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Thought Leadership

inCompliance - On the radar: considering the issue of risk mitigation in the expanding family office market

On the radar

Nick Parfitt considers the issue of risk mitigation in the expanding family office market

Set up to manage the wealth of ultra-high net worth families or individuals, family offices can handle anything from the essentials of wealth management, philanthropy, or fine art investment to planning private education for children. However, despite their financial capability and the size of the transactions and investments they work with, they have operated 'under the radar' for many years. This is because, unlike investment, wealth management or real-estate firms, family offices have been able to manage their wealth without the need to register or answer to regulators. Their numbers are growing: while in 2008 there were around 1,000 single-family offices in the world, just a decade later Ernst and Young reported their numbers to have exceeded 10,000.[1] Even these statistics may not show the full picture, because family offices are often not required to register or have a license for their investment activity and are highly discreet by nature.

Two factors have driven the rise of family offices around the world: it now takes less time to accumulate wealth, and there is far greater entrepreneurial potential. The result is that the world's billionaires have grown to the extent that, according to Forbes, 2,000 individuals today have a combined wealth of more than $9tn.[2]

Advantages of the family office model

It's easy to see the appeal of the family office model. By focusing on the family's own portfolio and having few clients, employees have relatively little administration and compliance work to deal with and can spend most of their time helping the family accumulate wealth. Family offices are also simple entities, able to make investment and pricing decisions easily, and they are, traditionally, not strongly affected by market trends and regulatory changes. As family office expert Ward McNally says, family offices are "as quiet as you possibly could find," but "they're writing extremely large cheques[3]."

According to Campden Wealth CEO Dominic Samuelson, family offices currently hold assets in excess of $4tn.[4]

Given their success, one trend today is for single-family offices to merge into multi-family offices. ►

The Rockefeller family office, for example, currently has over 250 clients. And as the concentration of wealth grows, family offices are also looking to hire more talent, for example chief investment officers, chief operating officers, chief financial officers and legal counsel. This growth trend has not gone unnoticed by others working in the same field, with hedge funds converting to family offices and big banks looking to appoint senior family office bankers.

Associated risk

However, despite their many strengths and advantages, family offices cannot escape the operational risks they face – similar to other mid-size corporates or financial institutions. This article focuses on three areas of risk: fraud and cybersecurity, personnel risk and regulatory and compliance risk.

