



WRMarketplace

An AALU Washington Report



The WRMarketplace is created exclusively for AALU members by experts at Greenberg Traurig and the AALU staff, led by Jonathan M. Forster, Steven B. Lapidus, Martin Kalb, Richard A. Sirius, and Rebecca Manicone. WRMarketplace #17-42 was written by Greenberg Traurig Shareholder Karen D. Yardley.

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TOPIC: Family Governance – The Why, What, and How for Affluent Families.

MARKET TREND: Studies continue to identify that the successful transition of large family legacies involves families who embrace and implement family governance systems to preserve family values and provide continuity for future generations.

SYNOPSIS: Substantial evidence shows that, without adequate protections in place, wealth accumulated by one generation can be completely dissipated by the third or fourth generation. To avoid this outcome, wealthy families should implement family governance systems to maintain unity and prepare future generations to manage and preserve their legacy. While each family will have a unique governance system, all should include key traits, like a mission statement (a family history and statement of the family’s goals and aspirations), a council (the family’s legislative or governing body), an assembly (for all family members), and a constitution (a set of policies, rules, and regulations adopted by the family to help achieve its goals).

TAKE-AWAYS: When the planning for future generations fails to have these generations participate in the conversation, it creates a recipe for disappointment. A family governance system enables the founders of wealth to impart their knowledge and values to their family and provide a roadmap the family can follow after the founders are gone, rather than leaving the family to struggle along without any stewardship or guidance. While implementing a family governance system takes time and requires the buy-in of all members for the system to work, evidence shows that the benefits – such as family unity, reduction of family conflicts, and preservation of family values and wealth – far outweigh the costs.

The “shirtsleeves to shirtsleeves in three generations” phenomenon is a concern for affluent families - the first generation creates the wealth, the second generation preserves the wealth, and the third generation dissipates the wealth. While the founders of such families spend significant time creating wealth and planning when passing wealth to the next generation, they often give far less attention to establishing a system to communicate the founders’ values and prepare the next generations for not only maintaining, but also enhancing, the family’s legacy. Affluent families are increasingly turning to family governance systems to combat the “shirtsleeves to shirtsleeves” paradigm, to preserve family wealth and values, and most importantly, to build and maintain family relationships.

WHY HAVE FAMILY GOVERNANCE?

Besides preserving a family’s legacy, a family governance system is critical if the family has “shared assets” (such as real estate, private business interests, or private equity holdings) or possibly a family foundation, which require family members and successive generations to work together in harmony. If, for instance, the founders pass their commercial real estate interests to their children in the form of a family business entity, the children will need an agreement that governs their ownership interests and control over the assets or, if the children serve as directors of the family’s charitable foundation, they will need a clear mission and governance structure to ensure a smooth transition of control from one generation to the next.

WHAT IS FAMILY GOVERNANCE?

Family governance is a system that helps families work together and provides a forum to address family matters. The following chart illustrates just a few matters that can be tackled through a family governance system.

Sample Reasons to Implement a Family Governance System

- Preserve the family history
- Build family unity through future generations
- Define and preserve family values
- Address family politics and resolve family conflicts
- Preserve and manage family wealth
- Provide oversight for the family business and family trusts
- Define and carry out family philanthropic objectives

No two family governance systems are identical - each family develops and refines a system that works for them and that they can expand and change over time. While there is no set structure, most systems incorporate four basic elements: (1) a mission statement, (2) a council, (3) an assembly, and (4) a constitution.

Example: Ted and Mabel Hays have been married for forty years, with three children and nine grandchildren, and have built a very successful business. One child is involved in the business, while the other two have pursued successful careers. Ted and Mabel also have acquired other wealth, including a large vacation “cottage” and their family home in Santa Barbara. They would like to pass their business, properties, and other wealth to their children and descendants, but have concerns that, after Ted and Mabel pass, the family will grow apart, resulting in sale or dissipation of the family assets. They want to implement a family governance system that will preserve their legacy for future generations and provide family unity.

HOW TO IMPLEMENT FAMILY GOVERNANCE?

Step 1: Create a Family Mission Statement

The first step is writing down the family’s history and defining the family’s values and mission. The senior generation (the family’s founding members) typically writes the initial family history, which will grow as other members add their own history statements.

The balance of the mission statement sets out the family’s values, goals, and aspirations for the family governance system. The statement can be created by the individual family members and then consolidated into single statement after a family discussion, or created by the senior generation and refined by the family group. As with the family history, the family’s values, goals, and aspirations will change and grow over time.

Example (Cont.): Ted and Mabel start to prepare a family mission statement by writing their family history – where they grew up, how they met, the work they put into building the business – and family anecdotes they want to share. They also ask their children and grandchildren to incorporate their own anecdotes.

Ted and Mabel also put together a preliminary list of values, goals, and aspirations for the family, with input from their children and grandchildren. The initial mission statement is finalized following a meeting and discussions between Ted, Mabel, and the children. The statement provides that the family mission is, in part, to:

- Create an environment where each member can reach his or her full potential.
- Be respectful of each member’s opinions and resolve conflicts without anger or judgment.
- Value each member’s unique personality and abilities.
- Promote a caring and joyful family environment.
- Promote and support family philanthropic endeavors.

