NORTHWOOD
FAMILY OFFICE

ALSO IN THIS ISSUE:

The Northwood PERSPECTIVE

Chairman's Message: A Matter of Trust

Tom McCullough

I had the pleasure of attending a two-day conference on Trustees and Beneficiaries in Atlanta last month put on by the Family Office Exchange (FOX). At Northwood, we help many of our clients manage various aspects of their family trusts and select appropriate trustees. I also serve as a trustee for several trusts and wanted to learn how to be the best trustee I can be.

It was interesting to be reminded of where the concept of trusts originally came from. The law of trusts first developed in the 12th century during the time of the crusades. When a landowner left England to fight in the crusades, he conveyed ownership of his lands to someone else in his absence (the trustee) to manage the estate and pay and receive feudal dues, on the understanding that the ownership would be conveyed back to the original landowner on his return.

Since that time, trusts have become widely used by families of wealth for tax planning, protecting assets, controlling assets and distributions, and gifting funds to future generations. In fact, one of the speakers at the conference quoted a study suggesting that "90% of assets today will end up in trusts".

Trusts have all sorts of positive benefits for families but, like everything, they can have a dark side too. In fact, the same study says that "80% of beneficiaries view their trust as a burden" in some way. Trusts can create uncertainty, mistrust, passivity and a sense of being controlled, a far cry from the original intent of the trust to enhance the life of a beneficiary. Many of the speakers spoke about the need to regain this positive perspective.

For this to happen, all parties (settlor, trustee, and beneficiary) must act with integrity (='trust'), each person must play their role proactively, and there must be effective communication.

Keith Whitaker, co-author of the book *Family Trusts: A Guide for Beneficiaries, Trustees, Trust Protectors, and Trust Creators* spoke about the five principles by which **trustees** should operate: (1) Do no harm, (2) Fidelity (i.e. keeping the spirit of the gift alive and continuing the grantor's intent), (3) Regency (i.e. standing in the place of the heir until they can stand alone and helping them become independent), (4) Discernment, and (5) Courage.

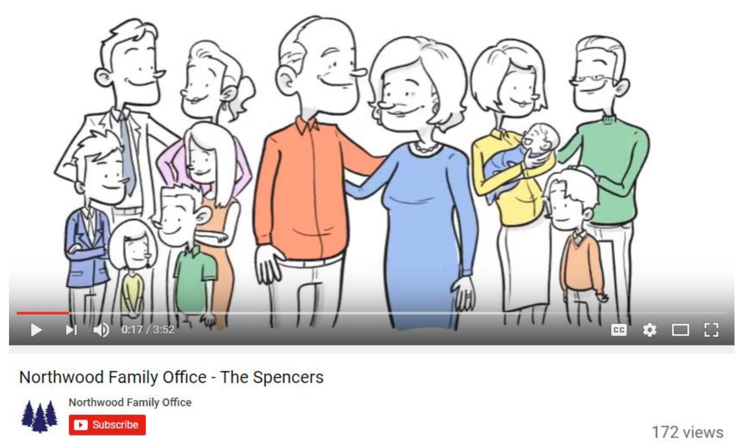
A **grantor** from a family of wealth talked about the 'Last Letter' (or Letter of Wishes) he has written to his beneficiaries so they will know *why* the trust was set up. There is usually a lot of information about the 'what' and the 'how' of a trust, but usually very little on the 'why'.

And **beneficiaries**, for their part, need to recognize their responsibilities (e.g. education, participation, engagement etc.) as well as their rights.

Lots of great food for thought in an important topic for most families.

Tom

New Northwood Video: "The Spencers"



We are often asked what a family office does for client families. With this in mind, we recently produced a short hand-drawn animated video that introduces you to *'The Spencers'*. They are a fictional family, but altogether typical of the families that need the services of a family office. Please click the link below to watch the video. You can also find it on YouTube by searching for 'Northwood Family Office'.

Enjoy the video and feel free to share it.
We'd love to hear your comments.

