

MANAGING THE IMPACT OF WEALTH

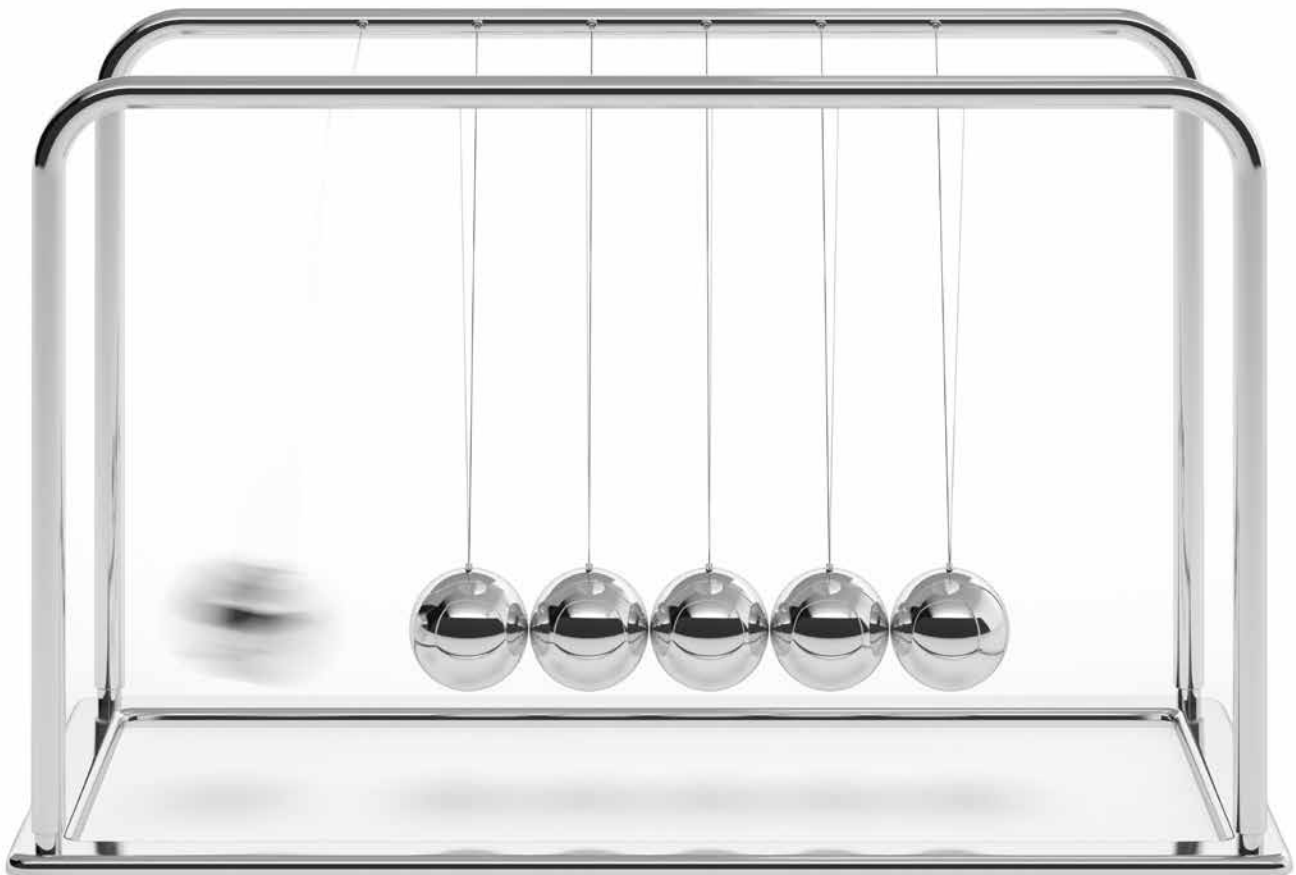


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Managing the Impact of Wealth

