ETON SOLUTIONS

"Business As Usual"
IN THE FAMILY OFFICE

“Business As Usual” in the Family Office

“The family office is a unique family business that is created to provide tailored wealth management solutions in an integrated fashion while promoting and preserving the identity and values of the family.” *(The FOX Guide to the Professional Family Office, 2014)*

FOX Guide to the Professional Family Office 2014

The graphic above defines the rasion-d’etre for a Family Office and why it is the best way to ensure these critical issues for the family are dealt with and that the Family Office delivers value. So, how does a Family Office ensure “Business As Usual” (BAU) at the highest level in times of a crisis?

There are two key elements for BAU that tightly linked:

- Business Continuity - the advance planning and preparation undertaken to ensure that an organization will have the capability to operate its critical business functions during emergency events
- Disaster Recovery - a set of policies, tools and procedures to enable the recovery or continuation of vital technology infrastructure and systems following a natural or human-induced disaster, defined by business continuity planning

In today's world the solution for the BAU challenge requires a "fit-for-purpose" technology base that supports business defined, embedded, processes and workflows. The starting point for evaluating the business processes and workflows is to look at the operational risk factors in the Family Office. This risk is defined as the prospect of loss resulting from inadequate or failed procedures, systems or policies. Any event that disrupts business processes, such as employee errors, systems failures, pandemic, economic catastrophe or fraud or other criminal activity.

The questions to be answered are:

- How does the Family Office interact with families and employees?
- What does the Family Office have in place to manage disaster recovery?
- What does the Family Office have in place around process management and procedures?

These are then further refined by looking at:

- People risk
  - Management failure
  - Organizational structure or other human resource failures
  - Poor staffing resources & poor training
  - Inadequate controls
- Process risk
  - Breakdowns in established processes
  - Failure to follow processes
  - Inadequate process mapping within business lines
- System risk
  - Both disruption and total system failures in both internal and outsourced operations
- External crisis – including pandemics, epidemics, natural disasters, terrorism, and vandalism

A Family Office should serve the family members and leadership must address operational risk to reduce fiduciary risk – the obligation to act in the best interest of the family.

In many ways the family office business, especially SFO's (Single Family Office), are regarded as a "cottage industry" and many of the players behaved as though it was. It is a consequence of many offices growing organically out of a successful operating business. The business processes in SFO's are often very manual, with little in terms of an audit trail.

On the other side, every SEC registered investment adviser, such as an MFO (Multi-Family Office), is required to adhere to some defined rules. However, as Wealth Management becomes an increasingly complex, expensive and risky operating environment, it creates new operational challenges. There is an opportunity for both SFO's and MFO's to look at the status quo critically and to be open to transformation.

Upgrading the business processes and workflows of a Family Office has benefits beyond risk management. What have typically been thought of as support functions can become strategic assets that are scalable, agile and nimble, and can successfully adapt to changes. For SFO's this means that high-value staff can focus on high-value tasks and not mundane tasks like data entry. In an MFO the operational changes can support the need to be competitive when the end-to-end business functions and processes work seamlessly together.

A crisis can cripple the functioning of a Family Office if it is not prepared and it can come in many forms, a pandemic that forces working from home, it can be the case where the leader of the office (who has the processes "in their head") is incapacitated, or where the technology the office relies upon does not include business continuity and disaster recovery.

The Family Office should operate on an integrated software platform designed for BAU:

- One that provides the functionality of Entity Management, Investment, Accounting, Trust Accounting, Partnership Accounting, Reporting, Estate Planning, Client Portal and Document Management/Storage
    - One 'system of record' where the use of spreadsheets is used for the job it was designed for, analysis
- The office staff, the family and advisors can log-in to the integrated platform and what they can see and do is defined by the assignment of a office system role and responsibility
    - A Family Office CEO gets transparency and can see all things related to the family, but a tax accountant can only see the tax related data and documents for the clients they represent
    - The office and advisors can work as a team from anywhere

- The platform has a data aggregation/normalization/exception management functionality to provide consistent and accurate data reconciled daily - facilitates cash management, estate planning, etc.
- The platform provides consolidated reporting at all levels of entities, family members, partnerships, trusts, etc.
- The platform has embedded business rules, processes and workflow to systemize knowledge
- All users can access the system wherever they are, 24/7/365, in a secure way and with full disaster recovery and business continuity
- Full KPI analysis and service level monitoring

"Business As Usual" is about being prepared, having transparency, control and access.

