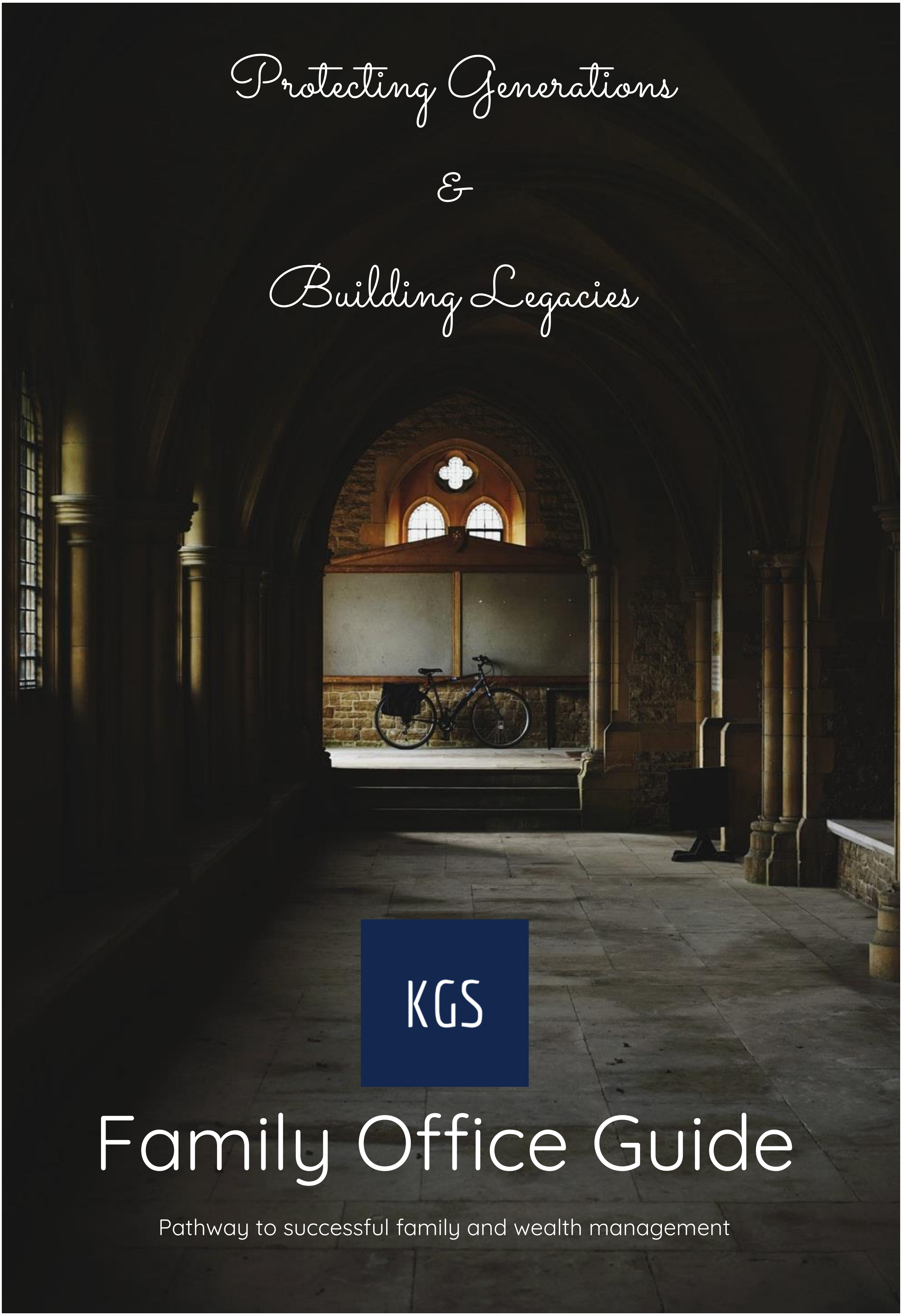


Protecting Generations

&

Building Legacies

KGS

Family Office Guide

Pathway to successful family and wealth management

Contents

About us

KGS is a differentiated player in advising, guiding and recognizing family businesses. With over many years in institutional investment management experience, advising many entrepreneurial and innovative family firms, we understand the unique challenges they face — and how to address them.

Through our unique Family Office Framework, we offer a personalized range of services aimed at the specific needs of each individual family business — helping them to grow and succeed for generations.

KGS Family Office Services

Our services for families and family offices are a reflection of our broad range of subject-matter resource and a symbol of our commitment toward family businesses around the world.

Our comprehensive and integrated approach helps families to structure their wealth and preserve it for future generations. Our goal is to unlock the development potential of the family through a multidisciplinary approach that scrutinizes operational, regulatory, tax, legal, strategic and family-related aspects.

For more information about the full range of our family office services, get in touch

Forward

Dear Reader,

It gives us great pleasure to bring to you our KGS Family Office Guide.

In the last decade or so, we have seen a distinct acceleration in the establishment of family offices around the world and even more so in the emerging markets. However, irrespective of geography, there's a certain consistency to the motivations behind setting up a family office. Mitigating family conflicts, preserving family wealth and supporting its inter-generational transfer, consolidating assets, dealing with a sudden liquidity influx, and increasing wealth management efficiency are some of them.

Another reason for the emergence of family offices is families' desire to have greater control over their investments and fiduciary affairs while reducing complexity. This need for a higher degree of control was partly provoked by the financial crisis, in the aftermath of which wealthy families wanted to ease their concerns about dealing with a wide range of external products and service providers.

Family offices are rather complicated structures, neither easy to understand nor simple to implement. This publication will offer a step-by-step process that aims to demystify what's involved in setting up and running family offices.

It is designed as a learning tool to provide guidance to families considering setting up a family office. They include business families who wish to separate their family wealth and assets from the operating business, and successful entrepreneurs looking to structure the liquidity gained from a highly profitable sale in order to further grow and preserve their wealth. It is also a useful guide on the current leading practices for those who already have a family office.

We hope that you will find this report helpful and illuminating for your decision-making as you plan the path for your family into the future.

introduction

What is a family office?

Family offices have their roots in the sixth century, when a king's steward was responsible for managing royal wealth. Later on, the aristocracy also called on this service from the steward, creating the concept of stewardship that still exists today. But the modern concept of the family office developed in the 19th century. In 1838, the family of financier and art collector J.P. Morgan founded the House of Morgan to manage the family assets. In 1882, the Rockefellers founded their own family office, which is still in existence and provides services to other families.[1]

Although each family office is unique to some extent and varies with the individual needs and objectives of the family it is devoted to (Daniell and Hamilton, 2010), it can be characterized as a family-owned organization that manages private wealth and other family affairs.

Over the years, various types of family offices have emerged.

The most prominent ones are the single family office (SFO) and the multifamily office (MFO), but there are also embedded family offices (EFOs) linked to the family business, where there is a low level of separation between the family and its assets. The SFOs and MFOs are distinct legal entities and manage assets that are completely separated from the family or the family business.

With the progressive growth of the family tree — owing to the birth of children and grandchildren and the addition of in-laws — and an increase in the complexity of the family's asset base, families usually professionalize their private wealth management by setting up SFOs. As subsequent generations evolve, and branches of the family become more independent of each other, investment activities within the original SFO activities become separated. This is the cornerstone for the emergence of an MFO. Sometimes these offices open up their services to a few non-related families.

Since the individual services of a family office are tailored to the clients, or the family, and are correspondingly costly, the amount of family wealth under management is generally at least US$200m. It is more revealing, however, to calculate the minimum wealth under management in the light of return expectations and targets, and the resulting costs of the family office. This shows that there is no clear lower limit for a family office. The costs of the family office, plus the return target, must be achievable with the chosen asset allocation and structure.

Family offices are arguably the fastest-growing investment vehicles in the world today, as families with substantial wealth are increasingly seeing the virtue of setting one up. It is difficult to estimate how many family offices there are in the world, because of the various definitions of what constitutes a family office, but there are at least 10,000 family offices in existence globally and at least half of these were set up in the last 15 years.

As wealth grows, particularly in the emerging markets, there is no doubt that family offices will play an even bigger role in the management of substantial wealth in the years ahead.

The increasing concentration of wealth held by very wealthy families and rising globalization are fuelling their growth. Particularly important in the years ahead will be the strong growth of family offices in emerging markets, where for the most part they have yet to take hold — despite the plethora of large family businesses in these economies.

This report attempts to define the family office in authoritative detail. It looks at issues such as the reasons for setting up a family office; legal structures and taxation; asset allocations; strategic planning; how to optimize investment functions and to ensure they work for the benefit of the family. It also addresses the relationship between the family and the external professionals who are brought in to run a family office. It is crucial for a family office to establish a balance between these two groups if it is to function well.

Family offices are complex organizations that require deep knowledge — not just of investment variables, but also a host of other factors. This guide is a detailed handbook for those planning to set up a family office and also for those looking to set benchmarks of leading practice within their existing family office.

Family offices in India

While there is a rich history of entrepreneurialism and family business in India, family offices remain a fairly new entity. Traditionally, Indian families have kept tight control over their family businesses, investing and re-investing profits back into operations and buying up public shares to ensure that they maintain close control over the business. Diversity has primarily been done through subsidiaries of the family business with little appetite being shown for risk, despite the potential rewards.

However, the rapid expansion of UHNW individuals in India has led to a growing appetite for more efficient, effective and prosperous ways to invest money and manage assets. Fuelled by global trends and a desire to further professionalise a family's practice, families of great wealth are starting to set up family offices as vehicles through which they can invest their wealth into different asset classes such as equities, private equity, private debt, real estate, gold, fixed income and hedge/ alternative funds.

Employing investment professionals who are savvy and skilled at operating across the different asset classes enables families to flexibly navigate changing tides, both in pursuit of alpha and when needing to balance high and low risk investments. This enables families to not only preserve, but grow their wealth for current and future generations.

Section 1

Why set up a family office?

As concerns about wealth preservation and succession planning within family businesses continue to rise, wealthy families are increasingly evaluating the benefits of setting up a family office.

The reasons why

There are many reasons why setting up a family office makes sense, but at the root of these is the desire to ensure smooth intergenerational transfer of wealth and reduce intra-family disputes. This desire inevitably increases from one generation to the next, as the complexity of managing the family's wealth grows. Without being exhaustive, the following points set out the reasons why a family office makes sense:

Privacy and confidentiality

For many families, the most important aspect of handling of their private wealth is privacy and the highest possible level of confidentiality. The family office often is, and should be, the only entity that keeps all the information for all family members, covering the entire portfolio of assets and general personal information on a holistic basis.

