TEN OPERATIONAL RISKS FOR FAMILY OFFICES

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INTRODUCTION

Family offices are not simply pots of wealth but wealth management businesses, and they need to be governed and managed with prudent and practical processes. Without committing time and resources to each potential risk, family wealth could be put in jeopardy.

Family offices tend to spend a disproportionate amount of time on "growing the family wealth" compared to "protecting the family wealth."
This isn't to say that seeking prudent investment opportunities isn't worthwhile work – it is – but like everything in the investment business, returns and risks must be identified and managed to successfully steward the family wealth.

When the investment industry uses the term "risk," it's typically with respect to the volatility or loss of capital and/or income within a given portfolio.

An area of equal concern should be the "investment operational risk management" of a family office.

The bottom line is that family offices are wealth management businesses that need to be governed and managed with prudent and practical processes that steward the family wealth for multiple generations.

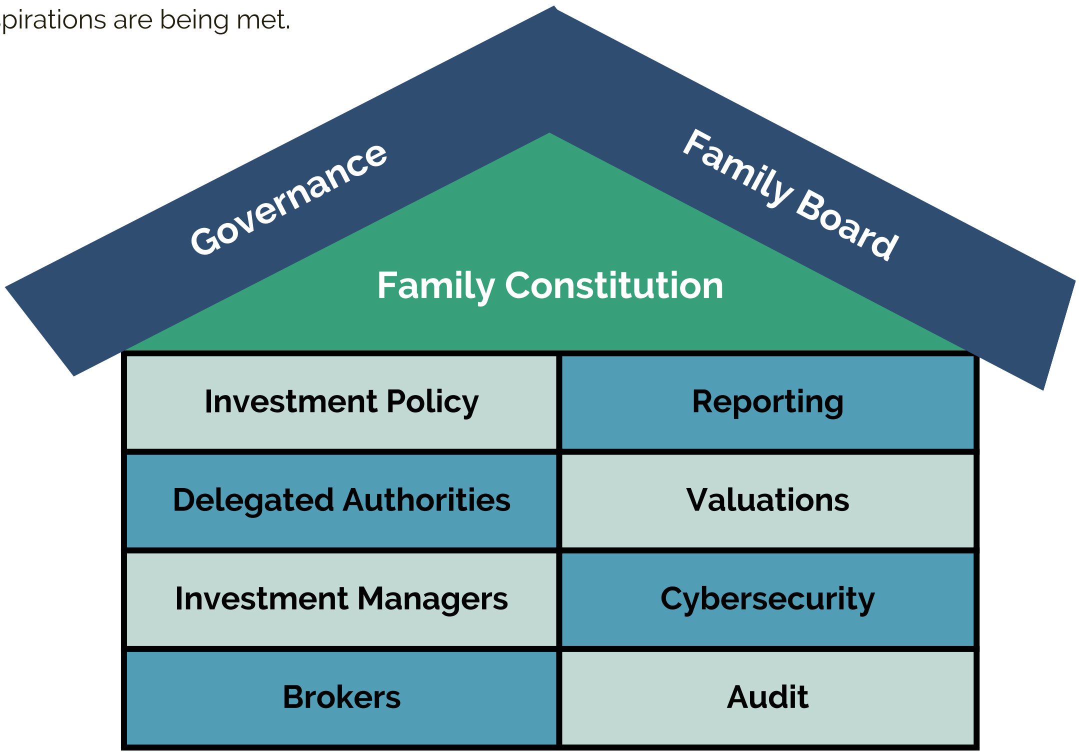
Here is an overview of the key investment operational risk management areas that should be proactively managed within a family office.

1. GOVERNANCE - FAMILY BOARD

Ensuring that the goals of the family wealth are met and investment risks are managed begins with effective governance, which can go by various names within family offices such as family councils, stewardship councils or what we'll refer to as a Family Board.

The purpose is to ensure that the family wealth – like the balance sheet and income statement of a business – is managed in a prudent manner that not only satisfies each family's unique set of goals but also mitigates investment and operational risks and supports the long-term sustainability of the family wealth across generations.

Ideally, a senior family member (a patriarch and/or matriarch, for example) should be the chairs of this board, as they are typically the best options to navigate the broad range of family wealth management subjects, across the various professional advisory inputs, to ensure that the family's aspirations are being met.



2. FAMILY CONSTITUTION

A family constitution is a written document that outlines the rules, values, and principles that guide a family's decisions and interactions. It is sometimes referred to as a family charter or a family agreement. The purpose of a family constitution is to establish a framework for managing family relationships and assets over the long term.

