Many Interrelated Disciplines

Crucial among these many challenges must be the notion that helping a family manage its wealth is much more than helping manage its financial assets. This misguided conception of the classical wealth management relationship is illustrated in Figure 1.1.

This first chapter discusses the fundamental truth that family wealth management is broader than simple asset management and the difficulties this injects into the management process. Our point here is not to be comprehensive about these difficulties, as they alone could be the topic of another book. Rather, we mean first to take inventory and second to introduce a few of the alternative approaches which we have seen at work over the last twenty years or so. The serious student of these challenges should dig further.

MULTIPLE SOURCES OF CAPITAL

At some elementary level, it is not hard to understand intuitively that there is more to any family than its bank or brokerage account. After all, if this is so obviously true for the average family, why would it be any different when the only change one makes from the average is to assume that the family is financially wealthy? No family can be simply reduced to its financial assets; if that were the case, why would it have occurred to anyone to create the phrase “from shirtsleeves to shirtsleeves in three generations”? Money certainly is

1 According to Richard M. Segal, “shirtsleeves to shirtsleeves in three generations” is an American translation of a Lancashire proverb, “there’s nobbut three generations atween a clog and clog.” Some say that Andrew Carnegie, the famed 1800s industrialist from Scotland, brought the proverb’s message to the New World. Further investigation proves that the adage is not unique to any one country or culture. In Italian, it is “dalle stalle alle stelle alle stalle” (“from stalls to stars to stalls”). The Spanish say, “quien no lo tiene, lo hance; y quien lo tiene, lo deshance” (“who doesn’t
a part of what a wealthy family is, but it is only a part, and hopefully not the most important.\(^2\)

\(^2\)This is the point at which readers who are interested in detail might want to brush up on the differences between the concepts of total and marginal utility in economics. The simple insight is that marginal utility decreases as more and more of a good or service is consumed, while total utility is the sum of all marginal utilities for a given good or service. Thus, one can have a good that has a high marginal utility but a low total utility, as only small quantities of that good are purchased and vice versa. Ostensibly, the concept is applicable to financial wealth.
Lisa Gray coined the phrase “authentic assets”\textsuperscript{3} to refer to the many different sources of wealth that exist within a family; her crucial point is to warn us that financial assets are only a part of the management challenge faced by the wealthy and their families. At a minimum, let’s consider just a few: clearly, the wealthy do have financial assets. But human, intellectual, social, emotional, philanthropic, and artistic dimensions cannot be ignored; and there are others. Each has its own definition, which can be generally accepted or hotly debated and many have been studied in the halls of academe for quite a while. Whether a family is indeed financially wealthy or not, it is still a grouping of related individuals who exist within a broader social context. Maximizing their financial wealth is rarely enough for all members of the family to feel duly fulfilled. In many ways, certain families have even adopted a mental framework that is well worth considering: financial wealth is an enabler in that it facilitates family members to seek overall, complete fulfillment, while less wealthy individuals often cannot focus on much more than making financial ends meet.

**EXPANDING ON THE CORPORATE ANALOGY**

There is even more to the wealth management challenge than the fact that there are various sources or definitions of capital. Families must deal with a variety of issues that are common across the whole wealth spectrum, although financial wealth or social prominence tend to magnify them somewhat. They must pay taxes on their income and need to meet their ongoing expenses. They must pay transfer taxes when some of the wealth passes from one generation to the next or simply from one individual to another. They must comply with rules and regulations, whether in the management of financial assets or otherwise. They often have important philanthropic intentions that require planning and executing. Last, but not least, they must manage a wide range of risks for which insurance exists in certain cases and not in others, and which wealth can exacerbate, for instance with respect to reputation risk!

