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## NEWS & VIEWS PODCAST

### Episode - Family Office: Understanding trends and challenges

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**Carrie Falkenhayn:** From Deloitte Tax, welcome to the Tax News and Views Podcast. In this series, we talk to specialists about current tax issues and developments. I'm Carrie Falkenhayn, your host for Tax News and Views, and today we're going to be talking about the family office. What are some of the trends we're seeing in family offices, including some of the challenges that they're facing. Joining me today in this conversation are two Deloitte specialists from the family office arena, Mark Bauters and Eric Johnson. Eric and Mark, welcome to the podcast!

**Eric L. Johnson:** Thank you, Carrie.

**Carrie Falkenhayn:** To get us started, let's just address what a family is, and when and or why a family might consider forming a family office.

**Eric L. Johnson:** Sure, I'll take that first, Carrie. So, a family office is a private organization, established by the family to oversee, either directly or indirectly, the financial and sometimes the personal affairs of the family. It is generally, it offers the same services as a top-tier bank or an investment firm might offer, but it's really just focused on serving the extended family. And it's often highly tailored to meet the needs of the family.

**Mark Bauters:** Supplement that, Eric, when a family would consider forming a family office, we generally see them in one of three ways. One, family has developed a successful family business. It's grown significantly. And profits from the business are no longer needed to be reinvested into the business, and so family members now hold new, diversified investments. And so, the management and administration of those investments has become highly demanding for the family business professionals and personnel there. To help with the oversight of these investments that are now outside the business, the family will often form a separate standalone family office to help with overseeing the administration of all those investments. The second area where we see a family considering forming a family office is that successful family business is sold, they now have monetized their interest, and there's a desire to have a group of professionals oversee this newly monetized wealth. And then the third instance is really when a principal of a private equity or a hedge fund, they may look to diversify their holdings and their investments outside of the fund and set up something separate from the fund in which they're solely investing their capital.

**Eric L. Johnson:** Yeah, Carrie, we often get asked, how much wealth is necessary to form a family office? And, you know, I think smart people can have different views on that. I would say typically, at a very minimum, probably $100 million to $200 million of investable wealth. Many of our clients are north of that, in probably the $500 to $800 million range, and a lot of the offices that we serve on a regular basis have a billion or more of investable wealth, so it really does vary across the spectrum.

**Carrie Falkenhayn:** That's really interesting background. Thanks for sharing that background. Are we seeing more family offices being formed, and if so, what is driving the creation of these new family offices?

**Mark Bauters:** So, to start, one of our colleagues, Rebecca Gooch, performed a survey of family offices, titled the Deloitte Family Office Insights Series, and in that survey, she estimated that there's over 8,000 single-family offices in the world today, which is up from the roughly 6,000 plus that there were in 2019. This is projected to grow by more than 2,000 up to over 10,000 in 2030, which is a remarkable 75% increase in the number of family offices. Similarly, within that survey, she noted that Family Office total asset under management is expected to rise 73% from approximately $3 trillion today to over $5 trillion.

**Eric L. Johnson:** Yeah, and Carrie, on the why part, why are more family offices being formed? There's just more wealth being created. You look at certain industries, like technology, or healthcare. There's just been a lot of wealth generation, and monetization, and many of these, wealth creators, it's very important for them to want to maintain privacy over their affairs. And frankly, control. And so, the family office is the catalyst for doing that. And I would also say that the barrier to form family offices has lowered. So, many years ago, it might be hard to know where to go to form a family office. Nowadays, there are talent agencies that cater to the family office industry. There's technology that has been designed to serve the industry. Service providers, including Deloitte, have aligned their services to serve family offices, so it's just becoming much easier to set up a family office as well.

**Mark Bauters:** Family office can provide some significant efficiencies for the family. Generally, in the family office, family members are pulling assets in investment vehicle, which allows co-investment, and it allows generations to invest in certain private equity or other investments that they maybe individually wouldn't have access to. Lastly, the family office provides a platform to help support succession and legacy planning for many of our multi-generational families.

