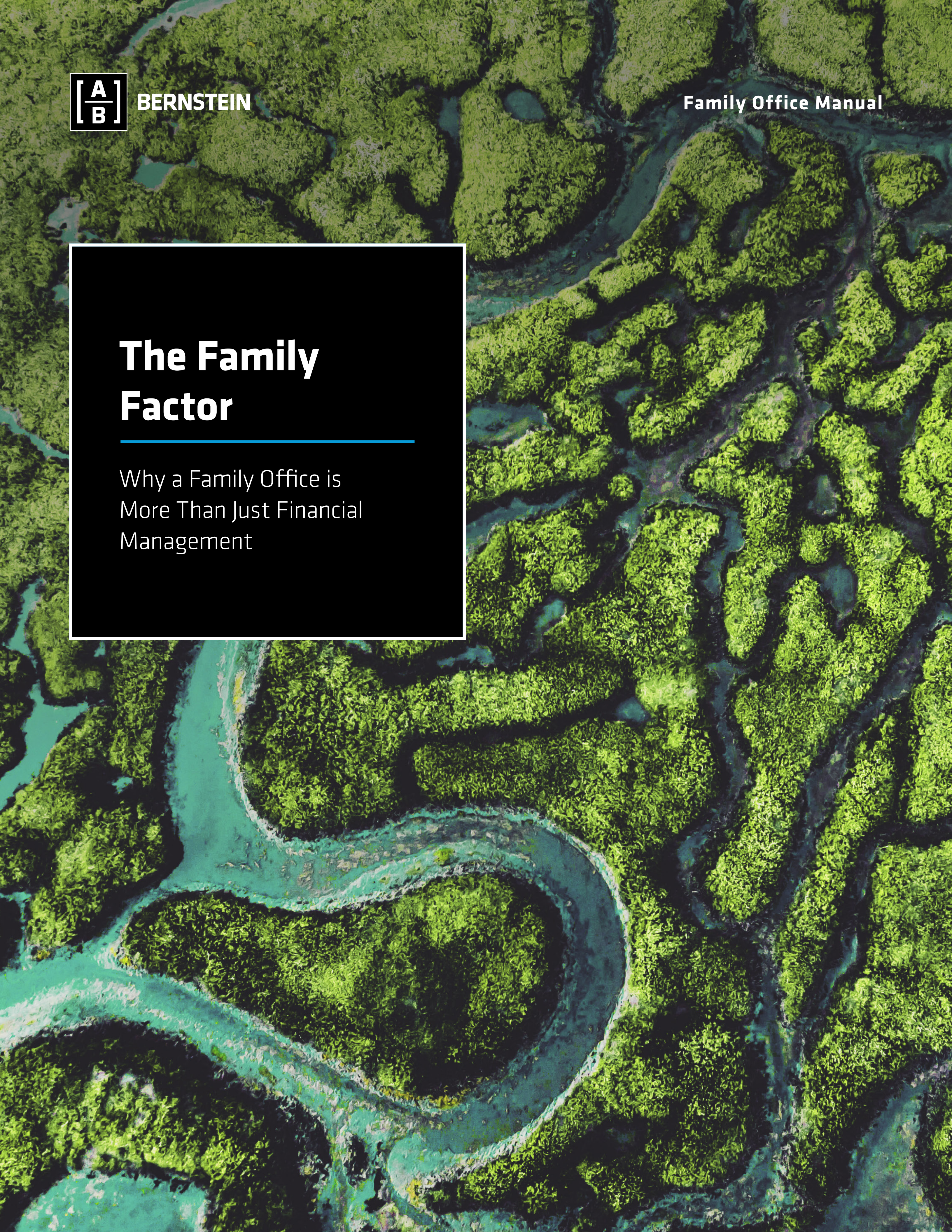
BERNSTEIN

Family Office Manual

The Family Factor

Why a Family Office is More Than Just Financial Management



As business owners, wealth creators and inheritors know, preserving assets for future generations—while meeting the present needs of extended family members—can be a daunting task. With so much to organize, direct and plan, it's easy to feel overwhelmed. That's where a family office comes in.

