Family Governance and Wealth Planning

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Many financially successful, high net worth individuals engage an advisor to help answer important questions around protecting and transferring their wealth to their children and future generations. They often have questions such as: "How much is enough?", "When is the right time to tell our children about our wealth?" and "How do I prevent our wealth from disappearing by our grandchildren's generation?" Although investment management and estate planning solutions are certainly pivotal to answering these questions, family governance strategies can be equally important in preparing the family for the money, not just the money for the family.

Wealth Trends Today

Why is this topic particularly relevant today? On the positive side, people are living longer, adding many years between the building of a family's wealth and its passing to the next generation. Children may in fact be parents, and even grandparents, before they inherit, giving families plenty of time to discuss with children and grandchildren how family wealth should be handled well into the future. On the negative side, with an estimated 45% to 50% of first marriages ending in divorce[1], family structures have become increasingly complicated, with parents often having children from different marriages and sons- and daughters-in-law joining and leaving the family picture.

Despite the unprecedented market turmoil of the past year, the amount of money passed to the next generation continues to increase annually, and is estimated to reach $41 trillion over the next 40 years[2]. That means a lot of very wealthy people are now — or soon will be — struggling to find a way to create a family legacy that will survive multiple generations.

[1] *Source: Linda A. Jacobsen and Mark Mather, "U.S. Economic and Social Trends Since 2000," Population Bulletin 65, no. 1 (2010).*
[2] *According to studies by Paul Schervish, director of the Center on Wealth and Philanthropy at Boston College.*

Three Wealth Planning Questions

In thinking about preparing their children for the money, many wealthy parents ask, "How much is enough?" While assigning a dollar answer to that question may be impossible, families who define their wealth and make decisions about it differently can improve the chances that, whatever the dollar amount, their financial legacy will be preserved.

The second question is, "When do we tell our children what they might be receiving, and how and when they'll be receiving it?" Parents worry that if they tell children too early, they risk creating a sense of expectation and entitlement that could discourage their children from pursuing fulfilling careers. On the other hand, waiting too long may mean missing an opportunity to help prepare the children for the money they're going to receive. A specific age may not be the answer, but rather a financial maturity — regardless of age — the children demonstrate to their parents.

The third question wealthy parents want answered is, "How do we break the paradigm of shirt sleeves to shirt sleeves in three generations?" What's remarkable about this paradigm is its universality: families starting from meager beginnings that are able to earn substantial wealth can end up with meager futures in a relatively short time. In the United States, very often wealthy individuals focus their attention on the estate tax, as if it were the only wealth transfer problem. But countries with no estate tax have similar wealth preservation issues. In fact, although estate planning is important, many other qualitative techniques can help to enhance a traditional wealth transfer plan.

These questions are both important and closely linked. But to address them holistically, we encourage families to establish a process for family decision making — also known as family governance — through a number of suggested exercises and ongoing discussions.

How Much is Enough?

Defining Wealth Differently

In his seminal book, Family Wealth, James E. Hughes, Jr., an estate planning attorney for high net worth families, found that most of the families he worked with were spending a great deal of time preparing the money for the family, but almost no time preparing the family for the money. Hughes searched worldwide in his effort to identify families who were effectively preparing the next generation for their family's wealth. Of all the families he met, only about ten percent were adequately preparing the heirs. Of these families, he discovered two key differences between them and the other families he had met. First they defined their wealth differently; they viewed it not solely in financial terms. Secondly, they made decisions related to their wealth differently.

Wealthy families who successfully passed their assets on for many generations tended to have a broad definition of their wealth, taking into account both financial and non-financial factors. Distinguishing and valuing each family member's unique contributions is an important step in looking beyond the pure financial aspect of family wealth.

Four Types of Capital

According to Hughes, by applying a broader definition of wealth, families who work toward preparing the next generation for the money tend to foster four types of capital, which, combined, define their wealth.

The first type is human capital, which Hughes defined as what makes the individuals in a family unique. A family may set aside a half day of their vacation to have a family meeting, spending the first hour talking about the human capital in the family and how it has grown since last year. Because money is not the topic, spouses can be brought into that discussion as soon as they marry into the family.

The second type of capital is intellectual capital, which is not where you went to school, but whether your family has a process of transferring life experiences from one generation to the next. The stories from these life experiences may relate to the family's heritage, traditions, or faith.

The third type is social capital, defined as how a family demonstrates what it stands for in terms of responsibility, values and purpose. Philanthropy can be a very powerful tool in developing a family's social capital.

Financial capital may be the easiest to define, but the most challenging to discuss

The last type of capital is financial, which may be the easiest to define, but the most challenging to discuss. In many cases, the family's financial capital is only discussed between the parents and their advisors, as they work together to create an effective investment management strategy and estate plan. Since the children often are excluded from these conversations, they may miss the opportunity to understand or participate in critical decisions about the family's financial wealth.

When these discussions are initiated effectively, families will discover that certain values are shared by all family members. But there can be surprises too. It can be enlightening, especially for parents who may assume they understand the values their children hold dear. These initial discussions begin to introduce the concepts of family governance.

