
## ASSESSING WEALTH SERVICE MODELS FOR THE AFFLUENT FAMILY

### OVERVIEW

As wealth increases, the complexity of financial matters becomes more of a burden on many families. This may lead to the decision to establish a single-family office, join a multi-family office or outsource certain activities to a financial institution such as a bank or brokerage firm. Cultivating and documenting the values and goals of a family requires significant time and effort, but it should help guide financial decisions and life choices. A family's goals may begin to diverge as wealth transfers through multiple generations. For example, the wealth creator may desire to be heavily involved in managing all aspects of their wealth while succeeding generations may choose to instead rely on qualified external advisors. Family members inheriting wealth may desire to focus on their passions and careers and become less interested in managing the legacy wealth. These diverging interests often lead to a decision to evaluate a service model that will best balance the needs of each stakeholder within the family.

Single-family offices are dedicated to providing services to one specific family whereas multi-family offices serve a select group of unrelated wealthy families. Many banks and brokerage firms have created a wealth management platform for a large and diverse group of their clients. The family often has a goal to transfer the burden of the administrative financial responsibilities of their wealth to a service provider. The capabilities, services and structure of the single-family office, the multi-family office or the bank/brokerage service model are important factors in their choice. Family harmony or independence will also represent key factors in the decision. This white paper reviews the benefits and limitations of each service model and also identifies relevant matters to help families of significant wealth better discern what may be the right choice for their family. At Colony Family Offices, we believe that an independent multi-family office generally provides the most attractive model based upon a careful evaluation of the considerations discussed below.

### Genesis of Evaluating the Appropriate Service Model

Typically, an event occurs that causes the family to consider or reevaluate their options. Examples are:

- Sale of family business and desire for outsourcing the financial management
- Death of wealth creator and complexity of estate planning structures created
- Succession of leadership of family office; key personnel retirement
- Growth in the number of extended family members becoming an administrative strain on the family or the single-family office
- Cost/benefit analysis of a single-family office no longer makes sense
- Technology costs and desire for "best-in-class" solutions
- Diversity of family relationships and location of family members
- Fairness of household fee sharing
- Friction between family members goals and values
- Desire for autonomy, privacy and independence

These events lead to new decisions about managing family wealth. Significant fee savings generated by consolidating investment management with other services like trustee services, bill-pay, general ledger bookkeeping, tax planning, financial planning, estate planning, charitable planning and governance may therefore become very attractive if each of these services can be delivered by the same provider rather than a collection of multiple different providers. However, family autonomy, family harmony, desired privacy and independence always needs to be considered when making the decision.

## UNDERSTANDING THE ALTERNATIVES

### Typical Structure of a Single-Family Office

Single-family offices usually hire in-house CPAs, attorneys and, in certain cases, investment advisors to serve their family. An executive director with relevant experience in wealth management, tax and estate planning – or, in some cases, a family member – is chosen to lead the family office. The family office is typically governed by a Board of Directors or Family Council comprised of family members from one or more of the family branches and may include outside advisors. The single-family office often provides financial, estate and tax planning and may include investment advisory services, tax preparation and/or bill-pay and bookkeeping services. Certain services may be outsourced to external providers, but the single-family office coordinates all outsourced services for each family member. The payroll and overhead costs are billed to each family member based on a negotiated fee sharing arrangement, or an asset management fee may be used, which incorporates the cost of the family office in the fee structure.