Family constitutions are often used by wealthy families to help manage their business and financial affairs, but they can also be useful for any family that wants to maintain strong relationships and ensure a smooth transfer of assets from one generation to the next.

Typically, a family constitution will cover a range of topics, including:

- The family's values and vision
- The governance structure of the family and any family-owned businesses
- The roles and responsibilities of family members, including those who work in the family business and those who do not
- How decisions will be made within the family and the family business
- How conflicts will be resolved
- How wealth will be managed and distributed over time

A family constitution is often created with the help of a lawyer or other professional who specializes in family governance. It is important for all family members to have a say in the creation of the document, so that everyone feels invested in its success. Once the family constitution is created, it should be reviewed regularly and updated as needed to ensure that it remains relevant and effective.

3. INVESTMENT POLICY

An investment policy is the key document that details how the family wealth, across its various portfolios from public markets to private investments, will be structured and managed.

An investment policy can be viewed as the blueprint of family office portfolios, as without a prudently designed policy, family wealth can quickly become a random collection of investment ideas instead of a prudently structured set of integrated investment strategies designed to meet each family's funding requirements while respecting their tolerances for risk.

4. DELEGATED AUTHORITIES

This can be easily overlooked in family offices given the typically high level of trust that often exists within families – at least in the early days of establishing a family office.

The unfortunate reality is that every family office needs to ensure that the appropriate people are authorized for signing off on various aspects of operating the family office business – from investment management and trading decisions to the cash management of both the family office business (i.e. accounts payable) and family portfolio payments to family office beneficiaries/family members.

Specifically, where multiple financial beneficiaries of a family office exist, it's typically prudent to have more than one person who has signing authority across all aspects of the family office business.

5. INVESTMENT MANAGERS

Whether a family office chooses to hire investment managers or outsource them, a due diligence process is needed to monitor and assess them. Although portfolio returns are important, portfolio risk controls are more important, as returns are always a by-product of risk and not the other way around.

When hiring external investment managers, family offices should also ensure that they conduct a thorough operational due diligence of each manager that examines the quality of their people, processes and technologies. Investment managers who deliver great returns but lack in prudent operational management can become a collapsing house of cards.

6. BROKERS

Family offices need to ensure that whenever brokers are used in the buying and selling of assets they be not just reputable but that the determination of price is both known and fair to the family office with ideally no conflicts of interest from the broker. If broker conflicts are identified, family offices need to ensure that these conflicts are either avoided or mitigated as much as practically possible.

7. REPORTING

All family offices/family boards need to ensure they receive regular, recurring reporting on their financial holdings, transactions and performance.

It's a challenge to integrate this financial information across various custodians and portfolio holdings, but it needs to be done using modern technologies. Otherwise it's difficult – and time consuming – for family offices to develop a true book of record of the family office's assets that is independent of any custodians or investment managers.

Increasingly, family office beneficiaries/family members are seeking this type of integrated reporting as it forces a level of accountability onto the family board.

Integrated investment reporting is a core offering of Generation Private.

8. VALUATIONS

Family offices should ensure that all assets they manage have valuations attached to them that are both independent and professionally determined. This is especially important for private holdings and alternative investments conducted through external investment managers, as the absence of this is another potential area of financial fraud.

9. CYBERSECURITY

As the global business world continues to integrate via web-based technologies, it's becoming critical for family offices, like any other business, to ensure that they've assessed and implemented cybersecurity protocols for not just "in the business" but also with its key suppliers such as investment managers. Failure to do so will increasingly place family offices at risk of cybersecurity hacking.

10.AUDIT

This is an area probably more suitable for large, multi-generational family offices, but the notion of executing independent audits on a periodic basis – regarding the valuations, transactions and performances across the family office portfolios – will become a growing service. This approach provides a level of accountability to the economic beneficiaries of family office portfolios.

CONCLUSION

The operational risk approach outlined above requires a lot of investment of time, people and resources. But without this commitment, a family office will be exposed to business risks that could jeopardize the safety and long-term sustainability of the family wealth.

GENERATION PRIVATE

Generation Private is a multi-family office practice servicing the needs of High Wealth Families. Generation Private provide a specialist tailored offering to its clients to seek and provide solutions to the many of the issues they may encounter. Whether it is compliance service, estate planning, investment management and reporting to family constitution development, Generation Private provides a holistic service to its high wealth client base.

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