consistent team of professionals

The family office model also addresses many of the conflicts and compromises that private wealth holders have faced with the standard financial service offering.

1. Coordinated, strategic approach to family wealth

The approach used by most family offices involves an integrated view of all the diverse components of a family's affairs, including investments, tax and estate planning, cash flow management, family governance and education, and philanthropy, among others.



The family office manager typically plays the role of coordinator or 'general contractor' and bringing the appropriate expertise to bear as needed and working closely with the family's other advisors to develop and implement a coordinated plan and ensure that it will be effectively implemented. It bears noting that the absence of this type of fully integrated approach to wealth planning can have dire and unexpected consequences, which are often not discovered until it is too late.

2. Time saving and complexity management.

As HPP's business success increases and their financial affairs become more complex, time becomes the scarcest resource. Because of its role as 'general contractor' (which normally includes planning, implementation and oversight of a family's financial affairs), the family office can take a significant load off the shoulders of the family member(s) to whom the financial and family leadership responsibility normally falls.

While many HPPs are capable of looking after their own affairs, they come to see it as a trade-off, and choose to invest their time in their business, family or leisure activities, and use the services of a family office to coordinate personal family investments and finances.

A family office can also significantly improve the effectiveness of the collaboration among professionals. For instance, the work of integrated tax planning, estate planning and will preparation can be significantly streamlined and enhanced with this kind of expert coordination and shepherding.

The family office will typically keep minutes, records and relevant documents in an organized fashion for ease of regular access and for succession planning. The ongoing, regular review process also helps keep the focus on getting things done.

3. Fee savings and tax savings

Fee savings, for clients of a family office, can be significant compared to the typical a la carte approach most private wealth holders use, which features a collection of stand-alone advisors and products and investments. When a family joins a multi-family office, they essentially become part of a 'buying group' that gives them access to better (i.e. institutional-level) pricing and other important fee savings.

For instance, in a typical case, a family with $10 or $20 million in liquid investments might spread their money among several investment managers and may pay 1% to 1½% at each manager (plus additional custodial fees), depending on the asset classes selected. A multi-family office can normally negotiate much lower fees for clients because it represents a large block of combined assets. The HPP should benefit from this group purchasing power.

Other benefits are also often available such as savings on custody, trading fees and professional service fees, and 'access' to investments (such as private equity) with otherwise much-higher minimum asset levels.

A family office will also typically arrange for third party providers to quote on other services -- property and casualty insurance, as an example -- to ensure the client is getting the best value for their dollar and has appropriate coverage. The 'sample fees' example below illustrates the impact of fee and tax savings that can be available to clients of a multi-family office.

Sample fees for a family with $20 million of net worth*

Fees for comprehensive family office services	0.60%
Savings on investment management fees	(0.20%)
Savings on custody and professional fees	(0.10%)
Tax savings	(0.25%)
Net cost of family office services	0.05%

Note: This is an example only. The actual results may vary substantially based on the individual circumstances of each family.

**Fees charged on family net worth, assuming half is liquid investable assets.*

A family office also offers the economies of scale associated with *experience*. Because the family office deals only with very high net worth families, it brings substantial experience and expertise to bear on many of the complex issues that are common to wealthy families.

Finally, the tax savings that can be uncovered from a diligent review of the family wealth and structures can be substantial, depending on the circumstances of the family (eg. number, age, income and tax rates of family members, trusts and other structures, employment or business income etc.)

For instance, let's assume an investor has $10,000,000 of liquid investments in his own name, is taxable at the top marginal rate and his spouse and three young children have no income. By simply setting up a trust, with his wife and children as beneficiaries (and possibly even himself), and then loaning the funds into the trust at the 'prescribed rate' of interest (currently at 1%, the lowest it has ever been) the investor can split income among his family members.

Depending on the rate of return available on the investments, the annual tax savings could reasonably result in an extra 1.0%-1.5% pre-tax 'return' on the portfolio – not just *this* year, but *every* year – with no additional risk. This strategy may be applicable for many families, particularly in this low-interest rate environment, but like any such strategy, requires professional advice, administration and review. It is indicative of the type of integrated tax planning offered by family offices.

For many families, the actual out-of-pocket cost of the family office services can be covered several times over by the fee and tax savings.

4. Proactive risk management

Risk management is one of the most important (yet most undervalued) roles of a typical family office. Many wealthy HPPs have highly concentrated assets – in terms of their 'human capital' (i.e. the net present value of their future earnings stream), their share ownership, or their carried interest. The risk of this degree of concentration is often not fully evident until a major episode takes place that exposes it, such as we saw in 2008 and 2009.

For instance, many senior investment bankers realized just how much of their net worth and their retirement plans were riding on the price of one stock. Many management consultants saw their business pipeline dry up (-- temporarily, as it turns out) as corporations waited to see if the world was going to end in 2008. And private equity partners understood illiquidity in a new way and, in some cases, readjusted both their business and personal goals.

Other significant risks that require attention and mitigation include:

- Dying without an updated will, or being incapacitated without an appropriate power of attorney
- Unwitting exposure to U.S. estate taxes and reporting requirements
- Improperly structured or managed trusts
- Divorce without proper protection of family wealth
- Poor planning and insufficient documentation on the death of the key decision maker. (Indeed, one of the major factors driving some HPPs to join a family office is the confidence that their spouse and children won't be left to fend for themselves in the event of the death of the HPP.)