**Benefits of a Single-Family Office**

Many families choose to create a single-family office to maintain the following benefits:

- High degree of privacy and confidentiality
- Autonomy to promote family harmony and continuity
- Customized solutions based on comprehensive knowledge of the family's assets and ownership structures
- Proactive process based on specific family goals
- Coordinated execution of estate and tax planning
- Cost savings of coordinated services (elimination of duplicate efforts of individual family members)
- Time efficiency due to streamlined communication with external advisors

**Limitations of a Single-Family Office**

Inherent in the single-family office structure are the following limitations and risks:

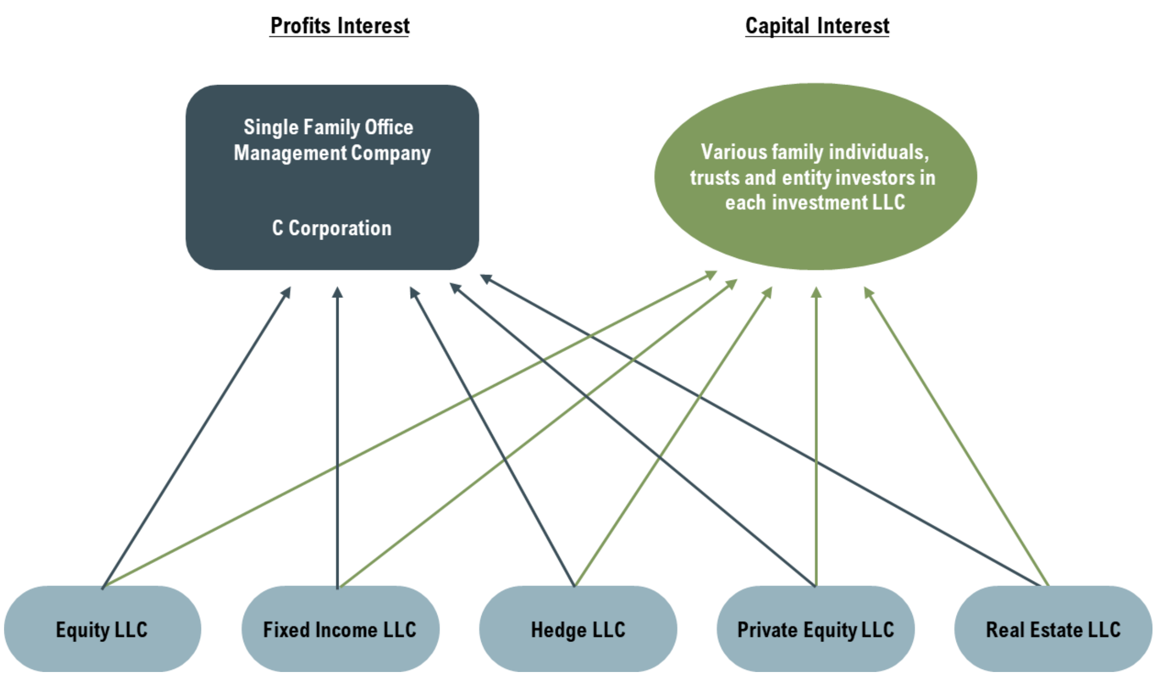
- Wealth creator sets mission and goals for the family office; next generation may not buy in
- Key personnel concerns about job security during succession of family leadership; key-person risk of retirement or departure (executive director and/or key personnel) and lack of equity compensation structure may generate limited upside
- Key persons may have limited exposure to a multitude of new ideas or become complacent (e.g., silo effect may set in as a result of lack of cross fertilization of ideas that might otherwise present opportunities)
- Overhead costs (e.g., rent, payroll, benefits, technology, etc.) may be cost prohibitive
- As the family grows, costs per household increase due to larger number of family members being served, while the size of each account may go down
- Perception of fairness of fee structure per family household
- Potential friction among family members
- Not all families want to work together in managing a family office

**Key Decisions in Structuring a Single-Family Office**

If a family decides to establish a single-family office, key decisions need to be made up front, and the governance structure is critical to the success of the office. The following questions are not exhaustive but are examples of decisions relating to governance.

- Will all family branches have a seat on the Board of Directors or Family Council ("Leadership")?

