TFOA

Texas Family Office Association, LLC

SERVING THE SINGLE FAMILY OFFICE COMMUNITY SINCE 2007

How Do You Create A Single Family Office?

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Creating an SFO to fit your family's specific needs and circumstances requires considerable thought and preparation. Families considering forming an SFO should put together a motivated group of family leaders and trusted advisors to lead the planning effort, with input from outside specialists, as necessary. The following, while not totally comprehensive, serves as a helpful checklist to get started:

- **Mission Statement**

Families planning an SFO should take time at the outset to consider the purpose of the SFO and its role within the family. A critical early task in setting up an SFO is defining the mission of the family office. Developing a concise, focused mission statement to guide the work of the SFO will help to avoid 'mission creep' in future years. The founders should avoid drafting a mission statement that is vague and short on specifics. A consultant can help a family mold its vision and values into a practical and useful tool to guide the work of the SFO for generations to come.

- **Needs and Objectives**

There are three critical questions to be addressed early in the planning and development phase of creating your family office:

1. Who are the clients?

Defining which individuals and entities will be served by the SFO is a critical activity. A comprehensive list should include all individuals and entities to be served, including family branches, investment entities, businesses, trusts, trust companies and foundations. The design of the SFO will need to consider each client's unique needs and requirements.

2. What assets will be managed?

Once the clients have been identified, a list of all the assets the SFO will be responsible for managing is needed. This will include marketable securities, hedge funds, MLPs, direct investments, oil & gas leases, operating businesses, residential real estate, commercial real estate, farms/ranches, collections, aircraft, yachts, horses, sports teams, etc. The SFO will need to hire or outsource the specific expertise needed to oversee and manage the assets.

3. What services are needed?

Families with extensive investments, or with liquid capital to be invested, will need investment management services, including an investment policy statement and asset allocation plan, manager due diligence, and investment reporting. All SFO clients will need comprehensive and accurate performance reporting, accounting, and tax-return preparation. Coordination of risk management - such as insurance, security, and reputation management - will also be needed. Development and coordination of estate and tax planning, possibly including management of a private family trust company, is another obvious need for multi-generational families, but can be equally critical for a first generation entrepreneur who wishes to perpetuate the family's long term legacy. Other possible services include property management and staffing, bill payment and concierge services.

The adage of "shirt sleeves to shirt sleeves in three generations" is well known. It has been documented throughout the world, across numerous countries and cultures. It is one of the driving reasons why many families of wealth recognize the need for proper family governance and family wealth-planning strategies during the lifetime of the family wealth creator. However, even after implementing a family governance system during the design phase of an SFO, families must constantly refine and re-evaluate their values, vision, and mission as their SFO adapts to the changing needs of the family and the global environment.

- **Business Plan & Budget**

Once the clients, assets and needs have been identified, a business plan can be developed that outlines the services to be provided, a short and long-term timeline, employee and outsourced talent required, service partners required (for example, custodians, tax counsel, security services) and technology needs.

A key objective in developing a business plan should be determining the budget. SFOs are not inexpensive to operate. However, when compared with the expense of managing the family's assets via an outsourced or third-party solution, taking into consideration all costs, fees and expenses, the expense of an SFO will likely be lower. Certainly, because the SFO will be custom-tailored to the family's needs, the return on that expenditure will be much higher.

Typically, SFO budgets are defined as a percentage of assets under management. SFO operating costs vary widely, with smaller SFOs, or those managing complex assets, costing more to operate than larger SFOs, or those managing a simpler portfolio, because there are fewer economies of scale to exploit. The budget of an SFO managing an extensive portfolio of alternative investments and commodities for three generations of family members, all of whom also share a passion for modern art and house their collections in multiple homes around the world, will necessarily be larger, both as an absolute number and as a percentage of assets under management, than the budget of an SFO managing a portfolio of publicly-traded securities for a single family unit. The budget will drive the creation of benchmarks to set expectations for SFO performance.

An SFO serving the needs of a multi-generational family must consider how the costs will be allocated and charged to individual clients of the SFO. Future conflict between family office clients or between the family and the office can be avoided if the method of allocating expenses, determining the expected contributions by each client, and collecting fees is made explicit from the outset.

- **Leadership and Staffing**

The plan should identify the expertise required to meet the specific needs of the SFO's clients, given the specific assets to be managed and the available budget. The plan should also specify whether such expertise will be provided internally or outsourced. Once staffing needs are determined, the issues of location, office space needs, technology, security, administrative support etc. can be addressed.

Finding the right talent is generally the most challenging aspect of setting up an SFO. Ideally the CEO candidate should be identified first (if this task has not already been completed). Because the CEO of an SFO must work closely with the family, the office staff and with a wide array of outside service providers, the CEO must have excellent organizational, management and people skills. Choosing a CEO purely because of his or her technical expertise in investing, or in accounting, or in tax planning, is generally a mistake. Often, families will give this important position to a trusted advisor or the controller of their operating business who has been loyal for many years. This can also be a mistake if the trusted advisor or controller is not scalable into the CEO role. Because the CEO carries out a high-level executive function and serves as the family's face to the outside world, candidates should have proven experience leading, managing, and communicating successfully in a wide variety of complex situations. It is a critical role to fill, since once identified and hired, the SFO CEO will take on the role of carrying out the buildout of the SFO in accordance with the plan.

SFOs often hire investment team members with extensive prior experience at private banks, investment houses and hedge funds. Such talent is highly sought after; candidates often

demand investment rights or bonus compensation based on investment performance. The SFO should take care in structuring such arrangements, particularly considering the Dodd-Frank Act's requirement that family offices comply with RIA registration requirements unless they fit a very narrow exemption. SFOs, both new and established, should seek advice of experienced counsel when bringing on new investment team members or adding
new benefits such as carried interest.

All staff members, at every level, should go through a background check and sign non-compete, non-solicitation and non-disclosure agreements. Whether the SFO is large or small, it should have an employee policy manual. The manual should be reviewed and updated at least annually by knowledgeable counsel.

The SFO should be overseen by a board of directors, which will meet regularly and be responsible for setting strategy and overseeing the CEO. Most families control the board of their SFOs, to ensure strategy is in line with the family's wishes. Many SFOs are following the lead of private businesses and bringing independent advisors onto the board to provide outside perspective and expertise.

- **Contingency Plan**

Planning for the SFO should include development of a contingency plan that outlines procedures to be followed in the event of a natural disaster, extreme volatility in the financial markets, theft, or technology breach or failure. At the most basic level, the contingency plan should include provisions for ensuring the safety and security of the family, its critical information and tangible assets, safety of the SFO staff, off-site backup of all information, and a plan for re-establishing critical office activities off-site as quickly as possible.

Marc J. Sharpe is the founder and Chairman of TFOA, an organization formed in 2007 to provide a forum for education and networking and to serve as a resource for single family office principals and professionals to share ideas and best practices, pool buying power, leverage talent and conduct due diligence. Mr. Sharpe is active in the community and has served on the Board of the Holocaust Museum Houston, the HBS Houston Angels, and on the Investment Committee for two Texas based foundations. Contact: Marc Sharpe