Governance and management structure

A family office can provide governance and management structures that can deal with the complexities of the family's wealth transparently, helping the family to avoid future conflicts. At the same time, confidentiality is ensured under the family office structure, as wealth management and other advisory services for the family members are under a single entity owned by the family.

Alignment of interest

A family office structure also ensures that there is a better alignment of interest between financial advisors and the family. Such an alignment is questionable in a non-family office structure where multiple advisors work with multiple family members.

Potential higher returns

Through the centralization and professionalization of asset management activities, family offices may be more likely to achieve higher returns, or lower risk, from their investment decisions. Family offices can also help formalize the investment process, and maximize investment returns for all family members.

Separation

Family offices allow for separation, or at least a distinction, between the family business and the family's wealth or surplus holdings.

Risk management

Family offices allow for operational consolidation of risk, performance management and reporting. This helps the advisor and principals to make more effective decisions to meet the family's investment objectives.

Centralization of other services

Family offices can also coordinate other professional services, including philanthropy, tax and estate planning, family governance, communications and education, to meet the family's mission and goals.

Focal point for the family

In cases where the main family business has been sold, a family office can offer a new focal point of identification for the family members, for example when the family office manages the philanthropic activities of the family.

Why might there be doubts about setting up a family office?

The establishment of a family office is a big undertaking, and there have been cases when family offices have not met the family's expectations. Some of the potential doubts and concerns about setting up a family office are:

Cost

The cost of regulatory and compliance reporting remains high, which means that the level of assets under management that a family office needs to underpin must be sufficient to offset its fixed costs.

Market, legal and tax infrastructures

Advantages of economies of scale of a Multi Family Office typically far outweighs the disadvantages resulting in overall better outcomes.

Family offices function better when operating from centers where there are sophisticated markets and legal and tax structures. The absence of these in emerging markets has undermined the development of family offices there. This has often meant that there has been little connection between the huge level of wealth in some emerging markets and the number of family offices. Much of the wealth in emerging markets is still controlled by the first generation. This has also inhibited the growth of family offices, because many are launched during a wealth transition from one generation to the next.

The Multi Family Office offering, and its Advantages and Disadvantages

To address the problem of the high operating costs of a family office, families often set up MFOs, in which several families pool their wealth together. Often these MFOs will be directed by the "lead" family that initiated the office. In MFOs, all assets are managed under one umbrella. But MFOs typically cater for a range of family size, wealth and maturity levels. This means that families can run the risk of not receiving the personalized advice that they would have done in a dedicated family office setup.

When considering establishing a family office, some can see potential positives as negatives. This tends to be particularly prevalent in the following cases:

The preference for privacy

Some families may be hesitant about consolidating their wealth information through a centralized family office structure.

Trust of external managers

Setting up a family office is typically contingent on the level of trust and comfort families have with external asset managers. However, trust typically stems from long-standing relationships with external managers.

Expectations on returns

Ultimately, family offices rely on their longevity through ensuring wealth preservation. This difficulty of securing market returns in recent years has led to some tension in this respect. Furthermore, during generational transitions, family office structures are tested, often to the point of destruction, as the next generation presses for different goals and objectives to manage the family's wealth.

Family office services

At the heart of any family office is investment management, but a fully developed family office can provide a number of other services, ranging from training and education to ensuring that best practice is followed in family governance. This section looks at the full range of services a mature family office could potentially provide (see figure in that follows). These include:

Financial planning

Investment management services

Typically, this will be the main reason for setting up a family office, as it is central to ensuring wealth preservation. These services will include:

- Evaluation of the overall financial situation
- Determining the investment objectives and philosophy of the family
- Determining risk profiles and investment horizons
- Asset allocation — determining mix between capital market and non-capital market investing
- Supporting banking relationships
- Managing liquidity for the family
- Providing due diligence on investments and external managers

Philanthropic management

An increasingly important part of the role of a family office is managing its philanthropic efforts. This will include the establishment and management of a foundation, and advice on donating to charitable causes. These services would typically involve:

- Philanthropic planning and strategy
- Assistance with establishment and administration of charitable institutions
- Guidance in planning a donation strategy
- Advice on technical and operational management of charities
- Formation of grant-making foundations and trusts
- Organizing charitable activities and related due diligence

Life management and budgeting

Some of these services are typically defined as “concierge” in nature, but they are broader in scope, inasmuch as they also include budgeting services. Services under this heading will include:

- Club (golf, private, etc.) memberships
- Management of holiday properties, private jets and yachts
- Budget services, including wealth reviews, analysis of short- and medium-term liquidity requirements and long-term objectives

Strategy

Business and financial advisory

Beyond the asset management advisory, family offices will also provide advisory services on financing and business promotion. These will include:

- Debt syndication
- Promoter financing
- Bridge financing
- Structured financing
- Private equity
- Mergers and acquisitions
- Management buyouts
- Business development

Estate and wealth transfer

Family offices will be involved in business succession and legacy planning, enabling the transfer of wealth to the next generation. These services will include:

- Wealth protection, transfer analysis and planning related to management of all types of assets and income sources
- Customized services for estate settlement and administration
- Professional guidance on family governance
- Professional guidance regarding wealth transfer to succeeding generations

Training and education

Much of this revolves around the education of the next generation on issues such as wealth management and financial literacy, as well as wider economic matters. These services will include:

- Organizing family meetings
- Ensuring family education commitments
- Coordination of generational education with outside advisors

Governance

Reporting and record keeping

The maintenance of records and ensuring there is a strong reporting culture is another core part of a family office's services. Key to these services is:

- Consolidating and reporting all family assets
- Consolidating performance reporting
- Benchmark analysis
- Annual performance reporting
- Maintaining an online reporting system
- Tax preparation and reporting

Administrative services

Administrative services, or back-office services, are essential to the smooth running of a family office. These services will include:

- Support on general legal issues
- Payment of invoices and taxes, and arranging tax compliance
- Bill payment and review of expenses for authorization
- Opening bank accounts
- Bank statement reconciliation
- Employee management and benefits
- Legal referrals and management of legal firms
- Public relations referrals and management of public relations firms
- Technology systems referrals and management of these vendors
- Compliance and control management

Succession planning

Ensuring a smooth succession and planning for future generations is integral to the long-term viability of the family office and the family it serves. These services will include:

- Continuity planning relating to unanticipated disruptions in client leadership
- Evaluation of the strengths, weaknesses, opportunities and threats (SWOT analysis) of senior executives both within and outside the family
- Re-evaluation of family board regarding roles of non-family directors
- Structuring of corporate social responsibility platforms and programs
- Development of formal knowledge sharing and training programs
- Implementation of intergenerational estate transfer plans
- Adoption of a family charter or constitution, specifically aiming to:
    1. Formalize the agreed structure and mission of the family business
    2. Define roles and responsibilities of family and non-family members
    3. Develop policies and procedures in line with family values and goals
    4. Determine process to resolve critical business-related family disputes

Advisory

Tax and legal advisory

Tax, in particular, has become a much more important issue for family offices in recent years and as such has assumed a more important part of the functions of a family office. Legal matters are also important. A family office will typically employ a general counsel and/or a chartered or certified accountant, or several accountants and tax experts. These professionals usually provide the following services:

- Construct a tax plan that best suits the family
- Design investment and estate planning strategies that take into account both investment and non-investment income sources and their tax implications
- Ensure all parts of the family office are tax compliant

Compliance and regulatory assistance

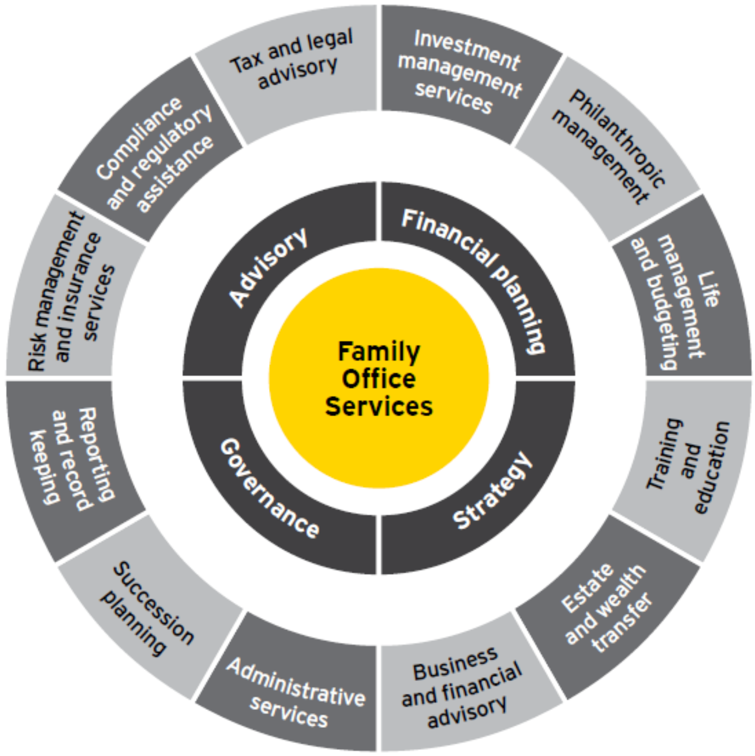
Family offices need to ensure strict compliance with regulations pertaining to investments, assets and business operations. These services will include:

- Providing auditing services for internal issues
- Establishing a corporate governance mechanism
- Ensuring a high level of staff hiring
- Group performance monitoring and compliance
- Offering recommendations on independent and board advisory formation
- Strengthening the regulatory investment process

Risk management and insurance services

This is a service that has assumed a more important role in recent years because of the financial crisis of 2008–09 and the subsequent fallout. It will be a crucial service for family offices in the future as well. These services will include:

- Risk analysis, measurement and reporting
- Assessment of insurance requirements, policy acquisition and monitoring
- Evaluation of existing policies and titling of assets
- Evaluation of security options for clients and property
- Formulation of disaster recovery options and plans
- Protection of assets, which could involve the use of offshore accounts
- Development of strategies to ensure hedging of concentrated investment positions
- Physical security of the family
- Data security and confidentiality
- Review of social media policy and development of reputation management strategy



Determining servicing priorities

Even the largest family office, in terms of assets under management, will need to assess whether or not to outsource services. Outsourcing certain services can be beneficial from a cost efficiency and know-how perspective, offering advantages to family offices that include:

- Reduced costs and overheads, and improved staff productivity
- Economies of scale, particularly for high-value professional services, thus enabling lower prices for related services
- The benefits of objective advice from experienced professionals who possess specialized skills
- Help with defending the family office's regulatory independence when outsourcing investment management, by allowing investment decisions to be made by external providers
- Due diligence and continuous monitoring can be carried out by the directors of the family office to ensure performance and security against risk

Key considerations to decide upon include

Who should be the beneficiaries of the family office and what is the overall strategy of the family to secure and expand its wealth over generations?