Figures 1.2 and 1.3 help put this notion in the proper perspective by drawing on the comparison once suggested by Charlotte Beyer, whom we already met in the Preface. The first step in our logic is to illustrate the broad

\textsuperscript{3}Gray, Lisa. *Generational Wealth Management: A Guide for Fostering Global Family Wealth*. Euromoney Books, 2010, pp. 11–13. Lisa Gray acknowledges that the term “Authentic Capital” was coined by James E. Hughes, Jr., and inspired her in the differentiations of the various forms of assets on which a family can draw.
management problem facing the chief executive officer (CEO) of any corporation. Figure 1.2 provides a graphical depiction of the issue. It is mighty hard to think of the successful CEO of a successful company who only focused on a single dimension of his or her job: the business world is littered with failed companies where the CEO only had time for research, engineering, finance, or marketing—to pick four areas at random. While not a totally inescapable proof, as there must be an exception to any rule, this helps set the simple proposition that a corporation is a complex assemblage of multiple functions and that the person at the top of the ladder must understand both how each of these functions operates individually and how they all work and come together to create the business of the whole firm for which he or she is responsible.

Now, let’s apply the same analytical framework to a family, assuming that a family is no different than a corporation. Making this assumption requires us to leave aside a number of important considerations, but the case can simply be made that these are not crucial to our point here. Let’s imagine
the head of the family as the CEO of his or her family’s wealth, a company Charlotte Beyer calls My Wealth, Inc. Just as was the case for a corporation, there are multiple dimensions and the successful high net worth individual must first realize the multiplicity of these dimensions, and, second, be able to deal with all of them. Figure 1.3 illustrates this point and recalls a number of the dimensions we mentioned in the introduction for this chapter.

Just as it would be silly for a corporate CEO to focus on a single aspect of the business, it is equally misguided for an individual to consider just one aspect of the wealth management challenge. And yet, the traditional approach would be exactly that. For years, the industry had us and many of our clients believe that their focus should be solely on managing their financial wealth, their financial assets. This may have made sense when financial wealth was primarily inherited and in the form of stand-alone trust structures; but it certainly no longer applies when these financial assets were created by the current senior or immediately preceding generation.
MULTIPLE INTERACTIONS

Now, if the challenge was simply to recognize that the problem is more complex and has more dimensions than initially thought, there would be little need to make dramatic change. Yet, just as is the case in a corporation, all these various “divisions” within the family structure do not exist in isolation. They have both their own issues that have to be addressed directly and a variety of tentacles that extend toward and into other dimensions. This is what makes it impractical for any service provider to the wealthy to argue that he or she can serve the family by simply focusing on a single aspect. I vividly remember the time when we first introduced the concept of tax-aware investment management to J.P. Morgan’s clients: I could be my own wealthy client if I had a penny for each time I heard people tell me that “the tax tail should not wag the return dog.” Most individuals who were raised in a world where taxes did not matter simply could not understand that there was a need to change the traditional investment process if one was going to focus on maximizing after-tax returns or terminal after-tax wealth at some future point in time.

Similarly, I was recently involved in a panel focused on asset allocation issues; it was sobering to observe highly gifted and successful people who principally operated in the world of institutional investors seemingly become “frazzled” when individual investor-related “complexities” were brought into the picture. Years ago, this was understandable to the extent that the bulk of the financial assets to be managed were owned by defined benefit pension funds. Now, with individuals owning more than 50 percent of all financial assets and with several institutional markets sharing “individual complexities” (Australian pension funds are taxable, for instance), what could uncharitably be viewed as a myopic inability to look beyond the theoretical and into the practical is rather surprising. Yet, their hearts

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The term “interaction” here and in subsequent occurrences within this book is meant to convey the idea that the various disciplines do not exist in a vacuum. Although a few of these interactions may be unwitting, most reflect the fact that what is done within one sphere has a direct—and often predictable—impact in another, in somewhat of an inevitable manner. A well-known Georgia family suffered from one such interaction, which did not have to be: the family hired two private jets to fly to a holiday event, and one of the two planes crashed. A wealthy family does not have to, but certainly may fly private. Yet, sticking to the example, the plane that crashed was said to have all trustees of all family trusts onboard; a different choice as to who sat in which plane might have helped avoid the catastrophe. This could, in the words of the Family Office Exchange founded by Sara Hamilton, have come under the “risk management” header.
are definitely in the right place; it is just hard for them to accept that some cherished framework might need to be amended.

