

Steps to Smoothly Transfer Control of Your Family's Finances

By Douglas P. McCormick

Article Highlights

- Continuity planning ensures limited disruption, protection and continued access to the family's financial resources should the "family CFO" become incapacitated or die.
- Tactical planning helps the family make the most of its financial resources through efficient transfer of assets and the use of sound planning tools and policies.
- Strategic planning instills skills and values in the next generation to not only preserve wealth, but also to position them to continue to accumulate wealth.

My father has gotten a lot of things right when it comes to money.

In his capacity as the "chief financial officer (CFO)" of our family, he saved well, invested well, managed his labor well and ensured that his legacies (my brother and I) were well-educated and capable of managing the family assets. In fact, because of Dad's mentorship, my brother and I have accumulated wealth that surpasses his.

Yet my father has failed miserably when it comes to family succession planning. Although I've been professionally managing money for 20 years, he is unable to relinquish the leadership role when discussing family finances. He is unwilling to provide a detailed accounting of his own financial circumstances or to promote an environment in which our extended family can openly discuss our financial situation, objectives and ways to maximize these resources over multiple generations. Because of my father's rigidity in this area, I am sure that my family has missed out on valuable chances to learn from one another as well as about worthwhile estate planning opportunities. Dad is not alone: Most families miss this opportunity. The conversations can be daunting, delicate and even embarrassing.

Succession planning for the family CFO is the most commonly neglected component of most family businesses—what I call Family Inc.—yet one of the most important actions that will determine the ability of your Family Inc. to thrive over multiple generations. Many successful people work a lifetime to accumulate substantial wealth, yet spend minimal time preparing their families to effectively manage this tremendous asset. When navigating this transition of



responsibility to your spouse or the next generation, it's helpful to look to corporate America for best practices. These activities can be broken down into three distinct types of planning: continuity, tactical and strategic.

Continuity Planning

The primary purpose of continuity planning is to promote effective and efficient communication and clearly assign decision rights and responsibilities when the responsibilities of the family CFO must transition.

This type of planning is the easiest and most tangible. It consists of activities that family members know to do when you—as the family CFO—become incapacitated or die, to ensure limited disruption, protection and continued access to the family's financial resources in the near term. In corporate planning terms, this is the "Emergency Response Plan" and consists of the following components:

1. Adviser contact information.

This is simply the publishing of your adviser relationships and contact information with a brief description of their areas of expertise, knowledge and responsibilities.

It is likely to include a family lawyer, accountant, investment adviser and trusted family friends. Within this group there should be one person who has been designated the role of "quarterback" among the team to coordinate expertise and referee when necessary.

2. Establishing a will.

This is intended to outline your wishes regarding the

Family Finance as a Business

Many of us go through great pains to separate our work life from our family life, and to leave “business” out of the family equation. Doing so diminishes our ability to make sound decisions about our financial future—and the financial futures of each of our family members. There is no reason why asset and liability management, practical financial statements, control of risks, asset allocation and tax planning can’t be adopted from the world of corporate finance and adapted for your personal use.

Though few people think about it this way, as I explain in “Family Inc.: Using Business Principles to Maximize Your Family’s Wealth” (John Wiley & Sons, 2016), everybody owns not just one, but two distinct businesses: a temporary labor business and an asset management business, which together comprise Family Inc. The temporary labor business is your finite labor potential, which is depleted over time. Your financial objective for this business is to convert it into financial assets as efficiently as possible. The asset management business is to oversee the wealth you have accumulated through labor, inheritance and other means. Your objective with this business is to manage and enlarge your assets and to produce adequate cash flow to support both your consumption needs and investment in your labor business (e.g., by paying for education.)

As the family CFO, your goals, therefore, are to:

- provide adequate cash flow now and into the future,
- maximize the family’s net worth and
- maximize what you can leave to family members or to worthy causes.

disposition of your personal affairs and assets in a way that is clear and avoids dispute among recipients, so family members can focus on assuming their new responsibilities within the family and not on arguing among each other.

Ideally, this document should be shared and discussed openly well before its effective date. While this can prompt difficult discussions, it is better to have them when you can participate and offer your rationale and provide opportunity for a two-way exchange and understanding, rather than waiting for them to occur in your absence.

3. Planning for the possibility of becoming disabled.

Designating a durable power of attorney and creating an advance medical directive ensures that your designee can effectively make decisions on your behalf regarding your estate, financial and medical affairs should you become incapacitated.

Tactical Planning

With a sound continuity plan, the CFO transition can occur with minimal disruption of the family’s financial affairs, and the new CFO can focus on the tactical responsibilities of the role change. Tactical planning is designed to help the family make the most of its financial resources through efficient transfer of assets and the use of sound planning tools and policies.

