How family offices conquer challenges, seize opportunities and sustain success

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RSM

Introduction

The coronavirus pandemic has ignited public health and economic crises that have challenged all of us to varying degrees. Family offices, of course, are no exception. But layered beneath those difficulties are opportunities for growth that line the path to sustained success.

With that in mind, RSM US LLP's family office team has compiled this e-book of insights about how to help your family office thrive, from investment analysis and tax strategies to risk management and operational insights. We hope you find this collection helpful as your family moves through the pandemic and emerges into healthier, prosperous times.

We at RSM strive to develop multigenerational relationships with family offices by providing tailored advisory services to help sustain your family's vision in an evolving, digitally driven world. We would welcome the opportunity to discuss with you these topics or any others as part of an exchange of ideas about how we can work together to achieve your family's vision.

Thank you for reading. We wish you all the best!

Anthony Wood

Tony Wood
National Practice Leader, Family Offices

Challenges and opportunities

For family offices, COVID-19 represents new challenges —and opportunities

As the human and economic toll of the coronavirus mounts, no sector of the economy has been immune from the downturn, and this includes family offices.

Like any industry sector, family offices have faced challenges in managing the crisis. For instance, it was uncommon in the past for employees to work from home because of the cost of technology improvements. But avoiding that cost is no longer an option; the coronavirus outbreak has forced firms to upgrade systems that allow for working remotely.

At the same time, family offices have a chance to capitalize on opportunities rarely seen in the markets. That's because this public health emergency, as severe and costly as it is, will eventually pass. Even if other sectors of the economy take longer to recover, the rebound for family offices, which have grown in size and scope over the past decade, could very well come more quickly. It's all the more reason that family offices need to manage the crisis and prepare for the rare opportunity to make investments at values not seen in years.

Managing a crisis

Depending on the size and scope of the family office, there are a number of factors that need to be considered in navigating these uncertain times.

Human capital management: As the old saying goes in the investment business, a firm's most valuable asset goes out the door every night. In family offices, this means placing a priority on taking care of employees and key executives who work in the office handling the administrative, investment or risk functions. These individuals are critical to making sure the office runs smoothly and is able to handle the family's needs during times of crisis. If necessary, outsourcing key back-office functions with third-party providers may provide that temporary transition while the office prepares for remote operations. Reviewing and memorializing succession plans will be necessary to prepare for the time when they are activated.

Liquidity and credit management: Depending on portfolio allocations, alternative investments may have a number of restrictions that will prevent the family from withdrawing capital. Investments with a hedge fund or private equity managers may mandate a lock-up period from when the original investment was made. In addition, investments in fine art, real estate, yachts, private jets or other illiquid assets may take some time to liquidate. Managing both sides of the balance sheet, and reviewing budgets and cash flow, are all functions that should be monitored. Working with a relationship banker to ensure access to lines of credit or other sources of financing will be important to help the family through these difficult times.

Information sharing and data management: The volatile financial markets during the pandemic have led some investors to make irrational decisions based on unverified data. Family offices with complex structures may have issues getting verified, timely data on their investments or businesses. Consider investing in business intelligence tools or hire outside consultants to gain a different perspective that the office would not normally have access to.

Cybersecurity and technology management: As offices close down to help slow the spread of the virus, confirming the strength of the information technology infrastructure, bandwidth and records management will help reduce any office disruptions as office personnel work from home. Cybercriminals may try to find opportunities to penetrate key reporting systems during this period of vulnerability. In

> Family offices need to manage the crisis and prepare for the rare opportunity to make investments at values not seen in years.

addition, social media platforms could be subject to possible phishing or social engineering campaigns by criminals against family members to gain access to private data. The digital transformation is happening all around us and may encourage some families to move away from the traditional office and convert into a virtual office.

Business continuity plans, insurance and regulatory management: In times of crisis, families need to review their disaster recovery plans on how the office will function when the office is closed for an extended period of time. Plans might include where members of the family will safely reside, travel restrictions, initiation of backup plans to outsource all functions of the office to a third-party provider, use of private security, or oversight of wealth by an institutional trustee. Also, review insurance coverages in connection with general liability, disaster, life, kidnapping, real estate, investments, personal assets and data breaches. Family offices registered with regulatory agencies like the Securities and Exchange Commission need to review communication plans and reporting to maintain compliance during this period of disruption. Documented plans regarding communications with outside investors will help facilitate discussions and calm anxiety.

Positioning for the future

A family office that has considered some or all of these factors may be best positioned to be invest in the depressed equity and credit markets.

Cash is king: According to Bloomberg LP, more than a third of family offices boosted their cash reserves last year as they bet on a global recession in 2020. Family offices are sitting on the sidelines as markets continue to fluctuate, and they will be ready to invest. As credit spreads tighten, family offices might be a good avenue for other businesses looking for liquidity in a down market.

Lower public market valuations: As equity prices have taken a tumble and financial conditions tighten, families questioning sustainable or impact investing in the past might find the lower market values an attractive opportunity to invest in this space. A 2019 survey completed by UBS reported that the average family office portfolio allocates 19% to sustainability. In that same survey, 25% of family offices globally engaged in impact investing.

AVERAGE FAMILY OFFICE PORTFOLIO ALLOCATION IN 2019, PER UBS:

19% Sustainability

25% Impact investing

Private direct investing: Families looking to invest in technology and health care businesses might have an opportunity to invest at a lower price compared to before the spread of the virus.

Generational planning: As interest rates hit record lows, this might be a good opportunity to use estate planning tax techniques to reduce future tax liabilities. In addition, this might be a good time to review the family office governing documents and mission statement, and bring in the younger members in the family to have their fingerprints on office policy. A stable family office during times of crisis provides a firm foundation for the next generation to continue for future generations.

The takeaway

This is a good time for family offices to review key policies and procedures. With proper planning, family offices will be well positioned to preserve capital, transition into the digital economy, invest in undervalued assets and equip the next generation of family members with the right tools to drive future success. One family office said it best to Bloomberg LP: "There's no doubt that huge amounts of wealth will be created out of this pandemic."