Technology Paradigm Shift for Family Offices

THE OLD MODEL

In this model the asset transactions from managers, custodians, etc. are downloaded and housed directly on the internal server of the Family Office. It has the added responsibility to manually enter and integrate data from alternative investments, cash management functions, and other private investments and holdings. All data is managed in-house with the Family Office providing access to the information via desktops or paper reports. As such, the full burden and responsibility for data integrity, reconciliation, security and distribution lies within the office.

This model has come under pressure in many ways, changes in asset diversification, the global reach of investment portfolios, the growth in information access and the expectations of family clients. The result is more pressure on the staff of the office to deal with the complexity and the strain it puts on the typically manual workflows and procedures. Family Offices must act to remove outdated systems and processes in order to keep pace with modern business practices in office efficiency, risk management, service levels and execution.

OUTSOURCING FOR THE FAMILY OFFICE

In the Family Office and Wealth Management world, the outsource solution remain the most significant new technology offering to be introduced in recent years. It often presents an entirely new way of working and opens a world of opportunity.

SaaS Delivered Technology Platform

This allows a Family Office to operate with only a very basic physical technology infrastructure, typically, a user has a computer, with internet access, and a browser-based Desktop. It is device agnostic so it can be used on a PC, Mac, Tablet or mobile device. It also allows the same Family Office infrastructure to be used by advisers and family clients.

A summary of infrastructure benefits is:

- No on-site servers
- All applications are fully managed and hosted in a data centers and delivered remotely
- Single sign-on and one password

- Secure identity and access management
- High level of security compliance
- Comprehensive support for end user helpdesk, nationwide on-site assistance, network management
- Fully managed infrastructure with typically a 99.99% availability Service Level Agreement

Think of it as delivering a browser-based application desktop and a file system that provides instant, secure access from anywhere at any time. As it provides access for Family Office staff, advisers and for family members on the one platform, it can also solve the problem of secure, up-to-date communication and collaboration.

Service Outsourcing

One of the major differences with a SaaS delivered solution is the option for a Family Office to use Service Outsourcing. This approach shifts many of the data gathering and key application responsibilities shift from the family office to the external, third party outsource.

Using this structure, all data first flows from the custodian and/or bank to the outsource host where data reconciliation, integration, consolidation and initial reporting occur. Initial reports are then available for the Family Office to review. All data resides in the application platform on the SaaS host server.

Under this new approach, the responsibilities of the family office fundamentally change, from day-to-day data administration to data oversight, analysis and modeling in support of strategic wealth planning. It is estimated that an outsource platform shifts up to 65% of typical office activity—in data integration and collection—from inside the office to outside the office.

The SaaS approach, along with the right Family Office technology platform, allows the Family Office to solve the other key element of BAU, operational risk.

Operational Risk – Why family offices should care

It is all about quantifying losses due to:

- How does the Family Office interact with families and employees?
- What does the Family Office have in place to manage disaster recovery?
- What does the Family Office have in place around process management and procedures?

This can be summarized as the risks stemming from people, processes, systems and external events.

- People risk refers to the risk of:
  - Management failure
  - Organizational structure or other human resource failures
  - Poor training
  - Inadequate controls
  - Poor staffing resources
- Process risk:
  - Breakdowns in established processes
  - Failure to follow processes
  - Inadequate process mapping within business lines
- System risk:
  - Both disruption and total system failures in both internal and outsourced operations
- External events can include pandemics, epidemics, natural disasters, terrorism, and vandalism

Effective management of operational risk is integral to the Family Office business and their role as a fiduciary.

Although operational risk is not a new risk, deregulation and globalization of financial services, together with the growing sophistication of financial technology, new business activities and delivery channels, are making institutions' operational risk profiles (i.e., the level of operational risk across an institution's activities and risk categories) more complex.

As an investment business with fiduciary responsibility, the prudent Family Office should be just as aware of operational risk as other financial services businesses – in fact operational risk management could be said to be even more important for Family Offices.