- Is the family's priority traditional asset management of liquid funds, with or without a portfolio of direct entrepreneurial investments? And where does philanthropy fit into the mix, if at all?

- Should the family office act as the asset manager for all family members, or should it just be an advisor for some specific services to selected family members?
- Is the family office's core task that of a financial advisor, or more that of an educational facilitator for the next generation of family members?
- What services should the family office offer from the range of asset management tasks, controlling and risk management, tax and legal advice to concierge services and educating the next generation?

Table 2.1. Key attributes of a Multi Family Office (MFO)

Cost and budget	Escalating costs can pose a serious challenge to family offices. Clearly, it is unreasonable to insource the whole range of potential services without considering the economic benefits. Appointing an outside provider can ensure quality, and possibly cost savings, as the family office would benefit from economies of scale.
Expertise	The priority services as defined by the family will most likely be covered in-house in order to ensure independent expert advice to the family. However, the family office will gain from outsourcing services that require specific expertise.
Regulatory restrictions	A family office should consider all regulations, depending on its distinct legal structure. While SFOs are significantly less regulated, as they deal with issues within the family, MFOs often fall under specific regulatory regimes. In the absence of professional management, a family office runs the risk of serious fallout from negative publicity. Legal action could also be costly and harmful to reputations.
Technology and infrastructure	The technology employed by an external provider can serve the family office effectively. Buying in these services has become even more of a priority as financial operations become more complex.

Case for Multi Family Office (MFO)

The table below provides a comprehensive case for the advantages a MFO can provide.

Type of service	Service category	Outsourced
Investment management and asset allocation	Financial planning	The more complex, specialized and diverse assets make outsourcing a practical option.
Tax and legal advisory	Advisory	Often outsourced to a trusted advisor to ensure state-of-the-art quality of service.
Reporting and record keeping	Governance	Basic reporting tools and software may be provided externally.
Philanthropic Management	Financial planning	Setting up a foundation and related activities often outsourced to a consultancy.
Compliance and regulatory assistance	Advisory	Full-time legal staff will be an unnecessary and costly addition to family offices, which are not large enough to require them, so can be outsourced when needed.
Risk management and insurance services	Advisory	Can be outsourced, as external risk and insurance professionals can offer trusted expert advice.
Training and education	Strategy	Can be outsourced if expert opinion on higher education is required for training and development.
Business advisory	Strategy	The services of an external expert can offer a competitive edge.
Estate and wealth transfer	Strategy	The family can consult external legal advisors for procedural and legal issues.
Succession planning	Governance	Education, objective assessment of managerial skill, and definition of entry path of next generation family members possible.

Benefits of MFOs

- Helps a family office reduce costs and overheads, helps with staff productivity
- Helps deliver economies of scale, particularly when it comes to high-value professional services, thus enabling lower prices for related services
- Offers the benefit of objective advice from experienced professionals who possess specialized skills
- Suggests less direct control, which implies due diligence and continuous monitoring can be carried out by the directors of the family office to ensure performance and security against risk

Philanthropy

Philanthropy: moving from giving to creating impact

The world, and the challenges it faces, are changing rapidly. Growing inequality, the forces of climate change, rapid urbanization and resource scarcity are increasingly putting pressure on the world's most vulnerable people, both at home and abroad. We need new strategies to meet these challenges — strategies that involve a fundamental rethink of the nature of philanthropy.

Traditional paradigms of philanthropy are evolving. With a focus on creating impact, they are becoming more accessible, sustainable and effective. Reflective of the social and technological changes happening around the planet, this evolution reminds us that, in a globalized world, small groups of people can have profound impacts.

Philanthropy is one of the most rewarding, and distinctively different, activities that can be undertaken from a family office. As with all family office activities, philanthropy too deserves to be conducted with total professionalism and commitment. Its challenges and rewards should be acknowledged.

How can a family office help the family achieve its philanthropic goals?

One common question facing family offices and family members is how to structure philanthropic endeavours to achieve tax, economic and long-term charitable goals. Many families see philanthropy as a way to not only make a lasting impact on their communities, their countries, or the world, but also as a way to connect with and guide the principles that will impact the multiple generations that have either benefited or may benefit from the family wealth. The form of charitable giving may vary from a direct gift to a charitable organization to a donation to a charitable vehicle (discussed below) established by the family for ongoing philanthropic activities.

Philanthropy as a way to guide future generations

Many families view philanthropy as a long-term mission that is critical to teaching future generation's responsibility and the impact wealth can have on society. They believe philanthropy can teach younger family members valuable life and business skills, enabling them to develop their passions and find fulfilment in working for something they believe in. In some of these families, the future generations will even get to decide which charities should receive benefits, how much and for how long.

A family office should memorialize the family's philanthropic goals in the family mission statement or the family constitution. It should make sure the charities qualify for tax-exempt status and that charitable pledges are fulfilled in a timely manner. It is the family office that will likely be involved in deciding which assets to donate to charity. In India and the US, for example, the type of asset donated can impact the amount of the eligible deduction as well as the potential yearly deduction limitations.

Philanthropy through investment choices

Wealthy families have made substantial charitable donations in recent years. There is also a trend for families to align their investment choices to their charitable motives. Families are increasingly making investments that can be categorized as impact investing or socially responsible investing. Both of these strategies seek to further philanthropic goals on the basis of how, and in which companies, the family invests.

Impact investing seeks to make a difference to communities by choosing to invest in companies that align profits with charitable intentions. For example, a family may decide to invest in a company that will produce methods to purify water in economically challenged regions.

Socially responsible investing seeks to maximize delivery of philanthropic goals, even at the cost of potentially higher returns. An example of socially responsible investing may be divesting your portfolio of all shares of Company X stock if they are producing goods in a manner that is not environmentally safe or if their chairperson makes a public statement on a position that the family does not agree with.

Family identification with philanthropy can be a means of honouring the family's founder. It can be a vehicle for finding new roles for family members — including those who might feel that their skills and interests may not lie in the family business. A systematic program of philanthropy can be both a shield (offering a proper process for responding to the many unsolicited and perhaps inappropriate requests for funds commonly received by high-profile families) and a sword (enabling the family to have a significant positive impact on an issue of concern to it). Most importantly, philanthropy can provide a family with at least one notable commonality — acting as "the glue that holds the family together" — especially as a family increases in size and diversity.

Philanthropy can expand a family office's networks, add skills, generate employee satisfaction, and offer new and post-career options. Family office or business involvement in philanthropy can be a tangible demonstration of corporate citizenship and can enhance the profile of the family.

Definition and change over time

The goal of philanthropy has always remained the same, to promote the welfare of society and to increase the business's public value. However, the means of achieving this goal have undergone rapid transformation.

Traditional notions of philanthropy emphasized doing good through donations or through the establishment of charitable foundations. This approach, born of social obligation, was free from the expectations of measurable impact, accountability, transparency and direction. In this traditional approach, philanthropy was also seen as exclusive — only accessible to those with enough money to give away — or organized through religious or political institutions with specific interests and agendas.

Modern philanthropy, however, is decidedly different. Today's philanthropists use innovative solutions to solve specific problems, with approaches that are targeted and selective, and impacts and outcomes that are measurable. Philanthropy is also not seen as exclusive anymore. Now, philanthropists come from a wide range of ages and backgrounds, ranging from individuals and businesses to NGOs and not-for-profits, all of whom are brought together by one common goal, to help fellow human beings.

Leading practices — the building blocks of an effective, family office-based philanthropy

Creating an effective, office-based philanthropic program requires decisions to be made on matters such as:

- Should there be a mission statement for the philanthropic strategy?
- Should the overall program be thematic or general and, if thematic, what should the priority issues be?
- What should the geographic reach of the program be?
- Should the program be proactive (programs to be funded and initiated by the office) or reactive (inviting applications from the community)?
- Will the funding be short-term or long-term?
- Will funding be directed at projects or general organizational support?
- Should there be a few large grants or several smaller grants?
- Should there be public guidelines and an annual report?
- What should the internal decision-making process be?
- How will the directors be chosen and what succession arrangements should be made?
- What is the role of non-family members as professionals and directors?
- Are professional advisors involved and is the philanthropic strategy carried out professionally to optimize tax and legal implications?

Impact investing

Impact investments are as those that set out to achieve positive social and environmental impacts, in addition to financial return, while measuring the achievement of both. Impact investing dismisses the notion that profitable investments and giving money to charitable work are separate activities, distinguishing it from other forms of philanthropy. Impact Investing research suggests that the market for such investments is expected to reach US$500 billion to US$1 trillion globally over the next decade.

Collective impact

No single policy, program or organization can tackle the increasingly complex problems the world faces today. Collective impact refers to the commitment of a group of important actors from different sectors to a common agenda for solving a specific social problem. The collective impact approach was first discussed by John Kania and Mark Kramer in the 2011 Stanford Social Innovation Review. They identified five key elements of an effective collective impact approach, including a common agenda, the consistent measurement of results, mutually reinforcing activities and the use of a backbone organization.

Responsible investment framework

A responsible investment framework helps organizations use their wealth to make socially ethical investment decisions, often based on environmental, social and governance (ESG) factors. Such frameworks will commonly involve thorough monitoring practices, rigid reporting policies and a great deal of accountability and transparency. For many organizations that are using part of their portfolio for ethical or impact investments, a responsible investment framework can ensure that the remainder of their portfolio is aligned to the same goals and does not deter or diminish the impact outcomes sought by part of their portfolio. An example of this is the Rockefeller family's decision to sell their investments in fossil fuels to reinvest in renewable energy.

