

**PORTRAIT OF THE FAMILY OFFICE**

*Offices that Serve Families with Exceptional Wealth*



In 1889, Byron Laflin Smith – a respected banker in Chicago, Illinois – founded The Northern Trust Company to serve the city’s wealthiest individuals and organizations. Through the years, Northern Trust grew to be the global financial services firm it is today, partnering with families, individuals and foundations as well as corporate and institutional clients.

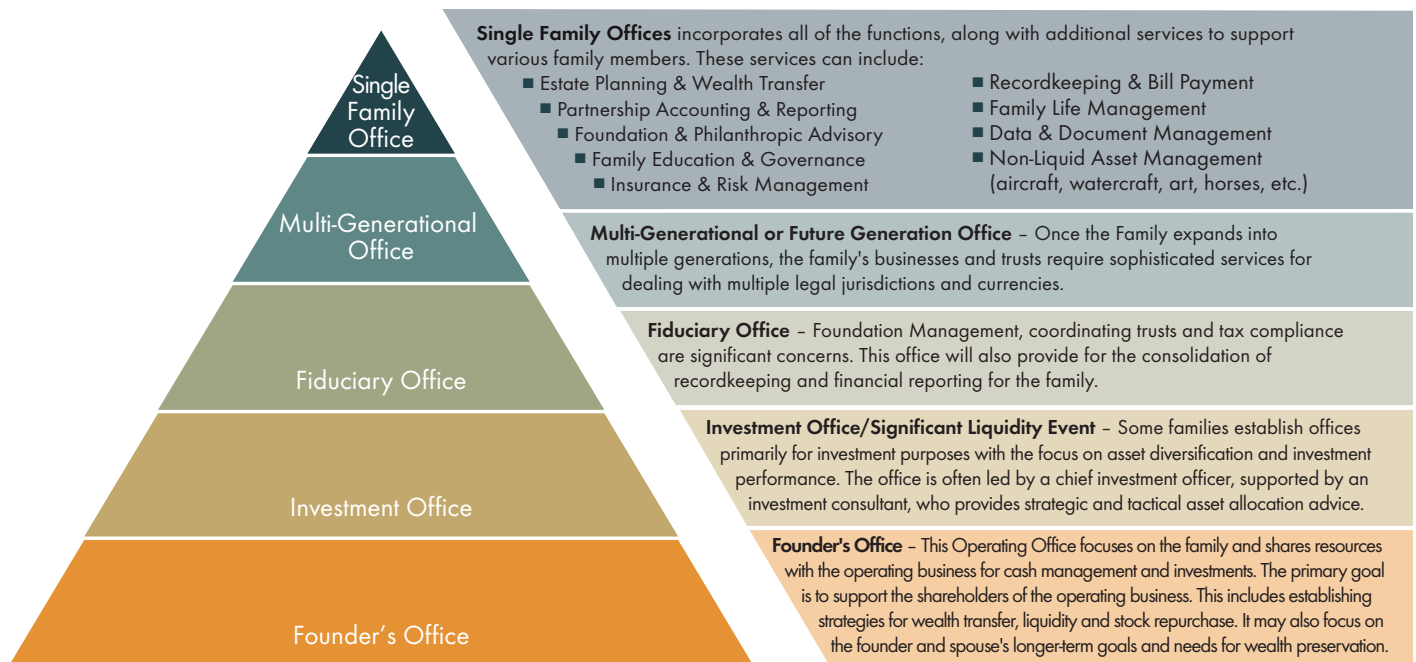
Throughout our history we have studied and surveyed clients to ensure that we are poised to offer solutions that serve their needs. Our research confirms that exceptionally wealthy clients hire professionals to assist with their operating businesses, as well as their personal investment management, bill payment and risk management issues.

To meet the unique needs of individuals and families of exceptional wealth (defined as more than \$200 million in investable assets) and the offices that serve them, Northern Trust created a specialized division in 1982 known as Global Family & Private Investment Offices. For these clients, we implement investment programs that utilize multiple money managers, require consolidated reporting of complex global assets and function within the context of a single family office.

Today, Global Family & Private Investment Offices works with over 350 family office clients – including 20% of the Forbes 400 wealthiest Americans.

**EVOLUTION OF THE FAMILY OFFICE**

In nearly 30 years of serving family offices, we have observed a distinct lifecycle in the progression of the family office structure. At first, the office tends to serve the family’s private operating business and the founder’s financial needs. The office continues to grow and reshape itself as the family becomes multi-generational and more geographically dispersed. This evolution continues in several stages:



## SERVICES NEEDED BY THE FAMILY OFFICE

Many wealthy families continue with or purchase another operating business upon liquidation, the most common being in real estate, agriculture or entertainment. The family office is often used to support the new investment.