[The Spencers]

A Common Reporting Standard

Barrett Lyons, CPA, CA, CFP, CIM

In 2014, the US government started enforcing the rules of the Foreign Account Tax Compliance Act (FATCA), and Canada announced it had entered into the Canada-US Intergovernmental Agreement. The purpose of the US FATCA rules was for the US to ensure tax compliance and raise revenues by tracking down US taxpayers worldwide. In Canada, the new rules created a great compliance burden for the Canadian financial services industry and impacted many Canadian financial institutions and individuals. Three years later, the US introduction of FATCA has led to a similar international program for OECD countries called the Common Reporting Standard (CRS).

The CRS officially launched in Canada on July 1, 2017. It is an international standard for the automatic exchange of financial account information between tax administrations to fight tax evasion and promote voluntary compliance with tax laws. 101 jurisdictions have fully committed to the program. Each country requires its financial institutions to report on financial accounts held by non-resident individuals and entities, and share this information with other CRS jurisdictions. Many countries are focused on cracking down on tax evasion and the CRS is the latest tool in the global effort to increase cooperation and disclosure between jurisdictions.

In Canada, these rules have been adopted into the *Income Tax Act* and each financial institution will now have an obligation to divulge specified account holder information to the Canada Revenue Agency (CRA). The CRA will disclose this information to other jurisdictions that have signed on to the CRS, and in turn will receive the same on Canadian accounts abroad. Most Canadian residents will not be impacted by these new rules, but the CRA will now know about Canadians' foreign accounts in all CRS jurisdictions, and foreign nationals (from CRS jurisdictions) with Canadian accounts will now have their accounts reported to the authorities in their resident tax jurisdiction.

Going forward, we expect that all new account opening forms from Canadian financial institutions will require an account holder to state their tax residency status. The information required to open an account will include the following:

- Identifying information for the account holder (name and address)
- Taxpayer identification numbers
- Date of birth
- Account number
- Account balance at the end of the year
- Certain amount paid or credited to the account

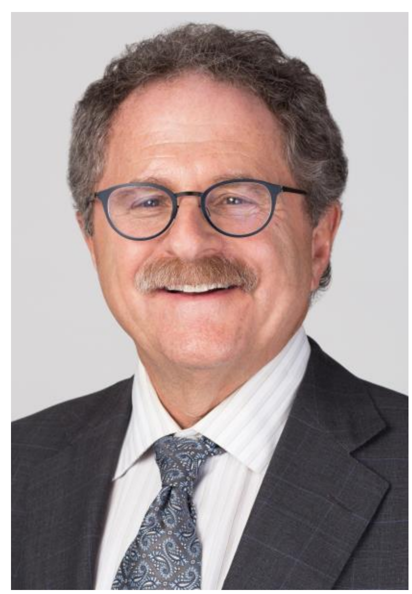
Canadian financial institutions will have to disclose the above account information to the CRA beginning in May 2018. In the meantime, you can expect some correspondence from your financial institutions to confirm the tax residency of each one of your accounts. Most registered accounts have been deemed to be low risk for tax evasions, and as a result have been excluded from the CRS. At Northwood, we will be closely monitoring the implementation of the Common Reporting Standards and their impact on the financial affairs of Canadian and global families of wealth.

New Northwood Addition: Lorn Kutner

We are pleased to announce that we have engaged former Deloitte Partner Lorn Kutner to work with the Northwood team.

Lorn is a Chartered Professional Accountant (CPA, CA) and has MBA and B.Sc. degrees from the University of Toronto. He recently retired as a tax partner from Deloitte LLP after 38 years in public accounting, 36 of which were in tax. Lorn's practice focused exclusively in the private company marketplace where he assisted high net worth families, shareholders and key management in designing tax efficient structures, minimizing both corporate and personal taxation and advising on estate planning considerations.

Lorn is a valuable edition to the Northwood team and we are all looking forward to working with him. Keep an eye out for articles by Lorn in future editions of *The Northwood Perspective.*



A Different Breed: The Family Office Advisor

Andrew Jeffery, CPA, CA, CLU, CIM

We are regularly called upon to answer the question, “how exactly is a family office different than other advisory firms?”

We can certainly cite the range of services we offer, from integrated planning to selection and oversight of investment managers to consolidated reporting (not to mention the myriad of customized services we undertake to simplify and improve our clients’ lives).

We could also cite the types of clients we serve – typically entrepreneurs and executives with over $10 million in net worth.