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Investment risks

Family offices must manage investment risks to weather economic storm

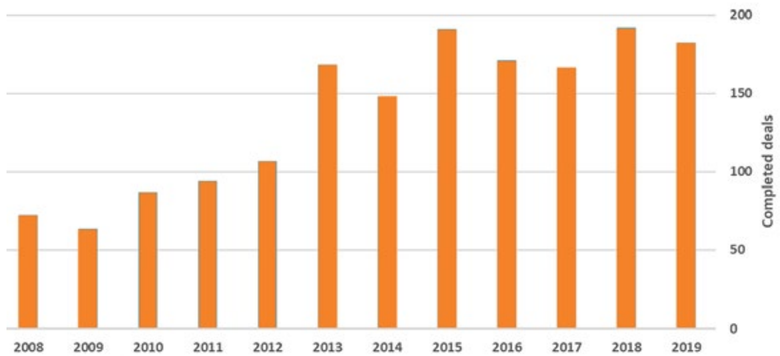
A study conducted by Campden Wealth found that family offices manage about $4 trillion globally. The amount of wealth managed by these offices continues to grow as more families sell out of their founding businesses; many now sit on a pile of cash. This has created opportunities for them to set out new agendas on wealth preservation, philanthropic activities and asset management.

The old normal

In 2020, UBS surveyed 121 of their family office clients about their 2019 investment profile.

They found that global equities accounted for almost 29% of an average family office investment portfolio. In addition, another 35% was invested in alternatives that consist of private equity, hedge funds and other alternative vehicles. The remaining allocation went to commodities, fixed income and cash.

DIRECT INVESTING BY FAMILY OFFICES



Source: PitchBook; RSM US LLP

Meanwhile, before the coronavirus pandemic disrupted the economy in early 2020, an important shift in family offices was taking place. With trends in the asset management space set by investors demanding lower fees due to poor performance, family offices began building out their investment infrastructure to assimilate professional investment firms; this has allowed them greater control of their money. These offices have evolved to make their own investment decisions as to which assets they should buy or sell.

A family office can be structured in one of three ways: a single-family office, a multifamily office or a virtual office. The common denominator across all three structures? The investment direction and risk profile is decided by the family.

In a sophisticated family office, the family's investment objectives are normally decided by the family and pushed down to the internal risk management oversight committee. A multifamily or virtual family office can outsource these activities to an investment firm or custodian.

The risk management oversight committee is in charge of managing the various internal and external risks while meeting the family's mandate of investment returns. There are seven different risk components, with several subcomponents, that should be considered by this committee:

The goal of the committee is to figure out how to measure, manage and maintain these risks.

The Great Recession of 2007–2009 taught many family offices a valuable lesson about risk management and resulted in protocols to avoid mistakes of the past. As the economy headed toward a recession in February 2020, a number of those risks became a serious concern for family offices.

While we have seen an increase in the number of family offices established recently, a number of them lack the experience to set up the risk infrastructure needed to guide the family office on the correct glide path to meet investment objectives.

Investment risks with financial markets

While the U.S. economy has been suffering through the effects of the coronavirus pandemic, family offices have not been immune.

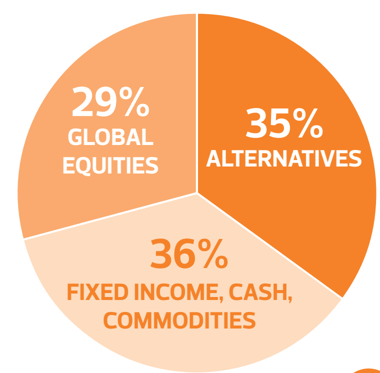
Various equity markets gyrated through summer 2020, governments scrambled to get more money in the pockets of citizens and businesses, and geopolitical risks rose.

Those factors and others create a challenging investment environment for family offices looking to invest in either private or public equities.

As mentioned earlier, based on the 2019 investment profile that UBS identified in their 2020 survey, over 35% of investments are allocated in alternatives, which should increase because interest rates have remained low and volatility in the equity markets will create an increased inflow of capital into this sector.

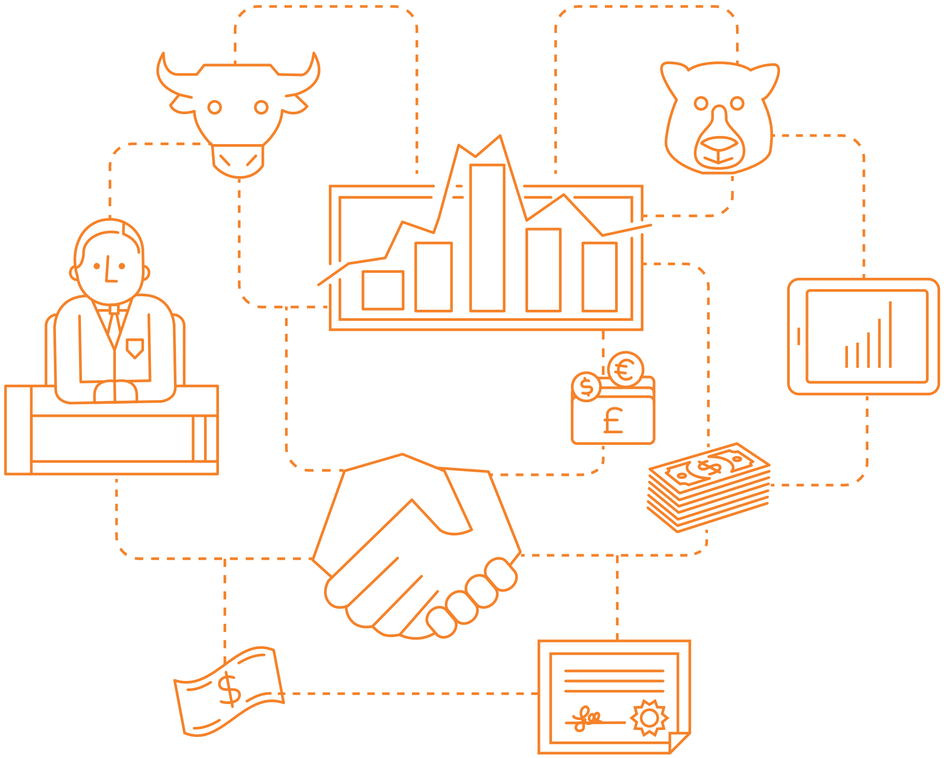
Private equity continues to show strong demand but is sitting on a ton of dry powder due to the slowdown in M&A. Changing customer dynamics and shifting business culture are some risks that managers are navigating while finding their next portfolio company.