5. Objectivity, independence and confidentiality.

A family office must be independent and objective so it can offer completely unbiased advice to the family. Normally this means that the family office does not sell any product and is paid only by the client. The family office often becomes a key trusted advisor in the family network.

A good test of the objectivity of your current advisor is whether he or she would recommend paying down non-deductible debt if it meant reducing the amount of investments on which they receive fees.

Confidentiality is important for all clients, but can be particularly important for people who are in senior executive, director or partner roles. In some cases there is a public nature to the executive role and there can also be regulatory restrictions on their activities or investments that must be handled expertly and discreetly.

6. Dedicated, consistent team of professionals

A family office provides a stable team of well-qualified staff who get to know the family needs and become both a coordinator of the family's financial activities and a trusted advisor. In addition to being technical specialists, family office staff act as a sounding board, problem solver and an objective source of reliable, dispassionate advice. Given the long-term nature of the relationship, the family office often becomes the 'institutional memory' for the family, safeguarding a wide range of important family records, decisions and wishes, often across multiple generations.

Contrast this with the frustration many private wealth holders face in the management and administration of their financial affairs. The high level of staff turnover at their private bank or advisory firm often means they have to re-explain their situation to a new person every few years. And the lack of integrated technical expertise often requires the client themselves to coordinate the sharing of financial administration and details among their multiple advisors.

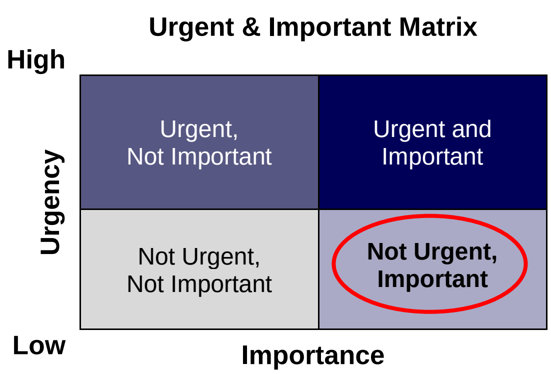
Other salient factors

It can be helpful to find a family office which has experience with families who have similar issues to your own. For an investment professional, senior executive or consultant, some of those specific factors might include:

- Concentrated stock positions
- Partnership issues
- Restricted issuers
- Illiquidity of private holdings
- Directorship agreements
- Credit line/ cash flow management
- Significant travel/ time constraints
- Relocation
- Tax-effective private school funding
- Dealing with 'product pitches' from friends
- Income splitting with spouse and children
- Retirement decisions
- Multiple homes in various jurisdictions
- U.S. holdings (stocks, real estate)
- Tax-effective philanthropic funding

The tyranny of the urgent

The now-ubiquitous 'Urgent and Important Matrix', shown in the diagram below, highlights the dilemma busy professionals face every day.



The upper right-hand quadrant represents the tasks that are both *Urgent and Important* (eg. responding to a call from a client). Most busy executives can get to those tasks right away.

The two quadrants on the left-hand side represent activities that are *Not Important* (-- whether *Urgent* or *Not Urgent*) and can be significant timewasters. Those activities should be efficiently managed, minimized or, where possible, eliminated.

The problem seems to be the activities in the bottom right-hand quadrant entitled *Not Urgent*, but *Important*. While we know the task is important, it somehow 'never makes it to the top of our in-basket' because it never seems urgent.

Getting a coordinated plan in place for a family's financial affairs with the right kind of advice and a regular review process clearly falls into this quadrant. Bringing in the resources and disciplines available from a family office can be a helpful step in accomplishing this important objective.

A trip to the 'shoe store'

Engaging a family office is a relatively new option for wealthy families in Canada and may be an interesting (and cost-effective) solution for the investment, consulting or business professional who is very busy 'making shoes' for clients and wants to ensure their families are 'at least as well shod'!

If you have further questions about whether a family office is suitable for you and your family, or would like to arrange a meeting for a complimentary consultation, feel free to contact me directly at (416) 502-6288.

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The Author
Tom McCullough is President and CEO of Northwood Family Office. He has almost 30 years of experience in the wealth management and family office field, and was a senior executive at RBC Financial Group for many years before co-founding Northwood. He teaches in the MBA program at the Rotman School of Management at the University of Toronto and is an Entrepreneur-in-Residence at the Richard Ivey School of Business at the University of Western Ontario. Tom also serves on the editorial board of The Journal of Wealth Management and is a frequent speaker on issues of importance to wealthy families and their advisors.

Northwood Family Office LP

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

The challenges that come with significant wealth should not be underestimated. Many families with complex family structures own a diversity of investments, business and real estate interests and need the independence, objectivity and counsel that a family office firm can provide. Northwood serves as the single point of contact, like a Personal CFO (Chief Financial Officer), who clients can call on any issue related to their affairs.

Northwood's mission is to bring direction, perspective and confidence to the everyday management of our clients' net worth. We help our clients to define a clear sense of the direction they want to take, and to develop a broader and longer-term perspective. We work closely with our clients' existing professional advisors to ensure that everything is coordinated and integrated.

We are hands-on managers with a 'get things done' orientation. With strong emphasis on building a long-lasting relationship with each of our client families, we believe regular, ongoing communication is essential. And throughout the entire process, Northwood maintains absolute confidentiality with respect to our clients and their private information.

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