While both of these explanations provide some level of clarity as to the distinctiveness of a family office, it doesn’t tell the whole story. Because the family office is in the business of providing advice to families, so much of ‘*what* we are’ is ‘*who* we are’.

When it comes to being successful as a family office advisor, or a practitioner of integrated wealth management, a diverse skillset is required. Good family office advisors will typically possess the following traits:

1. ‘Expert-Generalist’ Skill Set

Because family offices provide an integrated service that crosses many disciplines, a successful family office advisor could be described as what famous investor Charlie Munger calls an ‘expert-generalist’. An ‘expert-generalist’ is someone who has the ability to master and collect expertise in many different disciplines, industries, skills and capabilities. A typical family office advisor will usually have material levels of competency in several key technical areas including taxation, investments, accounting, insurance, business transaction, estate and succession planning and family dynamics. Having a broad range of interconnected skills is essential to the success of a family office advisor.

An ‘expert-generalist’ is someone who has the ability to master and collect expertise in many different disciplines, industries, skills and capabilities.

2. Listening Skills, Discernment and Empathy

At the end of the day, the job of a family office advisor is all about understanding the client family, helping them discern what is really important to them and building a plan to make sure that happens. The actual needs of the family are often buried beneath layers of history, complexity and family dynamics and must be gently drawn out. In order to do this job, the advisor must possess superior listening skills, the ability to get down to the real issues in the family, all the while, being empathetic to the client’s needs and values. It is also helpful if the advisor has a natural sense of curiosity and an orientation toward solving problems.

3. Project Management and Prioritization Skills with a Detail Orientation

Most families of wealth have higher-than-average complexity and many issues that need attention. The family office advisor must be able to understand the details of all of these components, prioritize them on the ‘urgent and important’ scale and manage each project so it makes progress and moves across the finish line at the appropriate time. These projects must also fit together under the overall strategic game plan, which often involves working in tandem with outside professional advisors.

4. Confidence, Healthy Skepticism and the Ability to Make Tough Decisions

The family office advisor needs a high level of confidence which is often developed over years of experience and professional practice. Confidence is needed because part of the job of a family office advisor is to make the tough decisions that require thinking about the family’s affairs holistically and on a long term basis. The advisor needs to be able hold to the plan in difficult times, to challenge the client directly sometimes when it is required, and to work with the client’s other advisors, suppliers and family members who may all have differing opinions. The advisor should have a healthy amount of skepticism, and be willing, for instance, to say ‘no’ to investment opportunities that do not meet the client’s needs. At the same time, the advisor should be a lifelong learner whose intellectual curiosity leads to continued professional and personal development and must be able to work effectively with all advisors and family members.

5. Broad Interests in Areas Relevant to Wealthy Families

It may seem obvious, but in order to be successful as an integrated wealth advisor you must be genuinely interested in all of the areas that are relevant to families of wealth. Topics that might fall into this bucket include family governance, philanthropy, family dynamics, business management and education. Good family advisors also get to know all of the family members and are interested in their lives and what is important to them. Family advisors are not primarily specialists in one narrow area of technical knowledge. Rather they are specialists in the family as a whole, their goals and aspirations, and how the technical expertise can be brought to bear on achieving those multiple priorities.

As you might imagine, no one family office advisor has all of these traits in equal measure. At our family office we work as a team to ensure that the broad base of experience required for this integrated service is there for every single client family.

How a Family Should Approach Investment Risk

Scott Hayman, CPA, CA, CFP, TEP

Most wealthy families have likely been through the standard risk assessment process that takes place at the beginning of a new advisor relationship. They have been asked to answer a series of boilerplate questions to gauge the level of portfolio volatility they think they can stand emotionally, which is often characterized as *risk tolerance*. The advisor may also take an inventory of the family's assets and liabilities to understand their financial needs and to determine their *risk capacity*, which is their actual financial ability to take on risk. This information establishes the risk profile for the family, which acts as the foundation for the advisor to build an investment strategy for the portfolio.

