

# Increasing the Odds of Successful Wealth Transition

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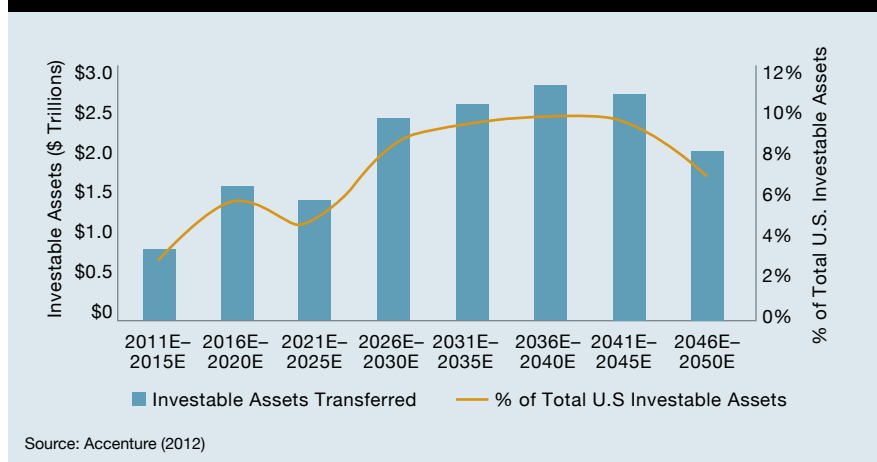
North America is in the early stages of a massive intergenerational wealth transfer with almost \$1 trillion changing hands each year, and this may be just the tip of the iceberg. Accenture (2012) suggests that a “great transfer” from the Depression-era generation to baby boomers is taking place now, but a second and even-larger wealth transfer from boomers to their heirs will continue over the next 30–40 years (see figure 1).

This all seems like good news, but many of these wealth transfers ultimately will be unsuccessful and will reinforce the maxim of “shirtsleeves to shirtsleeves in three generations.” Experts agree that the main reasons for this unhappy record are lack of planning, lack of preparation, and poor execution.

A U.S. Trust study (2013, 38) of high-net-worth families found that 72 percent of wealthy families do not have a comprehensive estate plan. Without planning, wealth can be destroyed by taxes, inflation, poor performance, investing errors, fraud, and overspending, not to mention the natural dilution of family wealth as the number of generations grows. This series of challenges has become more acute in recent years with the increase in complexity, speed, and globalization in both capital markets and family life.

The need for preparation and planning extends beyond financial, tax, and investment strategies. It extends to preparing the heirs—the recipients of intergenerational wealth transfer—to ensure they are well-equipped to

**Figure 1: U.S. Investable Assets Transferred by Year**



receive it. Countless examples (and much literature) illustrate how money has created havoc in families by creating disincentive to work, family conflict, and anxiety.

Consider the contrasting stories of the Vanderbilt and Rothschild families. In the late 1800s, multi-billionaire Cornelius Vanderbilt employed legions of accountants and lawyers to create tax-efficient estate plans for his wealth. But he did not prepare his children to receive the massive fortune. Instead, he left a history of family bitterness (he left 90 percent of his fortune to one son and 10 percent to his wife and other children), overspending, and poor self-esteem. At the family reunion in 1973, no millionaires remained.

Banking magnate Sir Nathan Rothschild took a different and more successful path. He ensured the requisite tax, estate, and investment planning was in place, but he also inten-

tionally prepared his children (and future generations) to be independent, self-confident members of society, apart from their family wealth. He created robust organizational and decision-making processes in the family that included family communication and a solid set of shared values. His tools included a family bank to encourage entrepreneurial activities, mentoring of the next generation, annual family reunions where shared values were taught, explicit expectations for family participation in group activities, and active charitable engagement within the community. The family continues to thrive to this day (Zeeb and Zeeb 2009).

So what are the important lessons for a family that is managing wealth and contemplating an intergenerational wealth transfer? Families that incorporate three components into their planning—understanding and passing on family culture, developing and communicating family goals, and intention-

ally preparing the next generation—will increase the odds of meeting their goals and ensuring a successful transfer.

### Understanding and Passing On Family Culture

Wealth always has meant more than just money. In fact, the word wealth is derived from the Old and Middle English words *wela* and *weal*—more akin to the concept of welfare and well-being than to finance. It is important that heirs understand this broader picture of family wealth to be well-prepared as beneficiaries and potential leaders.