Shared Risks

Business Ownership & Control

- Family Control
- Family Leadership of Business
- Family Dynamics
- Alignment of Interests
- Business Strategy
- Business Governance
- Business Operations

Wealth Preservation & Enhancement

- Investment Goals and Objectives
- Asset Diversification
- Manager Selection
- Investment Performance
- Public Equity Concentration
- Private Equity Control
- Private Equity Distressed Situations

Shared Risk

Financial Security & Compliance

- Legal Exposure
- Fiduciary Roles and Responsibilities
- Wealth Transfer Protection
- Physical Asset Protection
- Financial Leverage
- Financial Oversight
- Financial Reporting/Compliance
- Family Office Oversight

Family Unity & Governance

- Family Legacy
- Philanthropic Legacy
- Family Governance & Decision-Making
- Family Relationships
- Family Reputation & Public Image
- Personal Security & Privacy
- Personal Health & Wellness
- Personal Ownership Responsibilities

Source: Family Office Exchange Research

Operational risk exposure is important to financial institutions like banks because that "exposure" is used as part of a formula to calculate their regulatory capital ratio. Although the risk may not translate directly into higher capital requirements, or lower return on that capital. The nature of Family Offices and their responsibility to manage and conserve family money can mean that any failure can be very damaging.

The very absence of a regulatory framework for SFO's heightens the risk in many ways. Banks have established regulatory guidelines and clear best practices to create effective measures and management.

As many Family Offices grew organically, expanding into new business processes as required by the investments and services the office provides, they used tools and technology that were readily available, i.e. the MS Office applications on a desktop computer. What the staff do and how they do it in many Family Offices is often neither well planned or well documented.

When you consider this situation and bearing in mind the two definitions below concerning operational risk, it is an accident waiting to happen.

AN OUTLINE OF THE BANKING OPERATIONAL RISK FRAMEWORK

Operational risk: "The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events."

In the mainstream financial services world, operational risk governance processes and procedures need to be established on a firm-wide basis to identify, measure, monitor, and control operational risk in a manner comparable with the treatment of credit, interest rate, and market risks. Institutions are expected to develop a framework that measures and quantifies operational risk for regulatory capital purposes.

To do this, institutions have had to create systematic processes for collecting operational risk loss data, assessing the risks within the institution, and adopting an analytical framework that translates the data and risk assessments into an operational risk exposure. The analytical framework must incorporate a degree of conservatism that is appropriate for the overall robustness of the quantification process. The institutions are then permitted to calculate their minimum regulatory capital based on internal processes, the requirements for data capture, risk assessment, and the analytical framework created.

OPERATIONAL RISK LOSS: THESE RISK LOSSES ARE CHARACTERIZED BY SEVEN EVENT FACTORS:

1. Internal fraud: an act of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, which involve at least one internal party
2. External fraud: an act of a type intended to defraud, misappropriate property or circumvent the law, by a third party
3. Employment practices and workplace safety: an act inconsistent with employment, health or safety laws or agreements

4. Clients, products, and business practices: an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product
5. Damage to physical assets: the loss or damage to physical assets from natural disaster or other events
6. Business disruption and system failures: External or internal triggered disruption of business or system failures
7. Execution, delivery, and process management: failed transaction processing or process management, from relations with trade counterparties and vendors

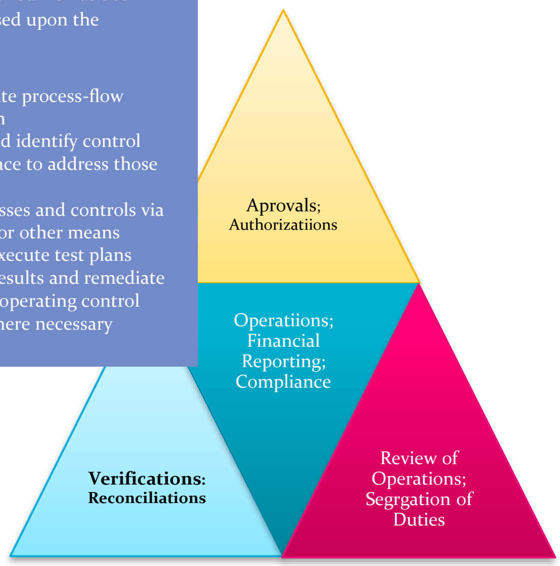
WHAT DO BANKS DO ABOUT IT?

