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# The Dynamics of Successful Family Wealth Transfers

## Notes From the Field



# Overview

The family office is increasingly a preferred vehicle for centralizing the stewardship of family assets across multiple generations. When coupled with a variety of family wealth transfer techniques, ranging from the cutting edge to the traditional and long established, a family office can provide the benefits of centralized wealth management, efficiency and privacy while safeguarding a family's financial legacy.

However, even with the growing importance of family offices among ultra-high-net-worth families, issues relating to the formal governance of families and family offices are often overlooked. While family offices and centralized family wealth transfer plans are created with the intention of preserving wealth and family cohesion for future generations, poor planning and a wide array of potential pitfalls can derail those plans.

Cross-generational family assets generally result from the endeavors of visionary entrepreneurs and business leaders. Although these founding family members may be well versed in corporate governance and business management issues, family governance is more complex. Family governance requires fostering consensus among disparate family members, who may have different expectations for the allocation of the family's assets. The challenges to family unity are more pronounced than ever as family members are increasingly geographically dispersed, and generational differences in investment and philanthropic philosophies can fracture a coherent family vision. Even beyond the success of a family's investment strategy, the preservation of generational wealth depends on critical internal family dynamics. This paper outlines considerations for success in developing effective family governance, identifies common pitfalls from the field and highlights potential functions of the family office – beyond serving as an investment manager – that can foster inter-generational cohesion and empower and position successive generations to continue to build the family's assets.

## Considerations for Success

Effective wealth stewardship requires attention to a family's culture and a plan for the development of family cohesion in successive generations, through relationship building, information sharing and attention to family governance. Building culture and cohesion helps to align disparate family members' values and investment priorities, while mitigating the potential that conflicts will arise among them. Established governance processes within the family can help promote a coherent vision and set of objectives and facilitate smooth leadership transitions across successive generations. Formal governance structures involving family members and external advisors, such as advisory committees or boards of directors, can help facilitate the discussion of issues among family members and reduce friction that may arise from emotional business and financial decisions.

## Avoiding Common Pitfalls

Divergent values and financial objectives among family members can dissipate a family's assets. Particularly as successive generations become more removed from the generation that accumulated the initial wealth, a sense of entitlement and lack of familial ties can threaten the success of generational wealth transfers. Leadership that encourages transparency within the family and buy-in of a shared philosophy across the generations can help overcome these pitfalls.

## The Role of the Family Office

In order to promote a sense of family cohesion, the family office should play a role beyond that of investment manager. The family office should be viewed as a vehicle for consensus building, the transmission of family culture and values, and communication of information. Some family offices establish an internal family bank and provide education programs to support entrepreneurship among younger generations. Moreover, effective family governance, using the resources of a family office, can promote efficiency through centralized management of the family's philanthropy, risk management, personal budgeting and other concierge services.

This paper also examines considerations for establishing effective cross-generational wealth transfers and family office governance that can help to preserve and grow a family's assets. We refer generally to "family offices" in this paper, although we recognize the wide variation in structural approaches that can be taken by different families, from the establishment of formal legal entities at one end of the spectrum to an informal collection of family members at the other.



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# Considerations for Success – Culture and Information



The fundamental dynamic in cross-generational wealth transfer planning is the tension between transparency among family members – that is, the provision of and access to information about the family’s finances and investments – and the control of information and assets by the senior generations.

Building cohesion and culture among family members requires information, as well as trust, but that trust has to extend across generations, as well as among members of the same generation.

## What Is G1 Willing to Share and When?

The dynamics between parents and their children are perhaps uniquely complex among all human interactions, and are well beyond the scope of this paper. However, in looking at how families plan for cross-generational wealth transfers, we continually return in our practice to a very small list of fundamental questions: What is the senior generation (G1) willing to do and when? How much information is G1 willing to share – with G2 or G3? How will G1 answer the “Are we rich?” and “How much money do we have?” questions? At what ages will members of succeeding generations be provided with participation in, or even access to information about, the family’s decision-making processes? And at what point will members of succeeding generations be given control over any portion of their inheritances? The answers to this suite of questions can establish the framework for a family’s wealth transfer planning for generations to come.