In general, family offices today are looking for the following services.

<p><b>ASSET SERVICING</b></p> <ul style="list-style-type: none"> <li>Global Custody Platform</li> <li>Global Tax Reclaim</li> <li>Auditing and Asset Normalization</li> <li>Multi-currency</li> <li>Custom Interface</li> <li>Partnership Accounting</li> <li>Aggregation – Manual and Advanced</li> <li>Reconciliation</li> <li>Alternative Asset Servicing</li> </ul>	<p><b>FIDUCIARY</b></p> <ul style="list-style-type: none"> <li>Delegation to outside managers</li> <li>LLC/Partnership Analysis</li> <li>Trustee/Co-Trustee/Directed Trustee</li> <li>Investment Oversight</li> <li>Foundation Management</li> <li>Estate Administration</li> </ul>
<p><b>SYSTEMS AND INFRASTRUCTURE</b></p> <ul style="list-style-type: none"> <li>Partnership Reporting</li> <li>Online Consolidated Reporting</li> <li>Online Document Storage</li> <li>Custom Reporting</li> <li>General Ledger Integration</li> <li>Online Global Money Movement</li> <li>Online Trading</li> <li>Multi-currency Reporting</li> </ul>	<p><b>INVESTMENT</b></p> <ul style="list-style-type: none"> <li>Consulting</li> <li>Guidelines and Process</li> <li>Outsourced CIO</li> <li>Custom Alternative Programs</li> <li>Manager Due Diligence</li> <li>Investment Mandate</li> <li>Brokerage</li> </ul>
<p><b>FAMILY OFFICE ADVICE</b></p> <ul style="list-style-type: none"> <li>Family Office Benchmarking</li> <li>Peer Networking</li> <li>Best Practice Sharing</li> <li>Human Resources</li> <li>Annual Office Assessment of Value</li> <li>Office Ownership Structure</li> </ul>	<p><b>PERFORMANCE ANALYTICS</b></p> <ul style="list-style-type: none"> <li>Performance Reporting</li> <li>Partner Level Performance Reporting</li> <li>Carbon Footprint Analysis</li> <li>Cash Flow Forecasting</li> </ul>
<p><b>INTEGRATED PLANNING</b></p> <ul style="list-style-type: none"> <li>Tax Planning</li> <li>Estate Planning</li> <li>Family Business Analysis</li> <li>Risk Management</li> <li>Financial Planning</li> <li>Insurance Consolidation</li> <li>Real Estate Management</li> </ul>	<p><b>SECURITY</b></p> <ul style="list-style-type: none"> <li>Business Continuity</li> <li>Operating Policies and Procedures</li> </ul>
<p><b>BANKING</b></p> <ul style="list-style-type: none"> <li>Liability Managers</li> </ul>	<p><b>CONCIERGE SERVICES</b></p> <ul style="list-style-type: none"> <li>Family Education</li> </ul>

The key solutions required by these family offices change with the type and complexity of the office, and also may be dictated by the number of generations and the overall net worth of the family. Domestic custody and fiduciary services are two of the most widely used services. As family assets and family members increase, other sought-after services include: online access to investment and trust data, risk and performance reporting, investment management and global custodial services.

### **Increasing Complexity**

The family office size often is dictated by the number of family members served. These offices typically employ from as few as three people to as many as 80 staff. Many families use Limited Liability Company (LLC), C Corp, Private Trust Companies and Registered Investment Advisor structures. Because of these complex legal structures, asset servicing, reporting and technology play a significant role in decision making.

To mitigate the pressures and risk concerns caused by increasingly complex ownership structures, as well as investments that are ever more complex, many family offices are looking to increase their operational efficiency and risk management. The search for a single information aggregator while still providing risk management leads most families and their offices to explore the benefits of a global custodian who can solve the issue of disjointed data aggregation, trouble transaction processing, challenging reconciliation and avoid the patchwork of manual Excel spreadsheets, files of statements and multiple software programs.

### **Importance of Asset Servicing and Reporting Technology**

Over time, the complexity of the family office increases, with LLC structures, higher allocations to alternative investments and multi-currency and multi-generational needs. As investment complexity and structures increase, so does the need for a centralized domestic or global custodian. Having a global custodian greatly reduces the time and energy spent on administrative functions, while ensuring the security of assets and data and creating cost efficiencies.