Operational risk monitoring and analysis in a bank is bundled into of a group of "Control Activities". These are:

1. Approvals
2. Authorizations
3. Verifications
4. Reconciliations (totals and transactions verified, exceptions investigated and reported)
5. Review of Operating Performance
6. Segregation of Duties

Best practice in this area for banks has been defined by PWC and is based upon the following:

- Update or create process-flow documentation
- Assess risks and identify control activities in place to address those risks
- Validate processes and controls via walkthroughs or other means
- Develop and execute test plans
- Evaluate test results and remediate design and/or operating control deficiencies where necessary



The figure shows the process areas where these control activities have an impact. For many banks, the multiple governance, risk and compliance initiatives they face can seem like insurmountable barriers when all indications suggest that the trend toward increased regulation is set to intensify in the coming months and years. The overriding challenge is that too many banks continue to tackle compliance initiatives, like operational risk, in silos.

What does Operational Risk mean to Family Offices?

The definitions of operational risk above can be applied to the work of a Family Office. Although no regulatory body requires compliance for SFO's, it is obviously very good business practice. The best practice of measurement and management of operational risk in a Family Office demonstrates awareness and risk management processes at a level commensurate with a regulated financial institution. Operational risk management is a prudent safeguard for if/when things goes wrong.

Family Offices can learn from the experience of banks outlined above, i.e. what is the best approach and when you use technology?

WHERE A FAMILY OFFICE SHOULD START? – A RISK ASSESSMENT

1. Identify problems using a Risk Audit
2. Undertake a Business Process Review using a "best practice" baseline
3. Implement a control structure
4. "Fit for purpose" solution approach - To be successful, an operational risk strategy must be driven by the needs of the business and its users (enabled by technology)

Such a program starts with senior management. The most effective way to create the catalyst for change is by implementing a phased approach that delivers verifiable outcomes based on a strategic focus. In other words, taking directed small steps that lead to obvious "quick wins" could smooth the path toward widespread adoption of the concept over time.

3 STEPS TO EFFECTIVE IMPLEMENTATION OF OPERATIONAL RISK MANAGEMENT

The key steps to implementing this program are:

- Know Your Processes - Evaluate the current situation
- Know Your Risks - Implement the appropriate controls
- Know What Happened - Develop a control, measurement and audit methodology

This section will cover each of these in detail.

1. Know Your Processes: This is a combination of undertaking a risk audit when you have best practice process understanding for evaluation.

a. It's an initial assessment that identifies areas of potential risk, any mitigating facts, risk controls, etc. using the event factors above
b. The initial assessment is then used to develop a specific program to develop and test the controls identified
c. One common misconception in organizations is that risk management must be achieved using technology. While technology plays a role, the most important component is "processes". Critical processes, require sound development, documentation and usage practices
d. The best practice process challenge - The need for procedures and policies at a certain standard must be recognized at all levels within the organization. Without executive-level commitment it will be difficult, if not impossible, to enforce and maintain an effective operational risk strategy

2. Know Your Risks
   a. Control activities are the steps taken to mitigate risk and meet the control objectives for the event factors listed above:
      i. Preventative—controls that prevent undesirable events from occurring
      ii. Detective—controls that detect undesirable events that have already occurred
   b. They can be easily documented in table form as indicated below:
3. Know What Happened
   a. The solution to this question might end up being "Audit ⇒ Knowledge ⇒ Process ⇒ Controls ⇒ Audit" circle based upon documentation
   b. Operational risk is an ongoing process and requires maintenance and documentation – either generated by software as an audit file, or by people carrying out an audit on the compliance with controls

THE RISK IMPACT OF SPREADSHEETS

Spreadsheets may sometimes look like a professional financial services application, but it isn't. The spreadsheet, as the 'tool of choice' for most Family Offices, with its lack of controls and audit trail ability does mean it should get special attention.

Spreadsheets will remain a business-critical resource in most offices and so it is important for two things:

1. ONLY use spreadsheets for analysis – what they were designed for – and develop a Spreadsheet Control Framework that includes rigorous process controls around the development, testing, and use of spreadsheets
2. Spreadsheets should not be Systems of Record:
    a. Inability to maintain data integrity due to lack of control
    b. Inability to integrate structured data with related documentation
    c. Lack of documented procedures - no way to embed risk management, data security and operational knowledge
    d. Totally dependent on key individuals

What can modern technology do for "Business As Usual"?