## Considerations for Success – Culture and Cohesion

In our experience, successful multi-generational wealth transfers depend on family culture and family cohesion more than any other factors. Families that are able to articulate and communicate a family culture and a sense of mission build the connections and relationships among generations and across members of the same generations that provide the “glue” that keeps families functioning as a unit. All too frequently, one sees families splinter – and their assets dissipate – as succeeding generations fail to maintain the connections and relationships necessary to continue to shepherd their family’s wealth collectively, especially when faced with economic or family stresses.

But building this cohesion takes effort and communication – and requires trust, information, cooperation, and the ability and willingness to recognize and accept the different strengths and weaknesses of family members. Successful family offices and family groups use a variety of tools to build family culture and develop that critical element of cohesion.

## Communication

Open and regular communication is a key element in building cohesion and connections among family members. Whether it is financial or business information or the more quotidian news that any family shares, regular intra-family communication supports the development of cohesion and the transmission of culture. It is critically important, as a family’s wealth moves from G1 and G2 to G3 and beyond, that family members know each other and feel a sense of connection, both to each other and more broadly to the family as an “institution.” The opportunity to tell the family’s story to succeeding generations, and to transmit the core elements of a family’s values to those generations, provides some of the “glue” that is essential to keeping families together over time. Family offices can play a central role in facilitating this communication, and the proliferation and widespread acceptance of social media provides family members with an expanded range of additional platforms and methods to maintain connectivity with each other.

Building cohesion through communication can help instill a sense of shared heritage and mission among family members, and can foster connections among and across the generations. These connections, when formed early and maintained over time, are invaluable when a “junior” generation succeeds to family leadership and its members must have trust in each other, as well

as familiarity with each other's strengths, weaknesses and foibles, in order to assume the stewardship of their family's wealth. It is much more difficult to try to build those connections in what can be the emotionally charged circumstances of the point of succession: family members who have deeply rooted connections with each other and with their family's mission are far better positioned for a seamless transition than those who are less connected with each other, and thus are more likely to be able to preserve the economic unity of a family across a generational transition.

## Family Retreats

Many families find that a regular program of family retreats can build culture and cohesion, through the formal sharing of information and ideas, and simply from spending time together. Family retreats can provide a platform for family members to create alignment to existing goals, report on progress, educate and to make important decisions. Successful family retreats often involve an educational component, frequently on financial or philanthropic matters, and can provide succeeding generations with a greater sense of familiarization with the family's businesses and investments and with their fellow family members. Some families use an "annual report" approach to provide "State of the Family" information in advance of the family's annual retreat. The annual report can provide a mechanism for the senior family members to communicate the state of the family "business," the state of the family and their aspirations for the years ahead.

Programming at family retreats can include presentations from the family office professionals and outside investment managers, to provide portfolio updates and performance information, and from philanthropic leaders, as well as recreational activities and team-building exercises. Expanding the scope of a family retreat to include members of younger generations can provide opportunities for social activities that can lay the foundation for relationships that will be valuable inside the family for years to come. And families with operating businesses can often use the retreat format to provide an opportunity to familiarize members of the family who are not involved in the business with the products and operations of their family's business, through site visits, meetings with management and similar activities. Annual family retreats often resemble a cross between a family vacation and a shareholder meeting, while monthly or quarterly update meetings tend to be short and focused on financial results. The choice of location of the family retreat can be an important success factor as well. While there is no single "ideal" location for a family meeting, family office professionals typically avoid family homes or family business offices, as those locations are rarely "neutral ground." A destination hotel resort with business conference room access can provide a more ideal combination of privacy, recreation, neutrality and formality.<sup>1</sup>