Specifically, the family CFO should consider the following.

1. Effectively employ trusts and gifting strategies.

Employing these tools over numerous years prior to a transition can facilitate tax-efficient transfer of assets among generations. A trust can also be used to protect family assets from creditors and impose constraints to ensure the estate is managed and consumed responsibly.

2. Integrate insurance into your estate plan.

Insurance products can be an ef-

fective wealth transfer tool, while also ensuring that the family has adequate liquidity to satisfy potential estate tax liabilities.

3. Implement an investment policy.

You should support the new family CFO with a clear investment policy. Such a policy provides valuable guidance regarding asset allocation, investment selection, diversification, fee profile and withdrawal strategies.

If you have been at the helm of the family investment decisions without much input from other family members, this can provide valuable “training wheels” in partnership with a trusted financial adviser.

4. Implement a charitable giving policy.

This can be a helpful resource for training the new family CFO with guidance about gift sizing, types of causes and criteria for best-in-class charities such as measurable impact and expense leakage.

Just like investing, learning to give effectively takes practice and experience.

Strategic Planning

Strategic planning is about instilling skills and values among the next generation of family CFOs. With strategic planning, we are migrating from defense to offense: Instilling these skills and values in the next generation of family leaders will not only help preserve the wealth you have worked so hard to create, but it will also position this generation to continue to accumulate wealth and pass on these valuable skills and values to their successors.

Strategic planning is challenging and requires time, patience, teaching, humility and honesty, but the payoff can be significant.

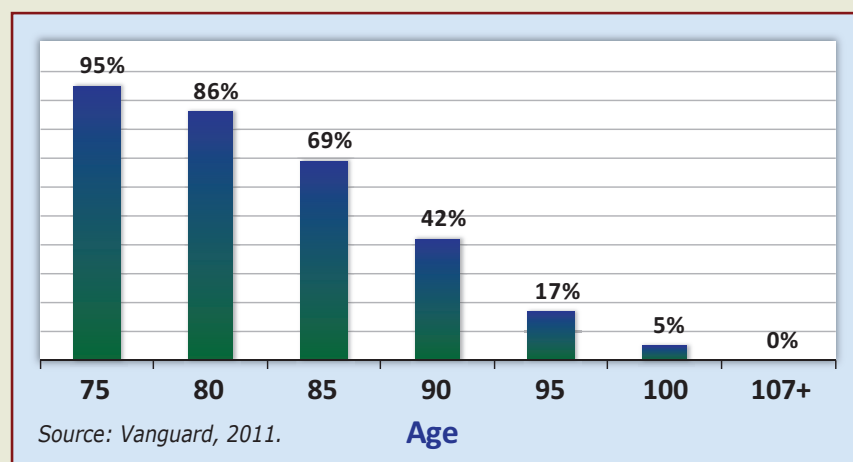
Below are some considerations for creating an environment conducive to developing the skills to take on the responsibilities of the next family CFO.

1. Leave emotions at the door.

One reason the discussion of gen-

Longevity Is Uncertain

Figure 1. Probability of at Least One Member of a 50-Year Old Couple Living to Various Ages



The uncertainty related to longevity presents a significant challenge to the family CFO (Figure 1).

The CFO must ensure assets last long enough to support a quality life for the retired couple, but not so much that consumption is unnecessarily forgone. It also directly impacts the management of the family finances, since the timing of a transition to a new CFO may be sudden and abrupt as opposed to a planned, expected process.

erational wealth transfer is so neglected is that parents and kids often have a hard time interacting without the bias of family routine.

When it comes to family financial business, the discussions and decisions should be based on the merits of the financial decisions, not the family roles.

2. Establish periodic strategic planning sessions to review your family's performance.

Just as a corporate board of directors meets to discuss the performance and strategy of a business, the family CFO should orchestrate periodic meetings—at a minimum, annually—to review the status of the family's performance over the preceding period and any major initiatives over the coming period.

This represents a low-stress way to engage and educate the family members about your finances.

3. Promote two-way communication.

Parents often seem uncomfortable candidly sharing their financial situation with their children. This apprehension can be minimized in several ways.

First, clearly establish that the family expenditures are at the discretion of the oldest generation—parents should not feel guilty about consuming their accu-

mulated assets and leaving less for the next generation; the younger generation should not feel entitled to the assets of the parents.

Second, promote a two-way exchange of information so that when finances are discussed, all family members are encouraged to share information and ideas and to acknowledge shortcomings, mistakes and weaknesses.

4. Establish that the skills necessary for the family CFO require years to develop.

Remember that your journey as a financially sophisticated professional has been an evolution. For most of us, it continues over a lifetime.

One of the primary responsibilities of the family CFO is to be a teacher. Be patient and take every opportunity to teach and reinforce the lessons of financial security. It's difficult to start this education process too early.

