KlarityRisk

FAMILY OFFICE RISK MANAGEMENT INFRASTRUCTURE: MONEY WELL SPENT!

INTRODUCTION

Is failure in risk management, “the million-dollar question”, a major factor that contributed to most financial corrections? Would it be possible to avoid or at least smooth that chart line going south when all turns negative and fear rules? The maintenance of family wealth across generations is an extremely complex task.

Single Family Offices (SFO), around the globe, were not well prepared during the crisis of 2008, and many suffered significant financial losses as a result of inadequate or a complete lack of risk management. Would they be in a much better financial position if their allocation to alternative investments, especially to illiquid investments, were minimized? There is no doubt that families of significant wealth had limited, in the past, the definition of risk management to a well-diversified and hedged portfolio failing to spend money to risk management infrastructure to provide prudent asset management and preservation of wealth for future generations.

FAMILLY OFFICE RISK MANAGEMENT: A PRACTICAL CHECKLIST

Family offices should first understand the definition of a holistic risk management framework including but limited to:

- Establish the proper risk management infrastructure (i.e. risk management software/platform with risk analytics, a data warehouse, and connectivity of risk infrastructure to other key systems like accounting and compliance.)
- Outline, in detail, SFO’s investment objectives and risk tolerance levels per asset class.
- List all family’s investments:
  - Direct and non-direct, liquid and illiquid.
  - Potential future investments along with specific due-diligence process.
- Identify, estimate and evaluate any investment risk (liquidity, credit & market risks)
- State the maximum drawdown acceptable per asset class/currency/country.
- Diversify: asset classes/currencies/regions/countries/sectors in an uncorrelated way.
- Run “global portfolio what-if-scenarios” by pay attention to geopolitical events.
- Be aware of volatility levels per asset class/investment and expected returns.
- Use analytics to optimize the risk portfolio and improve decision-making
- Monitor investment objectives as stated in the Family Office Investment Policy Statement.
- Write proper risk management governance rules including controls & internal audits.
- Implement an automated risk management process to materially improve the cost structure.
- Establish processes to support the risk management framework.
- Review the risk profile of the investment portfolio(s) and approve the family office’s risk and investment management guidelines, on a regular basis.

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