Section 3

Family Offices in the Indian context

As a precursor for understanding how ultra-high net worth families in India manage their wealth, it is helpful to first understand where their wealth originated.

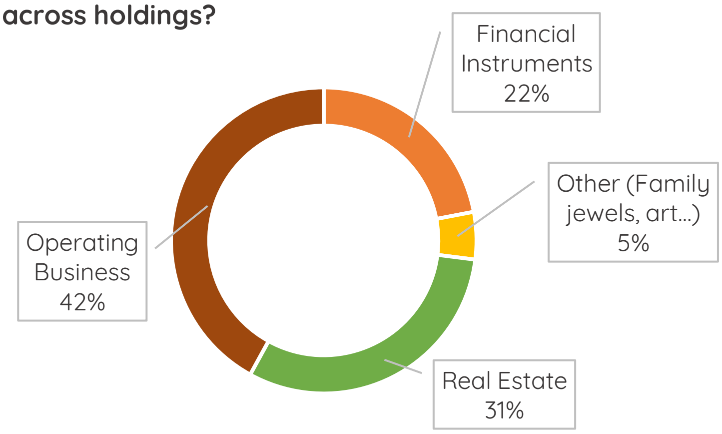
To make vast sums of money, individuals typically own highly successful businesses. And, it can sometimes take these businesses multiple generations of fruitful profits before its founders eventually become UHNW individuals.

Segregation of Family Wealth in India

The average level of wealth of the families studied within this report stands at $645 million. This is compared to an average wealth of $1.1 billion for family office holders globally, according to the UBS/Campden Wealth 2018 Global Family Office Report.

In terms of where the family wealth in India resides across individuals' assets, an average of 42% sit in families' operating businesses, 31% in real estate, 22% in financial instruments and 5% in 'other' assets including jewels, art, yachts, etc. (figure below).

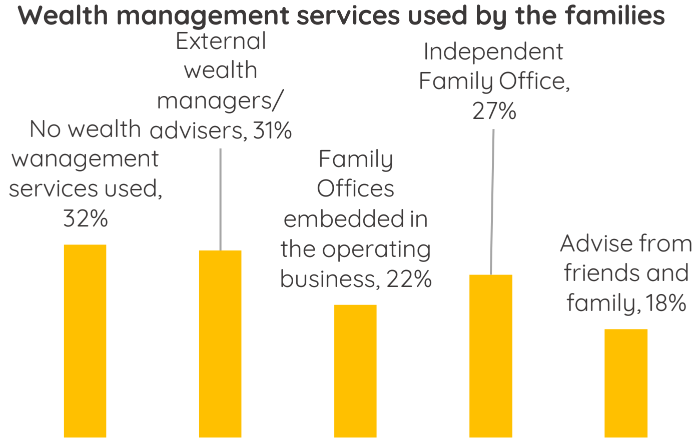
How the family wealth is split across holdings?



More than half of the families represented in this report have retained a complete (100%) stake in their operating business (51%), while 38% hold a majority stake, 3% a minority stake (with controlling rights) and 8% have sold their operating business.

Penetration of Family Office Services in India

The family office concept still remains it its nascent stage as many UHNW families have not set up family offices to look after intergenerational wealth.



Families of dynastic, multi-generational wealth often think beyond their own lifetimes. They think about what their legacies and the legacies of their businesses will be in the years to come. They think about how to provide financially for their families for generations into the future, and how to establish business and wealth management structures that can survive in spite of unforeseen events.

To help families such as these navigate the complexities of their business and financial planning, many turn to outside experts for advice or wealth management services. A growing number have also taken the added step of joining a multi-family office, where matters relating to both wealth management and general family planning and support are offered.

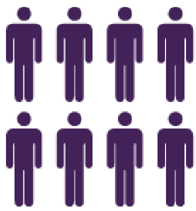
Amongst the families of wealth in India, the majority of those represented within this research use some form of independent wealth management service to preserve and/or grow their wealth. Just under a third (31%) use just external advisers, 22% have hybrid family offices and 27% have independent family offices. Just 32% report to use no such services at all.

"Family offices' average AUM is $318 million; families' average wealth $645 million."

According to Campden Research, the average amount of private wealth family offices manage stands at $318 million, while the average wealth of the families across this report stands at $645 million. Each family office also employs an average of eight members of staff, which is slightly lower than the global average of 11 (Global Family Office Report, 2018).

$318 million
Average private wealth managed by the family office (in AUM)

$645 million
Average net worth of the founding family



8 staff
Average number of staff employed by the family office

Primary Factors of Consideration for Indian Families setting up Family offices

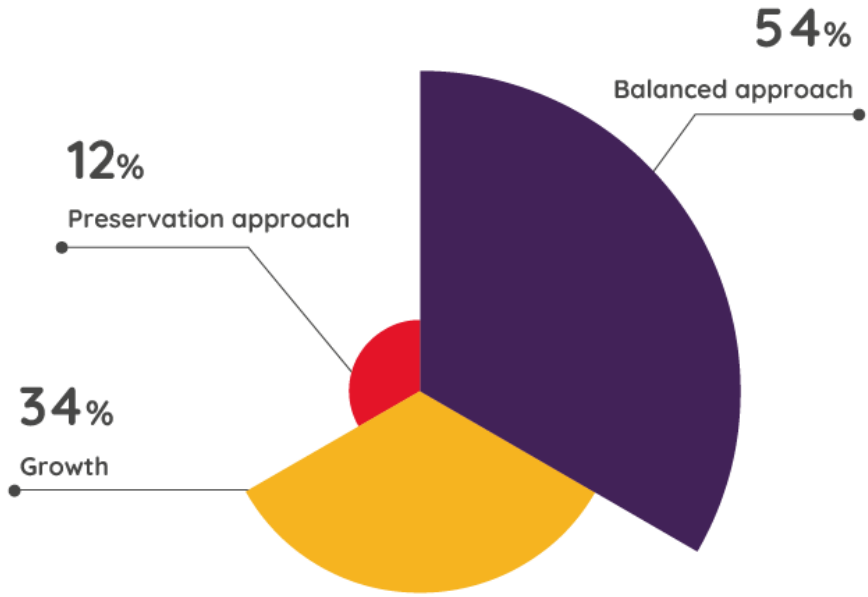
	Very Important	Important
Consolidating information and reporting on investments and operations	70%	23%
Family administration and professional services – accounting, bill paying, staff, insurance, and tax/legal/estate planning	56%	31%
Centralised control and risk management	48%	35%
Intergenerational wealth management	47%	41%
Family governance – family council secretariat, family meetings/events, and Next Generation development	39%	35%
Philanthropy	62%	38%
Real asset management – real estate, planes, and collectibles	23%	45%
Co-investing	14%	48%
Concierge services	7%	33%

31%

of UHNW families say they do not have a mission statement for their family's wealth.

Asset Allocations

The Campden Research quantitative data shows that the most common investment strategy is a balanced, preservation plus growth-oriented approach (54%), followed by a growth-focused (34%) and preservation-focused (12%) strategy.



Interestingly, the qualitative data suggests that a balanced investment strategy is the result of the older generation preferring a preservationist approach and the younger generation favouring a more aggressive growth-oriented model.

This finding is also supported by a 2017 study conducted by Deloitte into the next generation of wealth holders. The report found that the next generation is willing to take on greater amounts of risk by investing in wider geographical markets and facilitating growth by investing in innovative technologies. Moreover, a paper published by McKinsey & Company posits that for family businesses to succeed through the generations, they must have a dynamic investment portfolio in order to raise capital and expand.

Given the recent findings published in the Global Family Office Report 2018 that reveal developing market equities yielded a steep average return of 38% in 2017 and private equity venture capital 18%, this approach, if managed sensibly, might be strategically and financially prosperous if the economic climate is right.

India remains the focus for family investment. Across the survey respondents, nearly every Indian family invested in India

(99% of families)

Outside of this, 14% also invested in North America, 11% in Europe, 10% in Asia-Pacific, 7% in the Middle East and 5% in Africa.

Section 5

The costs of running a family office and setup structure

Overall costs

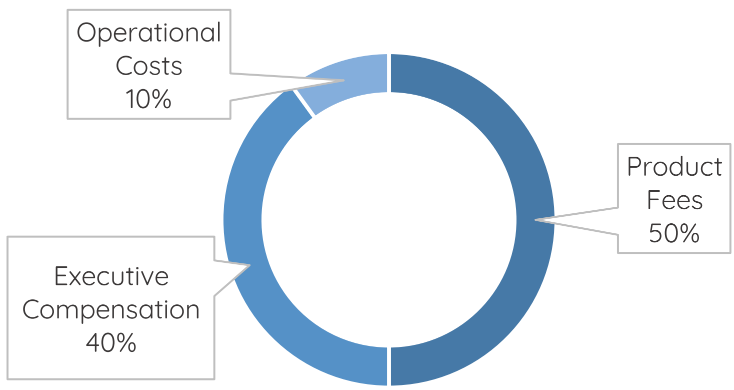
Family offices typically have operating costs of between 100 basis points and 250 basis points.

There is a declining marginal cost to availing family offices services in correlation to asset size

Asset size	Typical costs
Greater than $10 Mn less than $50 Mn	2.5% annually
Greater than $50 Mn less than $100 Mn	1.5% annually
Greater than $100 Mn	1% annually

The allocation of expenses between various services is likely to be product fees (50%), executive compensation (40%) and operational costs (10%).

Allocation of expenses for a family office



Section 6

Constructing a business plan & strategic planning

Planning a strategic way forward

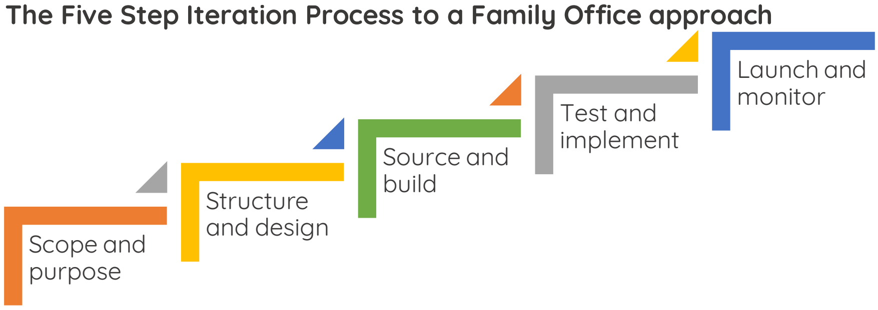
If a family decides that it needs a family office, what are the next steps?
It is an increasingly widely held view that a family office should not operate in the long term on a deficit basis, i.e., purely as a cost centre. Most successful entrepreneurs would not start a business without a written business plan. Once the business is running, these entrepreneurs generally create and update short- and long-term strategic plans for the business. Leading family offices provide that same level of diligence for themselves.