## Participation

One of the most vexing questions families face when trying to plan for generational wealth transfers is, "When should members of junior generations become involved in decision-making processes regarding the family's assets?" This question is deeply rooted in the issues of control, transparency and communication discussed above, and every family has a different philosophy on how to address it. In looking at families that have successfully managed generational wealth transfers, one of the tools that has been successful is the establishment of one or more "subfunds" as to which allocations and management is overseen by a junior generation. We have seen examples of successful "cousins' funds," where the senior members of a family make a separate allocation of assets that will be managed by members of a junior generation, who are tasked with determining asset allocations, investment return parameters and targeted investment classes, and with making formal reports to the family as part of the family's overall investment reporting. These subfunds can be set aside specifically for venture investments, social impact investing or any of a number of other investment approaches. A similar approach is to establish a philanthropic or grant-making fund to be overseen by members of a junior generation along the same lines. In either case, the goal is to build investment oversight experience among the junior generation, and – perhaps more importantly – to familiarize the members of that younger generation with each other and with their family's broader investment philosophy and goals, as well as to accustom them to working collaboratively with each other (and with the professionals in their family office), before they have to take over the reins of the family's wealth more comprehensively.

Families with operating businesses have an additional set of challenges, as they must manage the participation of family members not just in the process of overseeing investment decisions, but also in the management of an active business. As the spread of generations increases the number of potential family members who might seek a role in management, families find themselves in the sometimes awkward position of having to choose among themselves to allocate roles and responsibilities in operating companies, and to deal with the associated issues of promotion, compensation and the like. Some families make the decision early in the generational lifecycle of a business to turn to external management, with the family retaining ownership and, perhaps, board roles. Conversely, other families have taken the "independent trustee" approach and have included non-family members on their businesses' boards of directors. This approach allows a subset of the board to act as the intermediary between the family stakeholders and the family member or members who have management roles in the business. Trusted and respected non-family member directors can help lead a family through difficult business or management decisions, or through unexpected management transitions, by providing some measure of emotional detachment in what can be very fraught situations.

<sup>1</sup> My thanks to Edward Marshall, Director – Family Office Group, Citi Private Bank, for his valuable input on the family retreat and family bank discussions in this paper.

Notwithstanding the challenges, many families have been able to successfully identify family members in successive generations to take leadership roles in family businesses. This identification process can be undertaken with varying levels of formality, ranging from consensus-style decision-making by senior members of the family (a “council of elders” approach) to the retention of executive search consultants to review and analyze the qualifications and capabilities of potential executive leaders from within the family (or a combination search of both family and non-family members). In some families with very successful cross-generational family controlled businesses, the family has developed formal guidelines to provide a process for family members who wish to work in the business, setting forth minimum educational and work qualifications (often involving work experience outside the family business) for family members seeking to join the family enterprise and an application process specific to them.

## Family Governance

In almost no aspect of the family wealth dynamic is there as wide a range of approaches taken than those relating to family governance. Decision-making – difficult enough among siblings – grows vastly in complexity with transfers of wealth to children and beyond, as cousins and their descendants proliferate, bringing additional numbers of voices to the discussion, and who might be spread across geographies and have had widely different upbringings. In many parts of the world, where the extended family as a societal unit has long been the norm, a traditional “family council” or similar approach has shown itself to be easily transmuted to the generational wealth preservation role, and families have been able to adapt what is a traditional cultural element to their management of family wealth across generations. Even in this cultural context, families are increasingly finding value in memorializing the structure and governance of a traditional family councils in written documents such as “family charters” or “family constitutions.”

In other cultural settings, where the nuclear family is the more typical family unit, familiar legal structures, such as trusts and partnerships, have long been familiar vehicles for ownership of assets and for asset protection across generations. As families now increasingly use family legal entities such as partnerships and holding companies to own and direct the management of their assets across generations, they and their advisors must undertake careful planning to anticipate and address the governance and succession issues that inevitably arise as the generations unfold. The use of a legal entity can provide the means for formalizing thorny governance and succession questions by establishing a framework for the composition and selection of governance bodies, and for allocating voting rights among elements of the family and providing criteria for distributions. As is the case with operating businesses, families often look to independent trustees or directors to participate in the governance of their family entities, even those that are purely investment holding vehicles, in order to provide external perspectives and to add an element of independent judgment to the governance process. This can be especially valuable when a family engages in strategic planning processes around overall investment strategy, succession planning and the like.





# Pitfalls From the Field



## The Entitlement Trap

Recognizing and taking steps to address the “entitlement trap” is a challenge that is as old as the family unit itself.

