Family office succession planning[1]

Susan R Schoenfeld

A number of years ago, John and Ann Williams[2] sold their successful family-owned business and established a single family office to invest the sales proceeds and support their family's investment, reporting, tax and other needs. They had professionalised the office with strategic investments in staff, including a senior level COO and CFO who reported directly to John. Over the years, the office took on more responsibility, not only for John and Ann's affairs, but for those of their children and their children's families as well.

Now that John and Ann are getting ready to retire they ask for advice on succession planning for leadership of the family office. As a significant portion of the Williams' family wealth is managed by their single family office, this decision takes on great importance for their family. This article will cover three important considerations to prepare them for this all-important transition.

Selecting the successor

Ideally, the identification of a successor leader should happen years before the anticipated transition, but this step is often the most emotionally difficult for a successful patriarch and matriarch, who often don't believe that their children are 'ready' or that they possess the right combination of skills necessary to assume the leadership role. Successful entrepreneurs often reach their level of success by hard work and long hours in the extreme, the vision to see beyond what exists to what might be, and exceptional business acumen, with or without formal education. These traits are not as commonly found in second generation inheritors, who don't face the same level of economic adversity, though being the child of wealthy parents certainly brings its own challenges. It is difficult for many parents to recognise and appreciate the value, unique skills and experiences of their children.

John and Ann provided their offspring with the best of everything, and encouraged them to follow their own passions. As a result, their children did not grow up with the 'hard knocks' life experience or the fire in the belly that their parents have, and John and Ann have come to believe, perhaps too late, that none of their children are suited to take over the leadership reins when the time comes.

This view cannot, by definition, be entirely objective. Many parents never fully believe that their children are ready, no matter how old or accomplished they may be. John and Ann might ask their advisers for a more objective perspective on the readiness of the children to take on a greater leadership role, and for suggested interim steps to help them get there. John and Ann may need help coming to terms with the fact that, while they may never believe that their children are ready to take over, it is important for them to plan ahead. As an ageing patriarch and matriarch, they need to take steps to plan their retirement, and identify and train new leaders to take over.

In some cases, it makes sense to skip a generation, and select a grandchild to groom for this critical role. Depending on relative ages, interests and capabilities, it could prove to be the best solution for the family. One family that I advised several years ago, the Watts family, had three children, each of whom had three children of their own, or nine grandchildren in total, all in their mid-to-late twenties. As the patriarch contemplated his impending retirement, I encouraged him to initiate exploratory conversations about who in the family was best suited to succeed him as family head with each of his children and their spouses.

As a result of those conversations, he learned that they were each busy with their own lives and businesses, and it would be an imposition to ask any one of them to sacrifice their professional time to take on the successor mantle. Instead, we set up meetings followed by formal interviews with the grandchildren. In conducting the interviews we looked for who was most ready, willing and able to take on the leader role. I asked the retiring patriarch to list and rank the qualities and characteristics that he thought would be most beneficial, and then we asked the family's attorney, financial adviser and other trusted advisers to add to the list. The final job description included such traits as intellectual curiosity, financial acumen and the willingness to embrace change, including openness to new technologies.

After the interviews were completed, we identified a promising and willing successor among the grandchild generation, and began to develop her for future leadership roles. Instructive in this example is that the patriarch did not make these decisions in a vacuum – he sought out input from each of the stakeholders involved, and took into account their points of view. It is often true that self-made wealth creators are not accustomed to seeking or considering the opinions of others; this is one decision that requires the input of all concerned.

The new leadership should be selected with an eye towards the future. The new family office head will have to face very different challenges than did John and Ann, due to changing external socio-economic factors, ever-shifting global, political and economic realities, as well as the internal family challenges presented by an expanding diversity as family members marry and have children of their own. We have only to witness the recent Brexit vote in the United Kingdom, and the US presidential election to realise that the world is changing quickly, and the global political landscape is much less predictable than it used to be.

In the Watts family described above, as each of the nine grandchildren married, they dispersed and lived in many different countries, all of which have different tax and securities laws. The family office had to consider the expanding universe of the tax impact of its distribution and investment decisions. It also had to evaluate how the shifting political landscape might impact the regulatory and reporting rules in the various countries involved. The family office took on a critical role for the overall sustainability of the family enterprise; they coordinated and assumed responsibility for anticipating the impact of monumental global events on the family.