UBS surveyed a number of family offices they work with about their 2019 investment profile:



Another alternative asset, hedge funds, have continued to struggle as invested markets create multiple challenges for managers looking to provide returns for investors. The high fee structures, as well as lock-up periods, will present some risks for family offices looking to generate yields.

Family offices might be in a tough spot to invest in current market dislocations due to liquidity commitments to these various fund managers. Any oversight committee will need to weigh the seven risks to determine if investing with an outside manager makes sense.



Investment risks with direct investing

Direct investing by family offices was gaining popularity even before COVID-19 became headline news. Investments in middle market businesses fell in line with the family's investment objectives or values. But a number of risks do exist with direct investments. The concept of putting all your eggs in one basket applies.

Also, the ability to apply for any of the coronavirus relief financial support programs could be limited for companies with common ownership. This creates a cash flow issue as companies look to pay their employees and operating expenses.

As consumer behavior changes across the globe, companies that are customer-facing or require a brick-and-mortar presence will struggle in this virtual environment. Companies that have avoided making improvements in technology and innovation will be out of luck as they try to operate in this stay-in-place situation.

A longer time horizon for family offices will remediate that issue but may not matter if the operating company cannot sustain operations during this time.

The takeaway

Diversification of a family office investment risk profile will be top of mind on every risk management oversight committee. As we have seen, the financial markets and direct investing are not immune to the destructive effects of COVID-19.

The bottom line here: No vaccine, no recovery. Family offices will need to be prepared for the long run while meeting the family's investment mandate.

35%

of investments are allocated in alternatives, **which should increase** because interest rates have remained low and volatility in the equity markets will create an increased **inflow of capital** into this sector.

Investment opportunities

Shifts will frame family office investment opportunities beyond the pandemic

Where is the smart money going?

That is a common question being asked by families looking to invest their personal capital into certain industries that fit within their investment profile. The evolution of the global economy during the COVID-19 pandemic has created multiple arbitrage opportunities for investors looking for price dislocations.

Investment themes beyond the pandemic

Family offices in the late 2010s began to increase their liquid assets. In the latest benchmarking study by Family Office Exchange, an average office asset allocation toward liquid assets—defined as cash, fixed income and marketable securities—is about 59% of the entire portfolio.

As both public and private businesses struggle to adjust to the economic downturn in 2020, assets that normally held a high valuation could be available at a lower valuation. Direct investing is a popular topic, as families look to do their own exploring instead of leveraging a manager in either the private equity or hedge fund space.

But the family office has evolved, not just in the workforce, but as a handoff of wealth. According to Bloomberg, millennials are set to inherit about $30 trillion from their parents in the coming decades.

With the changing demographics and blending of multiple families, metrics such as return on investment will carry a different meaning from profitability to sustainability. Sustainability will be a word that carries a lot of weight when these younger investors look at corporate financial statements to measure a business's footprint on the planet.

From this, two investment trends are emerging from this period of economic transition for family offices: direct investing and sustainable investing.

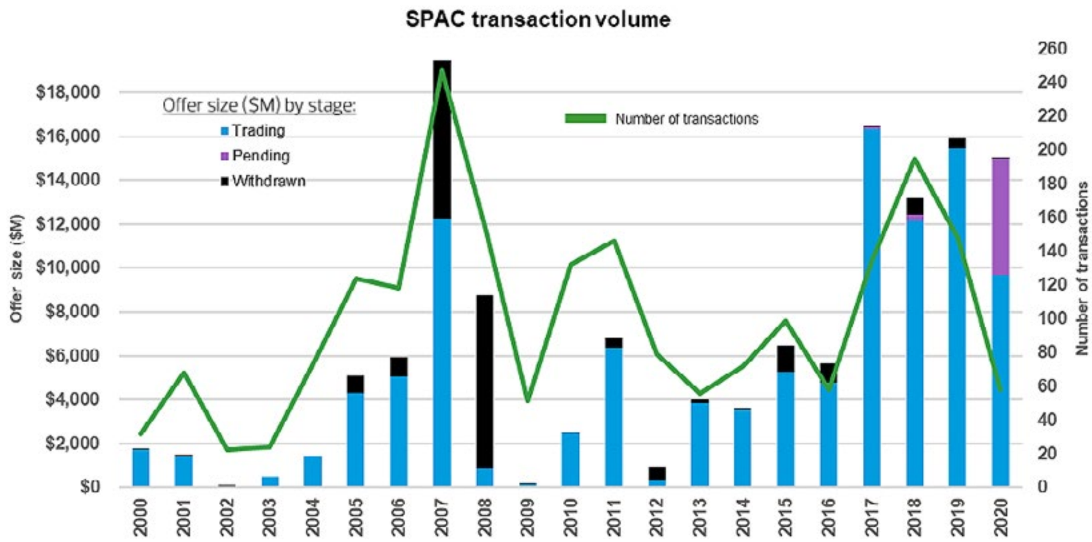
Family offices see an opportunity to invest directly into the middle market

Family offices historically have entered deals as limited partners in funds, relying on asset managers to perform due diligence on potential investments. But larger family offices are now building out their investment infrastructures in-house to incorporate professional investment firms, giving them greater control of their money and the ability to make their own investment decisions.

Through the first six months of the pandemic, as valuations of many private companies fell, family offices recognized opportunities to invest in companies they could not have before COVID-19. Industries such as technology, health care, real estate and energy will see increased interest from family offices looking to invest in emerging companies.

According to Bloomberg, millennials are set to inherit about **$30 trillion** from their parents in the coming decades.

A recent trend and something that larger family offices could look at closer are special purpose acquisition companies, or SPACs. These types of publicly traded entities will provide the opportunity to gather larger sums of public capital to purchase a private company. SPACs effectively flip the conventional order of establishing a private business and then taking it public. For an increasing number of firms, the SPAC has become the favored way to go public.



Source: Bloomberg LP; RSM US LLP

In addition to direct investing, family offices are looking at distressed assets of companies that are struggling to remain solvent or purchase packaged up loans for very low prices. As liquidity has dried up for some business owners, they turn to family offices that are willing to provide rescue lending to keep them afloat during difficult days.

These types of investment activities will occur across the globe. As reported by Bloomberg in August 2020, Tensai Holding Co., a family office that manages $3 billion, will be investing $300 million to $400 million into emerging-market stocks and distressed debt. As nations in Asia and Europe recover from the pandemic, family offices are shifting their attention to parts of the world where the virus originated to invest in future growth.