The first principle of wealth transition is understanding where a family has come from, where it wants to go, and how it wants to get there. This includes the family history, the origins of the wealth, cultural values of the family, and patterns of governance and personal relationships, as well as a vision for the future. Families rarely pause to think about what their wealth means or can accomplish for them. Only by understanding the context and the vision can a realistic and practical plan be developed and carried out, particularly for a shared pool of assets.

For instance, some families may have particular religious, cultural, or philanthropic values that should guide their wealth planning. Clear family values can establish how the family will act on the way to their long-term goals.

Some families are relatively straightforward and cooperative whereas other families have a history of complexity and difficulty. These relational aspects may drive whether assets are held in common and how governance is conducted.

Still other families may be very globally dispersed and will need to incorporate a variety of regulations, legal systems, languages, and currencies, not to mention cultures and communication styles.

Families may think about the next generation differently. Some will see the next generation as “owners” or “inheritors” of wealth and accept that the wealth is for their personal use. Other families view children as

“stewards” and see wealth as something to be tended for future generations. A family that aspires to be stewards is likely to take a longer-term perspective on the management and transition of wealth.

There is no right or wrong, but it is essential for families to have a conversation about their philosophies of wealth as they begin to think about the legacy of their wealth. A distribution and wealth-transfer policy itself can play a major role in shaping the family’s culture, values, and work ethic. Failure to clarify the family’s views about stewardship versus proprietorship, as well as the other contextual issues, may lead to misunderstandings, disappointments, and poor decisions. It also will detract from the ability to raise the next generation responsibly with wealth.

Of course multiple profiles, family groups, and objectives exist within any one family. Even if the money is managed as one pool, different investor profiles will be imbedded in that single pool, not to mention a wide range of needs, experience, sophistication, and risk tolerance. Some kind of central group, such as a family office or board of trustees, normally would be required to coordinate the management of the capital and the achievement of the group and individual family goals.

### Developing and Communicating Family Goals

The second principle is setting goals for the family and its wealth. An effective family wealth-planning process starts with the end in mind. It states clearly the objectives of the family and sets out to achieve those goals

with the highest possible probability of success and the least amount of risk. Most investors, prodded by the media and financial industry, still focus on the elusive search for the highest current return or try to beat a particular well-publicized benchmark.

Clear goals and good wealth management/transition plans are critical and will contribute immeasurably to the success and satisfaction of the family. Clarifying financial goals helps to determine clear priorities. It also helps make choices and allocate resources to specific priorities. A clear sense of goals also helps families stay on track and not be blown off course by the inevitable winds of the economy, markets, and family issues.

A helpful approach to goals-based wealth management is the lifetime and legacy approach. It categorizes families’ objectives (and the assets required to meet those goals) into two broad categories: lifetime and legacy.

Lifetime needs are those that will need to be funded during the lifetime of the owners. Typically, they also will be the highest priority and more near-term goals and can include maintaining current lifestyle, keeping an emergency reserve, funding children’s activities, and the like. A present-value calculation of net lifetime expenditures will generate an estimated amount of capital that will be required to fund them. This is an inexact science because of the difficulty of forecasting expected cash flows, but it does provide some guidance for the family on the order of magnitude of capital required.

## UNDERSTANDING AND PRESERVING FAMILY CULTURE

**Family history:** Telling stories of past generations can help ensure that family history is known by all beneficiaries and provides a way of linking family members together.

**Family values:** Engaging in a family-values discussion exercise can help ensure common reference points and principles on which decisions can be made for the common good of the family.

**Culture of stewardship:** The continued ability to maintain and grow assets over time will be dependent on beneficiaries understanding that they are managing assets for future generations, just as past generations did for them.

Once the lifetime objectives have been provided for, the balance of the capital is available for other purposes and to meet needs arising after the wealth owners' lifetime. Legacy goals typically include funding children, future generations, and charities, the key destinations of the expected wealth transfer. Assets designated for legacy purposes typically have very long-term horizons and can be invested with a higher risk profile and the potential for higher returns.

As the wealth management and transition plan is developed, cost estimates of all the goals will be needed to see if they all in fact are financially achievable given the family's asset base, investment capability, spending plans, and distribution objectives.