The spouses of all the grandchildren also brought another kind of diversity to the family office. They brought their own expertise, some of them investment, legal or tax professionals themselves. No longer could the family office operate in a vacuum, subject to the oversight of only the patriarch. Now many different sets of eyes would be watching and evaluating the performance of the office. This brought a heightened level of accountability and oversight to which the professional staff were not previously accustomed, which further enhanced the value of the family office to the various branches of the family.

While many families are tied to the idea of a bloodline-only succession line of leadership, increasing numbers of open-minded families are willing to consider naming an in-law for this important role. If neither of John and Ann's children are interested in or qualified for the role of heading the family office, perhaps a spouse might be appropriate. One family I know has been grooming their son-in-law for leadership for quite a few years, starting by including him on various governance committees, which led to his being named head of the family council, with the longer-term plan to name him as head of the family office. Not only did this provide needed diversity and expertise, but it also made a significant statement to the entire extended family about trust and inclusiveness. This individual was not just their son-in-law, he was the parent of their grandchildren and, as such, had just as much to say in passing along the family's stories and culture to the next generation as anyone.

Increasingly common in today's society is the blended family, produced by second marriages – or third – with children from previous marriages. The Watts family had such a situation. Two of the nine grandchildren were not of the family bloodline; one of the children had married someone with two adult children from a previous marriage. This child considered her husband's children as her own, though she did not legally adopt them, and wanted them treated equally with all the rest of the grandchildren. Other family members disagreed, and there was animosity among the family branches as a result. The patriarch did meet with them as part of the grandchild interview process, but ultimately selected a different grandchild whom he determined had broader education and experience, and therefore was more qualified. Each family must decide for itself how they will handle family members who are not of the bloodline, whether they are stepchildren or in-laws.

Not only might John and Ann think that their children are not prepared to assume the mantle of leadership, but another significant hurdle is their own readiness to give up that mantle. They have gotten accustomed to the financial and psychological trappings of leadership, including the literal and figurative seat at the head of the table, running the

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family meetings, and having the ultimate decision-making authority. They might not be comfortable relinquishing this power role to someone else, even as they realise the necessity of doing so. A possible solution might be to develop a longer-range governance process whereby John and Ann can maintain the titular leadership position of their family office, though not necessarily day-to-day management which they would transition over time to their successor.

In addition, John and Ann must bear in mind that planning for one's retirement has frequently been compared to planning one's own funeral, and often brings up deep-seated fears about mortality. Estate planners know too well how clients postpone critical planning out of reluctance to discuss thoughts of their own mortality. This common phenomenon is even more prevalent among strong-willed, successful, self-made entrepreneurs, who are convinced that only they are qualified to hold the keys to the kingdom. It is hard for them to imagine the day when they will not be at the helm to make all the important decisions.

I have often found it a useful exercise to ask them to imagine what would happen if they stepped out onto Fifth Avenue in New York City and got hit by a passing bus. Who would make the necessary decisions the very next day to carry on all the family's extended business and investment interests? Who would be prepared with the necessary authority, information, experience and education to do so? Was it fair to his wife and children, just at the moment when they would be dealing with personal grief over the loss of their husband and father, to also have to wrestle with unfamiliarity with the family's widespread holdings and business interests? Wouldn't it make more sense to begin sharing details now, in case of an untimely accident?

In some unfortunate cases, John and/or Ann have gotten on in years and may no longer have the requisite mental capacity to continue as leader of the family office. They have become increasingly forgetful and disoriented, and it appears that they should no longer be in control of the family's financial affairs. In such a case, their children might need advice on a course of action to relieve their parents of their decision-making roles while still providing them with respect and dignity.

In the United States, the Health Insurance Portability and Accountability Act of 1996 (HIPAA) provides privacy and security requirements for safeguarding medical information. While the intent and spirit of this law is to afford privacy to patients about their health care and medical conditions, it can present a serious impediment to families who need to plan for the orderly transition of their assets and who will be in control of those assets.

Many trusts and other estate planning documents have in their 'boilerplate' that two physicians must certify when someone no longer has the requisite mental capacity to continue to serve as a trustee. HIPAA restrictions may well prevent physicians from discussing the condition of a patient whom they have examined, creating a Catch-22 for the family. They can't remove their family member who is suffering from an evident mental incapacity, because they can't get physicians to violate HIPAA by certifying to that incapacity. How does a family resolve this without going to court?

One example of creative drafting to circumvent this obstacle that I have seen is to require that, if demanded by a majority of the co-trustees, the trustee must choose to either submit to a mental capacity evaluation and waive their HIPAA rights or else resign as trustee. This clause, or something like it, would provide John with a graceful way out instead of engaging in a potentially embarrassing competency hearing.