A top-tier global custodian simplifies the monitoring and management of a family's complete net worth. This is especially true when working with diverse legal structures, multiple money managers and different asset classes. Key asset servicing functions include:

#### REPORTING

- Net Worth Summary
- Customized Reporting
- Partnership Reporting
- Basic Performance Reporting
- Partnership Accounting
- Compliance Analysis
- General Ledger

#### OPERATIONAL EFFICIENCY TOOLS

- Transaction Initiation
- Bill Payment
- Alerts
- Downloads
- Document Management
- Custom Websites

#### DATA MANAGEMENT

- Automated Aggregation of Outside Assets
- Alternative Asset Servicing
- Global Asset Recording
- Consistent Pricing Methodology

Performance Reporting is another essential component of asset servicing and can help the family office operate more efficiently. More than two-thirds of the family offices we serve calculate performance at both the entity level and at the partner level. Three-quarters of the family offices we work with report their portfolio performance either monthly or quarterly.

The technology used for performance reporting must meet the specialized needs of exceptionally wealthy families and the family offices and advisors who serve them. It should be able to:

- Aggregate all assets and liabilities, including those held at multiple financial institutions, as well as for non-financial assets such as real estate, fine art, yachts and collections;
- Provide a complete financial picture for an individual or the entire family. Family members and advisors should be able to view key data such as daily, monthly, quarterly or annual rates of return, and drill down into each category to see greater detail.
- Analyze performance. It should provide an array of performance-reporting options, including snapshot views with more detailed information such as entity-level and security-level performance, asset allocation details and attribution analysis.
- Produce in-depth reports. It should report on asset allocation, pricing, taxes, transactions, security exposure, valuations, exchange rates and securities information.

## HOW THE FAMILY OFFICE HELPS PRESERVE FAMILY ASSETS

Successful families must grow in order to sustain future generations. There are several ways a family can help accomplish this.

### **Family Education and Governance**

Through education and governance, families share their values across generations, and more carefully define their intentions regarding the creation, preservation and distribution of family wealth.

This explains the increased emphasis we see on family education. Half of family offices we serve are responsible for family education. Of those, 50% utilize outside consultants while the other half manage the family education internally. The process begins when the children of the founders become more mature and financially aware. Topics include investment and estate planning, family mission, governance, philanthropy, leadership and ownership of the family businesses. These topics are discussed informally at family gatherings and increasingly, in more formal structures and programs designed and managed by the family office.

Formal family education and governance programs enable families to make shared decisions more effectively, and to negotiate their differences in a constructive fashion. Some of the trends we see in family education and governance include:

- Next Generation Issues and Impacts
- Adolescence and Early Adulthood + Financial Crisis = Extra Identity Turmoil
- Family Entrepreneurship
- Leveraging the Family's "Brand"
- Aligning Family Goals through Impact Investing

Clearly, as younger generations come of age, it is vitally important to integrate their thoughts and unique perspectives. Support for family ownership inspires the next generation and can help them gain exposure to "best practices" employed by other successful families and family offices.

### Family Foundations

More than 90% of families we serve use a private foundation to foster a shared vision among family members, while supporting the communities and organizations that are meaningful to them. More than two-thirds of their family offices support the family foundation, with such services as grant administration and tax reporting for the foundation.

### Seeking Alpha

Another way to potentially preserve and replenish family wealth is by pursuing alpha – investment performance that seeks to exceed the broader markets.

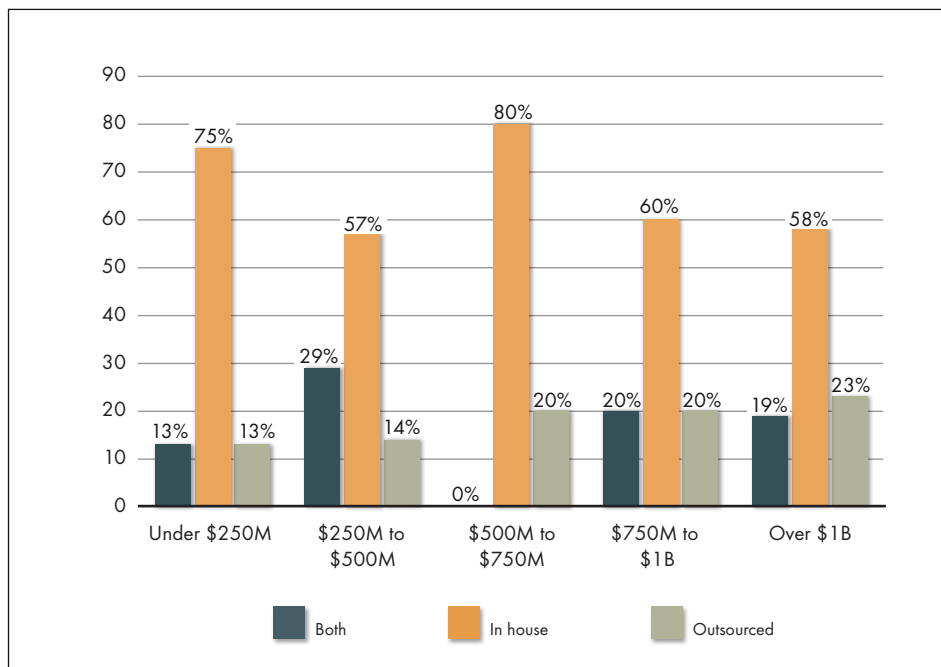
Roughly three-quarters of the family offices we serve hire an investment consultant to pursue this performance edge. They also use consultants for investment manager due diligence. Many families blend the recommendations of these consultants with investment management expertise provided in-house while also using a broad array of investment strategies and asset classes designed to reduce overall risk and volatility.