The family office structure provides centralized wealth management, efficiency and privacy while safeguarding your family's legacy. From managing investments and relationships to navigating family dynamics and charitable activities, a family office can help ensure that your assets are well managed, and your family's needs are met, for generations to come.

The idea of a family office has been around for centuries, dating back to ancient Rome in the 8th century and the United States in the 1800s. These early family offices were designed to manage the unique investment needs of wealthy families, ensuring the foundation of multi-generational wealth. And while the concept may not be new, the benefits of a family office remain just as relevant as they were centuries ago.

Notably, poor planning can derail even the best intentions when it comes to preserving wealth and family cohesion. When families are geographically dispersed and face generational differences in investment and philanthropic philosophies, the absence of established governance can fracture a cohesive family mission. By recognizing the importance of professionalization and governance, families can strengthen family bonds for generations to come.

Today, family offices are becoming increasingly popular among ultrahigh-net-worth families seeking tailored financial and lifestyle management as their lives become more complex. With over 10,000 family offices in the world and 1,300 new ones created each year, the model has become the go-to for families that share assets across multiple generations, legal entities and tax returns.[1] This guide is designed for families that are considering starting a family office, need family office services—or that already have an existing family office—and want to learn how Bernstein Private Wealth Management could best partner with them.

The Family Office Continuum

Many look to create a family office after a major liquidity event, such as selling a private company, an initial public offering (IPO) or receiving an inheritance. Some may even choose to create an office within their operating company as their wealth and needs evolve. Others shy away from the idea, though they recognize the need for greater professionalization. While each family's catalyst is unique, in our experience, they tend to share some similarities that can be plotted along a continuum (*Display*).

BERNSTEIN WORKS WITH A BROAD SPECTRUM OF FAMILY OFFICES

The "Non-Family Office" Office	Outsourced Family Office	Family Office Embedded in Operating Business	Existing or Virtual Single-Family Office with Outsourced CIO	Existing Single-Family Office with In-House CIO
• Often seen with business sale, inheritance/wealth transfer • May need just a few services • Prefers not to use "family office" label	• Often seen with business sale, inheritance/wealth transfer • Needs most, if not all, services	• CFO tasked with starting a family office • Often outsources family office services	• Require assistance with investment management • May also need help with governance	• May need only access to investment strategies

Source: AB

1 Family Office Exchange (FOX) and Campden Wealth

Reimagining the Family Office

The term "family office" goes beyond a physical location with a family name on the door. Today, it's more of a concept encompassing an array of tailored services. Some families may only require a handful of services, without needing a full-blown office at all.

In general, the minimum investable assets typically required to start a free-standing family office can range from $250 million to over $1 billion. But staff compensation, finding and keeping high-quality talent, and the rising costs associated with a physical office is pushing that minimum closer to $750 million. Size does not always matter—even multi-billion dollar families may choose to outsource a majority of their needs (especially for some of the higher priced roles like a Chief Investment Officer) to investment managers.

Bernstein Private Wealth Management defines a family office as any family entity driven by a common purpose that binds family members across generations. Today, our family office services have expanded beyond tax planning and investments to encompass a wide range of needs, from lifestyle and estate planning to philanthropic and governance services. Built around a trusted team, they essentially create a mirror, reflecting the professional services that best meet a family's unique needs, values and goals.

The Evolving Family Office

As the needs and complexities of rising generations change, technology improves and families seek to minimize costs and navigate an uncertain investing climate, family office-like structures are evolving. Many families starting at $50 million are embracing outsourced models that uniquely meet their needs in tailored, cost-efficient ways. At Bernstein, we work with a wide range of family offices, including those who:

- outsource select services that resemble a family office to address added complexities;
- outsource all services or create a virtual office, while tasking a single professional with administration or a liaison role;
- create a family office inside their operating business and need to outsource select services;
- have an existing family office and seek a partner for investment strategy fulfillment.

While some families with significant complexity favor a full-fledged in-house family office, most UHNW families have elements that could benefit from professionalization—such as bookkeeping redundancy, password management for peace of mind, and home insurance and protection for multiple properties, just to name a few. Bernstein can serve as a unifying quarterback to help ensure that your family's wealth is managed professionally.