If none of the children, grandchildren or their spouses, has a real desire or ability to assume the leadership role, John and Ann might have to consider a non-family member successor. The long-time COO and CFO of the family office have served the family faithfully for many years, watched the children grow up, and likely know more about the family wealth enterprise than even the family members themselves.

In such a case, it might be very appropriate to name one or the other of these long-time employees as successor. This person would likely bring on more professional management of the family's investment and tax functions, providing a greater level of accountability and service to the family at large than the founder generation would have.

As the family office takes on increasing numbers of professional managers, it will become increasingly more expensive for the family to maintain its family office. Who will bear the expense for funding the family office, and how will the expenses be allocated? Some families elect to share the cost equally among the branches, while other families address the inequality in how much they respectively use the family office resources by strict time allocations among the family branches. It is recommended to consider these potential trouble areas long before they become problematic.

Appropriate new policies would need to be established, not only for a compensation structure to incentivise the employee to continue on, but also a structure to groom a successor for this long-time employee who would continue the family's goals and values. The family is making a significant investment of trust in its future with this employee, and they wouldn't want him to leave for a better offer, or suffer a lapse in judgment that would put the family at risk. In addition, the senior-level employee not chosen might decide to take early retirement or seek other employment, rather than report to a long-time colleague, and the office will have to replace this talent in short order.

John and Ann may be confident that their COO, Charles, is trustworthy beyond reproach, but is this confidence justified? What checks and balances have been put in place to assure that the family's assets remain secure and that private information remains private? How well is Charles vetting and supervising the staff he hires to work under him? And what safeguards are in place to cultivate and retain talent that he may come to view as a threat to his own position and wrongfully terminate? And who is supervising Charles so that when he makes inappropriate remarks to female subordinates at the office holiday party, the family has a confidential reporting mechanism in place to learn about it and take corrective action so that they are not subject to a lawsuit?

Grooming the designated successor

Once John and Ann have selected their designated successor, the next step is a process to groom and develop that successor to eventually lead the family enterprise.

Many years ago, when John and Ann's children were young, they began to teach the children basic financial literacy skills in age appropriate ways. They kept this up over the years, established bank accounts for their children and encouraged them to save a portion of their weekly allowance. The children learned about interest compounding, and the basic principles of investing. They were also encouraged to donate a portion of their allowance in order to teach them about their responsibility to their greater community.

As the children got older, John and Ann would bring them to the family office, informally educating them on much of the day-to-day operations of the office. The children spent increasingly more time at the family office over time, taking on summer internship positions to learn about all the different accounting, investment and tax functions. Because all of this groundwork was laid over the years, the children have more than a passing familiarity with how the family office operates.

This continuing pattern of education is important for all children, not just the designated successor. I recently facilitated a family meeting with the King family: the mother and father and all three of their college-age children. The parents realised that their children were at an important crossroads in their lives; they were about to select and declare their major courses of study at university, and the parents wanted their children to have a basic understanding of their expectations for inheritance before they each made this important decision.

Their plan was to provide each child with a sum of money substantial enough that they could pursue a less remunerative career which might be more personally satisfying to them – one of the children was talented in the arts, for example – but not so much that it could be squandered indefinitely, if they were inclined to do so. In the course of the family meeting, these plans were discussed, questions were asked, and meaningful education and communication resulted. Each of the children was then able to think about their passions and future career path with a better understanding of what economic impact might be involved.

Now that John and Ann have officially designated a successor, a formal educational programme can be put in place to prepare the successor to take control. More intensive training about the inner workings of the office, and in-depth discussions about overall business vision and investment philosophy should become the priority. A detailed discussion about family office policies and procedures should be undertaken, with particular emphasis paid to the distribution policies for the family members.

The transition process should be a gradual one, in order for the new leader to develop the necessary knowledge base. The designated successor will have much to learn even as he or she may have already been exposed to the inner workings of the family office. The process might start with a shadow programme, where the successor may watch and learn from the retiring leader, not only the operational and management issues, but also the values and the vision that led to the success of the family enterprise.

The next step might be an interim power-sharing arrangement between the current leader and the designated successor. This step can last for varying time periods – in some families it is a mere matter of months; in others, it can last for years. It is important for all concerned to become accustomed to the new face at the head of the table.