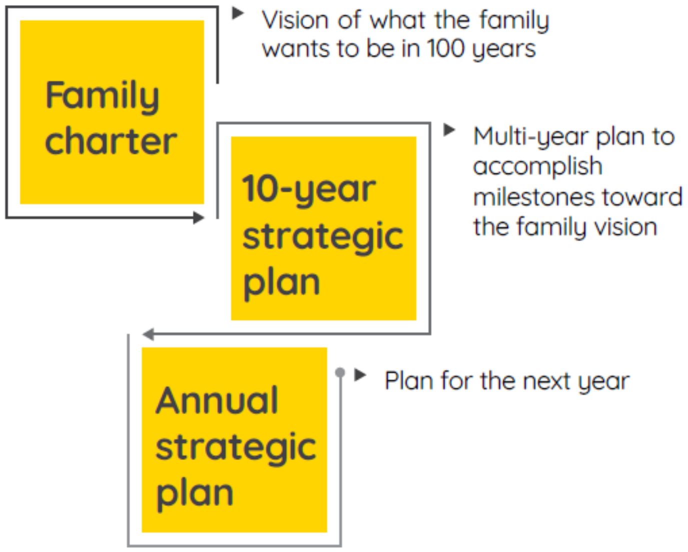
Business plan

The first step in creating a business plan is understanding the vision for the family (usually described in a family charter), and subsequently the vision for the family office. Here are some of the key components of such a plan:

1. **Summary**: It is important to describe the vision for the family office, explain why it is being created, whom it is designed to serve and how it is expected to evolve.
2. **Structure**: What type of entity will house the office, and who will own it? What is the plan for passing ownership across generations (assuming the office is intended to support more than the first generation)? Will the office support businesses, with the potential of having some expenses deductible against business income? It is important to discuss the intended tax impact of the structures to ensure that the family understand their potential consequences. Tax and legal advisors generally have a significant advisory role on structure and jurisdiction.
3. **Jurisdiction**: Global families need to consider which country the office will be based in, but this decision goes much further. Within specific countries such as the US, states have vastly different tax, legal, and judicial benefits. The business plan should specify where the office and entities will be based.
4. **Governance**: Governing boards or councils need to be defined, including how they will work. This structure often includes a family council, investment committee and even a philanthropic committee. The plan should define what boards will exist, how board members will be selected, how the boards will change over time, how decisions will be made within them, and whether they will include non-family participants.

The Five Step Iteration Process to a Family Office approach





Strategic planning
Once a family office is operational, strategic planning remains an important exercise. Annual strategic planning is important for all family offices, but offices that have continued for generations often create additional 5- or 10-year strategic plans. Family offices respond to a wide variety of demands from many family members, and it is easy to just be reactive.

The 10-year strategic plan
For family offices that have existed for a long time and are supporting multiple generations, recent years have seen an increase in 5- or 10-year strategic plans. These plans are designed to bridge the gap between the vision in the family charter (sometimes considered a 100-year plan) and the annual strategic plan.

Often, the process the family goes through is just as important as the outcome. Taking time to plan what they want to accomplish in the next 10 years causes them to think very differently than for annual planning. Here are the major elements often considered in these plans:

1. **Succession planning**: Preparing family for leadership takes many years, whether that is for leading the business, governance committees or the family office. Families may develop programs for an entire generation, offering training, mentorship, and business internship programs to give them the experience to lead the family.
2. **Business or investment growth**: Families may consider starting a new business, or perhaps a large real estate development plan, or a shift into private equity investing.
3. **Direct philanthropy**: Some families set philanthropic goals of changing a particular community, providing higher education or solving health issues. These may be long-term goals, better served through a 10-year plan. Due to the nature of these planning efforts, families often find it beneficial to engage an outside advisor to lead and facilitate the process, which can help to bring new perspectives.

Annual strategic planning
The outcome of annual planning is an evaluation of activities in the previous year, goals for the coming year, and a plan for achieving those goals. Here are some important factors in the strategic plan:

1. **Reflection**: How have the family and the office performed against the current year plan? What are the strengths and weaknesses of the family and the family office? What major changes have occurred since the last planning exercise? Is the family successfully moving toward its long-term vision specified in the family charter, or are there major gaps between the stated goals and what they are actually doing?
2. **Feedback**: Actively find out what family members think of the office, its staff, and the support it provides. Quite often, the

older generation are pleased with the office, while younger generations are less happy with it.

3. **Risks**: What are the major risks the family and the family office face, and how might they be mitigated? This is an opportunity to consider succession planning, risks from staff or operations, economic, legal, or tax events, and how business risks might impact the family or how family risks might impact the business.
4. **Family initiatives**: Consider what new initiatives the family desires and how the office will support them. Are there new businesses being formed, a real estate development activity, new philanthropic initiatives, or perhaps a major family anniversary to plan for?
5. **Budgeting**: Bringing together the above components will help determine the budget for the coming year, including a plan for how it will be funded. When the family agrees with the planning and future initiatives, they will be much more likely to agree to the required funding.

Section 7

Risk Management

Integrating risk management

The maintenance of family wealth across generations is an extremely complex task. There are many risks, any of which can prevent a family from achieving their long-term legacy. Families should develop an integrated risk management approach between the family business assets and the private family assets, in order to protect themselves from risks.

Categories of risk

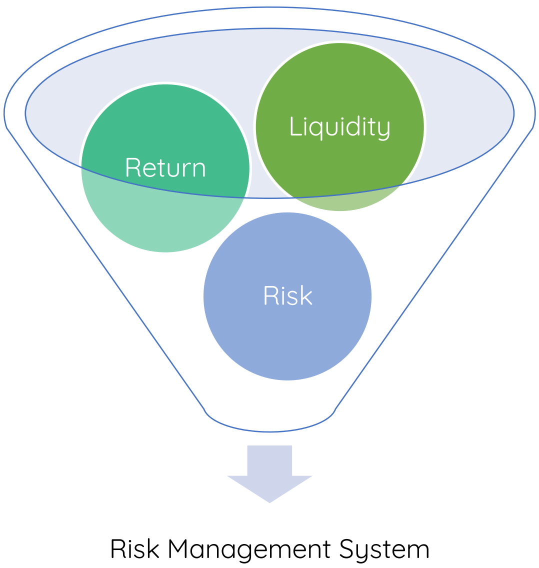
The family office is the right entity to manage the different risks facing the family. Typically, the family wealth originates from the sale in whole or in part of the family business, or from free cash flows that are not reinvested in the existing business. This process of asset diversification goes hand-in-hand with the enterprise risk management process.

Against this background, family offices are tasked with complementing their existing standard risk measures with additional ones, particularly as direct investments in real assets gain in importance. Risk management at family offices is moving away from a mere controlling role to a time-critical, strategic advisory role. This new demand for risk transparency has led to the desire to invest more in direct investment opportunities and in real assets, rather than complex financial capital market products. A lower level of complexity of investment products, the proximity to the investment, and the possibility of having a real influence on the investment are more sought after now than ever before.

Long-term investments with lower volatility and a moderate expected return are often combined with short- to mid-term investments with a significantly higher risk profile to achieve outperformance. As part of this process, a further professionalization is taking place. Families rank investment risk, family reputation and family data and privacy among the top risks they face, according to a Campden Wealth survey on global family offices in 2014. This guide recommends that seven risk categories need to be evaluated as part of a strong and coherent approach to risk management.

Risk category	Summary description
Vision/legacy	Stated family vision or purpose, services provided within the office, family governance, communication, education and planning
Operations	Transaction processing and controls
Estate/regulatory	Types of entities, management and oversight of those entities, compliance, reporting and office management
Business	Impact (or potential impact) on the family from the various businesses they own and manage, this encompasses financial, succession and reputation impacts
Technology	Evaluate platforms used in the office, and review the infrastructure of technology and security, particularly including cybersecurity
Investment	Examine the policies and processes around investment oversight, from investment policy statements to selecting managers, exclusive of evaluating the risk of specific holdings or portfolios
Disaster	Review plans and preparation for facing serious setbacks, which includes evaluation of existing insurance coverage

Three Key Pillars of Risk Management



Risk management systems
Risk, return and liquidity are the foremost issues to be considered in any investment decision and asset allocation process. These prerequisites will be the basis for the risk management system, which in itself will cover risk mitigation and cost reduction, and may lead to value creation as a result. These factors include:

Risk mitigation

- Identify and address key risk areas
- Effectively assess risks across the family office, driving accountability and ownership

- Manage and mitigate mission-critical risks
- Establish comprehensive risk frameworks

Cost reduction

- Cost efficiencies are a critical part of setting up a family office
- Implement an automated risk management process to materially improve the cost structure
- Reduce cost of control spend through improved use of automated controls
- Streamline or eliminate duplicative risk activities
- Improve process efficiency through continuous monitoring

Value creation

- Achieve superior returns from risk investments
- Improve control of key processes
- Combine risk and control management to improve performance
- Use analytics to optimize the risk portfolio and improve decision-making

Family office CEOs, CFOs and CIOs increasingly perceive enterprise risk management as adding real value to the family office operation. According to the 2014 European Family Office Survey by Campden Wealth, families are well aware of the different risks, but often have not implemented an adequate risk management process.
In an appropriate risk management process, each of the seven categories of risk mentioned before will be assessed against the specific situation of the individual family/family office. The assessment of the inherent risks, if no controls or mitigating factors were in place, combined with the existing control environment, result in the residual risk after controls are taken into account (measured, for example, on a scale from low to medium or high risks).

Following such a diagnostic process (risk review, risk identification and risk measurement) structured recommendations can be made to report the risk objectively, improve the control environment and ultimately to mitigate the risks.

Risk Management Process

Risk review

Establish risk appetite of family and family office; what level of risk is acceptable?

Define a common understanding of the risk level among family members, the investment committee or other relevant boards and the family office.

Risk Identification

Establish a detailed risk identification process.

Identify and document qualitative and quantitative risks.