Understanding Your Why

So where do you start? Instead of leading with the structure, we begin by helping families define their purpose and values. What does wealth mean to us individually and collectively? What do we care about? What purpose does our wealth serve?

Bernstein's Family Office and Engagement team believes that every family, regardless of size, should begin with value discovery. Even those with an existing family office can learn from best practices—especially when it comes to decision-making during times of transition. Our exclusive research, "Family Governance: Lessons from Families Who Have It Figured Out", explores the challenges and opportunities of family governance, drawing on the personal experiences of those who have already walked the path. The report captures intimate insights from a curated group of families, along with advisors with over 90 years of combined expertise.

Ultimately, before making any investments, we recommend seeking our team's help to understand your family's purpose, values, history, stresses and goals. By doing so, we can tailor our proposed investment solutions and ensure that your family's legacy endures.

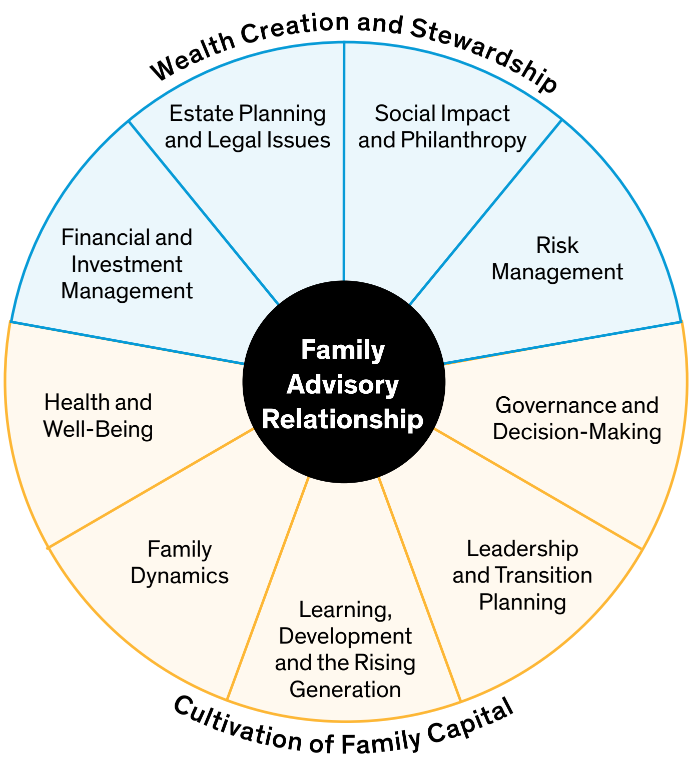
What's Your Value Allocation?

In our experience, ensuring family harmony is becoming increasingly challenging as family members become geographically dispersed, show a lack of interest in the family business or display growing generational differences and attitudes toward wealth and philanthropy. However, families that truly care about multigenerational wealth are discovering that spending time understanding their "why" and creating the right "value allocation" is just as crucial as having the right asset allocation. In a recent interview with Jay Hughes, widely considered the father of family decision-making, he emphasized the importance of growing spiritual, social, intellectual and human capital—supported by financial capital—to help grow what is most important to a family. To learn more, listen to the interview here.

Beyond the Balance Sheet

It's natural for families to measure wealth quantitatively. But Bernstein takes a broader view, ensuring that wealth is approached holistically, in a way that aligns with the family's values and goals both now and in the future. We believe a family office can help address the intangible aspects of living with wealth—like family dynamics and health and well-being—while managing the family's financial affairs and preserving its legacy (*Display*).

TEN DOMAINS OF THE FAMILY WEALTH MODEL



Source: The UHNW Institute

> **Forward-thinking families assemble a 'trusted team' of professional advisors who genuinely care about the family's needs."**

To Be or Not to Be: What Kind of Family Office Do I Need?