The lifetime and legacy construct translates nicely into a family balance sheet that combines the liabilities (goals) and the assets required to fund those goals. Table 1 shows a sample family balance sheet for a wealthy family.

Of course, effective execution is critical. Families must make reasonable assessments of expected returns on assets to fund liabilities, but a sound integrated wealth approach comprises many other components. They include good tax and estate planning, wise investment policy, asset allocation, manager selection, and careful risk management of a whole range of dangers facing most wealthy families such as loss of capital, inflation, volatility, overspending, divorce, legal challenges, tax increases, regime changes, and financial mismanagement. This planning also may include the hope or even expectation that wealth will continue to be regenerated by recurring entrepreneurial activities.

Families with legacy wealth must make a fundamental decision about how much of their money will go to the next generation and how much will go to future generations. As table 2 shows, current legacy capital of \$100 million can fund one generation of four children at \$25 million each, or 10 gen-

erations of more than 2,000 beneficiaries at almost \$50,000 each. (For simplicity, this assumes 1.8 children per beneficiary, 0-percent rate of return, and depletion of capital.)

The increasingly global nature of both the family's goals (i.e., the multiple locations of family members and their varying economic and cost-of-living outlooks) and the family assets (i.e., global investments, tax rates, and currencies) makes an already daunting challenge even more demanding. Trusted, expert advisors can play an important role in helping families manage these challenges and the critical handoff from one generation to the next.

### Preparing the Next Generation

The third principle is preparing and supporting the next generation for the wealth transfer. Families can prepare the next generations in at least three ways—education, engagement, and experience.

Intentional education and development of financial literacy is a key component of successful wealth transitions. This can range from dinner-table conversations about the value of money and the importance of budgeting to formal educational programs. The goal is to help the next generation, and those that follow, to be able to gain the skills, confidence, and independence they need to become functioning members of society and to be able to manage whatever wealth they ultimately may earn or inherit.

Thoughtful preparation and execution of a plan that sets out the timing, context, and

**Table 1: Sample Family Balance Sheet for a Wealthy Family**

Assets	(\$ Min)	Goals and Commitments	(\$ Min)
Homes	\$10	Lifetime allocation	\$25
Investments	\$20	Children	\$20
Business	\$70	Next generation	\$30
		Philanthropy	\$15
		Total Legacy allocation	\$65
		Total goals/commitments	\$90
		Surplus	\$10
<b>Total Assets</b>	<b>\$100</b>	<b>Total G&amp;C/Surplus</b>	<b>\$100</b>

Source: Northwood Family Office (2013)

**Table 2: Sample Number of Descendants and Distribution per Beneficiary**

Generations	Birth Year of Children of the Generation	Number of Beneficiaries Born into the Generation	Number of Living Beneficiaries from Previous Generations (over 18)	Number of Cumulative Beneficiaries	Lifetime Financial Distribution per Beneficiary
1	0	0	0	0	\$100,000,000
2	1971	4	4	4	\$25,000,000
3	2001	8	8	12	\$8,333,333
4	2031	16	12	28	\$3,579,429
5	2061	32	24	60	\$1,666,667
10	2211	1,024	768	2,044	\$48,924
15	2361	32,768	24,576	65,532	\$1,526
20	2511	1,048,576	786,432	2,097,148	\$48

Source: Northwood Family Office (2013)

messages sent is critical. Long before informing intended heirs about the magnitude of the family's wealth and their shares in that wealth, a phased program of communication should be introduced. It will involve talking and listening on both sides, and a discussion of the general benefits and burdens of wealth and the family's specific values and policies. It will review the long-term family plan, the governance or decision-making structure, and the financial skills and culture of responsibility and stewardship that will allow the wealth to continue. A family office or other thoughtful integrated advisor can help families develop this plan and help them diligently communicate it and execute it.

In families with legacy wealth, a tailored family financial education program also will need to inform and prepare family members with the information they require to fulfill their wealth management responsibilities. This can range from a high-level understanding of issues and options to a detailed understanding of the macro-economy and every asset class, manager, and product in the family portfolio.

A number of courses, books, and articles are available on the various elements of wealth management. *Family Wealth Management* (Daniell and McCullough 2013) may serve as a good overview of the key aspects of family wealth management and transition planning. Educational needs will vary over time, and an annual check on evolving needs and progress in responding to those needs should be part of the family's planning activities.