5. Create opportunities for failure.

Failure is a critical part of the learning process. We all have stories and experiences such as maxing out a credit card, failing at budgeting, committing financial infidelity (lying to your spouse about a purchase or how much something cost) or losing money on a stupid investment. These experiences helped us

become better financial managers and maybe even better spouses.

As the family CFO, you should create opportunities for your children to assume financial responsibility and likely fail. Give them access to a credit card, give them autonomy to spend budgeted money and give them authority to invest a small pool of capital.

By doing this, you create valuable teaching opportunities and chances to fail with a relatively low cost. I would much rather have my kids learn the lessons of finance through small, controlled failures than through catastrophically squandering the family resources that I and previous generations have spent lifetimes of work accumulating.

6. Create financial incentives to promote engagement and participation.

In business, we commonly fashion financial incentives to encourage desired behavior by employees and managers: pay raises, bonuses and equity ownership. Financial incentives can also be effectively employed in managing and transitioning your Family Inc.

Common and effective financial incentives include the following:

- Subsidized investments in labor development. Encouraging highly educated heirs by subsidizing

education is not only a great investment, but also a great way to perpetuate your extended family's financial success.

- A matched savings program. As many companies do with 401(k) retirement plans, you can promote higher savings rates among your children and grandchildren by establishing a program to match all or part of what they save.
- Compensation for responsibilities as a member of your Family Inc. board of directors. Just as some companies pay for the services of an independent board of advisers, you might choose to compensate family members for actively engaging in family financial meetings and for specific financial management responsibilities such as assisting with tax preparation or managing rental property.

- Capital contributions to heirs based on enhancing desired performance metrics such as income or net worth. For example, one might make annual payments to family members based on a percentage of their earnings or net worth.

No technique is perfect. These, however, are all designed to have the same impact: promote skill development and responsible financial planning and behavior that allows your heirs to not only assume the responsibilities of being the family CFO, but thrive while doing it.

Picking Your Successor

The activities outlined in this article can have a profound impact on your next generation's ability to effectively manage and perpetuate the family resources. However, it also takes willing participants and some level of natural

aptitude.

In some cases, family members may not possess that aptitude or interest to develop these skills. As the family CFO, you must be brutally objective about this aptitude and interest. Allocate capital and bequests based on equity and fairness. Allocate control of financial resources and decisions on the basis of capabilities and merit. These two concepts don't necessarily go together. You can allocate your financial resources equally among heirs, but give disproportionate decision rights to heirs or outside advisers with the aptitude and personality to effectively manage, expand and perpetuate your Family Inc.

Your heirs who are not financially astute may thank you in the long run for not simply awarding decision rights by default. And regardless of whether they thank you or not, they will be more financially secure. ▲

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Portfolio Strategies

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of the favorites for people who are as flexible about spending as my husband and I are.

There are ways it can go higher. If you're older, you might choose to go higher than that. But just remember that this is your plan and the basis is that it gets you through the worst 30 years.

If you say "the odds are I won't have those worst 30 years," then you can go higher. But again, if you go higher, you need to understand why you are going higher and what choices you've made. If you hit a very bad period for five years, as we had overall from 2000 to 2006, then you can cut back on your spending and ride it out for a while—refrain from

making withdrawals. And, by the way, I'm sure your members know this, but many people still get confused when you say a 4.5% withdrawal rate. I find that people think that's 4.5% a year; it is not.

If you take 4.5% a year, your income is going to go up and down. The objective of a withdrawal rate is to have a steady inflation-adjusted income that you can budget for. So the 4.5% applies only to the first year you start drawing on your money. After that, you simply increase the dollar amount you took that first year by inflation every year. So after that, the whole 4.5% concept goes away, and you are just increasing your withdrawals by inflation amount.

Now, 10 years down the road, you

may say, "I'm living too conservatively. I have a lot more money than that." Then you reset. Or maybe you started a little higher and the market turns out to be a little worse than you had hoped; then you reset 10 years from your retirement date.

The idea is to have that plan that you start with and to, what I call, "right-size your life." This means getting your expenses to a level where you are living within that particular plan you have chosen. You know that you can afford your life, which is a major thing. And once that's done, you can make other choices with your savings and your spending. ▲

See part two of the conversation with Jane Bryant Quinn on investing in retirement in the June AAI Journal.

Jane Bryant Quinn is a nationally known personal finance writer and commentator. Her latest book is "How to Make Your Money Last: The Indispensable Retirement Guide" (Simon & Schuster, 2016). Find out more at www.aaii.com/authors/jane-bryant-quinn. Charles Rotblut is a vice president at AAI and editor of the AAI Journal. Follow him on Twitter at twitter.com/CharlesRAAI.