The problems that can be caused within a family unit by the entitled child of privilege, and the intra-family resentments that can be created by the proverbial “prodigal son,” do not admit of any easy solution.

Families that are sensitive to this issue struggle to inculcate a sense of responsibility, discipline and balance in their children, who grow up in conditions of privilege, and to convey to them the message that creating and maintaining wealth is difficult and requires work and dedication. Communication among the wider family group, and with it the transmission of family heritage and values, has helped families instill a sense of broader responsibility and purpose in succeeding generations. Likewise, providing visibility into the work required to oversee and direct a family’s investments, and even providing early opportunities to participate in that investment oversight process, can help convey a sense of what is involved in the stewardship of family wealth. Family retreats and other avenues for education can help families prepare junior generations for their roles as responsible stewards.

## The “Problem Child” Problem

An equally perennial issue for wealthy families is how best to address the circumstances created by the problem child, and the ripple effects caused in a family arising from criminal behavior, substance abuse or similar issues, improvident personal relationships, or other problematic personal matters. A structured approach to wealth preservation and generational wealth transfers can provide some insulation against the financial effects of problem child behavior, by interposing legal protections and formal entity structures between the problematic family member and the family’s assets. Analogous to this problem are the complications that can arise from divorce, remarriage and multiple marriages, as families look to navigate the sometimes difficult wealth transfer and succession issues involving ex-spouses and step- and half-siblings. A family that has a rigid tradition of fixed succession parameters (first-born child, eldest son or any similar formulaic approach) is especially vulnerable to problem child risk, as it does not have either a history of, or any commonly accepted process for, dealing with leadership succession when that mechanical approach produces a patently unsuitable candidate for family leadership.

This unsuitability can manifest itself in ways that are less dramatic, but equally require an ability to come to a consensus within the family regarding the leadership of the family or a family business enterprise. It can be a difficult and painful process for a family – and, particularly, the family member in question – to accept that a family member is not suited for the role that traditionally had devolved on the person with his or her position in the family. Trusted outside advisers and family office professionals can play a crucial role in effecting the changes in leadership that those situations require.

## Lack of Connection

While the entitlement trap and the black sheep problem focus on issues relating to individual family members, the issues caused by lack of connection among family members are both less obvious and more insidious. As discussed above, transmitting culture and fostering cohesion are key elements in creating the connectivity that keeps wealthy families from splintering over time. It is a huge challenge for a family whose successor generations do not have that sense of connectivity to deal with family leadership succession and to find a common ground from which to work collaboratively to steward their family’s wealth. That sense of connection is extremely difficult to manufacture when needed – it either is developed organically over many years of planned and purposeful communication and engagement or, in most cases, it simply will not exist. In our experience, families that are unable to develop and maintain that connection across the

generations are much more likely to fracture over time, leading, at a minimum, to the “Balkanization” of a formerly unified vehicle of family wealth into a number of much smaller, separate units and, at worst, to the dissipation of family assets in protracted, painful and expensive intra-family litigation. Building relationships among members of successive generations early gives them the mutual familiarity and relationships that allow for cohesion and resilience in the face of change and transition.

## Alignment of Goals

Part of maintaining unity and successfully stewarding wealth across generations is communicating a sense of unified mission and shared goals to family members in those successive generations. This, in turn, can require a family to periodically undertake a process of identifying and assessing those goals and ensuring that they remain aligned with the goals and objectives of those new generations. Family leadership needs to recognize that successive generations may have different values and priorities than those of their predecessors. In recent years, we have found that this value shift has frequently manifested itself in junior generations’ strong interest in impact investing – for example, in environmental and social governance projects – with such interest being reflected in both venture investment projects and philanthropic priorities. As the Millennial generation comes to the fore, families seeking engagement with their Millennial family members increasingly look to strategies such as impact investment to find a basis for alignment of goals, connection and a sense of family mission and purpose.