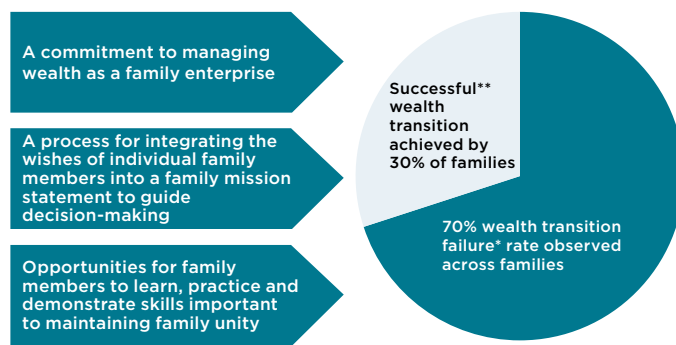
Unique wealth encompasses not only considerations of financial capital, but also individuals, families, future generations, and communities. With these human dimensions in mind, it's clear that wealth is about more than just the numbers. In fact, wealth almost always has an impact on individuals, couples, and families — in ways sometimes planned and sometimes unplanned; often positive and occasionally not. A focus on planning for how wealth can serve your truest aspirations is one way to harness wealth's potential for positive impact.

A comprehensive research study outlines how the impact of wealth can influence the success of wealth preservation and transfer for current and future generations. Two researchers followed over 3,500 ultra-high-net-worth families over a 20-year period. Their research showed, surprisingly, that 70 percent failed to successfully transfer their wealth beyond the family's third generation.¹ Even more surprising: 60 percent of these failures could be attributed to a breakdown of communication and trust within the family. Another 25 percent of these failures were attributed to inadequate preparation of heirs. Within the 15 percent of transition failures attributed to "all other causes," less than three percent of failures were linked to technical errors. In fact, the largest element in the "all other" category was the lack of a shared family mission or roadmap to guide the family's planning and decision-making.

In the same study, three elements distinguished the 30 percent of families who successfully transitioned wealth beyond the third generation. First, these families shared a commitment to managing wealth as a family enterprise. Second, these families had identifiable processes for integrating the wishes of individual family members into a shared family mission. Finally, and no less importantly, successful families created real opportunities for family members to learn about, practice, and demonstrate skills important to maintaining family unity.

Factors Predicting Success in the Transition of Family Wealth

20-year longitudinal study of 3,500 uniquely wealthy families with average net worth ranging between \$15-\$70 million



Source: Roy Williams and Vic Preisser, *Preparing Heirs* (San Francisco, Robert D. Reed Publishers, 2003).

* Failure was defined as "involuntary loss of control of the assets."

** Successful wealth transition was defined as "wealth remaining under control of the beneficiaries."

With ideas, questions, and concerns surrounding these topics, many families look for help to address the qualitative, non-financial dimensions of wealth (sometimes referred to as human, intellectual, spiritual, or social capital). Family leaders have become more willing to discuss the impact of their wealth and family dynamics as a routine aspect of a more integrated approach to wealth management. Frequently with the help of key outside advisors, often with experience in family dynamics and wealth education, many families are positioning themselves to more proactively address the myriad challenges and opportunities that can arise on a range of qualitative wealth management issues. The approaches taken by these families reflect a growing understanding around the importance of thinking cross-generationally and putting plans into action to engage and prepare the rising generation for the wealth, roles, and responsibilities they will inherit.

When clients are asked to rank their top risk concerns, qualitative issues surrounding wealth's impact rank high in importance.

Let's consider two key assumptions related to addressing these qualitative, non-financial issues as part of comprehensive wealth planning. The first and most important assumption is this: It is as essential to manage the impact of wealth as the wealth itself. There is a critical interdependence between the dynamic nature of families and the more technical aspects of managing wealth. This interdependence becomes more noticeable and pronounced as a family's assets grow and succeeding generations of family members come of age. The good news is that families can take steps to better ensure that significant wealth serves their true aspirations and influences individual family members in positive ways.

The second assumption follows from the first. If it is as important to manage the impact of wealth as the wealth itself, then fluency in the area of family dynamics (also known as "wealth dynamics") prepares individuals and couples to better understand and support their families with strategic wealth plans. Families grow and change through marriage and the birth or adoption of new family members. By taking into account the

often unexpressed interests, concerns, or questions that family members may have surrounding the family's wealth, family leaders can develop more nuanced, integrated, and productive approaches to communicating about wealth, educating and preparing future generations, and implementing strategies that support effective, shared decision-making.