The operations element of a Family Office relates to its ability to efficiently and effectively manage the various processes, people and systems that interact to deliver valued client outcomes. How an office structures and manages its operations is essential for delivering on the value proposition – why someone has a Family Office. A properly structured and maintained operational capability supports a good client experience, in addition to realizing efficiencies and controlling costs.

Workflow processes are at the heart of Family Office operations because many are repetitive. Well-defined processes that are clearly understood and consistently deployed ensure efficiency, enhance productivity, control expenses, facilitate scalability and reinforce a consistent client experience. Aligned to this, the right use of the right technology is obviously important to the operational success of the office, to allow the staff to efficiently carry out the workflow processes in a manner that is consistent, controlled and efficient.

CAN YOU BUY OPERATIONAL BEST PRACTICE USING TECHNOLOGY?

Family Office Exchange has defined best practice regarding technology for a Family Office and such a platform needs to start with the creation of best practice business rules, processes and workflows needed to operate the business. With this as the foundation, the required functionality needs to be built on single database to create a fully integrated, end-to-end platform. All of this delivered in a SaaS way to provide the business continuity, disaster recovery and security that the 21stC Family Office needs.

In many industries, Best Practice Business Rules, Processes and Workflow would come under the banner of Knowledge Management (KM) and the key tenet of this is to help you operationalize knowledge that resides in a business – often "in people's heads". The idea is to take well defined best practice approaches and apply them to make your business better. A move to apply best practice operational procedures to any business is commonsense and at the very least it captures and makes available the optimum way of working for that business.

Efficiency is often measured in terms of accurately completed tasks (as measured by error rates) as well as the number of hours required to perform a task. Performing operations processes using disparate systems, as in most Family Offices, is rife with operational risk, as a result of toggling back and forth between applications and manually keying in data. Inherently, it also takes more time to complete operations processes using disparate systems than using fully integrated systems, which necessitates increased headcount as practices grow and operations staffs become overloaded (which leads to even more errors).

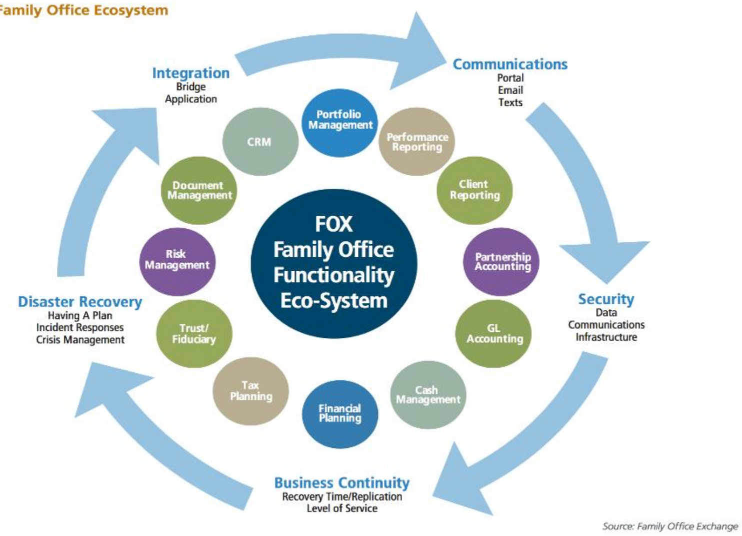
The key outcomes of using operational best practice are efficiency, effectiveness and better risk management. If something goes wrong in the operations of a Family Office it is the fiduciary nature, i.e. the trust element, that is impacted the most. There is the fiduciary duty to provide the highest standard of care over the tasks being performed in a Family Office.

The checks and balances of risk management go together with a fiduciary duty and provide the basic parameters for designing best practice operations for a Family Office. Given the large sums of money they are often dealing with, operational risk management must be a core part of a family office business and not a "nice to have".