### Investment Partnerships

Nearly 80% of our family office clients use LLCs or Family Limited Partnerships (FLPs) for investment purposes. By combining the assets of individual family members into an investment partnership, one can create a pool of wealth large enough to take advantage of significant investment opportunities. Such a pool may also provide efficiencies in trading and result in lower fees paid to individual managers.

However, investment partnerships also create accounting challenges. Aggregated data must be separated to determine each investor's portion for tax purposes. Thus, partnership reporting and accounting can be quite complex given the nature of LLCs and FLPs.

The chart below shows offices (77 respondents) that use LLC structures and identifies whether they complete the partnership accounting in-house, outsource or use a combination of both.



Investors within a partnership need to know the value of individual units and how they have performed against accepted industry benchmarks. Partner-Level Performance Reporting shows this detail. Sixty percent of families do partnership accounting in-house instead of outsourcing it.

Partner-Level Performance Reporting monitors asset allocation, measures style, risk and returns for individual portfolios and consolidations. It should also show comparisons of investment results versus peer group benchmarks, and provide a detailed analysis by country, sector, industry and individual security.

### **KEY TRENDS MOVING FORWARD**

Economic turmoil has affected every strata of society, including families of exceptional wealth. As families adjust to the changes, we have seen the following trends emerge:

#### ***A Renewed Focus on Risk Management***

There is an increased focus on risk management and wealth preservation. Many families are now striving to maintain 5-7 years of living expenses in liquid investments outside of their asset allocations. Cash allocations have increased to nearly 15% in some families. Many family members do not consider this allocation to be part of their investment portfolio asset allocation, but rather a “safe harbor” pool of funds to preserve wealth and provide added security. Attention to due diligence on alternatives and transparency is at an all-time high due to recent scandals in the sector.

Another risk management strategy is to diversify into:

- Distressed Real Estate
- Distressed Debt
- Farmland Investing
- Direct Private Equity
- Global Megatrends in Population and Green Technology
- International Currencies

#### ***Greater Operational Efficiency***

Families are seeking new ways to outsource and delegate key portions of their family office management in order to achieve greater efficiencies. Some of the strategies they use include:

- Hiring a corporate fiduciary. That means leveraging the expertise of a corporate fiduciary while maintaining the flexibility of a family representative.
- Delegated investment. Families are more willing to draw upon the expertise of third-party investment consultants to provide asset allocation and due diligence of managers.
- Liquidity Management. Nearly 75% of wealth families utilize lines of credit to finance and support yachts, private aircraft and other hard assets.

### **Peer Networking**

Many exceptionally wealthy individuals achieved their success due to a willingness to work with mentors and to participate in industry groups where they could access best practices. But it is often a challenge to find opportunities for family office executives to expand on this knowledge, due to the private nature of the families they serve.

We are seeing a growing interest in forums and peer-to-peer networking opportunities, where family office executives and family members can explore issues they cannot always discuss comfortably with other family members, friends or business associates.

Northern Trust sponsors a number of group education and networking programs for family members and family office professionals. These include: our annual Family Financial Forum for family members and family office executives; Inspiring Human Capital – An Educational Series for Global Family & Private Investment Offices Family Members; and Networking Groups for Family Office CEOs and CFOs.

If you would like more information about any of these topics or our peer networking opportunities, please feel free to contact a Northern Trust representative.

### **ABOUT NORTHERN TRUST**

Founded as a personal trust company in 1889, and undiluted by merger and acquisition activities, Northern Trust (ticker: NTRS) is a global provider of trust, banking, asset management, asset custody and administration services.

Northern Trust has its headquarters in Chicago and more than 100 offices worldwide. The company focuses its services on two key markets: wealthy families and individuals; and institutional entities, including sovereign funds and endowments worldwide.

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