Sustainable investing—not your father's investment thesis

The upcoming generational shift in wealth will transform the family office space, and the investment thesis may not be the same as what was practiced in the past.

Based on data from the Pew Research Center, millennials in 2016 overtook Gen Xers as the largest generation group in the U.S. labor force. And in 2019, they passed baby boomers as America's largest generation. On the minds of most millennials is how can they can protect the planet, support social justice and create healthy communities. It is our belief that members of this next generation will take their inherited wealth and promote ideas and values that are closely aligned with the various standards of environmental, social and corporate governance, or ESG.

Before we dig deeper, further clarification is needed regarding the various terms under sustainable investing.

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As described by PitchBook, there are three major categories.

1. Socially responsible investing (SRI)

a. This category of investors uses screening methods to avoid investments in negative social or environmental exposures

b. Applicable in public markets

2. Environmental, social and governance (ESG) investing

a. This category uses metrics (Sustainability Accounting Standards Board or United Nations Sustainable Development Goals) to measure a company's impact outside of financial statements

3. Impact investing

a. This category of investors invests in companies with a goal of both financial returns and measurable social and environmental impact

b. Applicable in private markets

Young members of the family office may be full of positive energy around sustainable investing, but a major challenge is establishing real consensus from stakeholders on how best to report this sustainable data.

And as a result, we're seeing a number of exchange traded fund (ETF) service providers emerge, all trying to create best-in-class products to measure ESG. The variety of sustainability ETFs now being offered in the market is the latest indication that investors are looking for customized benchmarks that conform to their missions and values.

While there is still a lot of work left to get the data and reporting in order, this will be an area of focus for family offices in the future as more capital enters this space. The expectation is that earning a rate of return will still be a priority but not at the same level held in the past. In the meantime, look for family offices to invest capital in the public markets until a better process is in place to evaluate private investments.

Source: Bloomberg LP; RSM US LLP

The takeaway

Family offices are well positioned and have a number of investment opportunities as they look to move forward from the pandemic. An eventual transfer of generational wealth and an accompanying shift in priorities and values will shape decisions and what ultimately constitutes success for investors. Traditional investment opportunities will struggle in future, but the next generation of family office leaders will have a bright future if they invest in the right direction.

An eventual transfer of generational wealth and an accompanying shift in priorities and values will shape decisions and what ultimately constitutes success for investors.

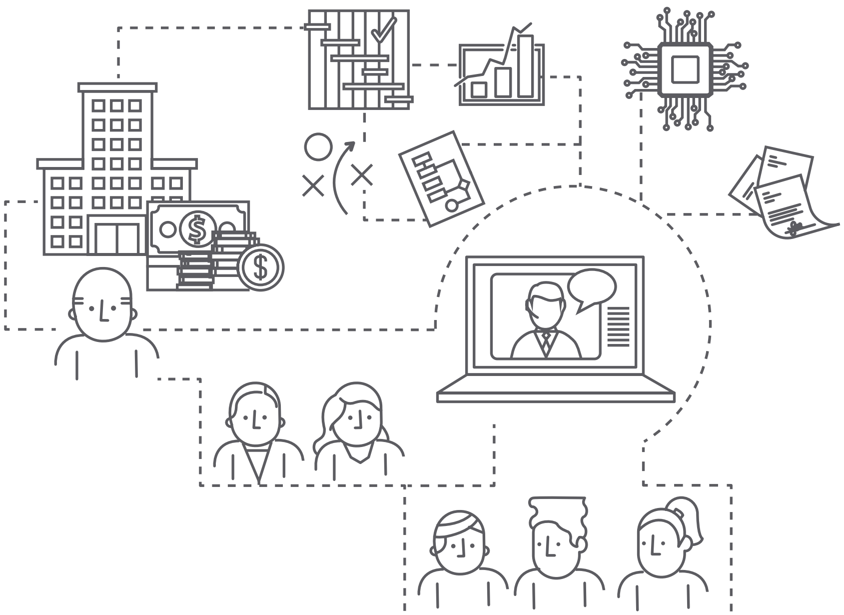
Virtual family office

The emergence of the virtual family office

As the human and economic toll of the coronavirus mounted in the first half of 2020, organizations of all kinds were forced to consider what the future of their operations would look like in a post COVID-19 world. Family offices were no exception.

Rapidly fading are the days when a family office would hire the right staff members, provide a space where they could work and then convene the family members a couple of times a year to discuss the strategy.

Most of these physical offices stood empty as working from home became the new normal. At the same time, family members—especially the younger generation—have demanded ever more access to the office's day-to-day workings as the economy has experienced wrenching change.



The answer, for many family offices, is to become a virtual family office.

But getting there has not been easy. Many family offices were simply not equipped with the technology to support a seamless remote work environment. They needed to quickly upgrade their technology and temporarily outsource back-office functions—all of which changed the way offices met the needs of individual family members.

As the coronavirus pandemic continued into the second half of 2020, family offices had little choice but to evolve as the digital transformation forced them explore the new world of a virtual family office.

“Family members—especially the younger generation—have demanded ever more access to the office's day-to-day workings as the economy has experienced wrenching change.”

Second business

Family offices have existed in many shapes and sizes since the 19th century, serving names like Rockefeller, Morgan, Rothschild and others. According to PitchBook, a research firm that compiles data on family offices, there are more than 1,900 offices around the globe, with more than 800 in the United States.

And there is no set approach. In some cases, multifamily offices provide investment management services to a range of families. In others, a single-family office has several generations to support.

Increasing costs

Families are dealing with a number of issues such as cybersecurity, tax law changes, regulation updates, family dynamics and digital transformation. With all of these variables in play, the mobility and intellectual horsepower of the single-family or multifamily office structure is debatable.

In addition, there are a number of vulnerabilities in the traditional family office structure that were exposed during the pandemic. A perfect example of this was outdated technology that made working from home a challenge. As the costs to manage the business climb and performance fades because of economic conditions, the structure of the office might limit the ability to meet the family's goals.

The next generation

Given Bloomberg's estimate that millenials are set to inherit $30 trillion from their parents in the coming decades, it's important to consider how those in the next generation share very different characteristics from their parents.