- What is the succession plan for each family branch's representation in Leadership?
- Will Leadership be limited to a specific number of family members for orderly direction?
- Will key decisions require a unanimous vote or a simple majority?
- At what age or life event (e.g., death of parent, marriage, children, etc.) will next generation members become eligible for Leadership?
- Should members of Leadership be required to have business experience or business degrees?
- How will the family remove a member of the Leadership and for what reasons?
- Will provisions be made for dissolving the single-family office?
- How much insurance coverage for errors and omissions, fraud, cyber-security and business disruption should be considered and what disaster recovery policies and procedures are most appropriate?
- Will the single-family office be sustainable after the wealth creator passes away?
- What if certain family branches choose not to participate and stop using the family office?
- If a holding company structure with a profits allocation model is desired to maximize the deductibility of certain expenses, should the economic interests of the holding company remain consistent with the ownership percentages of each family-pooled investment LLC across all family branches? See the illustration below.

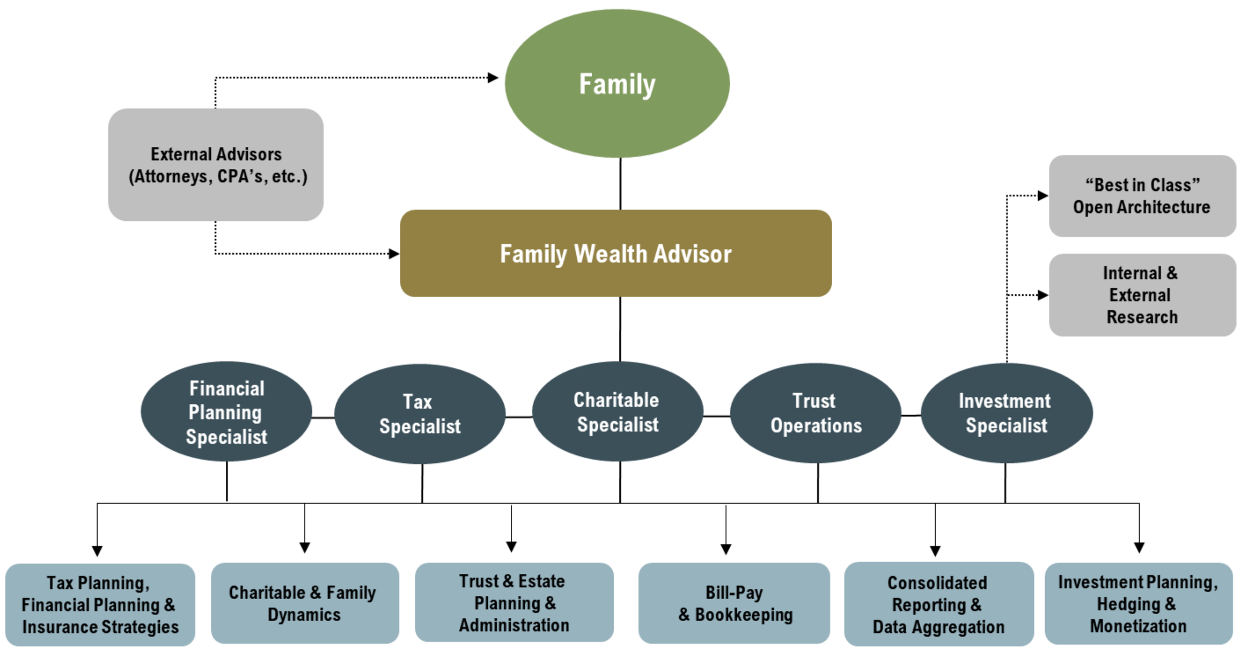



***If a family chooses to join an independent multi-family office or institutional wealth platform manager, the potential family friction and complexity created by the above structure may be greatly simplified.***

### Typical Structure of an Independent Multi-Family Office

An independent multi-family office is usually owned by its employees rather than a large financial institution or private venture fund. This means the owners retain more autonomy to customize the business model to the needs of their clients without becoming beholden to the earnings pressure of a public company or venture investor expectations. Multi-family offices hire wealth management advisors (usually CFAs and CAIAs), CPAs, CFPs and attorneys to serve a select group of wealthy families.