Many families would agree this is sometimes easier said than done. Think about your own family. With wealth as the context, what family dynamics issues surface most often and what happens when they do? As Family Dynamics and Education professionals working in the financial services industry, we regularly have the opportunity to discuss a continuum of wealth impact issues with a broad range of families — each unique in their make-up, priorities, values, and history. These families vary considerably in terms of their personal styles, preferences, comfort levels, and capacity for addressing dynamic family issues as part of managing wealth. That sometimes means there are certain issues families are more comfortable working on, others they may wish to side-step, and still others they'll sometimes choose to ignore or simply miss. Yet most families can articulate a short list of issues they'd like to be able to address more comfortably as part of wealth planning. Many are very astute in recognizing how certain issues — if left unaddressed — may jeopardize their relationships and well-intentioned plans.

Understanding the Family as a "System"

A natural starting point on any family's journey toward greater comfort, confidence, and competence in addressing the impact of wealth is to first understand the family as a system. The term "family dynamics" is, in fact, derived from a theory of family systems originally developed by sociologist Murray Bowen in the 1950s.² According to family systems theory, every family, even though it is made up of individual members, results in a whole or "system" that is greater than the sum of its parts. The ways in which family members interact with each other and in relation to the group as a whole are often referred to as family dynamics. Traditions, communication styles, behavioral patterns, and emotional interdependence all influence the dynamics between family members and ultimately, the family system. Significant wealth adds a layer of complexity to these dynamics with the potential to influence family members at the

individual and system level in both positive and negative ways.

This recognition is behind the key assumption that families frequently benefit from help managing the impact of wealth along with the wealth itself. It may also be why, when surveyed about their priorities, wealth creators and family leaders tend to rank qualitative issues surrounding wealth's impact as important concerns. In one often-cited survey of uniquely wealthy individuals, categories such as "Family Legacy," "Family Relationships," "Family Dynamics Related to Business," and "Family Governance and Decision Making" ranked as high, or higher, than topics like "Investment Performance" and "Financial Leverage" as top risk concerns.³

Unique Client Concerns

Family Legacy	38%
Family Relationships	38%
Family Dynamics Related to Business	36%
Family Reputation and Public Image	36%
Family Office Oversight	35%
Philanthropic Legacy	34%
Family Governance and Decision Making	32%
Financial Leverage	32%
Investment Performance	32%
Ownership Exposure for Private Equity	32%

Source: Family Office Exchange Research

In another survey,⁴ family business owners were asked to rate the difficulty of achieving specific corporate issues. Two issues emerged as being both highly important and, at the same time, difficult to achieve — the first related to resolving conflicts among family members working in the business, and the second related to formulating a family business succession plan. Interestingly, these issues were rated more important and more difficult to achieve than developing strategic plans to sustain or grow the business. The results of these two surveys suggest that issues pertaining to family dynamics are top-of-mind for many wealthy families. It is critical for families of wealth to address the impact of their wealth on their family.

When family business owners are asked to rate the difficulty in achieving specific corporate issues, two issues stand out as being both highly important and difficult to achieve: resolving conflicts among family members and formulating a succession plan.

Yet another survey highlights a disturbing disconnect related to how young people learn about wealth and money. Eighty percent of parents believe their children learn everything they need to know about money in school, yet 90 percent of students state that whatever they know about money they learned from their parents.⁵ This is a particularly sobering

Top Family Business Owner Concerns

Issues of greatest importance and difficulty for family businesses



finding considering the unique developmental journey and educational needs of a young person in a wealthy family.

These studies are important because they also speak to how common these concerns are about wealth's impact on current and future generations. It is less a question about whether a family's actions yield better results than another family, and more about the developmental journey that all families of wealth must take. For example, most families wonder about what others in similar circumstances are doing to navigate through the fairly complex qualitative issues surrounding wealth. Many also know from experience that, even within families, culture trumps strategy. That is, the best laid technical plans can go awry without adequate communication and preparation among family members. A family's wealth plans may yield long-lasting benefits when powered by the additional elements of family alignment and engagement of the next generation.