There are many other interactions beyond the simple integration of taxes into the investment process. Consider philanthropy, a very important activity for both wealthy and less wealthy families, particularly in the United States. Let’s limit this discussion to the idea of giving away financial assets, be they money or securities, although the rarest and most precious asset that families often have is the time of their members. Clearly, giving away cash will achieve the purpose of benefiting the philanthropic activity chosen by the family and may well provide the donor with some tax benefit. How much more powerful, from the overall wealth management standpoint of the family, might some different form of giving be? Giving away appreciated securities might provide the same ultimate philanthropic impact at a lower real cost to the family, as it might avoid their having to pay taxes on the unrealized gain. Assuming that the family has both some cash available for giving and appreciated securities within an equity portfolio, for instance, a smarter strategy emerges: the family may give the appreciated stock, thus satisfying its charitable intent. It can also use the cash that it has available to top up the equity portfolio (some part of which has just been given away). This could provide an interesting additional benefit: it might lower the ratio of the market value of the portfolio to its tax basis (the stock that was given away had the most imbedded unrealized gains, while the new stocks purchased with the cash have no unrealized gain). This increases the flexibility of the manager to be tax-efficient in his or her handling of that portfolio. Although beyond the scope of this book, one might also mention other routes, such as charitable lead or charitable remainder trusts as a means to achieve either tax or transfer benefits.

So far, we have discussed interactions between investment management and income taxes, between philanthropic and tax planning, and between these last two and generational planning. We have also discussed interactions between philanthropy and investment management. The list does not stop here. Consider interactions between investment management and social capital; this occurs when a family wants to reflect certain social concerns in its investment management activities, which might lead it to consider so-called “socially responsible investing,” or, more recently “impact investing.” Consider interactions between strategic asset allocation and the development of the business skills of future generations. This occurs

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5 A family we serve has a particularly complex set-up, including inter-generational loans to combine investment management with income and estate tax efficiency.

when some portion of the family’s assets is dedicated to financing some or all of the entrepreneurial activities of younger generations. Consider the interaction between the management of a family’s philanthropic activities and the education of future generations, either in terms of the values the family wants to steward from one generation to the next or with respect to promoting family unity across different branches. In truth, the list of these interactions, if not endless, is only limited by the imagination of the family and of its advisors and its willingness to countenance what can become somewhat daunting complexities.

EDUCATING FUTURE GENERATIONS AND WEALTH TRANSFERS

Although we looked into these two issues a couple of paragraphs ago, the topic deserves more attention. Educating future generations is always important, whether a family is or is not financially wealthy. Yet, wealthy families often feel that they must dedicate a disproportionate amount of time and attention to it. The logic is simple and is best illustrated by an example. More than ten years ago, I found myself in the office of a multi-billionaire who had just stepped down from the chief executive position in the company he founded, which was the source of the family’s financial wealth. After having spent some time focusing on the family’s goals and fears, I asked him the same two important questions I had been asking all clients, in a bid to create a sort of a feedback loop. The first was: “We are now five years from now and you want to say that the program we have designed and implemented has been successful. How will you justify that?” The second was the obvious reciprocal: “We are now five years from now and you want to say that the program we have designed and implemented has been a failure. How will you justify that?” At that point, this hard-nosed executive simply broke down in tears. He answered the second question saying: “I have ruined my grandchildren!” The point was made, and nothing more needed to be said.