Conversely, the failure to transmit that sense of family connection and purpose, and the failure to develop an alignment of goals across generations, can lead to fracture and disunity. Members of a junior generation who do not feel that their voices are heard or that their goals are taken into consideration are less likely to feel a sense of engagement with, and connection and commitment to, the family as a unitary cross-generational entity, and thus, are less likely to maintain that unitary family when they succeed to seniority.

The failure to find alignment and compromise regarding investment strategy and goals among family members, even absent generational shifts in emphasis, can be equally problematic. For example, one member of the family may be interested in short-term liquidity to finance lifestyle ambitions, while other family members might be more interested in holding investments for longer-term wealth creation, or to enable substantial philanthropic endowments or the like. Misalignment can also occur when there is a pressure from a family member to devote significant family assets to a vanity project: investing in an asset that is not of interest to the family members more generally, or engaging in high-profile and expensive philanthropic or political activity. Finding a way to mediate these individual priorities in the context of a more broadly based family strategy can take creativity, patience and no small measure of diplomacy.

## Training and Education

A family puts wealth preservation at risk when successor family members have not been prepared for their stewardship roles. That preparation can take many forms, depending on the specifics of the family and its assets, but without adequate training and education, successor generations can find themselves in positions of responsibility for their family’s wealth without having been provided with the tools to discharge that responsibility successfully. In our practice, we have seen family education and training events cover a wide range of topics, depending on the family and its particular activities. Families frequently use educational programming to provide family members with a measure of basic financial literacy on investment and accounting topics, but also use training and education sessions to provide family members with a fundamental understanding of the family’s operating businesses and philanthropic activities.

## Assumptions and Expectations

Among the most challenging and sensitive issues in effective generational wealth transfers are those arising out of assumptions and expectations concerning family members’ roles. These issues can arise in various contexts, but in each case, demonstrate the importance of open and honest assessment of skills and aptitude when considering family governance. Assumptions regarding roles of, and expectations for, sons versus daughters can be a challenging mindset to change, and can vary widely across cultures. Family-controlled businesses that have “always” had a family member as CEO can be faced with difficult succession issues where there is no suitable family candidate, particularly where a family member has an expectation of assuming that role. Conversely, a family member can feel an obligation, because of those same assumptions and expectations, to assume a role for which he or she is not suited and that would be better filled by an outside executive. The addition of sons- and daughters-in-law to the mix can make those succession questions even more complex.

# The Role of the Family Office



## Beyond Investment Management

Family office professionals increasingly find themselves filling broader roles in the process of stewardship of family assets than the traditional functions of investment management and bookkeeping.

With these broader roles has come a realization that family office leadership can require an additional range of skill sets than previously considered. In the role of facilitator and convener of families, the family office can play a central role in guiding a family through the process of consensus building, values-setting and the transmission of a family's culture and values, in much the same way as a private foundation's leadership is central to the communication and transmission of the foundation's mission and history, in addition to the stewardship of its assets.

## Information Hub

The family office is often, in its investment management role, the clearinghouse for family financial information. The family office will typically be responsible for coordinating the collection, collation and dissemination of information regarding the family's investments and performance. In that role, the family office will be the source for information for the family and, therefore, it is of critical importance that the financial information disseminated by the family office be transparent, accurate and verifiable. For that reason, many family offices undertake the organization and review of that audit or verification function centrally, on behalf of all of the family members.

The family office can likewise be the hub for sharing a range of information, not just investment results. Using social media and other technologies, the family office can perform a valuable role in maintaining connections among far-flung family members, and can serve as a repository of family history and experience. As "convener" and "communicator" the family office can serve as a brain trust to succeeding generations as they consider new business ventures, personal investments or commercial relationships, facilitating intra-family connections for information-sharing on a wide range of topics and acting as a central repository of the family's prior relationships and experience with external service providers and vendors.

## Training and Education

Along with organizing, analyzing and communicating financial information and investment performance results, the family office can play a valuable role in planning and coordinating family retreats and other educational and training activities. Many families combine a tradition of family retreats with a regular program of seminars and other educational sessions for family members. Depending on which generation is being addressed, these educational sessions can develop familiarity with basic financial and investment topics, and frequently involve interviews and teach-ins with the family's investment managers and other topics related to financial and risk management matters. For families that have active operating businesses, the family office can help coordinate the process of familiarizing family members with those businesses and assist in preparing family members for roles at the board or management level. For families that have a program of regular family retreats, the family office is typically responsible for the preparation of family meeting materials and meeting planning, sometimes in conjunction with outside consultants or meeting facilitators.