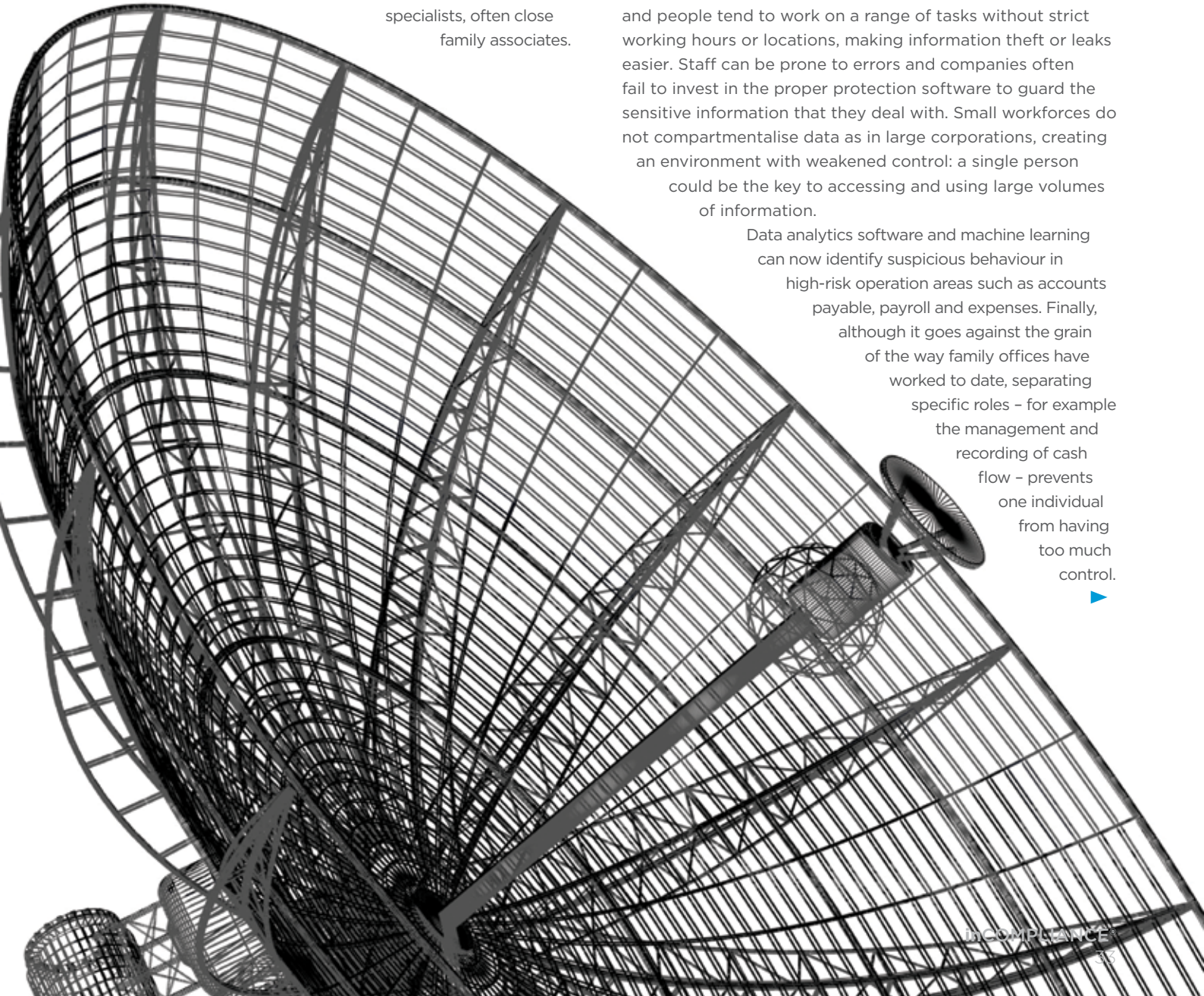
A family office aims to manage funds with a focus on personal service and discretion with consideration for the cost of service relative to the pool of wealth. Often, there are few employees, each managing a number of different tasks, which puts a great deal of responsibility on and decision-making power into the hands of single individuals. Larger companies have the benefit of dividing up roles and responsibilities, whereas wealthy individuals tend to prefer hiring a few trusted specialists, often close family associates. This concentration of responsibility can lead to problems if a single employee commits a crime or simply makes a mistake.

Fraud and cybersecurity related risk

Fraud and cybersecurity are key risks for family offices and can affect the business in many ways, resulting in reputational damage, information leaks, identity or original works theft, and bank account manipulation. The structure of family offices and their desire for discretion makes tracking losses difficult. Employees and wealthy individuals themselves are often not sufficiently educated about cybersecurity risk, and lack cybersecurity technology and personnel. While family offices have recently started to hire outside experts to diagnose and monitor cyber risk, the position of 'chief information security officer' only exists for a few of the biggest family offices in North America, even though family offices can be found all over the globe. Cybersecurity tends to be addressed in reaction to a significant event, rather than proactively.

Family offices tend to overlook cybersecurity because of the common misconception that criminals only target larger corporations and governments. However, the way that family offices work puts them at a high risk of attacks. There tend to be few formal rules or management roles in family offices, and people tend to work on a range of tasks without strict working hours or locations, making information theft or leaks easier. Staff can be prone to errors and companies often fail to invest in the proper protection software to guard the sensitive information that they deal with. Small workforces do not compartmentalise data as in large corporations, creating an environment with weakened control: a single person could be the key to accessing and using large volumes of information.

Data analytics software and machine learning can now identify suspicious behaviour in high-risk operation areas such as accounts payable, payroll and expenses. Finally, although it goes against the grain of the way family offices have worked to date, separating specific roles – for example the management and recording of cash flow – prevents one individual from having too much control.