Define the chief drivers of volatility of the main asset classes and investments.

Risk measurement

Measure impact of risks on investment decisions.

Prioritize risks according to impact level and likelihood of occurance.

Risk reporting

Include relevant and sufficient level of information in regular reporting

Establish family governance to deal with risk management.

Risk mitigation

Establish measures to mitigate at least the top priority risks.

Opportunities need to be identified in the same way as risks.

Establish regular monitoring of the family risk landscape.

Section 8

The investment process

Background

How do family offices invest their principals' money? There are no fixed investment regulations that apply. Family offices tend to follow their own individual investment policies, because, unlike banks and other financial service providers, they are generally subject to the more relaxed regulations applicable to companies, trusts and foundations. However, the degree of freedom enjoyed by family offices is reduced in proportion to the level of services provided by third parties and the number of families served by the family office.

Family offices can often diversify their assets very broadly, much more than institutional investors can, thanks to the amount of assets under management. Family offices are also generally better able to think and invest on a more long-term basis, and they primarily pursue wealth preservation in order to pass on assets to the next generations. Many prefer direct investments, and where organizations have an entrepreneurial principal, they are more likely to get directly involved in the investment process. More than a third of those surveyed would be glad to contribute to the planning stage of their investments.

Many family offices take an open approach to their investment policy and try to avoid conventional investment paths. This can be seen in the way that many invest in alternative investments, such as yachts, horses, art, forests and farmland, or car, wine or watch collections. This enables them to spread risks while reflecting the personal preferences and passions of family members.

The growth of family offices is a relatively new trend, and because of the diverse origins of many family fortunes and the different backgrounds of CIOs, it is difficult to pinpoint a uniform family office investment process. Very broadly, the process should first set out an investment "road ahead", listing goals and risk tolerance, and resolving issues relating to business shareholdings and family member stakes. The next phase is to establish the portfolio structure (i.e., how much in equities, real estate) to deliver the risk and return trade-off the family requires. Implementation and governance then follow — finding the appropriate investments to make up the portfolio, and overseeing their performance.

Role of the family

The crafting of an investment process is heavily dependent on legacy issues. In what economic sector has the family made its money, to what extent is the family still actively involved in the business and what is the background of the CIO of the family office? Each of these factors has a tendency to produce a strong behavioral bias on how a family's wealth is invested and on the subsequent need to produce a diversified portfolio for the long term.

Another issue that is also important is the composition of the family. For example, a family office that is set up by a first-generation entrepreneur would probably be very different in its aims to one that is established by a large fourth-generation family. As a result, the behavioral, financial and legal issues involved in structuring the investment process of a family office are complex and fascinating.

Credit Suisse's Family Business Survey 2012 suggests that most family businesses, even those at the third generation and older, do not yet have a family office. Cost and complexity are two contributing factors here, though it is also clear that the rate of growth of family offices is accelerating, and that the need for a transparent, independent and structured investment process is a key reason for this.

Setting investment goals

For most investment funds, whether they are sovereign wealth funds, endowments or family offices, the first step is to establish clear investment objectives and risk profiles. These different investment structures can have varying goals and objectives, and there is also variety in how these objectives are constructed. For example, some institutional investors work with inflation-related return objectives, others might not.

An important distinction can also be made at this stage between liquid assets, such as tradable securities, and illiquid assets, such as direct investments, private equity and real estate — the latter being difficult to value and often requiring some support in terms of funding. From a conceptual point of view, many CIOs tend to view illiquid assets in a different way, when it comes to returns and investment horizon, to liquid asset portfolios.

Examining prior investment styles and questionnaires can help to identify the family's tolerance to risk. In addition, scenario testing that illustrates and draws out important sensitivities to risk and portfolio drawdowns can be useful. In some cases, the discussion of the investment process is led by the CIO. In others, it can entail a more collective discussion involving family members, and cover any desires they have to establish charities or philanthropic initiatives alongside the family office.

Once an asset allocation recommendation has been reviewed, understood and accepted, the family should formalize their investment plan in an investment policy statement. Such a statement is a road map that is the focus for all parties involved in the client relationship, including investment advisors, investment managers and trustees. It also provides a course of action to be followed in times of market dislocation when emotional reactions may result in imprudent courses of action.

Once the specific investment goals and the risk profile of the family office have been established, the next step is to structure an overall portfolio and then bring to bear the necessary investment tools to drive the investment process. In some cases, historical asset return data is used to give a sense of what future returns might look like, but, as recent stock market history has shown, the past is not a great guide to the future.

Tax considerations

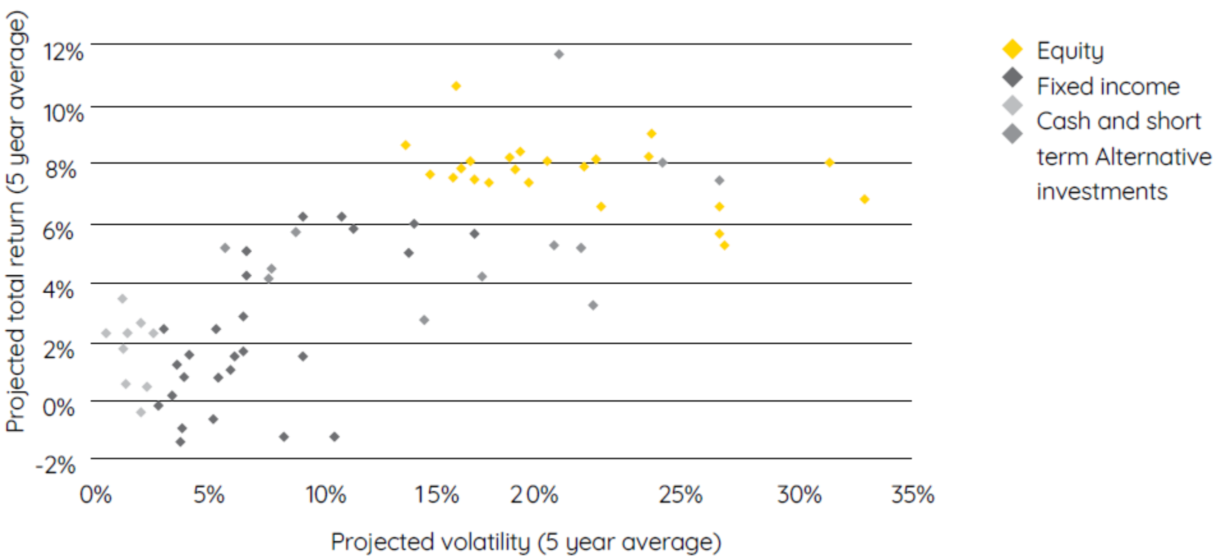
Selecting the most efficient combination of assets for the family requires an adjustment to portfolio optimization that takes into consideration the ultimate after-tax return that they would expect to receive. For each asset class, the expected return should be deconstructed to reflect the income yield from interest and dividends versus return from capital appreciation. Based on the level of turnover typical for each asset class, it is possible to estimate the percentage of asset appreciation that comes from realized versus unrealized capital gains, and also the extent to which realized capital gains would be treated as short-term as against long-term tax liabilities. Providing asset allocation analysis on an after-tax basis presents a realistic view of the return the family can expect from its portfolio investments, as well as an optimal mix of investments tailored to a family's specific tax situation.

Stress testing and modelling

Once an initial portfolio shape is in place, several further exercises can be useful, such as stress testing the return profile of the portfolio to demonstrate to family members how the portfolio might behave during periods of volatility. In performing this type of analysis, it is sensible to examine all the family's wealth, not just their investment portfolio. Modelling the core business holding of a family as a form of private equity or direct equity holding, and then analysing and optimizing other components of a family's wealth with respect to this, is a difficult but necessary task.

In the context of family businesses, one common outcome of this part of the process is to show that the initial investment portfolio of the family office could be better diversified, since it often has a large holding in the underlying family business or, in some cases, legacy investments that tend to be over-concentrated in certain asset classes (e.g., private equity). There are several different ways to achieve a more diversified portfolio for the family office.

Projected total return and volatility of various asset classes



Source: The Captial Market Assumptions framework at Credit Suisse produces five year average return and volatility forecasts for 75 asset classes, some of which are shown in the chart.

The importance of cash flow
Family offices are different from other organizations, in that there is often a greater and more irregular call on the investment portfolio. Family members request funds for business-related or private equity stakes, philanthropic and impact investments, or ongoing expenses. In this respect, being able to model the impact of cash flows on an overall investment portfolio is important, and experience suggests that the focus on yield and cash flow tends to be higher for family offices than for other client types. Accordingly, families should consider their overall liquidity needs carefully during the portfolio creation process.

Implementation and governance
The implementation and governance quality is crucial. From an investment point of view, how a portfolio is implemented must be consistent with its objectives and structure. Having a formal investment policy statement in place is an important step in maintaining an appropriate governance structure. In addition to reviewing the family's goals and objectives, it is vital to review asset allocation. This can be done by rerunning asset allocation diagnostics on portfolios at least once a year, in order to make sure that they perform as initially prescribed. Governance and transparency are also very important, and regular meetings and calls between principals, the family office staff and external advisors will help to clarify broad macro views, turning points in strategy, and issues relating to implementation.

In summary, while the family office space is growing and evolving quickly, several building blocks can be identified as forming the key components of a family office investment process. These are:

- Consideration of how legacy issues determine the starting point of the fund.
- Objective setting and creation of an investment policy statement.
- Mapping risk tolerances.
- Building a portfolio structure across all liquid and illiquid assets
- Implementation using strategic and tactical investment tools to ensure that investment solutions fit the goals and objectives and meet cash flow needs.
- Governance.
- Rebalancing.

Investment strategy overview
Once investment goals have been established, family offices can begin thinking through how to deploy and manage capital. The type of investment strategy a family office pursues is a function of sourcing capabilities, desired control, liquidity needs, investing experience, and family office infrastructure. Family office investment strategies generally fall into three broad categories: (i) third-party managed, (ii) public direct and (iii) private direct. Often family offices use a mix of these strategies to diversify investment exposure and improve risk-adjusted returns.

Third-party managed investing consists of family offices using asset management funds to invest their capital. Families can make high-

level decisions around how to allocate their capital between industry sectors and asset classes at the fund selection level. Below fund selection level, however, they have limited influence over investment decisions. Asset managers can focus their investments on public or private entities and on traditional or alternative asset classes
Direct investing involves the family office making the decision to invest capital into a specific asset or security. This requires the family office to do its own research and due diligence in the investment process. The family office is also responsible for continuing to follow asset level performance and manage its portfolio of these assets on a day-to-day basis.