Ensuring that financial wealth transferred to future generations does not “ruin” them is one of the highest priorities of most financially wealthy parents and grandparents. Yet, there are many schools of thought as to how the process can be structured. Certain families choose to hide the money from future generations, at least until they are required by law to disclose its existence. A family once told me that the wealth had been almost totally dissipated one generation ago, because they had not been aware of the wealth or prepared to deal with it; the younger generation squandered it when it received it. Others choose to disclose the wealth very early, but place a great
deal of emphasis on values, as opposed to the wealth. Family meetings are opportunities to discuss achievements and the family “history” as a means of reinforcing the traits that the currently controlling generation feels should be emphasized. Others finally choose a trickle approach to make future generations aware of the responsibilities they will one day have and to teach the skills required with small amounts, one at a time. In short, there is no such thing as a one-size-fits-all solution, but there is a one-size-fits-all requirement: the issue deserves to be thought through carefully and in depth, and whatever decision is made must be carefully implemented.

I remember a meeting with a family with two of the three current generations in the room. One of the members of the second generation was defending his spouse’s decision not to attend the meeting and the fact that their two boys did not want to be involved with the management of the family’s wealth. I felt it was my job to make a simple point: whether the boys and their mother were comfortable or not was not the issue. They did not object to the treats the wealth made possible, did they? They would one day have to take responsibility for the management of the wealth, would they not? With that, I suggested that there were really only two options. First, they could decide to add the wealth to what was already in the family’s substantial private foundation. The members of the family who were reluctant to participate would then truly be “normal,” in that they could not draw any income from the financial wealth and would have to live “like their friends.” If they were not prepared to dispense with the wealth, then they had no option but to take responsibility for it and thus be adequately trained in its future management! The patriarch and his wife were beaming!

Related to the issue of education is the truism that wealth transfers should not be driven solely by tax issues, but really reflect what the family expects future generations to do. Thus, sheltering the family against all taxes could work wonderfully well, if younger generations were simultaneously prepared for the advantages that wealth might bring to them and for the responsibilities that went with them. In other circumstances, sheltering the family against transfer taxes might play directly against crucial family goals and would not be the preferred approach. Helping families deal with this issue is one of the most important tasks a good advisor can perform and, back to the topic of this book, is one of the great benefits of a goals-based wealth management approach. As it indeed demands that future goals be made quite specific, both in terms of dollar amounts and time horizons, it requires one to have thought through all these issues. Simply postulating some equity/bond mix as the risk profile that best characterizes the family misses out on an important opportunity to raise issues early that can otherwise be irrevocably set in stone once wealth transfer strategies have been implemented.
A final concern relating to intergenerational transfers cannot be ignored. Whose money is it anyway, and when? Although many families do carefully prepare wealth transfer plans, I have seen several cases where future generations were not or did not want to be aware of the way in which the passing of the ownership baton was orchestrated and of its timing. There were conflicts in that the generation owning the assets ostensibly had different goals than the one to which the assets would pass; one could see either open bickering or at least muted resentment at times. This may be less frequent when the “older” generation happens to have created the wealth: then, subsequent generations often tend to respect the fundamental role of the wealth creator and accept that his or her will should prevail, whatever documents may say. It can become a bit harder when the current owner of the wealth did not directly create it: he or she might have inherited it or received it in some form of legal settlement. Then, following generations do not always have the same natural willingness to stand aside; they can openly worry that spending patterns or clinging to some property—real or financial—may deprive them of what they see as ultimately and eventually theirs. To me, the heart of the solution must be in appropriate communication and education, with some measure of mutual understanding and respect promoted to foster family continuity. It is indeed part and parcel of dealing with the risk of creating an entitled mentality, which can pollute virtually any generation, including the non-wealth-creating senior family members, at any point in time.

THE MAKE OR BUY DECISION

Although selected very large families, in terms of number of members, with substantial financial assets continue to prefer to “make” most of what they need in the management of their wealth, it has become much more frequent for families to delegate certain functions to outsiders while retaining others with the family. The single-family family office has often morphed into multi-family family offices. Indeed, the cost and regulatory burden associated with running a single-family office have increased substantially over the last twenty years, to the point that a fully staffed family office that carries out all the required activities has become the exception rather than the rule. Another contributor to that trend has been the gradual realization, on the part of families as well as within the wealth management industry loosely

7 I actually saw one such conflict between the management committee of a trust and its beneficiaries. There, a member of the management committee—who was not a trustee—seemed to object to the fact that the beneficiaries were living too well. Was he reacting that way because he knew the grantor of the trust or because he himself did not feel it was right to live ostentatiously?
defined, that the number of disciplines is just too large. How can anyone be an expert or have an in-house expert in so many fields?