First, they are always connected. This is a generation that grew up with technology and demands full transparency to data and information with no disruption. Second, this is a generation that expects immediate results. They live faster-paced lives and demand immediate changes when problems arise.

Digital transformation

A virtual family office is the ideal structure to do more with less by leveraging outside specialized expertise, embracing emerging technologies and deploying resources more quickly. This structure allows the family to have a leaner staff that is focused on the biggest goals for the family. In addition, there is no need to have a physical office because everything can be done remotely.

As the next generation is about to take the reins of the office, a single platform holistically focused on the family that provides real-time data and transparency will be adopted more quickly than the older office structures.

"A virtual family office is the ideal structure to do more with less by leveraging outside specialized expertise, embracing emerging technologies and deploying resources more quickly."

Tax strategies for distressed assets

Tax strategies for family offices with distressed assets

Examining deductions and estate planning during the economic downturn

Featuring Noah Ginsburg and Ben Berger
Partners, RSM Family Office Team

As family offices evaluate their investments and assets during the economic downturn caused by the coronavirus pandemic, tax considerations will help them manage liquidity and estate planning.

Noah Ginsburg and Ben Berger, two RSM partners and members of the firm's national family office team, discussed how the valuation of distressed assets can shape family offices' strategies during the economic response and recovery stages. The following Q&A session has been edited for clarity.

For family offices, what are the most significant tax considerations regarding the valuation of their distressed assets and investments during the economic downturn?

What family offices are looking for is any change in the law that will allow them from a liquidity standpoint to go back and recoup taxes. The concept is: Where can we get deductions under the CARES Act that we weren't able to get before? The three main opportunities are section 165(i)—financial loss due to natural disaster, excess business loss limitation and worthless stock.

For family offices with operating businesses, the disaster-area deduction, section 165(i), has to do with assets in which the businesses have been directly affected by COVID-19 and incurred costs because of it. The benefit under the CARES Act is you can elect to take these deductions in 2019 even though they happened in 2020—if you can satisfy the criteria to claim a loss under section 165(i).

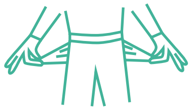
What factors contribute to uncertainty about satisfying the section 165(i) criteria?

As a firm, we have issued some guidelines on the section 165(i) rules that discuss when this loss might apply. In general, you need to have physical damage or other costs that are directly attributable to COVID-19 and not reimbursed by insurance. Some examples of these are assets/inventories that are scrapped or abandoned, worthless securities and business locations that are closed. The harder part is determining whether you can take a decrease in goodwill as a permanent decrease in value, and you'll never recoup that. It's a business-by-business discussion. It's not the easiest argument, and it's got to be determined situation by situation and fact pattern by fact pattern. It's the hardest one to claim. Three years from now, will the business rebound and the decrease in value turn out to be only temporary?

Someone might have a building that was worth $2 million before the pandemic, and now it's worth $500,000. They believe they should be able to write off $1.5 million. That's difficult because there's no physical damage and no assets abandoned. Let's use a mall as an example. If 70% of your tenants went bankrupt, and now you have no revenue, is that a permanent decrease or not? In three years, you could find new tenants, and it's not permanent; it's just temporary. That's the gray area. There are a lot of speculations here, especially in the goodwill area. It has to be a permanent decrease in value, not a temporary decrease.

Where can we get deductions under the CARES Act that we weren't able to get before? The three main opportunities are section 165(i)—financial loss due to natural disaster, excess business loss limitation and worthless stock.

What other considerations apply to claim a loss under section 165(i)?



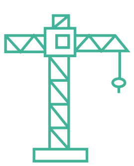
The umbrella concept is writing down assets. How do we write down assets? With distressed investments, we would either have to sell them for a very small amount to take the loss, or claim they're worthless. You want to review all your assets and identify any stock investments or distressed assets that are not worthless that you're abandoning to take the tax write-off.

Worthless is defined in the law. It has to have no value. So let's say you owned assets in a company that went into bankruptcy. When that company comes out of bankruptcy, and it is determined that you will get nothing, it's worthless at that time. If it's a liquidating bankruptcy, and you're not going to get any money, and the company sends you a letter saying, "Under our bankruptcy plan, you will not get any money," then that would be a claim of worthlessness. You would write it off at that point. For worthlessness, you need proof that it's worthless.

What about the [excess business loss limitation, section 461(l)]?

The CARES Act retroactively eliminated the excess business loss limitation for tax years 2018 and 2019. If you had a business loss in excess of business income, the loss was nondeductible. Any excess is a carry-over item. The law now allows for the loss deduction in 2018. For example, say an individual had a $400,000 excess business loss in 2018 that we were carrying over to 2019. Now, we can amend the return in 2018 to take the loss.

Some family offices have investments in qualified opportunity zones (QOZ). How has the economic disruption affected them?



The general rules on qualified opportunity zones are if you buy a piece of property or invest in a property in a QOZ, and you double the amount of investments in improving the asset, then depending on how long you hold the asset, you may be able to defer/exclude any gain. There were a lot of investments in QOZ property; however, you have to spend it within a certain amount of time. Depending on the structure, 90% of the assets have to be in qualified opportunity zone property (QOZP). Cash does not qualify as QOZP. This 90% rule gets tested twice during the year—June 30 and Dec. 31.

For example, let's say you put in $200,000 on Jan. 1. You bought the property for $100,000, and now you have another $100,000 to improve it. If you don't spend at least $80,000 by June 30, you will violate the 90% test. However, due to the pandemic, if the construction is held up, and you cannot spend the money in time, you end up getting penalized.

Recently, the rules have changed for 2020. The testing date for the 90% test was pushed back to Dec. 31, 2020. Therefore, as long as you meet the 90% test by Dec. 31, 2020, you will not have a penalty for 2020. Under the old rule, investors put in cash in December thinking they're going to spend it by June, which was the original testing date, and suddenly construction got delayed. Now, they have too much cash, which means the penalty starts. People are reexamining their QOZ investments and making sure that they're still on track for the construction and improvements in order to keep the deferral. If you hold it 10 years, you get a permanent deferral. If you hold it five or seven, you get a haircut off the gain. Some families are looking at opportunity zone investing they did to make sure they're meeting the timing.

What estate planning opportunities might distressed assets and investments present family offices?

Families can come to the table and be more aggressive with estate planning and shifting assets—or future growth of assets—out of their estate. If asset values today are depressed, whether they are securities or business assets, there are opportunities—assuming you believe that the asset values are going to increase over time—to shift a significant portion of that growth into vehicles that are exempt from estate tax.