Public direct investing is centred on liquid debt, equity securities and derivatives that trade over a public exchange. These investments are made through the use of public information and are subject to regulatory requirements that both protect and constrain the investor.

Private direct investing focuses on taking a more active role in the deal process and underlying investment. The family office will often be more involved in business decisions and strategy for the entity or asset. The investment can be structured as debt, equity, or as a specific asset purchase (e.g., real estate).

Presented below is a summary of the key benefits and considerations for family offices regarding each investment type.

Family office investment strategy

Strategy	Benefits	Considerations	Examples
Third-party managed	• Lowest infrastructure requirements • Investment access is good but customization is limited • Third-party expertise can be valuable	• Management fees • Limited control over how capital is allocated at fund level • Transparency can be limited • Potential conflicts of interest • Redemption features can impact liquidity	Fund investing: • Mutual funds • Private equity funds • Infrastructure funds • Hedge funds • Fund of funds
Public direct	• Liquid asset class • Avoids management fees • Highly customizable portfolios • Large investment universe • Ability to use family office expertise in investment selection	• Limited to public market opportunities • Information must be public • Generally has limited influence over underlying entity or asset • Subject to public market volatility around valuation • Moderate infrastructure requirements to manage portfolio	Traditional investing: • Money markets • Fixed income • Equities • Commodities • Options
Private direct	• Avoids management fees • Highest potential for “alpha” • Structuring flexibility • Ability to use family office expertise in investment selection • Highly customizable portfolios • Increased access to information, including non-public • Ability to influence decision-making around underlying asset	• Investment sourcing can be challenging • Illiquid asset class • Investment process, including due diligence and documentation, can be burdensome • High infrastructure requirements	Alternative investing: • Private equity • Venture capital • Mezzanine debt • Real estate • Infrastructure projects • Natural resources • Royalty streams

Private direct investing

Recently, a strong trend has emerged of family offices beginning to pursue direct investments in the private market. The primary drivers for this trend have been: (i) a search for better investment control, (ii) attractive risk-adjusted returns that have limited public market correlation, and (iii) lower price volatility. This type of investment strategy, however, requires the implementation of a formal investment committee process to identify, vet and execute new opportunities, as well as manage ongoing portfolio needs.

Some family offices have chosen to team up with other family offices to pursue this strategy as a club. This teaming-up offers attractive synergies around infrastructure, deal sourcing, and idea sharing but does create governance issues with investment selection and ongoing management. For small- to mid-sized family offices, the club approach also enhances their overall competitiveness in the marketplace by increasing the capital available to pursue new opportunities — an important criterion in winning a competitive deal. Along the same lines, family offices can also decide to pursue individual deals on a co-investment or standalone basis. The private direct investment process can be broken into three broad phases: (i) making, (ii) managing and (iii) monetizing. Setting up a formal investment committee process around the implementation of these phases and setting up the necessary infrastructure in the family office for dealing with direct investments are critical. Family offices need to make sure that they have the right resources available and policies and procedures in place to ensure that the risks and opportunities around each investment are understood and managed

Private direct investing process

While family offices often possess the foundation needed to create a successful direct investment strategy, investment gaps can exist at each phase of the process. Family offices, like traditional asset managers, often rely on outside professionals to assist with specific services that are not carried out in-house (e.g., M&A advisory, capital markets advisory, legal advisory, tax advisory, accounting). This is particularly true as a family office platform initially begins pursuing the private direct investing strategy. Over time, however, as it gains experience and builds out its infrastructure, many of these professional services can be brought in-house.

Making

The process of deciding to make the investment

- Researching
- Sourcing
- Evaluating/due diligence
- Structuring (e.g., M&A and tax implications)
- Financing & capital markets/structure
- Closing

Managing

The ongoing management and monitoring of the investment

- Strategic objectives
  - M&A, organic, etc.
- Operations, financial results/cash flow
- Capital markets/structure
  - Refinancing
  - Dividend recapitalization
  - Future capital needs
  - Compliance
- Governance

Monetizing

The process to return capital to the investor (can be ongoing)

- Full sale
- Partial sale
- Capital markets/structure
  - IPO
  - Refinancing
  - Dividend recapitalization
  - Securitization

Section 9

The Legal Framework & Taxation of Private Family Trusts in India

A family may engage a MFO to advise on setting up a suitable structure to achieve its succession planning goals. Since MFOs pool money from multiple families, it allows them to achieve economies of scale as expenses are shared and they have a larger pool of capital for making investments.

There are various considerations which become relevant while drawing up a succession planning structure. These include the long-term investment objectives and vision of the family concerned, the a family may engage a MFO to advise on setting up a suitable structure to achieve its succession planning goals. Since MFOs pool money from multiple families, it allows them to achieve economies of scale as expenses are shared and they have a larger pool of capital for making investments.

There are various considerations which become relevant while drawing up a succession planning structure. These include the long-term investment objectives and vision of the family concerned, the risk appetite, and the anticipated future requirements of different branches of the family, applicable legal, regulatory and tax regimes of various jurisdictions involved, etc. In India, there are various options for setting up family offices (for example, private company, limited liability partnership and trust). Generally, the trust structure is preferred due to the flexibility it offers. There are also different options available for appointing a trustee.

A popular, but slightly cumbersome option is to use a **Private Trust Company (PTC).**

A PTC is set-up by family members with the sole purpose of acting as the trustee for a family office structured in the form of a trust. Since a company has a separate legal personality, having a PTC as trustee offers several benefits such as ring-fencing potential liabilities that may arise for breach of fiduciary duties as a trustee, flexibility to on-board independent professional managers for management of the trust (as employees of the PTC) with the family members having overall control over the operations of the PTC in their capacity as shareholders.

Arbitrability of trust disputes

While India has steadily been moving towards a regime favourable towards arbitration, there is an ambiguity regarding the arbitrability of disputes arising out of trust structures due to conflicting judicial decisions on this point. The Delhi High Court has held in the case of Ms. Chhaya Shriram v. Deepak C. Shriram that disputes involving beneficiaries are not mandatorily required to be submitted to arbitration. The court reasoned that benefits which a beneficiary becomes entitled to under a trust structure arise not out of any contract between him and the trustee and the settlor but rather because of the desire of the settlor. The trust deed is not a binding contract between the settler and the beneficiary, or between the beneficiaries and hence, disputes involving beneficiaries are not mandatorily required to be submitted to arbitration. Interestingly, the Delhi High Court also applied the same logic to disputes arising between legatees of a Will to hold that the legatees are not mandatorily required to submit their disputes to arbitration.

The Bombay High Court also considered this issue in the case of Mr. Jayesh Dinesh Shah v. Kaydee Family Trust, but arrived at a different conclusion. A clause for resolution of disputes "between the Trustees, or the Trustees and beneficiaries, or the beneficiaries inter-se" by way of arbitration was incorporated in the trust deed. The Bombay Court held that the beneficiaries who had been identified in the trust deed were also to be treated as parties to the arbitration agreement. The Bombay High Court took this view, even though the beneficiaries were minor at the time of execution of the trust deed and hence, lacked the competence to enter into a valid contract.

In India, there are various options for setting up family offices (for example, private company, limited liability partnership and trust). Generally, the trust structure is preferred due to the flexibility it offers.

As there are conflicting judicial pronouncements from coordinate benches of different High Courts on the issue, ambiguity will persist until a position in this regard is articulated by a judgment of the Supreme Court of India. With respect to multi-jurisdictional succession planning, the issue of whether beneficiaries can be bound by/seek the benefit of arbitration clauses in a trust deed would need to examined as per the laws relevant to arbitration in the jurisdictions involved. In practice, several trust structures in India and abroad are currently being set up with arbitration clauses covering potential disputes between the trustees and some / all beneficiaries, or between the beneficiaries inter-se, as there is generally no down side to inclusion of such clauses.

Further, in light of the possibility that dispute resolution mechanism may be unsuccessful in resolving any dispute, it could be useful to include a framework for exit in the governance documents to mitigate protracted and bitter confrontation among family members. The family members may agree upon a period during which any party which decides to exit, may choose to alter his or her decision. Such a cooling-off period could increase the likelihood that decisions regarding spilt of business, assets or otherwise are adequately deliberated upon and are not made in haste.

Disclosure obligations

Individuals who are resident in India are required to disclose all assets held by them (including financial interest held by them) outside India and signing authority held by them for any account located outside India. Such disclosure is required to be made as part of tax returns filed every year. In case of trusts set up outside India, disclosure is required to be made in the following circumstances:

- If the resident individual is the settlor of the trust;
- If the resident individual is the trustee of the trust; or
- If the resident individual is the beneficiary of the trust and if either the trust is a determinate trust (where the shares of the beneficiaries are pre-defined) or if the trust makes distribution during the relevant year for which tax returns is being filed.

Non-disclosure of such information is subject to stringent provisions. Under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, 30% tax is levied on undisclosed foreign income (UFI) and undisclosed foreign assets (UFA) held outside India. Further, penalty up to three times the tax liability is also levied. UFI encompasses income from foreign assets which has not been disclosed under applicable tax returns under the Income Tax Act, 1961. UFA refers to an asset (including financial interest in any entity) located outside India, held by a taxpayer in his name or in respect of which he is a beneficial owner and he has no explanation about the source of investment in such asset or his explanation is not to the satisfaction of the revenue authorities.

Rigorous imprisonment for a minimum period of six months and a maximum period of seven years along with fine, has been prescribed for furnishing any false information in any verification with respect to foreign income and assets. Further, similar penalty has also been prescribed for those found to be abetting such furnishing of false information. In the context of the fund managers or wealth advisers engaged by the families, this becomes important as it is presumed that the accused had the intention, motive or knowledge of a fact or belief in, or reason to believe, a fact to commit an act considered an offence under this law. The onus to prove non-culpability beyond reasonable doubt is shifted to the accused.

Taxation is one of the key determinants of how a Private Trust is set up.