## Risk Management

A family office's most important role is to protect the assets of the family it serves. Beyond investment management, families are increasingly looking to their family office professionals to advise on risk management issues more generally. In this risk management function, family offices can, for example, review a family's overall suite of personal and business insurance coverages, and work with insurance advisors to optimize coverage and cost,

while reducing exposure for the family as a whole. Increasingly, families are concerned with cybersecurity, data privacy and identity protection, and family offices are acting as the central hub for data protection services for their families, even coordinating the establishment of family IT networks and information security for a family's computers and smart devices around the world.

## Ancillary Services

Beyond investment management, family offices have historically provided a range of related services, such as bookkeeping and bill-paying, and overseeing tax return preparation. In our practice, we find our global families looking to family offices and their advisers to assist in an increasingly wide range of other ancillary services. These can include arranging the vetting and hiring of household staff, philanthropy management, assisting with personal budgeting and providing "concierge" services such as vacation home management, travel planning, aircraft rental and the like. As described above, families are also increasingly responding to data security concerns by looking to centralize their personal technology, with group cell phone plans covering multiple generations of family members and their personal devices, family websites and private networks.

## Family Bank

Inevitably, families with substantial means will be the recipients of seemingly endless requests for investments or loans from business associates or others seeking capital, as well as for philanthropic donations. The family office can serve a key role as a gatekeeper and evaluator of those requests and, by interposing itself between the family and those seeking funding or donations, provide a helpful element of objectivity, distance and, if need be, deniability for the family members. Perhaps even more valuable is the role the family office can play in addressing those same kinds of requests from family members, which inevitably are more emotionally charged and more difficult to address as purely business propositions.

Many families will earmark an amount of funds for intra-family disbursement as the "family bank," to finance everything from purchases of residences or other personal property to investments in business ventures and, in coordination with family office executives, create a systematic process through which family members can request funds for identified projects. A family bank can provide a way for a family to build cohesion across generations, encourage intra-family collaboration, expand financial literacy, instill family values, prepare future generations for leadership and encourage innovation. The funding of business ventures can be combined

with entrepreneurship or other financial education programming. Project selection can be done by family office professionals or by a family committee, either of which selects the "best" projects and works with the recipients to ensure success and accountability. The interposition of family office professionals in the process can add a measure of objectivity to the intra-family lending dynamic, lessen the inevitable potential for discord, ensure appropriate legal protections for the family lenders and optimize the tax effects of such transactions.

The family office can play a critical role in establishing criteria for funding requests of various kinds and, by establishing those criteria and a process for intra-family funding, can help avoid difficult inter-personal issues that can otherwise frequently arise from these transactions. This establishment of a funding process, and appropriate legal documentation for various types of funding transactions, can have the further benefit of ensuring that those transactions can be appropriately vetted by legal and tax counsel and can be audited as part of the family's overall asset monitoring. Creating "market standard" documentation to evidence intra-family loan and investment transactions can protect family members from potential creditor claims, legal questions arising from ambiguous documents, and potential gift tax and other tax issues arising from non-arm's-length transactions among family members.

## Conclusion

In our practice, we see our clients around the world looking to address the two critical elements of successful stewardship of family assets across multiple generations: family culture and family cohesion. Although the approaches that different families take can vary widely, and cultural norms can influence those approaches as much, if not more, than legal structures and financial planning, almost all families seek ways of building cohesion across generations to maintain family cohesion as stewardship of the family's assets passes to succeeding generations. The range of potential pitfalls to effective family wealth transfer are seemingly endless, but the family office can play an important role in supporting a number of the most critical elements of successful generational wealth planning. By being the family's information hub, convener and intermediary, a successful family office can provide the structure, training and management that can bridge the generations and can provide a path for family succession, moderate challenges to intra-family unity and support the successful stewardship of family wealth.