In the Watts family with the nine grandchildren described above, we undertook a comprehensive training and development programme for Elizabeth, the designated successor. We started with a review of the family history, including the detailed inner workings and growth of the family business, even though it had been sold about 10 years before, so that Elizabeth could understand not only the source of the family's wealth but also its values and culture. We then moved on to extensive sessions with the investment personnel so she could understand the investment philosophy behind the family's holdings. As Elizabeth grew more comfortable with the existing positions, she was given increasing input over new investments, so that eventually the resulting portfolio was her own responsibility and reflected her own, more global, philosophy. Similarly, she was given

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ultimate hiring authority over all new personnel, so that she had their loyalty and respect, and had responsibility for their performance.

We also reviewed all of the office's policies and procedures with her, paying special attention to the policies impacting the family, especially the distribution policy. The current policies had been established by the retiring family patriarch on his own over the years, and reflected his own needs and point of view. While he always had tried to consider his family members' concerns, the family rarely ventured to contradict him or offer any input and viewed him as a benevolent dictator.

The incoming successor, by contrast, sought out and encouraged differing points of view, and recognised that the family's needs had expanded over the years, as indeed the family itself had expanded, and that there were new distribution needs voiced, new careers to be launched, homes to be purchased and educations to be financed. Over time, she implemented changes to the family office policies that were more reflective of the current needs and concerns of the whole family, not just those of the senior generation.

Power-sharing can be tricky for many reasons. John and Ann have been accustomed to sole decision-making authority for many years, and will not be comfortable sharing this power. They will be tempted to second-guess every new decision that is different from what their own judgment might have been. The designated successor too will struggle with this dual decision-making arrangement. They will have a great deal of responsibility, but with limited authority to effectuate change. Further, the family office employees may have conflicts in loyalty, especially if they receive mixed messages from the two sets of leaders. I have witnessed several instances where valued long-time staff resigned in frustration during such a challenging transition.

As the new generation takes on more and more of a leadership role, Elizabeth will generally want to take steps towards professionalising the processes of the family office in order to broaden the services provided. As increased responsibility and authority is given to a widening team, and perhaps existing team members are being asked to leave, an important precaution is putting appropriate safeguards in place. The office should take this opportunity to undertake a review of its information security precautions, access to sensitive material, online access points, and the like. A review of cyber-security policies, procedures and precautions is never so important as when a leadership transition is underway.

Passwords should be changed periodically in any event, but after staff have been terminated it is especially critical. Office-owned equipment such as mobile phones, laptops or tablets, and physical keys, should be retrieved. Multi-party authorisation for expenditures over a nominal amount should be required. Access to sensitive information should be limited to a need-to-know basis, without inhibiting the ability of personnel to accomplish their responsibilities.

On a broader basis, the office might take the opportunity to consider implementing a policy around the use of social media. Seemingly innocuous posts about upcoming family holidays could lead to home break-ins as outsiders learn that the family home is unoccupied, or even kidnapping or other personal security risks depending on the holiday destination.

The final step in the transition is the ultimate transfer of sole decision-making authority. While, strictly speaking, this is a legal matter, John and Ann should not limit this final step to the simple act of signing some legal documents. As discussed more fully in the next section, the family office might plan a formal ceremony or other event to celebrate this culmination of all the planning, training and development.

Communicating the succession plan

Another reason that the transition process should be a gradual one is to allow for all stakeholders in the transition plan to acclimatise to the new leadership regime.

The non-management family members may have a more passive interest in the management of the family office, but will undoubtedly care very much about their continued financial interest in the ongoing family enterprise. They will need to be assured that there is a formal education programme in place to provide for an orderly transition of family office leadership.

Some may wish to opt-out of future participation in the shared family economic enterprise if they are not assured that the designated successor leader will continue the expected economic prosperity. As much as the family investment portfolio may be structured in such a way as to take advantage of a larger investment pool to participate in particular deal flows, it is wise to allow each member an individual exit option should they decide not to stay invested with the group. It can be limited in time, so as not to cause forced liquidation sales of investment positions that would disadvantage the rest of the family portfolio value.

In the Watts family with the nine grandchildren, we held a family meeting to formally announce the designated successor, explain why she was selected, and give everyone the opportunity to ask about what would change for them personally going forward. They were all provided with a three-month buy-out offer, should they decide to leave the collective family investment vehicle. In the end, everyone elected to stay invested in the collective family enterprise after hearing about the future plans and about Elizabeth's interest in a more inclusive approach going forward.