On a related note, the present Central Government has been continuously taking various steps towards information exchange with other jurisdictions. For this purpose, the Government has been renegotiating India's tax treaties to include express provisions for information sharing. The Government has also signed the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information and the Intergovernmental Agreement with the US to implement the Foreign Account Tax Compliance Act (FATCA). Therefore, the Government is expected to obtain a lot more information relating to assets held by its residents in various jurisdictions than previously seen. There is growing concern on how such information would be used and processed and whether there could be reputation issues or unwarranted harassment faced by taxpayers who may have set up legitimate structures outside India. The recent Panama Papers incident is one such example and it is expected that there would be many such instances going forward.9

Applicability of General Anti-Avoidance Rules

In line with emerging international focus on curbing tax avoidance, India has enacted certain General Anti-Avoidance Rules (GAAR) as part of the income tax law conferring powers on tax authorities to investigate and declare an arrangement as an "impermissible avoidance arrangement". Upon such declaration, tax authorities have been empowered to disregard or re-characterise such structures and adopt a "look through" approach to determine the real nature of the arrangement. The tax authorities may also deny benefits conferred under an applicable double taxation avoidance treaty. An "impermissible avoidance arrangement" is an arrangement entered into with the main purpose of obtaining a tax benefit and satisfying one or more of the following: (i) non-arm's length dealings; (ii) misuse or abuse of the provisions of the domestic income tax provisions; (iii) lack of commercial substance; and (iv) arrangement similar to that employed for non-bona fide purposes.

Since its introduction, commencement of applicability of GAAR has been deferred multiple times and is now slated come into effect from April 1, 2017. In view of the announcement of the Finance Minister in the course of his speech for the 2016 Budget, no more deferrals are expected. Also, during his speech for the 2015 Budget, the Finance Minister announced that investments made prior to April 1, 2017 will be grandfathered from the applicability of GAAR and that rules will be issued in this regard. However, such rules have not yet been issued.
In the context of succession planning and family office structures, to mitigate risk of invocation of GAAR, all documentation (especially trust deeds, minutes of meetings, websites, disclosures and filings before Indian regulatory authorities, etc.) should clearly and consistently reflect the commercial objectives of the structure, wherever appropriate.

Maximum marginal rate of tax is not applicable in all cases and there are exemptions in place to take account of unique reasons for a trust setup.

Tax treatment of trusts in India

In the case of private trusts, if the individual shares of the beneficiaries are ascertainable, they are included in the individual taxable incomes, the tax assessment being made either directly on the beneficiary or on the trustee as a representative of the beneficiary. However, if the trust has income from business, the entire income from the trust is taxed in the hands of the trustee at the maximum marginal rate applicable to individuals unless the trust is created by will for the benefit of relatives. When the individual shares of the beneficiaries are indeterminate (i.e., discretionary trust), the entire income is taxed in the hands of the trustees, in most cases at the maximum marginal rate applicable to individuals.

Taxation of Private Trust When the shares of the individual beneficiaries are determinate:-

- The shares falling to each of the beneficiaries are liable to be assessed, either in the hands of the trustee(s) as a representative assessee or directly in the hands of the beneficiary entitled to the income. Such assessment is made at the rate applicable to the total income of each beneficiary.
- Where the income of the trust consists of or includes profits and gains of business, income tax shall be charged in the hands of trustee(s) on the whole of the income at the maximum marginal rate. This provision is not applicable, in the case of a trust which has been declared by any person exclusively for the benefit of any relative dependent on him and also such trust is the only trust so declared by him.

Taxation of Private Trust When the individual shares of the beneficiaries are indeterminate or unknown:-

- Trustee(s) is liable to tax as a representative assesses.
- Where the income consists of, or includes, profits and gains of business, the entire income of the trust is charged at the maximum marginal rate of tax, except in cases of the a trust which has been declared by any person exclusively for the

benefit of any relative dependent on him and also such trust is the only trust so declared by him.

- Where the income does not consist or include profits and gains of business, income is chargeable at the maximum marginal tax rate.

However, the maximum marginal rate of tax is not applicable in the following cases, and the income will be chargeable to tax as if it were income of an association of persons (AOP) :-

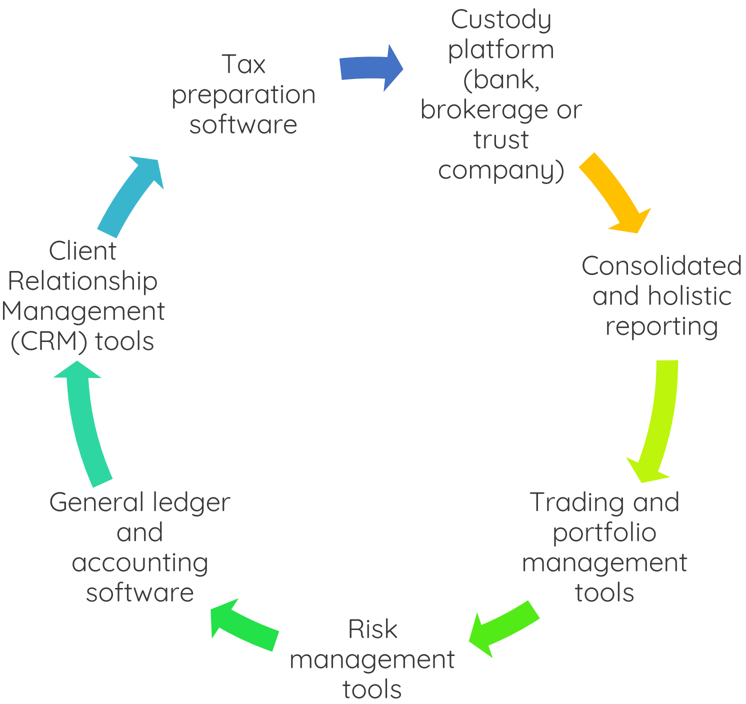
a. Where none of the beneficiaries has any other income chargeable to tax under the Income Tax Act and none of the beneficiaries is a beneficiary under any other trust or
b. Where the relevant income or part of relevant income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him or
c. Where the trust is a non-testamentary trust created before March 1, 1970 for the exclusive benefit of relatives of the settlor mainly dependent on him for their supporter maintenance or, where settlor is a Hindu undivided family, for the exclusive benefit of its members so dependent upon it or
d. Where the trust is created on behalf of a provident fund, superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or profession.

In cases of (a), (b) and (c) supra, the relevant income is taxable in the hands of trustees as if it were the total income of an association of persons, while income falling under (d) supra is exempt from tax.

Section 10

IT, trading tools and platforms

Technology plays an important role in creating an efficient family office. Furthermore, finding the right individuals to manage these platforms is crucial. Technology helps a family office to navigate core objectives, manage legacy changes and adhere to industry updates. It is important that a family office identifies its core technology needs before choosing or creating solutions. Automation is an excellent way to keep costs under control and to mitigate risk. IT tools and platforms that a family office should consider are depicted in the chart below:



The selection of IT should be well thought out and designed in order to provide efficient reporting, trading, portfolio management and accounting. The technology can range from off-the-shelf products to highly sophisticated, customized solutions. Much of this can be outsourced or provided at low cost from service providers, freeing up the family office resources to focus on growing the wealth. The following sections examine a selection of the various platforms in more detail.

Custody platform
The use of multiple custodians creates the obligation to consolidate the assets. This can be done for a fee by a third-party vendor, in-house with the proper investment in systems, or by the use of a global custodian.

The custody of bankable assets is the safekeeping and servicing of assets, either with one or multiple custodians or banks (see figure 8.1). Global custody refers to the custody and administration of assets with one custodian, which offers many advantages such as:

- The consolidation of all bankable securities, financial instruments, and liquid assets, so that the time-consuming work of consolidation resides with the global custodian and not the family office1

- The provision of a comprehensive, transparent overview of the performance of all the assets at all times via a consolidated investment report (providing a uniform format and standards for all assets)
- The assets can be managed either by the custodian bank, an external asset manager, or the client himself (i.e., the client selects their preferred asset manager with no restrictions, and the asset manager is free to select the brokers for securities trading)
- The opportunity to include some non-bankable assets, such as direct real estate investments, mortgages, third-party derivatives, art collections and yachts

Consolidated reporting
A proper design of this process early on will allow families to understand their investments on a holistic basis, identify risks and strengthen their confidence in their family office. Consolidated reporting has been proven to be the most valuable tool of all for a family office, and is highly recommended.

Trading and portfolio management tools
Some family offices employ an asset allocation model, which they give to fund managers. Others make their investments in-house, in which case portfolio management and trading systems become more important.

Various modules can be added to the infrastructure to deal with the increased scale and complexity. These can include:

- **A portfolio management system:** This provides the backbone of a fund's operational infrastructure and acts as the internal books and records.
- **An execution management system:** An electronic trading platform that provides Direct Market Access trading connectivity as well as direct connectivity to broker algorithms.
- **Order management system:** This provides the main trading platform for the firm. As with an execution management system, it also provides Direct Market Access trading and broker connectivity. Other key functions include compliance (pre- and post-trade), rebalancing, order staging and allocations, and portfolio modelling.

CRM tool
A CRM tool is vital for a family office to manage critical information, such as that relating to family members, in one central location. Information retained in a CRM database should include family contact information, family discussions regarding services or major family events, the structure of the family, and third-party contacts, such as legal counsel, accountants and insurance contacts.

Human capital and technology
When choosing technology for a family office, it is imperative to have the right individual(s) in place to manage and operate the software. Such individuals, who may be in dual operational roles, should have an understanding of performance analysis and of accounting principles. They should be "detail oriented", have the ability to leverage technology for integration purposes and have basic Excel skills. Depending on the size and technical complexity of the IT system, some family offices may hire a Chief Technology Officer. This person would be responsible for support, updates, communication and software training.

The implementation of IT in a new or existing family office may require additional resources. These resources might involve external consultants, who can provide advice and support with respect to integration, implementation and the verification of input and output data.

Implementing technology
Once the core needs have been identified and the appropriate solutions chosen, it is vital to implement them effectively. Appropriate implementation may include the following:

- Conceive a detailed project plan, setting out the responsibilities of each vendor
- Agree the data import processes with each vendor
- Create data and functionality test scripts for each platform
- Hire an external consultant for data output testing
- Hold frequent meetings with each vendor on progress and on project plan milestones

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- Life Management and Budgeting

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- Estate and Wealth Transfer
- Business and Financial Advisory

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- Tax and Legal Advisory

Governance

- Reporting and Record Keeping
- Succession Planning
- Administrative Services

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