The overarching point here, though, is estate planning starts with a plan. It doesn't just start with, OK, I've got an opportunity now because I've got depressed assets. Let me do all these crazy gymnastics to begin to shift assets out of my estate. You've got to take a step back and think about—not only for you personally, but the family and different generations overall—what is your estate plan? Do you have a comprehensive plan? How does

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"People are reexamining their QOZ investments and making sure that they're still on track for the construction and improvements in order to keep the deferral."

what you're doing now fit into that plan and into your overall objectives? If you just start implementing strategies without starting with the basics and a plan, you're probably not going to end up achieving your objectives.

With a family office, it's even more important to have an overall strategic plan because you've got a large family with multiple generations, and the estate plans for multiple generations are intertwined with each other. When you think about it, there are members of the senior generation, who are in their 90s, who have likely done estate planning, and their assets are being allocated to various individuals, trusts, charities, etc. Then you've got their children, who are in their 60s, and their grandchildren in their 30s. The generation in the 60s isn't going to achieve successful and effective estate planning without understanding what tools are already in place, what their parents have done, and how it's going to affect them personally. It all has to work together. Within family offices, that's the important piece. It starts with: What are the mission and foundational objectives of the family? The next step is taking that and layering it into each family's personal objectives. Then each individual will craft a plan that not only meets their own objectives, but meets the overall objectives of the family.

If transferring depressed assets to another generation fits into a family's overall plan, what are some important considerations?

If the assets are really distressed and the value is really low, but you don't think the assets will remain depressed, then now is the time to transfer the assets. Because any gift made will likely include a relatively low valuation, you will utilize less unified credit. It makes a lot of sense for families to start identifying assets that have lost a lot of value and have remained really low. Shifting those assets into estate planning vehicles such as grantor-retained annuity trusts (GRATs) or other trusts makes a lot of sense. If a family has charitable objectives in addition to wealth transfer objectives, utilizing a charitable trust could be the perfect solution.

Another important consideration is to assess the assets being gifted. Families want to utilize assets that have the best chance to increase in value. You don't want to transfer assets that are likely to remain depressed for a long time. If you transfer an asset that becomes worthless, you've wasted some of your unified credit on that transfer. That's an important consideration.

Once a family determines that a transfer makes sense, what strategies might be appealing?

There's straight-up gifting and utilizing trusts as recipients of gifts. There are also sales to defective grantor trusts—selling an asset to a grantor trust and taking back a note and, if structured properly, doing so on a tax-free basis. This is a powerful tool. The use of GRATs is another one that allows for the shifting of wealth to occur outside of an estate.

In a GRAT, let's say $1 million in cash is put into a two-year GRAT. The IRS publishes on a monthly basis what they call a 7520 rate. It's a rate of return that the government assumes you're going to earn. Because this rate is based on market interest rates, the rate today is historically low (today's rate is 0.6% as of June 2020). At the end of year 1, the grantor takes back $458,758; and at the end of year 2, the grantor takes back $550,509. Now, if the $1 million in that GRAT grew greater at 7% annually, the residual in the GRAT would be $103,520 that is now in the hands of the grantor's children. This was accomplished without utilizing any unified exclusion amount. So what have I done?

I have not made any gifts because I took back all the money I put into the GRAT. And I've been able to siphon off growth into a trust that's now available to my children. So I essentially shifted appreciation or wealth out of my estate without using any gift exemption. If there are dividends paid or stock sold, then there is some tax to pay; but those taxes are paid by the grantor, not the trust, allowing the trust to grow tax-free. If you're dealing in market conditions in which assets are depressed and the opportunity to grow is greater, you have a lot more potential for success when the Dow is at 20,000 versus when the stock market is at 30,000. That's why using assets with depressed values in any estate planning strategy, whether it's GRATs or other strategies, this is why the time is right—potentially—to take a hard look at that.

Families can come to the table and be more aggressive with estate planning and shifting assets—or future growth of assets—out of their estate.

Remote work is chance for family offices to upgrade technology systems

Outsourcing and automation lead to more efficient core competencies

Featuring Christina Churchill
Principal, Management Consulting
RSM Family Office Team

Disruptions triggered by the coronavirus pandemic have prompted all types of businesses to run a magnifying glass over their processes and infrastructure to ensure continuity and viability. Although survival is not at stake for most family offices, the pandemic response is an opportunity for them to evaluate crucial technology systems, knowing that timely enhancements could improve operational efficiency, security, and the long-term likelihood the family office achieves its business and familial objectives across generations.

Perhaps a family office has postponed outsourcing finance and accounting services or managed information technology functions. Maybe a family office has resisted moving to automated processes for payroll, accounting or document management. The pandemic-induced economic downturn is an impetus to move forward. It invites a set of questions with advancements in mind: What functions depend on your technology systems? How does your technology support our needs for accessibility, scalability and reliability? How do you create a platform that meets your goals?

"One of the challenges for family offices can be finding a starting point or knowing these kinds of tools exist," said Christina Churchill, RSM's management consulting principal. "Unless they're very active in trying to find that information, nobody drops it on their plate. Everybody is trying really hard to do the right thing, but they just don't know there are other choices."

Outsourcing solutions

Many single-family offices have small staffs, some of which include employees who have worked for the family for two or three decades. Crucial responsibilities involving accounting or IT, for example, fall to a disproportionate few staffers, and processes have been carved into stone over time.

Outsourcing certain functions to a first-choice advisor, though, can improve back-office options without compromising loyalty. Leveraging digital technologies can create efficiencies while establishing a fixed cost for services and deeper, broader support. This can allow employees to devote more attention to providing timely information and analysis instead of repetitive tasks.

By outsourcing finance and accounting services, the family office has software and corresponding security components provided to it. That enhances compliance measures by establishing dual controls, which small family offices commonly lack. The timeliness and depth of financial reports improve also.

Leveraging digital technologies can create efficiencies while establishing a fixed cost for services and deeper, broader support.

"This is very similar to what many family offices are doing with their brokers already, but they don't necessarily see that in the same light," Churchill said. "They have their third-party broker, who is managing funds and providing the financials for them on a website. Outsourcing finance and accounting services works much the same way—a third party records transactions, the family approves payments and reports are online."