The organised and thoughtful communication to the family about the reasons behind the selection of Elizabeth and about the selection process itself defused any uncertainty and discomfort by addressing it head-on. Knowing that they had the right to leave gave them the freedom to decide to stay without feeling trapped. The family was assured that there had been a disciplined and considered review of eligible candidates rather than relying on favouritism or nepotism within family branches, and that there would be an extensive training process so that the new leader would be fully prepared to take over the reins.

In addition, there may be resentment about the choice of a successor, and family members not chosen, or members of their family branch, may seek to disrupt the planned orderly transition. Depending on how extended the family is, there may well be family members who thought they were qualified but were passed over for the top spot.

In order to overcome these and other objections of other family members, an ongoing programme of open communication should be established, providing the opportunity for questions and concerns to be voiced, and to allow for new ideas and ways of approaching the overall family office transparency.

Special roles might be created for these other family members to utilise their special talents on an ongoing basis. The Watts family created committees with many different purposes, and encouraged all the family members to join or head whichever committee interested them most. Some members volunteered to plan the annual family meeting soup to nuts, selecting the location, planning the social activities, even the meals. Another committee was formed to create a family newsletter. The family office took care of the administrative aspects of the newsletter, but the family committee members created original content and solicited newsy titbits year-round from the rest of the family. A third committee, comprised of members and spouses with investment expertise and interest, served as an advisory committee for the office's professional investment staff. And yet another committee was formed to advise the trustees of the family trusts – on a non-binding and non-fiduciary basis – with respect to various aspects of trust administration, including suggestions on the appropriateness, timing and amount of discretionary distributions for younger family members.

All these various committees were more than mere busy-work to appease family members passed over for the top spot. They each performed important functions for the family and strengthened the value that the family office provided to the family. Moreover, by working together on committees comprised of members across the lines of family branches, distant cousins came to know each other better and created bonds of trust that might not have been otherwise achieved.

Similarly, the family office employees will appreciate honest communication about the planned transition, and what is expected of them during and after the transition. They may have concerns about their continued future employment, and should be reassured to the extent appropriate. If staffing changes are expected, they should be communicated all at once, so that morale is not compromised by the uncertainty of ongoing terminations. Regardless of whether Charles the COO can be assured of his continuing employment, those staff who report to him need to know where they stand; if they are being kept on, then they should be assured, and if they are to be terminated, that too should be communicated with dignity, respect and professionalism.

Finally, John and Ann, as the retiring family heads, will often have complex and ambivalent feelings about their own impending loss of control. The power-sharing balance during the transition period may be especially difficult for the hard-charging entrepreneur who has traditionally had the final say. This may be part of the reason that the leader doubts that his or her children are 'ready' to take the reins.

John and Ann will have to come to accept, often over an extended period, that such a transition is not only inevitable but ultimately beneficial for the overall family enterprise. One technique that has proven effective here is to establish a new 'emeritus' role for the retiring leader, to smooth the personal emotional difficulties for the founder created by the transition. In this role, the retiring leader still retains a title, a continuing role with defined responsibilities, and some defined perks of his or her position as founder.

The family office should plan a big ceremony for the actual day that the new leader takes over.[3] This will accomplish three important purposes: to provide an opportunity to acknowledge and celebrate their leadership over the years; to welcome the new leader; and to serve as a clear demarcation of the date of the transfer in leadership.

The importance of this first purpose cannot be overstated. John and Ann are not only the founders of the family office, but they are the creators of the family's wealth. Their hard work over many years has assured the family of its comfort and privilege to make many choices in life. This should be celebrated in a meaningful way.

Secondly, the incoming successor should be encouraged in their new role and assured of the support and backing of all the family members as well as the professional staff. While the new position will undoubtedly have its perks and privileges, it will also carry with it much pressure and responsibility.

The third purpose will prove critical going forward, especially if John and Ann overstep their emeritus roles and attempt to veto decisions made by the new family office head. Having a certain date beyond which John and Ann no longer have final authority will provide the family office staff with a reliable yardstick going forward.

A carefully orchestrated transition planned well in advance may suffice to avoid many pitfalls of family office leadership succession. The existing leaders should select a successor well in advance, organise and plan for a detailed process to groom that successor, and be sure to communicate with all the stakeholders to ensure a smooth transition.

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2 All names in this article have been changed to protect client confidentiality.
3 The author thanks Barbara Hauser for reminding her of this effective technique to smooth ruffled feathers, as well as the emeritus role.

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