Step 2: Forming a Family Council

The family council serves a role similar to the board of directors or a legislative body and is the core of a family governance system. It provides a forum to discuss family objectives, grievances, and other issues and to develop procedures and policies to address such matters. The following chart illustrates some of the topics that can be addressed by the family council.

Sample Family Counsel Topics

- Development of family unity, family assembly meetings, retreats, and social gatherings
- Dissemination of information to other family members
- Review of portfolio performance and development of investment strategies for family wealth
- Structuring rules for ownership, management, and employment in the family business
- Review performance of the family trustee and trust distributions
- Create policies for use of trust owned property by family members
- Create education and development programs and events to help family members understand the family business and/or manage family wealth
- Develop programs to assist family members in being self-sufficient and develop their own wealth
- Develop procedures to resolve or avert family conflicts
- Develop family philanthropic activities (charitable donations, service projects)

During the early stages of family governance, the family council may be composed of all adult family members and descendants over a designated age. As time goes on and the family expands, however, the family council may become a representative body composed of members from each branch of the family, generation, and/or age group, as determined by the family council. As the family grows, the council may adopt subcommittees, which can focus on specific areas of interest (such as the management of the family's wealth or businesses, philanthropic activities, and/or retreats) and develop recommendations for review and approval by the full council.

Example (Cont.): As part of their family governance system, the Hays family adopts a family council composed of Ted, Mabel, their three children, the children's spouses, and grandchildren over age 16. They anticipate that eventually the family council will need to be a representative body with members elected by the three family branches, but for now the numbers seem manageable.

During the initial meetings, the family council starts to tackle issues regarding the structure of Ted and Mabel's estate plan, future ownership and involvement in the family business by family members, use of the family cottage, setting up education programs and standards for family members, ways to strengthen family relationships, and holding a family assembly meeting.

Initially, the family council may need to meet often to develop the family governance system. Once the system is up and running, the council can determine how frequently meetings should be held, but to provide continuity, the family council should meet at least annually.

Step 3: Develop a Family Assembly

A family governance system generally incorporates a family assembly – an annual gathering of all adult family members, which may include spouses and children over a certain age – particularly as the family grows and the family council becomes a representative body. Much like a shareholders' meeting for a corporation, the family assembly provides the entire family with information about decisions and policies adopted by the family council, shares the family history, informs members about the family business and financial matters, provides educational opportunities (such as how to read financial statements, how current economic conditions may impact business or portfolio performance, and how the business or the portfolio should be adapted to meet these future challenges), and discusses family philanthropic activities, service projects, and other family matters. The core purpose of the family assembly is to keep the family informed and develop close ties – functions that are critical to the preservation of family wealth and continuation of a business as time passes and new generations are added to the family.

Example (Cont.): The Hays family council decides to hold the first family assembly at the family cottage. All family members (including spouses) will attend the meeting. Mabel starts the family assembly meeting by servicing the family history and mission statement. Ted then reviews decisions and policies adopted by the family council, such as use of the family cottage, current and proposed ownership structure of the business, and requirements for family members to be employed in the business. A consultant then teaches family members how to read a financial statement, and the family discusses the current financial status of the family business. At the end of the meeting, the family discusses the next family assembly and a community service project the family can do during the next retreat.

Step 5: Develop a Family Constitution

Much like the bylaws of a corporation, the family constitution sets forth the aspirations and goals of the family governance system, a roadmap to achieve those goals and aspirations, and the guidelines, rules, and regulations by which the family council and family assembly will operate. The following chart illustrates typical matters laid out in a family constitution.

Sample Topics in a Family Constitution

- Code of conduct for family council meetings and family assemblies
- How members of the family council will be selected and whether council membership is for life or limited by a term of years
- How a chairman of the family council and family assembly will be selected
- Whether family council decisions are to be made by majority vote or by consensus
- Whether members of the family council will be compensated or reimbursed for expenses
- Who is to attend family assembly meetings, including whether spouses and minors may attend
- Frequency of family council and family assembly meetings
- Education and development goals and targets for family members
- If there is a family business, rules regarding:
 - Who may own voting and non-voting shares of the business
 - Whether spouses may own shares after divorce from, or death of, a family member
 - Requirements for family members to be employed in the family business and how they will be compensated
 - Policies to guard against interference with the business by family members not employed in the business
 - Whether shareholders are to be bound by a shareholders' agreement
- Ways to help family members develop their own careers and businesses, encouraging family members to be self-sufficient
- How family conflicts will be aired and resolved
- How the family will approach philanthropy – monetary contributions, service projects, etc.

TAKE-AWAYS

When the planning for future generations fails to have these generations participate in the conversation, it creates a recipe for disappointment. A family governance system enables the founders of wealth to impart their knowledge and values to their family and provide a roadmap the family can follow after the founders are gone, rather than leaving the family to struggle along without any stewardship or guidance. While implementing a family governance system takes time and requires the buy-in of all members for the system to work, evidence shows that the benefits – such as family unity, reduction of family conflicts, and preservation of family values and wealth – far outweigh the costs.

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