Best Practices in Family Office Structures: Mistakes Can Cost Millions

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Lessons in Structuring Family Office Structures

The number and sophistication of family offices has grown substantially over the past several decades. In fact, some estimates suggest that there are more than 3,000 family offices managing trillions in private wealth. This growing prevalence has fueled a surge in demand for highly-trained professionals capable of handling the complex financial, tax, legal and managerial challenges of family office structures, many of which are unique to the wealth and dynamics of the family being served.

In order to achieve meaningful returns on investment while protecting the wealth that a family has already accumulated, a family office staff must work within a legal and organizational structure that suits the particular demands and risks inherent to that family office. To ensure appropriate family office structures, it is essential that a family office is created in close consultation with experienced legal counsel and accountants.

Family Office Structures for the Present

A modern family office is typically established to manage a diverse group of assets worth a minimum of $250–500 million. In addition to a significant amount of liquid assets, the family office will also likely be responsible for managing real estate, fine art and other collectibles (including cars, boats, planes and helicopters). Given this range of assets, family office structures must insulate the family's wealth from all potential liabilities.

A family office can put the bulk of a family's cash and securities into a trust for investing through an LLC subsidiary vehicle. But personal property items (such as vehicles) are kept separately and directly owned by family members. If structured appropriately, a third party pursuing a claim against the family (in the event of a boating accident or plane crash) will not be able to reach the investment trust holding the bulk of the family's wealth.

Family Office Structures for the Future

A family office should also be focused on sustainable wealth for future generations. One approach is to create a generation-skipping trust for purchases of real estate, direct private equity-style investments and other long-term deployments of capital. A family office might use a subsidiary entity for each of these ventures. That way, hundreds of separate entities may eventually be organized under the umbrella of the generation-skipping trust. When the generation in control of the family's wealth passes away, the assets held in trust can pass outside of probate to future generations.

Structuring for Your Team

A management company entity, which is used to employ family office staff and provide an array of services to the rest of the family office's corporate entities, is a key element of sound family office structure. The management company will handle operating expenses, perform professional, consulting and administrative services to family office entities and pay out salaries and bonuses to the family office staff. This entity should be organized to achieve a wide range of operational and management goals.

Over time, most family offices create a vast legal structure with a breadth of inter-company transactions. A family office must remain vigilant about its compliance with governance requirements.

For example, maintaining separate and distinct bank accounts for each of its various entities. With an experienced team of professional advisors, a family office can establish, maintain and evolve a structure that maximizes short and long-term investment possibilities for family wealth. By doing so, they will simultaneously mitigate risk exposure.

About Gary Levenstein

Gary Levenstein concentrates his practice in the areas of corporate and family office counseling, mergers and acquisitions, private equity, corporate finance, securities regulation and corporate governance. He represents privately and publicly held corporations, private equity funds, financial institutions, family offices and boards of directors. He has a vast network that has enabled him to connect clients with business opportunities, and he has been responsible for creating numerous “marriages” of great and lasting benefit.

About Michael Katz

Michael Katz is an associate at Nixon Peabody’s Private Equity & Investment Funds practice. He handles a full range of corporate transactions, including acquisitions, mergers, joint ventures, financings and complex licensing and commercial negotiations. In addition, Mike serves as counsel for companies, assisting with entity formation, corporate governance and contracting matters. He also advises companies with respect to privacy and cybersecurity, such as with policy development, reviewing internal readiness and compliance procedures, and preparing for or handling cross-border transfers of sensitive information or remediation and state regulatory compliance following a data breach.

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