Outsourcing managed IT services creates additional efficiency and security, especially given the widespread shift to remote work during the pandemic. The service provider ensures workers have equipment they need, such as laptops. It can strengthen controls such as BYOD (bring your own device) policies and establish protections for all devices, including the capability to remotely wipe sensitive data. It also creates a shift of liability because the provider becomes responsible for keeping software and servers operational and secure.

"Do you have device-level security? Or are you just using the same laptop your children are using for school?" Churchill said. "Someone accesses an unsecured website, you've got malware and someone is accessing your device directly."

Managed IT services includes cloud functionality, which makes remote work more efficient. Laptops and mobile devices become portals to access files, which reduces the importance of what machines employees are using and where they are using them. Employees do not have to depend on thumb drives, which tend to easily be misplaced because they're so small. Efficiencies extend to tracking software and communication channels during emergencies, and simply keeping up with family members who frequently travel.

Automation equates to efficiency

Some family offices manually perform payroll and accounts payable functions. Others might use accounting software or various databases to manage those, but they might lack the functionality and consistency necessary to work remotely or efficiently.

"Automation within the tool sets that they have is helpful," Churchill said. "That allows for truly having remote workforces, so that they don't have to go to the office and print checks and go to someone to sign them."

Also, families want timeliness, accuracy and transparency with their portfolios. But relying on dated quarterly information, and working from separate spreadsheets and proprietary reports from individual managers make it difficult to clearly view investment performance.

From robotic process automation to automated bill pay to enterprise resource planning solutions, shifting toward automated processes can steer family offices away from spending unnecessary time and resources on manual bookkeeping.

Such advancements improve operational efficiencies, which propel family offices closer to their business and familial goals. Whether through outsourcing solutions or establishing automated functions, they will find those goals are within reach.

"Do you have device-level security? Or are you just using the same laptop your children are using for school?" Churchill said. "Someone accesses an unsecured website, you've got malware and someone is accessing your device directly."

Cybersecurity for family offices begins with awareness

Taking a business-minded approach to cybersecurity

Featuring Tauseef Ghazi
Principal, Cyber Governance and Compliance
RSM Family Office Team

Some family offices are attractive targets for cybercriminals because of how basic their resources and protections are relative to the high value of their assets. Financial institutions that manage millions of dollars commonly are fortified by safeguards, such as a virtual private network (VPN) for employees and dual-factor authentication for transactions. But single-family offices often operate with small staffs, elementary cybersecurity protocols and limited technological infrastructure.

"Family offices generally tend to believe they're too small to be a target," said Tauseef Ghazi, a principal in RSM's security and privacy risk practice. "But the ones that believe they're not at risk generally are *really* at risk."

That misjudgment is why Ghazi, who is also a technical lead on RSM's family office enterprise team, considers awareness to be one of the most important cybersecurity issues facing family offices. And, in fact, the awareness is twofold: understanding how cyberthreats have evolved and acknowledging the family office's comprehensive risk profile.

Those complementary components are central to a proactive approach to cybersecurity, as opposed to a reactive one after a breach or crime has done costly damage.

Evolving threats

Over the last five years, cyberattacks have moved away from targeting millions of dollars in a single attack. Hackers have found it increasingly difficult to infiltrate big corporations and fraudulently transfer such large sums.

"Real hacking these days happens in transactions of $100,000 or less, and family offices are quite capable of approving those," Ghazi said. "Hackers have tried to make their lives easier by going after smaller organizations with very limited security controls and making a bunch of smaller transactions. They're focused on transactions involving relatively small dollar amounts but a higher volume of them."

The attacks commonly begin with a phishing email and take the form of wire transfer fraud or ransomware. The threats are especially troublesome for single-family offices without dedicated IT support that prioritizes protection.

Once hackers compromise an email system or file storage system, they will try to access accounting systems and the corresponding security information—such as passwords, screen images or keystroke data—that would enable them to execute a transaction.

"The bank then looks at that transaction, and from their side, everything looks perfectly fine," Ghazi explained. "It came from the legitimate source. It used correct user credentials. This looks pretty legitimate because it comes from the source of truth."

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> Hackers have tried to make their lives easier by going after smaller institutions with very limited security controls and making a bunch of smaller transactions. They're focused on the volume of transactions because it's easier to do.

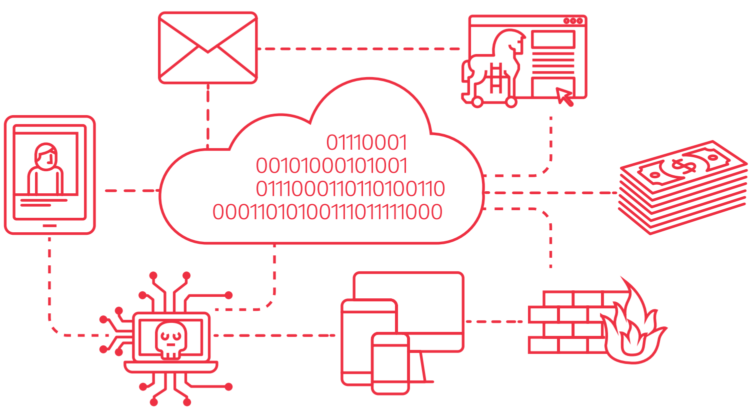
Risk and vulnerabilities

Once family offices understand the strategy and methodology driving prevalent cyberthreats, they can more clearly identify vulnerabilities in their cybersecurity protocols. Of course, family offices vary in size and scope, so risk profiles differ. But that just underscores the value for every family office to look closely at how thoroughly it has protected its assets.

"It's not crying wolf; it's saying that you need to understand the dynamics of your own landscape," Ghazi said. "What are your risks? What kinds of transactions do you make? What do your employees know? Are you even aware of some of these things?"

Single-family offices might outsource IT support. That, by definition, creates a multitenant environment for which controls and protections are necessary. And if a family office doesn't have the right IT support, it might lack explicit cybersecurity policies and protocols in case of a cyberattack.

Another focal point is how transactions are authorized. Dual-factor authentication is a more sophisticated protection than simply entering one password, especially if the secondary authentication involves a separate device, such as a mobile phone. That way, if the person authorized to execute transactions has their computer compromised by malware, the second device would serve as an additional safeguard.