Leading with purpose and a holistic approach allows the best model to come into view. Many successful families assemble a 'trusted team' of professional advisors who genuinely care about the family's needs.[2] While those needs vary, some of the most common functions we see include:*

- **Legal services (General):** Legal advice regarding the appropriate structure for your family office—whether C-Corp, S-Corp or private trust company.
- **Investment management:** Oversight of investable assets, including asset allocation advice, manager selection and creation of an investment policy statement for investment portfolios.
- **Real Estate management:** Includes physical property management (across different geographies), brokerage services for new purchases & sales, etc.
- **Tax and estate planning:** Minimizing tax liabilities and planning for the transfer of wealth to future generations, often by establishing trusts.
- **Accounting and financial reporting:** Financial reporting and tax preparation in accordance with a given jurisdiction's tax laws and regulations. Some accounting firms may also handle administrative tasks such as bill payment.
- **Governance:** A framework for communication and decision-making around shared assets. Components may include succession planning, family meetings, investment committees and boards, mission statements and the preparation of rising generations.
- **Philanthropy and charitable giving:** Strategies that facilitate charitable donations aligned with shared values and goals.
- **Lifestyle management:** Handling personal and household tasks, such as travel arrangements, event planning/concierge services, household staffing. May also include management of collectibles and access to medical services (including behavioral and mental health).
- **Global risk management:** Identification and mitigation of potential risks, such as cybersecurity, compliance, insurance, etc.
- **Aggregate Reporting:** Facilitates a full view of how assets are working together.

2 Jaffe, Dennis T. Wealth 3.0: How the Next Generation of Investors Is Shaping the Future. John Wiley & Sons, 2023.

*Any services would be provided by third parties with whom Bernstein is not affiliated. While Bernstein can make introductions to such parties, it is not responsible for any services they may provide.

Family Office Structure: What's the Tax Impact?

How do your family office's services and setup affect its income tax liability? In the past, family offices could deduct expenses related to their investments in two ways:

1. As a miscellaneous itemized deduction, which only applies if the expense exceeds 2% of the family office's adjusted gross income ("AGI")[3,4]
2. As a regular expense paid while conducting a trade or business[5]

However, the Tax Cuts and Jobs Act of 2017[6] has suspended most miscellaneous itemized deductions until January 1, 2026. To address these limitations, a family office may try to be classified as a trade or business to boost its allowable deductions.

But what counts as a trade or business? Current law does not provide an exact definition. But at a high level, individuals looking to establish a family office as a trade or business can compare their office's ownership and services to those of an unrelated investment advisor. For example, in making this determination, courts have previously looked at the following factors[7]:

- **How much do the owners of the family office overlap with the family members investing through it?** If there is substantial overlap, it may seem like the family office is a conduit for personal investing. In the past, courts have held that an individual's personal investing does not qualify as a trade or business, even if it's implemented through an "entity."[8] For this reason, a family office may need to show that it's independent by limiting its number of investor-owners.
- **Does the family office provide personalized services to its investors that are similar to those of an unrelated investment advisor?** To bolster the case that it qualifies as a trade or business, a family office may wish to replicate the offerings of a third-party private equity fund or hedge fund. Courts have previously focused on whether a family office provides one-on-one advice that's tailored to each investor's individual circumstances when making this determination.[9] It also helps if the family office selects service providers based on their skills and expertise—rather than family relationship.
- **How is the family office compensated?** The way a family office is paid may provide another way to send a signal. For instance, a family office may use a compensation structure that's similar to what third-party investment funds use, like granting profit interests. This helps to distinguish it from an investor who receives a simple return on their investment portfolio.

Given the complexity of this issue, each family office should work with its legal and tax advisors to determine whether it can—and should—attempt to qualify as a trade or business and how doing so will impact its potential income tax liability.

Gauging Complexity

Engagement, coordination and communication preferences are unique to each family office and can be influenced by various factors. These include the number of professionals involved, the mandate of the office, and the level of autonomy. However, there are six key variables[10] that can heighten complexity:

1. **The number of legal entities**
2. **The number of family trusts**
3. **The level of investable assets (pooled or dispersed? Illiquid?)**
4. **The number of tax returns filed annually**
5. **The number of generations providing leadership**
6. **The number of adult households (size of each? Geographic proximity?)**

Bernstein understands the challenges that families face and can provide the support and guidance needed to navigate these complexities with confidence.

