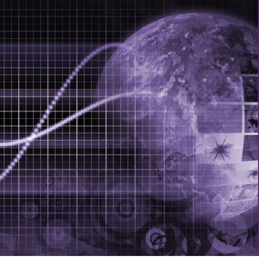

FEATURE:
THE MODERN PRACTICE

By **Matthew Wesley, Michael Liersch** & **Scott Cooper**

A Strategic Approach to Estate Design

Create a structure that matches a family's culture

Some families do well in generational transitions, but many fail–some miserably. Those that thrive are rare, but not as rare as some think. These families tend to be strong, resilient and deliberate. But most importantly, they're paying attention to the real threats to wealth.

These families understand that successfully navigating wealth is a bit like flying a jetliner–two, well-matched wings are required. One strong and one weak wing won't do. Failure of either wing is catastrophic. In many families that flounder, the "planning wing" has received disproportionate attention—trusts are established, advisors are in place, tax strategies are adopted, investment approaches are calibrated. The planning is superb. But, these complex structures comprise only one wing of the plane, and the other is equally important—the wing of family "culture."

Creating estate-planning structures that match the family culture is critical. Identifying misalignment between culture and structure can help families—in collaboration with their professional team—create an intentional cultural shift (over time) or design a plan that's more likely to succeed given the existing family culture. This practice can help mitigate everything from family legal battles to negative relationship dynamics by promoting positive family interactions and outcomes.

Culture

Culture is the unseen driver of family behavior. Every family has invisible "software" that encompasses its beliefs, perspectives, attitudes and actions. Families that successfully curate their cultural software take charge of writing their own "operating systems."

Lack of attention to nurturing family culture is the principal reason most plans fail. Three primary conditions underlie this inattention:

1. **Fear.** Concern about confronting challenging family dynamics or historical behaviors can leave culture unaddressed. Family members may believe that discussing challenging issues could worsen financial outcomes and relationships. While that's certainly possible, if discussions are navigated thoughtfully, a family can rewrite its cultural software.

2. **Complexity.** Families are complex. Navigating that complexity requires frameworks (such as those outlined in this article). It also requires dialogue and the collective development of beliefs, perspectives and principles that guide the actions of the family.

3. **Inconsistency.** To establish a productive family culture, leaders of the family find ways to facilitate accountability systems for appropriate behavior within the family. Family meetings and policies help to create a cadence of consistency that can align the family.

The Pathways

Advisors who systematically plan for transition as a culturally embedded process serve their clients more

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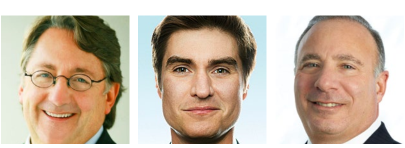

effectively. This planning allows family leaders and their advisors to play a proactive long-game so they're not just tactically reducing estate taxes (which aren't the greatest threat to wealth), but strategically matching the structures created to the individuals who are inheriting the wealth. The goal of planning shifts from merely saving taxes to planning matched to the capacities and capabilities of beneficiaries (failure to do so can cause wealth to disappear).

To help with this matching process, we've identified three core overarching strategies designed to help ensure that wealth, once accumulated, is more likely to achieve its strategic purpose over generational transitions. We call these strategies "Pathways," with each Pathway requiring different levels of preparation and different levels of teamwork on the part of the family members. Any Pathway is a valid choice—the question isn't which is "better" but which best fits a particular client family.

Pathway 1: Division

In this first Pathway, each heir receives some fixed amount, and the balance goes towards taxes or to charity. This Pathway usually results in the disappearance of the wealth within a generation or two. Typically, such plans arise from concerns about enabling entitlement among children or not wanting to saddle children with the complexities of trusts and entity management.

Metaphor: In explaining these strategies, we use the analogy of the goose that lays the golden eggs. In division, the eggs are given to the children and the goose (or bulk of accumulated capital) goes to charity or the government.

Structures: Division estate plans are basic; they don't include generation-skipping trusts, entity planning or other complex structures designed to last for extended periods of time. At most, these plans educate grandchildren and/or give them a jumpstart on their financial life, but terminate quickly after that.

Skillsets required for success: For such plans to be successful, beneficiaries must have financial literacy (that is, how to effectively earn, save, invest and spend their money).