For those willing to proactively address the qualitative issues, there is so much a family of wealth can do right. The key is to step back, understand the full impact of wealth, and then implement strategies to ensure that the impact is positive.

Communicating About Wealth Within Families

- When and how should I talk to my children or grandchildren about our family wealth?
- When I do talk to my heirs about money, what should I say?
- How do I help beneficiaries understand how assets contained in trusts, property, and other investments will flow to them?
- How much do we share with those who marry into our family, and how do we discuss these issues with them?

These are among the most challenging questions on the minds of many parents and grandparents as they:

- Contemplate finalizing their estate plans
- Worry about raising responsible heirs
- Watch their families grow through marriages, births, and adoptions

- Seek to ensure wealth has a positive impact on future generations
- And, wonder how best to communicate the most important aspects of the family's legacy

Nearly all experts on family wealth agree that it is of central importance to communicate actively with family members who will be affected by your estate plans.⁶ At a very basic level, this should be seen as an important part of educating the individuals in your family to become competent stewards of the wealth they may inherit or manage — on behalf of themselves or others in the family.

At a more fundamental level, communication is a form of empowerment when it comes to the impact of wealth. We've all heard stories about families where there was surprise, disappointment, sadness, or even anger after learning about how they were treated in the estate plans of their parents or grandparents. The truth is, secrecy surrounding family wealth can contribute to false assumptions, misunderstandings, hurt feelings, and difficult family relationships as future beneficiaries struggle to understand how decisions around wealth may impact them in the future.

Family members may deem an estate plan to be unfair or unequal. Or, it may come as a surprise that the bulk of the estate of parents or grandparents is designated to benefit a charity or foundation instead of them.

More commonly, beneficiaries know there is family wealth, but they do not have the details, or enough context, to help them plan for their own lives, including:

- What financial education they need
- Whether money will be available to them for college, buying a house, or starting a business
- How trust distributions are timed for specific ages or life stages
- What their parents' or grandparents' truest wishes or intentions are regarding how wealth will benefit them as inheritors
- What they should, or shouldn't, expect in terms of future inherited wealth

- What happens when money and love co-mingle and what prenuptial agreements mean

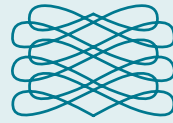
Many families hesitate to communicate and address these issues, sometimes out of concern that sharing too many of the “secrets” of their family wealth will take away their ability to control the impact that wealth has on their children and grandchildren.

Another common concern is that understanding the full extent of family wealth and future inherited wealth will take away the drive and motivation of next generation family members to achieve important life milestones, such as establishing a strong independent identity, going to college or pursuing work or a career, or committing to a significant relationship.

Other families have a concern that sharing too much about the nature or size of the family’s assets will burden family members. For example, rising generation family members may feel they can never live up to or match the success achieved by prior generations. Or, that these up-and-coming family members will feel that their lives are dictated, or controlled, by the decisions their parents or grandparents make with estate plans.

Some parents and grandparents also have legitimate concerns about sharing information that they consider personal and private with their children and grandchildren, as well as new members of the family by marriage. It’s important to remember here that some individuals have grown up in families where money was considered a taboo topic better left for discussions with attorneys, CPAs, and investment advisors. The irony is that often these outside advisors know far more about the nature and extent of the family’s wealth, including what assets will flow to individuals within the family, than actual family members do.

Talking to children and grandchildren about wealth isn’t just of hypothetical importance — it is an established best practice for ensuring that wealth is preserved and successfully transitioned over time. Epictetus, the ancient philosopher, issued a warning that is applicable as we think about what, when, and how to talk to heirs about money and family wealth.



“Be careful to leave your sons well instructed rather than rich, for the hopes of the instructed are better than the wealth of the ignorant.”

Epictetus

When to Talk to Family Members About Money and What to Say

In the age of the internet, social media, and global connectivity, young people have more information at their fingertips than ever before. That information may include information about your family’s wealth. Consider websites where the value of your home (or homes) can be estimated or where information about your net worth, philanthropic gifts, or political donations is public.