3 IRC Section 212
4 Notably, the miscellaneous itemized deduction shields less of a family office's income than that granted a trade or business due to its 2% AGI floor.
5 IRC Section 162
6 P.L. 115-97
7 For a more in-depth discussion of this issue, see Daily, Robert (2020) "Deducting Family Office Investment Expenses After Lender," ACTEC Law Journal: Vol. 45: No. 3, Article 2. Available at: https://scholarlycommons.law.hofstra.edu/acteclj/vol45/iss3/2
8 See Higgins v. Comm'r, 312 U.S. 212 (1941)
9 See Lender Mgmt., LLC v. Comm'r, T.C. Memo. 2017-246, 114 T.C.M. (CCH) 638 (2017); see also Order at 4, Hellman v. Comm'r (T.C. Oct. 1, 2018) (No. 8486-17)
10 2021 Fox Family Office Benchmarking Report

Wealth Transfer with Alternatives

Once you have optimized your asset allocation, investment strategy fulfillment follows. Here, alternative investment strategies are a natural fit for many family offices because they've historically delivered attractive risk-adjusted returns over multi-year investment horizons. But what many investors overlook is that alternatives are also tailor-made for estate planning. By transferring an asset with high-growth potential while its value is low or discounted—a description that fits many alternative investments—you keep more applicable exclusion amount to apply to other gifts.

That's why a growing number of family offices are sourcing wealth transfer from their alternative portfolios. Gifts of alternatives can provide growth and income for subsequent generations. But keep in mind, such gifts must be managed carefully to comply with relevant tax and securities rules. Working with estate, tax and investment specialists who are well versed in planning with alternatives is critical to maximize the benefits.

How should you size an allocation to alternative investments? Bernstein's strategic asset allocation advice helps astute family offices make nuanced decisions across the entire universe of investment choices (see Holistic Advice for Allocating Capital).

Holistic Advice for Allocating Capital

Bernstein provides strategic and comprehensive advice for capital allocation that goes beyond providers and products. Our approach is unique in that we set dynamic and flexible targets, resulting in an investment policy statement that instills confidence in achieving long-term goals.

At the heart of our advice is Bernstein's proprietary capital market engine—a distinctive, proven model that projects 10,000 plausible evolutions of the capital markets from today's market conditions, ranging from spectacular to dismal. What else sets our model apart? Unlike those offered by peers, Bernstein's is global and multi-currency, factoring in the prevailing economic environment along with cross-asset class correlations.

Above all, our model treats asset allocation as a journey, rather than a singular destination. It sets long-term, aspirational targets, which allows for fine-tuning along the way. And it is flexible, dynamic and adaptable, responding to changing personal circumstances and opportunities that arise. This distinctive approach to capital allocation is one of the main reasons family offices turn to Bernstein for holistic advice when sizing their allocation to alternative investments.