When things go bad: Wealth erodes rapidly from such things as overspending, failure to hold productive employment and psychological issues such as mental illness, addiction or the inability to maintain stable social connections.

Adequate preparation allows Preservation strategies to maintain assets for a generation or two.

Pathway 2: Preservation

Preservation is the predominant approach of many wealthy families and advisors. Here, the patriarch and matriarch adopt a complex structural matrix of entities designed to reduce taxes and exercise control after death. The anthropologist George E. Marcus, who studied wealth in families, calls these structures "surrogates" in that they stand in proxy for the control of the wealth creator.[1] At death, the surrogate employs a host of advisors who manage the entities and the assets within them. This becomes what Marcus calls the "Formation." He noted that, in wealthy families, children don't inherit wealth—they inherit Formations defined as complexes of structures that hold wealth and advisors who manage it. Active professional capital management and passive beneficiaries with strictly limited responsibilities are the hallmarks of this planning.

Adequate preparation allows Preservation strategies to maintain assets for a generation or two. Inadequate preparation often tips over into failures to launch, attitudes of entitlement and even lawsuits. Ultimately the numerical growth of the family will deplete the wealth.

Metaphor: Here our erstwhile goose is entrusted to "third-party" farmers charged with keeping the goose healthy and productive. "Eggs" are distributed to the beneficiaries who use them as they see fit. Eventually, the law of large numbers and the limits of productivity exhaust the goose, and she dies.

Structures: The structures in a Preservation strategy usually involve complicated interlocking trust structures and entities. Professionals with fiduciary obligations to both present and future beneficiaries manage these structures and entities.

Skillsets required for success: Family members must not only develop financial competency, but also develop a sophisticated wealth competency. They learn to understand the structures and work effectively with the advisors who support those structures. These tasks are often supported by family meetings, a common vision and commitment to core family principles.

When things go bad: This is arguably the most difficult Pathway to successfully sustain: Legal entitlement often slips into indolence. Most often, the family begins to demand more than the structures can produce.

Over and above the other skills, families that succeed focus on the culture of the family and on teamwork.

Pathway 3: Growth

The family actively manages the complex structures of the Preservation strategy. The structures either work or fail based on the ability of the family to productively collaborate. Professional advisors play a supporting role. Often, these families inherit direct ownership in operating companies that require them to become excellent owners, board members and business managers. Technical and cultural advisors support the work of the family.

Metaphor: In this scenario, the family develops the skills to be goose farmers. They're careful not to demand too many eggs; the optimal care and comfort of the goose is what's most important.

Structures: Sustainable structures for Growth require deliberation and family decision making. Often, capital is distributed among actively managed assets, such as real estate holdings and operating companies, as well as more traditional diversified portfolios of passive asset classes. In this Pathway, structures such as family offices, operating companies, trust companies and family foundations become part of the planning.

Skillsets required for success: Over and above the other skills, families that succeed focus on the culture of the family and on teamwork. Capital is invested in the personal development of individuals and the collective evolution of the family. Most families must hone business competencies as owners, managers, governors and directors. These families are typically characterized by regular whole-family gatherings and eventually develop moderating governance structures such as family assemblies, constitutions, policies and councils. The entire family becomes a learning community with an intentional commitment to its own evolution through mentoring and experiential learning. Leaders arise as "torchbearers" in each generation out of a deep commitment to family cohesion.

When things go bad: These plans tend to fall apart because of failures of collaboration; failures of family commitment; and insufficient or hard to exercise exit and re-entry for family members who have different interests.[2]

Trade-offs

Is one Pathway "better" than another? No. All of the Pathways involve trade-offs. Pathway choice should be non-judgmental—what's most important is that both wings are in balance to take flight and achieve the family's desired outcomes. What's essential is that successful plans account for the culture and capacity of the family to bring the chosen Pathway alive in ways that enhance the lives of beneficiaries.

Endnotes

1. George E. Marcus and Peter Dobkin Hall, *Lives in Trust: The Fortunes Of Dynastic Families In Late Twentieth-century America*, Westview Press (March 30, 1992).
2. Once the planning and culture "wings" are aligned and the family is launched, some families move to a different stage not discussed here. A rare few move into an "Expansion" Pathway where—in our goose analogy—the eggs (and the goose) are sold to buy more geese.