## MULTI-FAMILY OFFICE SERVICE MODEL




Multi-family offices retain experts from diverse backgrounds across the full spectrum of financial, accounting and legal disciplines to assemble a client service team to be responsive to the needs of each family. Each client family typically is assigned a designated client service associate, wealth advisor and portfolio advisor. All family office personnel are aware of each family's specific goals and services and sign a confidentiality agreement with the firm. Privacy and discrete confidentiality remain pillars of this model.

### Benefits of an Independent Multi-Family Office

- Strict privacy and confidentiality (although service providers are not family members)
- Serve in a fiduciary capacity (in the best interests of the client) versus a suitability standard, which is more common among broker-dealer firms
- Estate administration and trustee services may be available if the multi-family office has a trust company charter
- Customized solutions based on comprehensive knowledge of the family's assets and ownership structures

- Broad range of experience gained from working with multiple families (cross-fertilization of ideas)
- More robust compensation structures to retain key personnel, including potential equity participation
- Institutional memory (usually less employee turnover than institutional wealth platform and more robust succession planning for team members' retirement or departure)
- Breadth of investment research and options for investing based on open architecture platform (no bias associated with pressure to sell internal products)
- Access to managers with high minimums and ability to negotiate lower price structures based on volume
- Experience with multiple external advisors (attorneys, CPAs, insurance, etc.) yielding a best practices advantage
- Lower costs for families due to investment fee break points and ability to spread costs among multiple families rather than a single family
- Regulated by SEC and/or a state banking commission or OCC (if corporate trustee services are offered)
- Self-sustaining, viable business enterprise assuming adequate insurance coverages are in place to cover most unforeseen risks

**Limitations of an Independent Multi-Family Office**

- Service team may change due to personnel retirement or departures
- Perception of loss of family autonomy and continuity
- Families may question the prioritization of their family in relation to other families
- Multi-family offices may not offer certain concierge services that in-house employees of a single-family office might perform (examples include coordination of travel arrangements, property management, vacations, event planning, etc.)
- The long term financial viability and adequacy of the firm's errors and omissions, fraud and cyber-security insurance coverages could be called into question as a result of costly litigation or other business disruptions ("potential lack of deep pockets")
- While multi-family office advisory fees are typically similar to those of an institutional wealth platform, they may be higher than the internal payroll costs of investment managers employed by a single-family office

**Evaluating the Independent Multi-Family Office**

Due diligence on the independent multi-family office is critical to the success of the family client relationship. Important factors to be considered are:

- Leadership of the independent multi-family office – their expertise and backgrounds
- Succession plan for leadership

- Is the independent multi-family office majority owned by employees, or do certain client families own a large stake in the business? Is the firm's success and management practices tied to a few of the firm's larger family clients?

- How do current clients of the firm rate their relationship with the multi-family office?

- Is the firm proactive?

- Do respected attorneys, CPAs and other trusted advisors recommend the firm?

- Does the firm have sufficient insurance coverages, including errors and omissions, fraud, cyber-security and business disruption and disaster recovery policies and procedures?

- Is the firm sustainable, or are the economics tied too heavily to certain key client families?

- What is the service platform for family members at each generational level?

Understanding how the multi-family office serves each family member and how the firm is aligned with the family's goals will give the family a sense of the firm's culture and values. Excellent client service should be a hallmark of the firm.

**Typical Structure of Wealth Services Offered By Larger Financial Institution**

Banks hire private bankers, who may be CFAs, CPAs, CFPs and attorneys to serve a large number of wealthy families. Banks utilize a client service team to serve the different families. Each client family typically is assigned a designated client service associate and private banker. The investments are usually managed by the bank's internal investment platform and a portfolio advisor is assigned to the family. Brokerage firms are similar. The client will usually work with a broker and his or her team. Brokerage firms historically have different compensation structures based on the sale of investments and/or other products. Some also charge commissions based on transactions. Commission structures are contrasted with wrap fee programs or asset-based fee arrangements.