Assessing Risk Based on What Your Family Requires

While this typical approach to measuring risk meets all the necessary regulatory hurdles, in our view it is missing one critical component. At Northwood, our definition of risk is 'not having the funds available at the time you need them'. In conducting a risk assessment, it is imperative for the advisor to consider the family's *risk requirement* as well. This is the rate of return they will need to meet all of their liabilities (goals) throughout their lifetime.

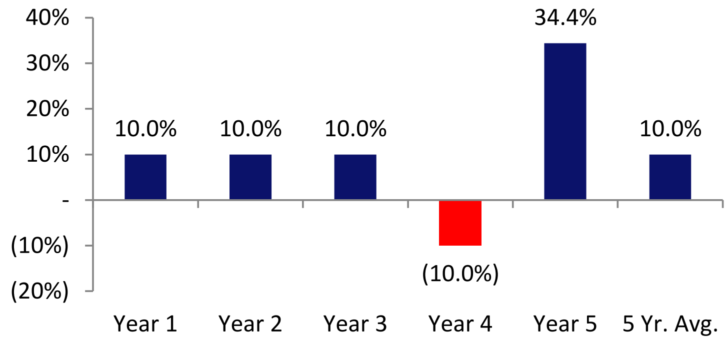
When risk requirement is left out of the equation, investing families can end up taking on more risk than they should. A family may have high risk capacity due to their significant financial resources, and high risk tolerance based on their financial resources. This combination can lead an advisor to structure a portfolio that aims for a return that well overreaches what is actually required for the family. This approach of 'going for the highest possible return' may seem appealing when markets are in an uptrend. But taking unneeded risk to earn 'higher' return could result in investment losses in the inevitable down markets, which can be detrimental to the ability of the family to achieve its objectives.

Taking Unneeded Risk Can Be Detrimental to Your Family's Capital

Consider the following hypothetical example where a family's risk requirement *isn't* factored into the mix. Under the guidance of their advisor, a wealthy family with both a (perceived) high tolerance and capacity for risk strives to earn an average annual return of 10% per year over five years. The family manages to earn a 10% return in each of the first three years, but in the fourth year suffers a 10% loss.

Now to achieve their goal they will need a 34% gain in year five (see Exhibit 1). So what is that family likely to do after year four? Given the fragile nature of risk tolerance (which tends to be high in good markets and low in bad markets!), they might get nervous and go to all cash, abandoning their goal and missing out on any potential market upside in the final year by not being invested. Or they might feel compelled to take on much more risk to 'get back' to their long term 10% annual return goal. Neither outcome is likely to yield desirable results for the portfolio.

<u>Exhibit 1: Hypothetical Return Scenario</u>



What if this family, based on a detailed cash flow analysis, figured out that they actually only required a modest average annual return of 4-5% to meet their objectives? Had the advisor tempered their goal to that level at the outset of the relationship, perhaps more of the focus could have been on preserving capital and ensuring all of the family goals could be funded, leading to a much better and more predictable outcome by the end of the period. In the serious pursuit of wealth management, "Discretion", as they say, "is the better part of valour."

Consider the Big Picture When Measuring Risk

In order to ensure the most optimal outcome to the risk assessment process, it is also important that families review their risk in context of their complete portfolio and not just their investible assets. This includes illiquid assets (i.e., the business, private investments), personal assets (i.e., house, cottage) as well as human capital (i.e., your future income streams).

At Northwood, we help entrepreneurs, executives and high-performance professionals manage the often-challenging transition from wealth creators to wealth owners, which is a significantly different stage of life. These families have already taken substantial risks to create their wealth and do not want to lose it. For these families, we suggest that when they think about risk it should not only be focused on making the most money, but on ensuring that all of their goals can be funded (both now and into the future) and protecting what is most valuable to them.

In our initial meetings with clients, we recommend a plan that concentrates on aligning the family's portfolio to meet their actual objectives instead of trying to 'shoot the lights out' because they have the means and inclination to do so. By taking this approach we are better able to ensure that that their financial needs are met while preserving the wealth that they have worked so hard to build.

