

AVOIDING OZYMANDIAS'S LEGACY: PLANNING FOR FAMILY TRANSITIONS

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In 1817, the Romantic poet Shelley wrote a sonnet about a king whose legacy is not what he thought it would be. The tale is told from the perspective of a traveler who happens upon ruins next to a pedestal that reads: "My name is Ozymandias, King of Kings: Look on my works, ye mighty, and despair!" The next few lines—"Nothing beside remains. Round the decay of that colossal wreck, boundless and bare, the lone and level sands stretch far away."—underscore what can happen when succession plans are not well crafted.

In the hopes that our readers will plan better than Shelley's ancient king, CFA Institute consulted with three experts on family wealth transitions: Chancellor Grover Brown, formerly of the Delaware Chancery Court; John DeMoss, CFA, president of DeMoss Capital; and Mike Slud, CFA, family investment officer at Genspring Family Offices. The following is an excerpt from that discussion.

PLANNING

When asked about the most common mistakes investors tend to make, each participant put failing to plan at the top of the list.

Brown: One of the matters I adjudicated involved a nonprofit Delaware corporation controlled solely by Howard Hughes. Mr. Hughes formed the corporation to hold his stock in Hughes Aircraft, but he never spelled out what he wanted done with it after he passed. If someone could have produced an authentic will or something speaking to a succession plan, the process would have been much simpler. As a result, we had to proceed with a complicated and expensive process that could have been avoided entirely.

DeMoss: Once you do have a plan in place, it's important to keep it up to date. Things change. You should review your plan regularly and make sure it reflects your current situation. I had a client come to me with a plan he had not reviewed in almost 10 years. During that time, his situation and the tax laws had changed. As a result, he wasn't going to be able to take advantage of estate tax exemptions with a structure that was put in place a decade before.

Slud: And it's also important to stick to your plan. A lot of families still have too much of a short-term perspective, and sometimes monthly

returns can dissuade them from keeping their plans in place. I also see too much focus on relative performance, which is interesting but not really relevant to whether a family is on track to achieve its goals. It can also discourage a client from keeping an appropriate asset allocation. A goals-based planning model is a better approach.

EXECUTION

Another important element in executing a smooth wealth transition is ensuring that the individuals who will be receiving the wealth are prepared to steward it appropriately.

Brown: The most popular way to do that is to pass wealth on in the form of a trust, where someone regulates how the income is distributed. I've seen cases where the trustor has written into the document that he wants the beneficiaries to have something but he doesn't want them to lose the benefit of learning how to make a living.

Slud: My firm's approach is education. It's important to share and communicate, not keep the family wealth a secret, and support the younger family members so they can learn more about the overall family enterprise. We like to see them included in meetings with financial and legal advisers so they can understand what's going on with the family finances. We've also found that a family foundation is an ideal vehicle to have the younger generation learn at the feet of the more senior generation.

ADVISERS

The financial advisers that families engage can also have a large impact on the proper execution of their plan.

DeMoss: I'm a proponent of the family office model, which gives the adviser a broad understanding of a client's goals and situation along with the ability to oversee a broad range of efforts, including taxes, estates, and investment portfolios.

Slud: It's important to remember how a great adviser can contribute to the family. It helps to have somebody serving as a quarterback for the various legal, investment, and accountancy professionals that families work with.

DIVERSIFICATION

Diversification is an important consideration with any portfolio, but it can be a particular problem when the bulk of a family's assets are tied up in the family business.

Brown: Courts and banking institutions always stress diversification because that's the safest thing from the standpoint of a trustee. I know of two cases where somebody set up a trust with the stock of a private company, and the value of the stock went way, way, way up. But the stock didn't pay a dividend, so there was no income for the inheritors, and it could not be sold readily because it was a private company. At some point, it becomes necessary to diversify to get the benefit to people in the second and third generation, for whom it was intended.

DeMoss: One of the things 2008 highlighted was that you can't rely on simple efficient frontier models that assume a normally

distributed return. Going into the credit crisis, a lot of people thought they were diversified, or that the model diversification would help preserve their portfolios, and that was not the case in most instances.

Slud: Families often question the value of asset class diversification during extreme market events, but it's important for us as advisers to stress that diversification still worked during 2008, just not as well as in prior downturns. This market downturn, because it happened in conjunction with a liquidity crisis, was really quite different from a more traditional market downturn. If you were to look at the 2000–2002 bear market, when the S&P 500 Index declined by half, you would see that some asset classes (e.g., bonds, value stocks, and small-cap stocks) did not suffer as much in terms of losses as large-cap stocks and, in some cases, generated positive returns.

*****THE PRECEDING DISCUSSION WAS CONDENSED AND EDITED*****

Frances Melville and William Ortel contributed to this article.

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