Yet, families at times find themselves making the decision about what activity they will conduct by default, rather than consciously. They tend to keep inside the office those functions that have typically been there, rather than asking themselves what they should and should not delegate.

The decision to delegate or not to delegate can be influenced by many factors, all of which can be analyzed in terms of some cost. One can think of four generic forms of cost. The first, the most obvious, because it adheres to the most traditional definition of what a cost is, looks at dollars and cents. Paradoxically, this may well be by far the easiest one to handle, if only because these accounting costs can be somewhat precisely determined. The second is a variant on the same theme, but is harder to assess. It relates to sustainability rather than current circumstances. Families might be able, for instance, to attract a top flight chief investment officer, who could be someone who has decided to step down from the world of the rough and tumble and to focus more sharply on a single client. However, will he or she be able to attract and retain the talent that might be needed if the assets are not growing sufficiently to provide for growing revenues from which to draw the compensation increases that this younger talent might expect?

This naturally leads to the third decision, which relates to confidentiality of family information. Any staff turnover means that someone outside of the family and of the office is aware of family circumstances. Despite the many “legal” precautions that can be taken through “non-disclosure” agreements in various forms, it is only a small step before one worries that the information will eventually leak! The final such cost is driven by the ability of staff to grow; certain disciplines are in a state of flux and the ability of individuals to be exposed to more than one set of circumstances or to more competing ideas can be an essential element of professional growth.

**THE CREATION OF A WISDOM COUNCIL**

One of the families we have been serving ever since our company was formed came up with a brilliant idea years ago. They created a Wisdom Council, which they defined as a group of specialists, all of whom had to have an interest in discussing and the ability to understand the various interactions that had to take place across the disciplines that were crucial to the family and its sustained well-being through time. We have since had the opportunity to see this put in place by a few other families and feel that it is a smart way to create an advisory and supervisory process within a family. These councils, as we have grown to appreciate them, tend not to meet more often than once a year, as theirs are strategic rather than tactical roles. The best analog would
be to view them as a corporate board of directors stripped of its governance role. It takes a fairly insightful patriarchal generation to recognize its own limits and seek “counsel,” but the rewards can be high. Yet, it is fair to say that the importance of the council should be expected to fade over time as the patriarchal generation gains the experience it lacked at the outset.

A Wisdom Council can be incredibly helpful to the family’s development as long as its members recognize that they are not involved in day-to-day matters and that they should never become advocates, least of all for their own specialty areas. Members would typically be “experienced” enough that they are at ease within their specialties and have seen a large enough number of different circumstances to be able to react to them. They should also be “young” enough mentally that they are not set in their ways and are always prepared to speculate on or consider new angles and perspectives. Wisdom Council members also can “mentor” various individuals within the family or the office. Such a Wisdom Council may well be a requirement for families who decide to “make” most of what they need in-house. It should indeed serve as a useful sounding board for the family to make sure that they are fully exposed to all that is happening outside of their office. Though not the same as a Wisdom Council, which comprises skilled external professionals, the Family Council is also an important dimension of family governance, as it serves as the forum where important family decisions can be made, relying on more decision makers than the sole patriarch or matriarch.  

SUMMARY AND CONCLUSIONS

The point of this first chapter was simply to set the broad stage for the challenges that wealthy families face. Managing their wealth cannot be subsumed into the simple action of managing their assets; it must be set in the proper framework. That certain families will choose to focus on asset management primarily is not an indication of misguided decision making; it is fine provided that decision has been made actively, rather than by default, after having considered all the other dimensions of the challenge. Yet, most families will want to consider and work across several of these dimensions and actively manage the numerous interactions that exist. Whether they do this all internally or through the use of external service providers is very much the result of an internal cost/benefit analysis.