Another key aspect of beneficiary preparation is engagement of the next generation. Engagement is the degree to which individuals choose to spend time, invest effort, and feel a sense of ownership in the management of family wealth. It is hard for many to imagine that managing substantial family wealth, with all its benefits and advantages, can be seen as a burden rather than an opportunity. Yet for some, fund analysis, tax planning, investment selection, and risk management are areas of little expertise and daunting complexity. Creating shared

## QUESTIONS FOR FAMILIES TO ASK THEMSELVES

Who are we as a family?

- What is the history and culture of the family?
- How does that affect family relationships, goals, and decision-making processes?
- What is the family's vision for the future? How does the family ensure that the vision is realistic, achievable, and aligned with the family ethos?
- How do the current values and governance systems help or hinder the wealth management and transition process for the family?
- Is there strong alignment among family members? Is this necessary or even possible?

What are our goals and how will we accomplish them?

- What are the family goals?
- What is the balance between lifetime spending and legacy objectives?
- How much capital will be allocated to children vs. future generations? How many generations should be funded and by what amount?
- How much certainty does the family want that each set of goals will be met?
- Can all of the goals be afforded given current and expected assets and liabilities? Is there a gap between liabilities and assets? How will the gap be addressed? Will goals have to be prioritized or deferred?
- Should the assets be kept in one pool or divided by subfamily or individuals?
- How is the family balance sheet likely to change over time?

How do we prepare the next generation?

- What skills does the family need to develop within the younger generations?
- How much should the family invest in educational activities relative to investment management functions?
- How can the family engage the next generation in the work of building and sustaining family wealth and relationships?
- What family structures are most appropriate?
- What are the costs of disengagement?
- Who is responsible for the success of the generational wealth transfer?

emotional ownership and a substantive connection with an operating business may have its own challenges, but forging a motivational or even inspirational engagement with a portfolio of funds and trading accounts is even more difficult.

Family leaders who are well-tuned to the attitudes and interests of the younger members can help make the activities more engaging. Investment activities can become more visibly a part of a shared family activity (e.g., sitting on an investment committee), can be more fun (e.g., dividing the portfolio into two, with two teams competing for best results), or can become more relevant and meaningful (e.g., allowing beneficiaries to choose charitable projects for the family to fund). Some families choose to make involvement and engagement a precondition for distributions, and

the role is intertwined with a broader family responsibility.

A proactive financial education program and effective engagement in the family wealth management process will be valuable but no substitute for real-life experience. Allowing younger family members to work with an advisor to manage their own money, to participate actively in family meetings, to join an investment committee, and to direct some philanthropic funds all can contribute to good experience in family wealth management. These activities and experiences should be encouraged.

Failure is also an important part of experience. The more-difficult experiences help us to learn, to grow as individuals, and to develop the skills and instincts necessary for survival and prosperity.

Far too often great wealth deprives individuals of the experiences they need to grow into mature and independent adults; wealth all too often overprotects individuals from the real and the meaningful. Maturity can come late, if ever, to individuals and generations never facing a tough performance review, never striving to obtain a desired job, never testing skills in a real meritocracy, and not exposed to situations in which they need to manage without the outcome-controlling presence of financial wealth.

As one wealthy individual told us: “I don’t want my children to know that there is a big, comfortable safety net below them at all times. That can make them reckless and lack seriousness about what they need to learn and how they need to prepare for life.”

The high rate of failure in maintaining and transferring wealth across generations may be the fault of a massive underinvestment in one of the most critical areas for the enhancement of family wealth: the provision of effective education, engagement, and experience for inheriting generations. Family leaders and would-be stewards of family wealth might ask themselves two simple questions:

- Over the past year, how many hours have you spent structuring and managing family financial wealth?
- And how many hours have you spent preparing the recipients to be good owners of wealth?

As in so many aspects of family wealth management, the successful transfer of wealth across generations is a balance of family and financial principles. Addressing both in an integrated fashion is obviously the best way forward.

It is critical to both prepare the heirs for the money and prepare the money for the heirs. One without the other is likely to result in frustration and certainly will not accomplish the family’s goals. Families wishing to ensure that both family and funds survive and prosper over many generations will do well to pay close attention to both. They will want to invest the time to

understand family values and culture, to clearly determine and quantify family goals, and to prepare the next generation to be good beneficiaries and leaders. In so doing, they will increase the odds of success in a priceless, challenging pursuit. ●

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