**Carrie Falkenhayn:** So, you mentioned that there's a rise in the number of family offices, but you also mentioned that there's talent agencies right out there catering to that. What does the talent model look like? Are there, is there enough talent out there to provide the services that the family needs?

**Eric L. Johnson:** Yeah, that's a great question, Carrie. There are a number of new offices being formed, and I think, broadly, there's a shortage of talent just in the financial services industry altogether, and I think we're even seeing it at our firm. And so there absolutely is a war for talent. These family offices are fighting to get top talent, which then kind of lends itself to how do you incentivize and retain people at your organization, which is a completely different topic. But I think it's important for the family office to kind of assess what services do we want to provide our principals, or the extended family, and then for the services that we are going to provide, which one of those are going to be done by us in-house, which ones will be co-sourced. And which ones will be outsourced to a third-party provider? And for the ones that are done in-house, then what does that talent model look like? What type of people do we need? What type of skill sets?

**Mark Bauters:** Yeah, I think just with the increasing number of offices being formed in the war for top-tier talent, just like many other professional service organizations, family offices, we're seeing them, assess their ability to perform services in-house. I think there's been a trend in terms of firms and people able to support family offices as it relates to if they decide, okay, we don't have the talent necessary to perform this service in-house, there's firms and people that can supplement that as it relates to outsourcing that activity. But the war for talent, we've seen it with our clients in terms of trying to identify professionals that can perform these services in-house.

**Eric L. Johnson:** Yeah, a couple current trends there. One is we've seen a lot of investment offices being formed, so those are family offices whose, really, the main focus is to manage the wealth and the investments on behalf of the family group. We've also seen a trend towards smaller, but highly sophisticated offices, so, you know, the offices maybe of the past that had dozens and dozens or a hundred employees. That's less frequent, and what we're seeing is much smaller offices that then rely very much on technology, as well as third-party service providers to provide the services to the family.

**Carrie Falkenhayn:** So, how do family offices supplement this need for talent with technology? Are there any specific areas you've seen family offices reshape how they operate?

**Mark Bauters:** Yeah, and with a leaner talent model, family offices, they're really trying to optimize the resources that they have available, and use technology to handle mundane or perhaps routine tasks, and so they're focused on being as efficient as possible with those resources that are available. What I've seen is family offices, they're really focused on how their professionals are spending their time, what are their processes, and are they doing things the most efficient way, in supplementing with technology. Many family offices are working closely with their vendors to automate processes such as information gathering, they're utilizing OCR to read documents and gather data. We've seen this in the investment function, where they'll get statements from investors, and there'll be a scanning or reading of that document, which will feed into their general ledger system. So, clients are really looking to Supplement what their people are doing and leverage technology, to help with facilitating the services that they're providing.

**Eric L. Johnson:** Yeah, I'll add to that too, Mark. Family offices, you know, as they've increasingly are more reliant on technology, they're also becoming a frequent target of attack by bad actors. Often, you know, there's a lot of wealth there, but they're smaller organizations, and maybe the controls aren't as robust as larger organizations, and so they're a very opportune target for cyber-attacks, and identity theft, and ransomware, data breaches, deepfake scams, phishing. You talk to the offices out there, and, you ask who's been attacked by, you know, some sort of event, and virtually everybody raises their hand. Deloitte did some research in this. Again, the family office global reports that we did, and in that, publication, we determined that 43% of family offices had experienced a cyber attack in the last two years. So, focus for these offices has been really on creating awareness of the issue and training for the employees, being able to help them develop incident responses and have them focus on, on, backup and recovery processes.

**Carrie Falkenhayn:** I can see where that would be very important to a family, to make sure that their office could deal with those issues. So, you've talked about a few different ways family offices can be different. What are the trends that we're seeing in how family offices are formed, how they're making decisions, what their governance structure is?