**Benefits of a Large Financial Institution**

- Offer different models – some may be based on a fiduciary standard (in the best interests of the client) or a client can choose to have investments on a bank or brokerage platform (suitability standard). Some clients may fall in a hybrid model

- Brokerage commissions may generate less fees for assets that are bought and held since commissions only apply as securities are bought and sold

- Access to extensive bank or brokerage products for private clients (e.g., checking accounts, CDs, credit cards and lending)

- Broad range of experience gained from working with multiple families (cross-fertilization of ideas)

- Investment research and options for investing available through bank or brokerage investment platform (may include bias toward internal mutual funds and other proprietary investment products)

- Coordination of bank or brokerage services; access to bank/brokerage products with higher minimums
- Experience with multiple external advisors (attorneys, CPAs, insurance, etc.)
- Regulated by FINRA, the SEC and/or a state banking commission or OCC (if corporate trustee services are offered)
- Viable business enterprise as part of a larger financial institution

**Limitations of a Large Financial Institution**

- Privacy and confidentiality may be impacted (large numbers of bank/brokerage employees may mean less privacy)
- Service team may change more often due to higher employee turnover levels when compared with independent firms; creates potential for loss of institutional memory than would normally be perceived from a larger, more long-standing institution
- Private bankers and/or brokers are encouraged to cross sell bank or brokerage products
- Higher volume of family clients may lead to less attention to proactive solutions
- Less customization in investment allocations to fit bank or brokerage investment firm models; cookie cutter approach
- Private bankers and brokers have sales goals and may focus on profitability of the bank or brokerage firm since it may be tied to their compensation
- Lack of integration and coordination among private banker, broker and trust department for trustee services
- Bank and brokerage restructurings and mergers are common and can routinely cause disruption in service teams
- Wealth management departments of large public banks are built to achieve economies of scale and may represent a small percentage of the bank's overall earnings, which means cost cutting efforts may have a greater impact on the client service experience and their ability to offer customized and tailored solutions – brokers in brokerage firms are not immune from some of the same issues
- Public banks and brokerage firms are subject to continual market forces, including quarterly earnings reports and pressures to cut costs and increase margins
- Compliance and risk management bureaucracy and red tape imposed by larger institutions that have experienced costly litigation can negatively impact the institution's ability to customize and offer novel and creative solutions for its clients

**Evaluating the Large Financial Institution**

Due diligence on the bank or brokerage firm and its wealth management operations is critical to the success of the family client relationship.

Important factors to be considered are:

- What is the expertise and background of leadership of the wealth management division of the bank or the corresponding leadership of the brokerage firm?
- What is the succession plan for leadership?
- Is the success of the division dependent on profitability goals? If so, how profitable is this segment of the overall institution?
- How do current clients of the firm rate their relationship with the organization?
- Are the preferred bank or brokerage products useful for the family compared to other alternatives outside the institution? What minimum investment management requirements exist in order for the family to take advantage of preferred institutional products?
- Do respected attorneys, CPAs and other trusted advisors recommend the institution?
- What is the service platform for family members at each generational level?

Some families may find loyalty to their banking relationship creates a sense of comfort and simplification. Attention to each individual family member's financial planning and goals – and not just the wealth creator's goals – may represent a material factor in deciding to consolidate services with a larger financial institution.

## SUMMARY

The complexities of wealth require thoughtful management. Making the right choice for the family can be difficult. Selecting a wealth service model requires a thoughtful look at the benefits to the family as well as how family harmony may be affected. An independent multi-family office may be the solution for many families desiring to create and sustain their family legacy. This model should promote family harmony and cost savings while honoring the privacy and confidentiality of all family members.

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