Poloz Takes the Plunge

Scott Dickenson, CFA, MBA

Until earlier this month, the last time the Bank of Canada (BOC) raised its benchmark interest rate was almost seven years ago. September 2010 was a very different time; Donald Trump was still a reality TV star and real estate developer, and Justin Trudeau was simply the Liberal representative for the small riding of Papineau, Quebec. Since that time, the BOC cut its benchmark rate twice (both occurring in 2015), but had never felt comfortable enough with the strength of the Canadian economy to raise rates. This changed on July 12, when BOC Governor Stephen Poloz raised the benchmark interest rate by 25 basis points to 0.75%.

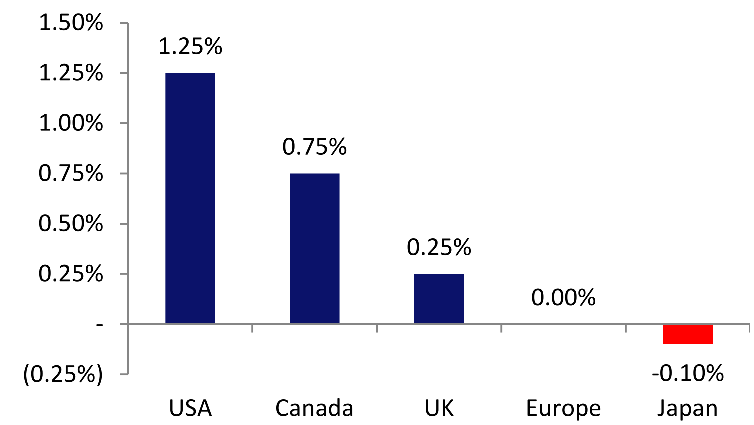
This rate hike had been widely expected by markets and economists, as Poloz and other BOC deputies had been hinting at the need for higher rates over the last couple of months. In the announcement, the BOC emphasized the recent acceleration of economic growth and downplayed persistently low inflation data. They also brought forward their estimated date for when the output gap will be closed (i.e., the economy returns to full capacity) from the first half of 2018 to the end of 2017.

Although there was no specific mention of the Canadian housing market in the rate statement, the effects of the decision will obviously be felt there. With housing prices still at or near record highs in some of the country’s biggest cities, many Canadians have taken on million-dollar mortgages that will become more expensive in a higher interest rate environment. In fact, many of the major Canadian banks had already boosted their five-year fixed mortgage rates earlier in the month in anticipation of the BOC’s rate hike. RBC is predicting that the BOC benchmark rate will increase to 1% by the end of 2017, and will likely be at 1.5% by the end of 2018. If the BOC follows that type of rate hike path it could cool housing markets, especially in cities like Toronto and Vancouver.

The Canadian dollar has also strengthened over the last quarter as markets began to price in the likelihood of the July 12 rate hike. After dipping below 73 cents US in early May, the Loonie has been on the rise ever since and has now hit 80 cents US. This strength has largely been driven by an improving domestic economy and monetary policy expectations, as the price of crude oil (usually a catalyst for CAD moves) has been flat over the same time period. The Canadian dollar has not been this strong in over two years, and many forecasters are now beginning to wonder if the recent strength can be sustained in the face of persistently low oil prices. With WTI Crude Oil still priced below $50 USD per barrel, some are beginning to question if the Canadian dollar will be able to continue its recent run in the coming months.

Taking a more international perspective, Canada just became the first G7 nation to raise interest rates since the US began its own tightening cycle in December 2015. With speculation growing that the Bank of England may also raise rates for the first time in a decade, it seems we may be entering a new global cycle of monetary tightening. With the American stock market bull run now in its ninth year, it will be interesting to see how local and global stock markets react to a shifting global monetary policy regime.

Exhibit 1: Current G7 Benchmark Interest Rates (July 19, 2017)



Who is Northwood Family Office?
Northwood Family Office is an independent, privately-owned boutique family office which provides comprehensive Net Worth Management™ for wealthy Canadian and global families. Northwood clients have significant family net worth, typically in the $10M and above range. The firm acts as a Personal CFO or Chief Advisor to client families using a dedicated team of professionals who oversee and manage their integrated financial affairs. Northwood Family Office is Canada’s leading independent multi-family office and has consistently been ranked the ‘#1 family office in Canada’ in the *Euromoney* Global Private Banking survey. For more information, visit our website or contact Tom McCullough for a confidential conversation.

NORTHWOOD FAMILY OFFICE

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