Also consider what your children or grandchildren may hear from their peers about your family wealth. The teenager of one family recently came home to ask her parents “Are we rich?” in response to teasing from a classmate about being a “spoiled, rich kid.” Young people are also capable of deciding the “Are we rich?” question for themselves, based on the vacations you take as a family, the number of homes or commercial properties you own or manage, how you travel, the purchases you make, how others treat you, what they can research on the internet, or simply by listening in on the casual conversations of more senior generations.

Learning about money and wealth as a young person is an important rite of passage for any future wealth steward. Take a developmental approach to deciding “when” to talk about money with children and grandchildren. Generally speaking, the most important concepts to discuss with children between the ages of 5 and 13 are:

- The history of the family and the wealth creation, including the success stories and overcoming failures
- The importance of developing good habits related to saving, spending, and giving
- Understanding the value of a dollar, including what it takes to make money in the first place or in situations where it is lost

- Clarity around the difference between a need and a want
- Practice utilizing an allowance to budget how funds are spent and learning from making poor choices
- Feeling the intrinsic benefits of volunteering time and resources to help those in need
- Establishing how to get paid what you are worth — allowances are one example
- And, knowing that not all families come from backgrounds of privilege

As children become adolescents, concepts like basic education around investment fundamentals and how to responsibly use credit are important elements of “wealth conversations.” It becomes increasingly important for young people to take on expanded responsibility and accountability for money and other tasks related to stewardship. A great example is for family members to engage their rising generation family members in discussions around charitable giving or philanthropy as a way of teaching the value of giving back to communities and causes of importance. As another example, one couple set up small investment accounts for each of their children when they turned 16, connecting their children to their first investment advisor, and giving them experience with controlling their own money within the relative safety of a managed investment account.

As children become adolescents, it’s important for young people to take on expanded responsibility and accountability for money and other tasks related to stewardship.

Many teenagers are uninterested in discussions about family wealth but some are capable and interested to learn more. A good general practice is to start discussing these issues with heirs around the time they are in mid-to-late adolescence and definitely by the time they are young adults or entering a significant relationship. Messages might include:

- “We are fortunate to be successful financially as a family.”
- “Your grandparents left an important legacy for us to preserve and pass on.”

- “We are very lucky to be able to afford to pay for your college (or first home).”
- “We (or your grandparents) plan to pass along some of our assets to you at an appropriate time.”
- “Now that you are 18, 21, or 25, we have some important information to share with you about a trust we have set up for your benefit.”
- “It’s important for us to discuss planning for the preservation and retention of family assets before you enter into your first serious relationship.”

One of the ways to think about this process is that by communicating with heirs and beneficiaries, they become initiated into the “secrets” of family wealth, thereby becoming full family “citizens.” In developmental terms we might think of learning about family wealth as an important rite of passage that will prepare your heirs for their future roles as wealth stewards. Ongoing secrecy can be counterproductive to the experiential learning wealth stewards need to become financially fluent, competent, and confident.

How to Talk About Wealth with Heirs

Context is everything when it comes to how you discuss wealth with your next generation family members, and the “set-up” of a conversation is important.

Let your child or grandchild know you would like to sit down with them to discuss current and future plans surrounding family assets.

Then find a quiet time to initiate the dialogue about family wealth. With the goal of not burdening your beneficiary with too much information, we recommend initial conversations focus on the nature and architecture of the family’s wealth. That is, what the estate plan may consist of, the range of assets included — for example, family properties, shares in family owned or operated companies, inherited wealth, and other types of assets. It’s always important to start with basic education such as what wills are and how they differ from trusts. It’s less important to talk about specific dollar amounts or figures during these first conversations — that information can often wait until later. Instead, focus on helping your child or grandchild understand the basics of estate planning, the range and nature of

family assets, and any provisions that trust plans contain regarding them individually.

Allow time for this information to sink in and for your heirs to ask questions or express concerns. Consider inviting your financial advisor to help you prepare for such conversations. And don't forget about the spouses of your family members. They may benefit from this same education, especially in relation to discussions about prenuptial agreements and always in cases where estate plans concern their children. At a later time, once you are sure these basic "architecture" concepts have been mastered, consider having a more detailed discussion with your child or grandchild surrounding the full extent and value of family assets.

