

FOMC - Special

Case Practice – 1 November 2011

As a result of the increasing demand for information in the family office market, Family Office Management Consulting publishes its quarterly newsletter as well as ad-hoc briefing notes on various subjects relating to the family office theme. The selection of topics results from the experience in working with families, entrepreneurs and family offices on a daily basis, current developments in local and international markets as well as on requests by clients.

A comprehensive risk review

Risk management in a family office goes far beyond the traditional risk considerations, classical financial calculations and ratios. More and more family offices have realized this need for not only comprehensive risk management frameworks, but additionally thoroughly-defined contingency plans and programs. The starting point for such endeavors and the role of the family office as a risk manager is often an in-depth review of existing structures and set-ups, including governance, infrastructure and operations.

Risks in governance

Key risks in governance are mainly related to human capital as well as decision-making, and this on owners' and family office sides. Starting with the definition of decision lines and authority manuals including day-to-day decision delegation, measures and actions to be taken in case of contingencies and the respective policies and legal provisions.

Most common gaps and therefore key review questions to be asked in a typical family office set-up are hereby the following:

- *Contingency and succession plans:* Who are the key decision-makers and which are the contingency measures in case of their permanent or temporary absence?
- *Immediate and long-term deputy plans:* Which deputy structures are in place and who has been identified as the key contingency persons?

- *Reporting lines and board structures:* Are decision lines direct, enabling efficient control and decision-making?
- *Authority and delegation manuals:* Are authorities clearly-defined and are the respective powers of attorney in place?
- *Incentive systems, retention and training programs:* How can best-in-class staff be attracted and retained? Which expertise is core to successful operations in the long run?

Risks in infrastructure

Risk sources in respect to family office infrastructure and platform are mostly found in IT, security and information processes. A strong IT and security system represents the backbone of every family office structure, regardless of the region where operations are based or whether multiple locations are involved in day-to-day business.

While one does not have to go as far as deploying lie detectors and self-destructive computer hardware, as we've seen with family offices based in the world's more instable regions, a few common challenges stand out:

- *Access manuals/information barriers:* Who has access to which information?
- *Outsourcing guidelines and controls:* Who are key external partners and which confidentiality/protection measures are in place?

- **Back-up and archive systems:**
In-house versus outsourced servers?
Are physical archives in place? How is documentation classified?

Risks in operations

Risks on the operational side are largely dependent on the individual family office structure and organization. While family offices with substantial headcounts of 20 to 50 or even more, operating out of multiple locations, need to implement risk and compliance measures similar to a small to medium size business, a lean set-up averaging 5 to 10 employees mainly calls for key-man risk considerations.

However, regardless of the individual set-up, internal control processes are one of the most neglected concerns in family office operations with the following aspects being amongst the most common flaws:

- **Short- and long-term strategic planning:**
Have clear goals been defined and communicated to the family office team(s)?
- **Policies and procedures:**
Are guidelines in place in regard to compliance to regulations, laws and other contracts (for all jurisdictions involved)?

Additional risk considerations

In addition to the risk frameworks for the family office itself, owners' structures demand a thorough review of key gaps and challenges in regard to potential risks that are presently implicit or may occur including first and foremost, succession and estate planning structures.

Core measures and key questions to be asked in regard to existing structures include hereby typically the following:

- **Estate planning structures:**
Are succession planning structures conform with the wishes of the current owners, and this on business and financial sides? Are family members or external advisors prepared and have the respective expertise to act as trustees or advisory board members?
- **Advisor and partner structures:**
Have selection processes and criteria been defined in regard to key governance bodies on family and business sides including investment committee, board of directors, family board/council and executive boards? What are the risks of bringing in non-family leaders into the structure on the wealth and business sides?

Clearly the above-mentioned concerns are only a small and very high-level summary of risk considerations and challenges, and a detailed risk review goes far beyond.

Mapping risks and likelihood of occurrence

Following the identification of the key risk sources and events, combined with an estimation of the respective likelihood of occurrence as portrayed in figure 1, a detailed risk matrix aims to help identify the necessary measures and action points on a clearly-defined priority scale.

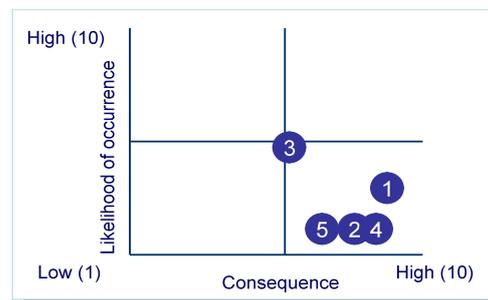


Figure 1: Risk mapping