Family Mission Statements

One way families can help identify and appreciate the broader definition of capital is through a family mission statement, a valuable tool for both defining the full range of a family's wealth and collaborating on how it will be used in the near term and in the future. Writing such a statement should be an inclusive process that begins with each family member creating a personal mission statement. Working together, the family then layers their individual statements to identify overlaps and recognize the uniqueness of each family member. Many family mission statements include a historical family biography which helps children understand how family values contributed to the creation of the wealth, how it is invested, and how it has been used to promote the family's philanthropic goals. Most family mission statements will also examine the relationship between financial capital and individual initiative, addressing how family members can enjoy the benefits of wealth while leading productive lives.

When Should We Talk to Our Children About Money?

The second question for which wealthy parents want an answer is, “When do we tell our children what they might be receiving, and when and how they’re going to receive it?”

But some similar questions may serve families better, for instance: “What capabilities would we like our children to have before we discuss family wealth with them?” “What confidence would we like them to be demonstrating?”

Decision Making and Communication Styles

Another characteristic of families who more effectively prepare the family for the money is the way they make decisions about their wealth. Many families practice vertical, or hierarchical, decision making with one or two people making the bulk of the decisions, often behind closed doors. Sadly, in such families the first major decision that children make together regarding wealth may be around settling their parents’ estate. At that point, not only are the children older and possibly have grown apart, but some or all of them may be married, with spouses further complicating the situation.

As an alternative approach, families can practice horizontal decision making by including children early on in some basic financial decisions. For example, parents can encourage their children to work together to invest the funds for an upcoming family vacation. Older children with knowledge of investment fundamentals can work with younger siblings to make decisions with a tangible outcome.

It is important to note that the success of these family discussions can be affected by the individuals’ communication styles. One way to learn about these communication styles is to have a family wealth expert administer one of several communication skills tests, which help each family member determine his or her style of communication and how to use it as a strength rather than an impediment.

Children and Philanthropy

Initiating a meaningful discussion about philanthropy is another significant way to get children making decisions together. Parents might give each child an amount to donate to charity, with the children making a small match of their own savings. Or siblings may be asked to discuss and agree together on the organization receiving the donation from a donor advised fund. Additionally, many organizations welcome children’s participation in volunteer activities, another way to unite family members as they work together toward a common goal. As long as the parents aren’t dictating the whole plan, philanthropy is almost always an overwhelmingly positive experience. Community foundations can be a great resource for this type of giving, often organizing events where families can bring their children to meet and learn from each other about philanthropy. In many cases, the powerful benefits a family achieves by building these connections can rival even the best estate plan.

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Trusts as Family Endowments

Establishing trust structures that distribute money to children at age 30, 35, or 40 is common among high net worth families. The idea, theoretically, is that by the time the children reach these ages, they will have gained financial maturity. Unfortunately, these trusts may instead create an attitude of entitlement in the next generation. Although they are designed to protect money long term, in some cases, they have the opposite effect.

Parents and grandparents can choose instead to create a trust that distributes funds during their lifetimes and treat this trust more like a family endowment. Together the family can create an application that asks how the money is to be used as an investment in the children's human, intellectual, social or financial capital. The children need to view that money as an investment in themselves, not a distribution to them. As children start to demonstrate financial maturity with regard to this trust, parents or grandparents can be assured that the children are ready to hear more about the family's financial situation and to begin taking a larger role in family wealth decisions.

How Do We Prevent the Shirtsleeves to Shirtsleeves Phenomenon?

"Shirtsleeves to shirtsleeves in three generations" is a paradigm recognized throughout the world. The first generation creates the wealth, the second can either build on that financial success or, more likely, begin to whittle it away, and by the third generation, in many cases, the wealth is gone.

Preparing the money for the kids and the kids for the money are two sides of the same wealth preservation coin. Solid investment and wealth planning advice and execution are, of course, key to preserving, growing and transferring wealth. But the suggestions discussed above — defining wealth differently, writing a family mission statement, using horizontal decision making, incorporating philanthropy and fostering financial maturity — are ways to involve children early on in family wealth decisions, ultimately preparing them to preserve both the family's values and its wealth for many generations to come. Family governance creates a foundation for families to begin to discuss these and other important questions that in turn effect wealth planning.

Keys to Family Governance

- Define wealth differently
- Collaborate on writing a family mission statement
- Practice horizontal decision making
- Incorporate philanthropy
- Foster financial maturity

Conclusion

Many families divide considerations about their financial wealth into two categories: investment and wealth planning, and preparing their family for the money that they will some day inherit. Mental barriers are built between the two and, rather than working together, each is less effective than it could be. Instead, communication, family values, and philanthropy should be continuously linked to a family's wealth planning, a process that can help to foster family continuity, harmony and increased multigenerational wealth.

About the Author

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Mr. Rogerson has worked with top U.S. law, accounting, insurance and investment firms, educating, motivating and training their employees, prospects and clients on advanced financial and estate planning strategies. He continues to be invited to speak to wealthy individuals, business owners, and board members of universities, hospitals and charitable organizations throughout the country. His audiences include: Harvard University Business School, The World Presidents' Organization, Council for Advancement and Support of Education, National Society of Fund Raising Executives, as well as many others.

Mr. Rogerson's professional history includes serving as director of marketing for State Street Global Advisors' Trust & Investments group. Prior to that, Mr. Rogerson worked for Coopers & Lybrand, LLP, where he was responsible for creating the firm's estate tax and financial planning practice in the Boston area, and also served for seven years at Merrill Lynch in varying capacities including head of the Boston office's retirement planning services.

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