Throughout conversations like these, it is important to highlight the history behind wealth creation in your family, including how the values, hopes, and hard work of prior generations (including yours) allowed the family to prosper financially. It is equally important to share your aspirations for how wealth will positively benefit the family, including any wishes you may have surrounding how your beneficiaries embody the role of wealth steward to preserve wealth for future generations. Connecting wealth to your family history, values, and a vision is a best practice for ensuring future generations have a full understanding of the family legacy with which they have been entrusted.

Help is Available

For families with unique wealth, it's especially important to step back and consider wealth's potential to serve the family's true aspirations. Through dialogue and reflection, many families are increasingly taking the time to surface and clarify their most important values, goals, plans, questions, and concerns with regard to how wealth's impact is managed. With the clarity that such intention brings, there is a natural opportunity to then analyze, summarize, and consider core family strengths that already exist and can be leveraged, as well as perceived risks or opportunity areas that families may wish to prioritize and address.

Successful practices for managing wealth's impact in this context may range from aligning around a shared family mission to establishing a family governance

structure to comprehensive next generation financial education.

Families can often identify opportunities by asking themselves questions related to the following topics:

- **Family Vision, Mission, and Values** — Does the family have a vision or mission statement that spells out the overall purpose or intended impact of the family's wealth to serve as a roadmap for future generations? To what extent are the family's core or shared values articulated and incorporated as part of wealth planning activities — including in conversations with outside advisors?
- **Wealth Communication Strategies** — How often or to what extent does the family communicate about wealth matters and how is the current process working? Has the family ever gathered for a formal family meeting organized around specific wealth planning topics or priorities?
- **Family Transitions** — Is the family dealing with any major transitions due to marriage, divorce, death, or the birth or adoption of a child? How have new family members, such as in-laws, acclimated to living amidst significant wealth? Are there any current pressures (or stressors) related to geographic or generational drift within the family?
- **Family Governance and Decision-Making** — To what extent do family members have the opportunity to learn about or participate in decisions related to the family's business or wealth? Are family members generally familiar with the roles and responsibilities that are open to or expected of them? What are the various pathways to responsible ownership in the family enterprise and how has this been communicated?
- **Family Talent and Leadership Development** — Is there currently a process in place for identifying and developing family talents and aptitudes? Is the family thinking about future leadership of the family enterprise and succession planning? Is there a well-developed employment policy with regard to family members who wish to work in the family business?
- **Next Generation Opportunities** — What steps has the family taken to ensure that family members are financially fluent and well positioned to serve as responsible stewards of wealth? To what extent are

heirs prepared for the wealth, roles, or responsibilities they may inherit? What are the most pressing educational needs within the family at present? Are there any special considerations for parents and grandparents with regard to how next generation family members are raised?

Conclusion

In this white paper we've covered some basic information about managing the impact of wealth, and offered simple strategies around not only when and how to discuss wealth with your heirs, but also what to say. We've also listed some questions families may wish to ask themselves to identify opportunities surrounding education, next generation preparation, and family decision-making. Every family is unique, of course, so many of the strategies highlighted here can and should be customized to address your specific family needs.

If you would benefit from a consultation focused on managing wealth's impact or communicating about wealth with your children or grandchildren, please contact your Abbot Downing relationship manager to begin exploring these topics with the Abbot Downing Family Dynamics and Education team.

Endnotes

¹ Williams, Roy and Preisser, Vic. *Preparing Heirs: Five Steps to a Successful Transition of Family Wealth and Values*. Robert D. Reed, Publisher (2003).

² Bowen, Murray. *Family Therapy in Clinical Practice*. Jason Aronson, Inc., Publisher (1993).

³ Family Office Exchange's 2006 Thought Leaders Compendium: *Recasting the Central Role of the Family Office as Risk Manager*.

⁴ Grant Thornton, Catalyst: *The Family Business — Maintaining Balance* (2004).

⁵ *Making the Case for Financial Literacy*, Jumpstart Coalition, 2005.

⁶ Jaffe, Dennis and Grubman, James. *Client Relationships and Family Dynamics: Competencies and Services Necessary for Truly Integrated Wealth Management*. Journal of Wealth Management (2010) pages 16-31.

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