Remote work also presents important considerations. While some family offices lack the technological infrastructure or staff capabilities to facilitate flexibility for employees, other family offices encourage flexibility as a perk—and that was before the pandemic triggered a widespread shift to working from home.

For employees working remotely, a VPN provides a secure connection that protects data and information. This is especially important if employees are using their work laptops to access social media sites and have various other household devices connected to their home networks.

And speaking of social media, family offices that strongly value privacy should communicate to employees clear policies and guidelines about sharing information, even on password-protected sites. Reducing risk involves minimizing the amount of information available for sophisticated hackers to mine.

A business-minded approach

Taking a proactive approach to cybersecurity not only protects systems and strengthens processes before a cyberattack wreaks havoc, it also enables family offices to make upgrades that benefit all parts of the operation.

As Ghazi explains, the cybersecurity strategy of a family office should encompass more than just cybersecurity. For example, if systems such as email, file storage or payroll show vulnerabilities, enhancing their security and privacy can be part of a greater effort to connect systems, establish controls and create operational efficiencies.

"You're probably better off moving into a single viewpoint," Ghazi said. "You still use the cloud and those technologies to keep it cost effective, but you create a more holistic view of that with better monitoring, situational awareness and controls. That puts you on a transformative journey and helps you change the cyber maturity of your environment."

A trusted advisor with knowledge and experience in crucial areas—finance operations, managed IT services, accounting systems, cybersecurity—can help establish continuity between them. In that sense, a process that begins with awareness can elevate the entire family office and position it for long-term success.

Family offices that strongly value privacy should communicate to employees clear policies and guidelines about sharing information, even on password-protected sites.

Workforce issues

5 things family offices can do to recruit and retain talented employees

By Cyndi Mergele, SPHR, SHRM-SCP
Senior Director, Management Consulting
RSM Family Office Team

Attracting and retaining talented employees can be difficult for some family offices because of how they often differ from common corporate environments.

Some family offices require one person to fill a variety of roles. The controller at 10 a.m. might be the rental real estate agent by 3 p.m.

At other family offices, opportunities for career advancement are more limited than at larger companies. These types of issues can lead to suboptimal performance and an unfulfilling experience on the employee side, while creating stifling inefficiencies for the business.

However, family offices can tailor their hiring practices and talent experience initiatives to minimize these pitfalls and ensure a positive and productive relationship with prospective and actual employees. Here are five such steps they can take.

1 Be clear about the value proposition for working for a family office

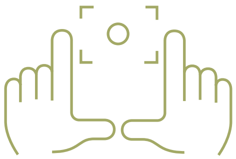
The work environment at a family office can significantly differ from an ordinary business. Some family offices have relatively small workforces and prioritize privacy and confidentiality. And there can be socioeconomic dynamics that apply to high net worth families that don't translate as plainly to the corporate world.

So it is important for a family office to align a candidate's expectations with reality when considering the candidate for employment. By being clear about the value in working for the family office—likely a combination of compensation, flexibility, growth opportunities and perks—a family office can increase the likelihood of finding an employee that fits well with the responsibilities and demands of the job.

For example, because employees of single-family offices commonly wear multiple hats, a requirement for employment is tolerance (even better: enthusiasm!) for a multitude of tasks. Being up front about the diversity of work during the recruiting process should help a family office match that requirement with the personality and work ethic of a candidate.

By being clear about the value in working for the family office—likely a combination of compensation, flexibility, growth opportunities and perks—a family office can increase the likelihood of finding an employee that fits well with the responsibilities and demands of the job.

2 Be purposeful in making growth opportunities available

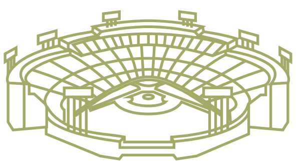


Career advancement can be limited or nonexistent in some family offices because of staff size. Also, roots of loyalty take hold in some cases, resulting in long employee tenures and limited opportunities for succession.

A family office, however, still can foster employee growth and development by paying for and supporting professional association participation, certifications and continuing education. A commitment to training employees to use modern technologies—everything from digital document scanners to software programs—will help the business while adding to employees' personal toolkits.

This type of outreach should be deliberate, reflecting the family office's genuine desire to invest in their employees.

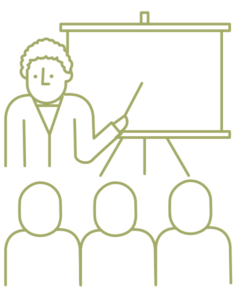
3 Establish an enticing incentive plan



In most cases, equity is not going to be a possibility for family office employees. So developing attractive executive incentive plans, including cash or nonqualified stock options, becomes crucial for key senior talent.

Family offices should evaluate whether some of the leisure activities they already pay for can be leveraged as perks or fringe benefits for employees. For example, memberships or season tickets to sporting events, concerts and shows.

4 Embrace how managed services can strengthen human capital management



Human resources commonly are an under-resourced function in family offices. A lack of understanding regarding employment obligations can lead to missteps, including misclassifications that jeopardize compliance with the Fair Labor Standards Act, which can lead to unnecessary risk, penalties and reputational impact.

No organization is too small for a human capital management system. Most payroll services today offer human resource information system technology. If it does no more than eliminate the need for transactions on paper, the efficiencies from that alone would be worth the investment. Some of those organizations offer business process outsourcing in addition to payroll. They can provide employees a larger company experience in a smaller family office. Meanwhile, the family office would benefit from that strategic expertise and tactical support without making the full-time hires that otherwise would be required.

5 Invest in team building

Interpersonal dynamics and workforce morale within family offices can be colored by an additional dimension from ordinary businesses, particularly when members of the family comprise a sizeable or influential group of employees. This underscores the value of team-building initiatives. Nurturing lines of communication and cultivating loyalty should contribute to a positive, productive work environment.

Attracting and retaining talent is a priority of all organizations, and the competition for this talent continues. To be better positioned to compete and retain the best employees, family offices can, with minimal investment, initiate these five steps and secure the team that delivers on the family office's needs.

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RSM understands the issues driving your family office forward, whether it's multigenerational wealth management, adopting technology solutions as part of a digital transition, philanthropic activities or any of the other challenges family offices tackle every day. Our family office professionals are curious, cohesive, caring and collaborative, focused on building relationships with the families we serve. We don't view ourselves as a service provider to family offices; we view ourselves as your partner and an advisor that will earn your trust.

To talk more about RSM's Family Office Services, please click here.

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