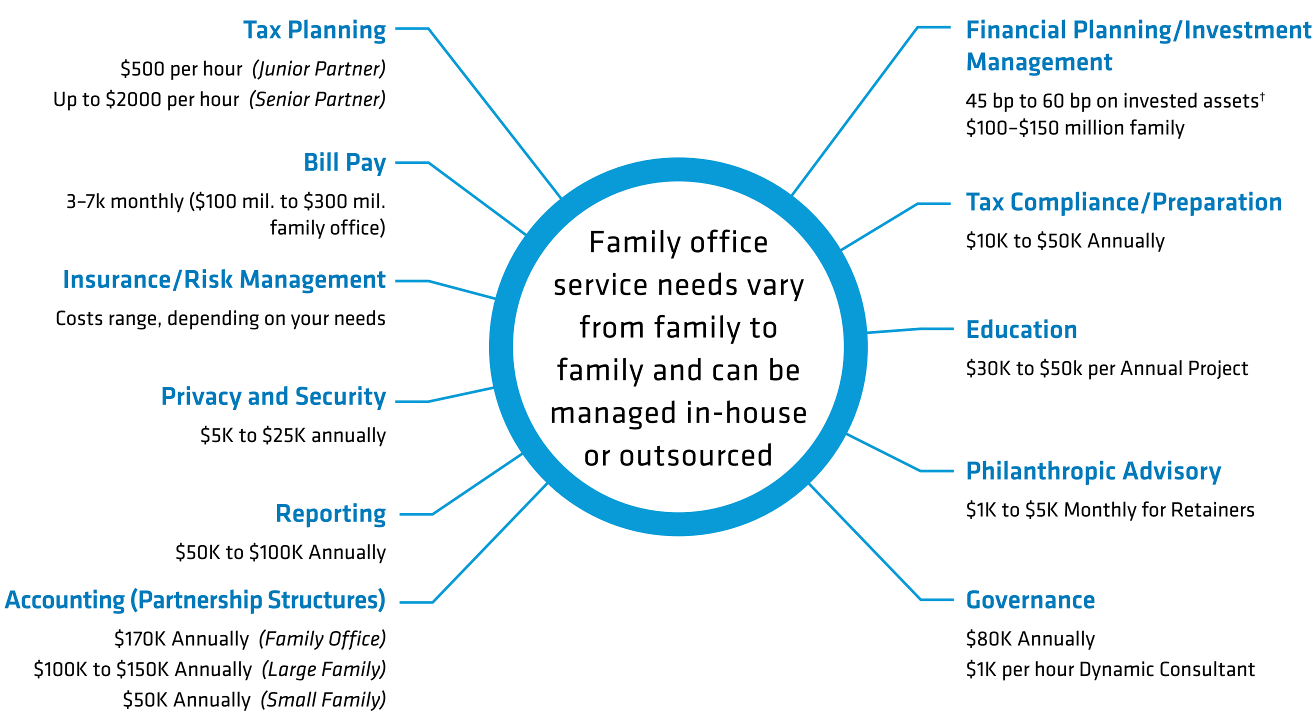
How Much Will It Cost?

Setting up a family office can be a complex and challenging process, especially when it comes to determining the cost. It's difficult to obtain data on the price tag involved, especially gathered all in one place.

Ultimately, it is expensive to run a family office. Expenses typically include salaries and other costs for staff, fees for legal/accounting services, direct and indirect investment expenses, technology and infrastructure, and a variety of other requirements specific to a family's needs. After determining the support functions your family requires, you'll need to determine the cost, which will vary depending on the complexity of your needs.

Estimates for in-house family office models can range from 1% to 2% of investable assets. Put another way, costs could range from $1 million to $2 million annually for a $100 million family. According to Campden Wealth, an in-house Chief Investment Officer(CIO) can range from $337,000 to $821,000 for smaller versus larger family offices, respectively. The same report noted that on average, small family offices incur costs of nearly $1 million. Midsize family offices have costs that run four times higher, while large family offices see costs that are three times higher still.[11] That's one reason fully outsourced models have become increasingly popular—they allow for flexibility to work with different service providers on an as-needed basis. Below, we provide broad guidelines and rules of thumb to help you get started (*Display*).

FAMILY OFFICE COST RANGES*



*Ranges are subject to change based on scope of work, geography and provider.
†Please note fees could change based on asset allocation and size of assets.
Source: AB

11 **Source:** Campden Wealth, The Family Office Operational Excellence Report 2024.

Where do I start?

Setting up a family office may feel daunting but breaking it down into core steps can make it more manageable. Here are the key steps to follow:

1. **Know your "why"**

   Pinpoint the purpose of the office. What is your mission and how do you plan to meet your goals?

2. **Set up governance**

   Be clear about who is making decisions and serving as leaders. Outline roles and communication plans, ensuring there's consensus within the family and that everyone understands the rules. You can learn more about family governance here.

3. **Assess what you already have**

   Scope out your starting capital and all the family's assets. Be sure to include non-financial assets like human, social and cultural capital too.

4. **Determine the right structure**

   Based on your asset level and degree of complexity, decide on the optimal structure. Consider involving an experienced professional who can help you quantify the trade-offs and minimize taxes for your family. Keep in mind that many families start with an outsourced model and may find that is enough, while others may move to a hybrid or entirely in-house model.

5. **Build your dream team**

   Let your mission and plan guide which team members you'll need. For instance, if your mission is to build wealth for future generations, gather investment experts and professionals who can help with family education.

Ready to take the first step in setting up your family office? Bernstein Private Wealth Management can help you achieve your goals and build a legacy for future generations.

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