**Mark Bauters:** Every family and every family office is different, but like any successful company, you want to ensure that the structure supports the family's mission, vision, and its goals and objectives. And so, as the family office grows, so does the importance of governance. There's often a shift towards a more structured operation where you're hiring experienced executives, perhaps a chief investment officer, establishing clear decision processes, and implementing robust risk management. And so, the family office governance structure, it's a framework, that defines clear, transparent decision-making, will define roles in. Shared values to really help manage the family's wealth and ensure that, to the extent possible, there's long-term family harmony and success. Additionally, depending on the principal or the family's desired level of involvement, we oftentimes see a delegation of authority to the family office professionals as it relates to administering the family office services and operations.

**Eric L. Johnson:** Yeah, I agree with that, Mark. Some of the larger family offices have really become institutionalized. They're generally governed by boards. The boards then often form committees to attack various issues. And those boards are populated sometimes by family members, but more often by a number of some of the key employees. And probably a challenge unique to family offices and their structures is, unlike an operating business that might have a single entity, there are many entities involved in the family office structure with their own governance. So there might be a family office, there might be a private trust company, there might be a private foundation, and so whatever governance framework that the family puts forth. Needs to kind of work across, like, this broader structure of various entities. And another unique feature, which Mark just pointed out, is the family, although they're in control, certainly, they're generally not involved in day-to-day decision-making, and so there's often a broad delegation of authority to trusted employees, and that's something that's a bit unique to the family office industry.

**Carrie Falkenhayn:** So you both have worked with hundreds of family offices across the country. What are some trends you're seeing that we haven't talked about yet?

**Mark Bauters:** First, I'd say, just, there's been an evolution in how the family office is being compensated by its clients. Family offices have broadened in terms of the scope of services that they're providing, and really institutionalized those services, and so we continue to see a trend or evolution in terms of the compensation arrangements that the family office has with its clients. And kind of in tandem with that, the family office is bearing a lot of the investment-related expenses. That, that, that are within the family ecosystem. And in exchange for that, they're getting higher upside on managing those investments.

**Eric L. Johnson:** Yeah, if I had to add a couple more observed trends, Mark, one of them is engaging the next generation. That's so important. There's going to be a succession in many families from the older generation to the next gen, and so understanding how they can participate For example, having them become a board observer, if you are circling back to the governance topic.

As a way to acclimate themselves to board responsibilities, or having them serve on various committees to have them understand the kind of the different facets of the overall governance structure, or even being a part of the family's foundation and helping direct where philanthropy is headed. That's something that's really important to that next gen. And that's just another great area to get them involved as well. So important to engage that next generation for the continued success of the family office. I'd say probably another area, too, that continues to be a topic, and we mentioned it earlier in this podcast, too, is the whole balance between what services are we providing? Do we do them in-house, or do we outsource? So, do we build it? And, add to our own talent model and try to hire people to perform those services, or do we buy it? With third-party service providers, and that is a constant theme across all offices, and different offices come to different decisions on that. Some of them want to do everything in-house and build up a very large talent model, and some of them would rather just have very few execs, and then rely very heavily on third-party service providers. I think one of the trends we're seeing with wealthy families is a migration away from more kind of liquid, marketable, exchange-traded investments to more illiquid private equity investments, and I think there's just a trend in the marketplace to do that, because there's just a belief that there might be some outsized returns in those asset classes. That migration to that type of asset class and away from Lakewood presents just additional challenges. Challenges in terms of getting personnel engage to help identify and source those types of deals, which is obviously more involved, and then being able to be patient with those investments over a period of time, until they can become monetized, as well. And so, that there's all kinds of threads from that in terms of, you know, cash flow planning and being able to monitor those types of investments. So that's certainly a trend that we're seeing in the market as well, and something that I think families will continue to migrate towards, even in this current environment.

**Carrie Falkenhayn:** Eric, Mark, thank you so much for such an interesting discussion on family offices and what the trends are. If our audience would like additional information, you can go to Deloitte.com and search on family offices in particular. If you search on family office, sure, you'll see a comprehensive overview of our suite of services, but there's a lot of other resources there, including the survey, I think, that Mark mentioned. So you will all find those resources if they're of interest to you. You could also reach out to Eric or Mark directly on LinkedIn if you'd like to connect with them directly. In the meantime, thank you all so much for listening, and hope you are able to join us for our next edition of Tax News and Views. Be well, everyone! Take care.