As governments and regulators work to increase their reach in order to combat money-laundering, terrorism and tax avoidance, their attention is shifting to the rich and to how they operate their finances, especially given the growing role family offices are starting to play in wealth management and investment

Family offices often rely on human honesty rather than reliable systems that eliminate the risk of fraud.

Personnel risk

This brings us to another important point that is often overlooked when discussing family office business security and compliance – the process of hiring personnel. The more family office structures grow, the harder it is to hire close associates, and more offices are looking to appoint professionals in order to increase their efficiency and profitability. As these individuals will be presented with great responsibility, strong due diligence and monitoring are advisable. This, of course, applies to all outsourced activities, third parties, investment interests and advisory services used by the family office.

Outsourcing certain activities can provide a degree of objectivity to the way the family office works, which can in turn lead to better governance. However, this also introduces third-party risk and can lead to poor coordination between outsource providers.

The approach to the combat of fraud taken by family offices should reflect what other financial institutions do. This means that, in organisations that value discretion, it's important to promote an office culture that encourages transparency and the reporting of suspicious activity. The behaviour of employees who may be committing fraud – including working long hours, arriving early and leaving late and never taking long vacations – is similar to how honest hard-working employees behave, so good training and robust processes are needed to identify fraudulent individuals. Regular risk assessment is advisable.

Regulatory risk

And this leads to our final point – regulations. The regulations that apply to a family office depend on its legal structure (be it trust, partnership or limited company); the people it hires (family members, trusted individuals, or professionals); and on the jurisdiction that it chooses for its registration and activity. Apart from providing non-financial services, family offices also often manage and invest their clients' wealth. In more than one jurisdiction, family offices have been outside of the reach of regulators for some time. However, as governments and regulators work to increase their reach in order to combat money-laundering, terrorism and tax avoidance, their attention is shifting to the rich and to how they operate their finances, especially given the growing role family offices are starting to play in wealth management and investment. In many jurisdictions, regulators have begun to create rules that include certain family offices and require a level of compliance by them.

Examples of regulatory environments

In Switzerland, often a location of choice for family offices, family wealth management qualifies as financial intermediation under the Federal Act on Anti-Money Laundering (AMLA) if it is carried out in a professional and commercial manner (i.e. it creates a certain amount of revenue) and if the entity appoints employees who are outside of the family itself. Assuming a family office meets these conditions, it must be supervised for anti-money laundering (AML) either by the Swiss Financial Market Supervisory Authority (FINMA), or an approved Self-Regulated Organisation (SRO). And if the family office manages a pension fund in more than one jurisdiction, it must answer to the corresponding pension authority of the country in which the fund is based.

Another example is Singapore. Here, if the family office acts as an investment adviser or manager to a vehicle owning the family's assets, its activities could be regulated under the Securities and Futures Act (SFA), requiring it to register as a Registered Fund Management Company, or obtain a licence from the Monetary Authority of Singapore (MAS) in certain cases where there is a third-party asset under management. Similarly, in the UK, financial advisers and stockbrokers giving advice have to register with the Financial Conduct Authority (FCA) or with the Prudential Regulatory Authority (PRA) if they are larger. Here, a family office would have to answer to the FCA.

Above the parapet

While there is a great deal of variation from country to country and from case to case, it's clear that family offices are no longer under the radar in the way they once were. As their structures evolve, so do the laws that govern them. Anyone starting out in the family office business or working for a family office needs to make sure they have the information they need to operate effectively for their own benefit and that of their clients. Education, professional advice, corporate culture, accountability and robust technology all help to reduce operational risk for family offices in a constantly changing financial landscape.

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1. EY Family Office Guide https://www.ey.com/Publication/vwLUAssets/EY-family-office-guide-en/$FILE/EY-family-office-guide.pdf
2. https://www.forbes.com/billionaires/
3. https://www.wsj.com/articles/the-new-force-on-wall-street-family-offices-1488991396
4. https://www.forbes.com/sites/francoisbotha/2018/12/17/the-rise-of-the-family-office-where-do-they-go-beyond-2019/#748c325c5795