This is where technology can help. The approach that most Family Offices have towards technology is one of multiple entry of data, manual processes, multiple spreadsheets and silo technology does not create a seamless and efficient operational process. A Family Office needs a platform where the creation of best practice business rules, processes and workflows needed to operate are at the core. With this as the foundation, the required functionality needs built on single database to create a fully integrated, end-to-end platform.

Using an integrated platform, data is entered once (often automatically), tasks are assigned by user role and the process flow is automated and with approval steps built in. An integrated platform with Entity Management, Document Management, Investment Management, General Ledger, AP/AR, Budgeting, Task Management, Consolidated Multi-Dimensional Reporting, etc., with full business continuity and disaster recovery.

Figure 4: Family Office Ecosystem



The graphic above represents best practice regarding technology for a Family Office and, as we said, such a platform needs to start with the creation of best practice business rules, processes and workflows needed to operate the business. With this as the foundation, the required functionality as shown here needs to be built on single database to create a fully integrated, end-to-end platform. All of this delivered in a SaaS way to provide the business continuity, disaster recovery and security that a Family Office needs.

Conclusion

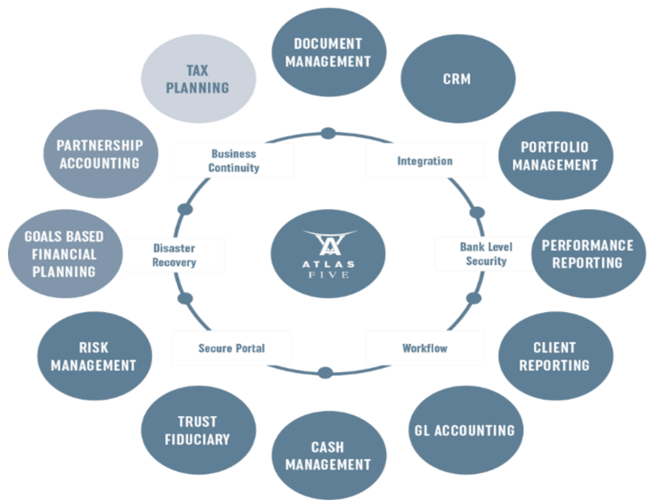
The strategies and technology described in this paper can help Family Offices achieve success in establishing operational risk control policies that can meet many business needs. They can then provide the BAU to their fiduciary responsibility to the family they serve demands.

Family Offices need to fully professionalize and be "fit-for-purpose" in the 21st Century. This approach, on an operational risk level, would be formalizing the best practices the office wants to achieve as an organization and systematize the knowledge of the office so that people/staff of the office can benefit. Then, the ability to buy and use an integrated technology platform designed for the Family Office, where the best practice business rules, processes and workflows are embedded would facilitate the Family Office achieving a BAU infrastructure "out-of-the-box".

The outcome would be a leap in the effectiveness and efficiency of the Family Office, and positively impact the perceived value of the office and provide consistent measures (KPI's) of that value.

With this approach every Family Office can achieve the professionalism needed and be prepared for BAU in a disaster.

AtlasFive by Eton Solutions



- Integrated enterprise management system built for the family office space
- Full suite of entity management, data aggregation, investment reporting, general ledger, document management and transaction initiation
- Proprietary process and role-based workflow functionality
- Cradle-to-grave transactional processing without touching the data
- Key Benefits and Differentiators
  - Created by a Family Office for Family Offices
  - Where the design premise started with best practice business rules, process and workflow
  - Granular, permissioned user access for optimization, transparency and accountability
  - Designed to significantly reduce staffing and operating costs
  - Built-in daily data aggregation and consolidated data approach
  - System scalability
  - Risk mitigation through integrated audit and compliance
  - Effective collaboration platform
  - Lower cost than a best-of-breed application/integration approach

Many family offices are trying to bring their infrastructure into the 21st century, but unfortunately the market hasn't delivered a platform to make that possible, until now. Eton Solutions through it's AtlasFive platform, delivers a next generation, end-to-end platform built for a Family Office, by a Family Office, specifically to meet that objective.

The AtlasFive platform starts with the creation of best practice business rules, processes and workflows needed to operate the business. With this as the foundation, the functionality a Family Office needs was built on single database to create a fully integrated, end-to-end platform. All of this delivered in a SaaS way to provide the business continuity, disaster recovery and security that the 21stC Family Office needs.