



SECURING THE FUTURE

Managing Threats and Opportunities Through Effective Risk Planning



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Dedication

Without a doubt, the individual who most understood strategic risk planning in the private wealth industry was James S. McDonald, the former CEO of Rockefeller and Company who died tragically in September 2009. Because Jim started his career as a corporate attorney, he gained a working knowledge of how business owners evaluate risk and opportunity. In his second career at Pell Rudman, Jim used his exceptional communication skills to describe those risks in terms that owners could understand – identifying opportunities and “avoiding bad decisions” as Jim liked to say.

Jim was fortunate to have the knowledge and technology tools to manage the financial risks for clients. He refined the technology to provide state-of-the-art exception reporting for every client portfolio, and his team used the technology tools daily to orchestrate the planning process. Jim was at his best describing how advisors could isolate investment opportunities and manage portfolio risk using integrated financial models and “what if” scenario planning. We will all miss Jim and the many contributions he made to the private wealth industry.

Sara S. Hamilton

October, 2009

The FOX Thought Leaders Program

Established in 2003, the FOX Thought Leaders Program utilizes a multi-faceted, investigative approach to generate new insight and innovative solutions to some of the most difficult issues facing wealth owners and their advisors. In particular, this risk initiative brings together industry experts (wealth owners, family office executives, advisors and academics) for a face-to-face roundtable discussion to debate and share ideas on how to successfully manage some of the greatest challenges faced by our generation.

This study outlines the findings from the June 2009 roundtable meeting in addition to broad member interviews and surveys. It is the fourth in a series of FOX Thought Leaders Programs and the second study to examine how families with generational wealth can effectively identify, prioritize and investigate family risks.

To view other publications in the FOX Thought Leaders series or to learn more about the program, please visit the research section of the FOX website at, www.familyoffice.com.



From left to right: Sharon Schneider, Lisa Ottum, James Kane, John Benevides, Anna Nichols, Jack Parham, Lex Zaharoff, Sara Hamilton, James Reiss, Scott Welch, Bryan Dunn, Mark Rubin, Joe Calabrese, Greg Curtis, Douglas Rogers, Michael Zeuner, Dennis Jaffe, Steven Oyer, Amy Renkert-Thomas, Ken Mindell, John Duncan, Margaret Vaughn Robinson

The 2009 FOX Thought Leaders Participants

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A Letter from Harris myCFO

Dear Family Office Exchange member:

The economic climate of the last year has taught us a lot about ourselves—and about our true appetite for risk. In conversations with families, they have offered a full spectrum of responses. Some express optimism and view the down markets as the buying opportunity of a lifetime. Others fear the worst—and have considered bold actions to mitigate investment and custodial risks. Still others find themselves awash in information—and want help making sense of it. Most are simply re-examining their personal tolerance for risk and, in some cases, making moderate adjustments that give them greater peace of mind.

There is no right or wrong perspective. But, no matter what your personal outlook is, one thing is clear. The way each of us view risk management has changed dramatically.

That is why we have been very excited to partner with Family Office Exchange on the 2009 Thought Leadership Study on Managing Risk and Uncertainty. Throughout our participation in this research, we have had the opportunity to share many of the risk management procedures that are ingrained in our processes, while learning about how others approach the many areas of their lives where risk is inherent. For me, some of the key take-aways from these discussions were:

Stay informed - It is important to stay informed of how many complex factors affect your investments, taxes and estate planning. Now more than ever, it is critical to apply clear-headed thinking to your financial decisions. Dig even deeper with your due diligence of investments and partners. Insist on absolute transparency.

Build a risk culture - While we are all more concerned with managing the risk that we take on, this is also an excellent time to establish a strong family culture that promotes positive risk-taking among family members. By using this time to discuss long-term goals for maintaining family wealth and exploring the risks family members have taken to create wealth, the family can provide guidance to younger generations on how to weigh different opportunities and help reduce the anxiety around taking action in future times of uncertainty.

As you read this research study, we hope that you find it to be as thought-provoking and insightful as we did during our participation in its development.

Sincerely,



Joe Calabrese
President
Harris myCFO

Study Intent

The 2006 FOX Risk Study, **Recasting the Central Role of the Family Office as Risk Manager**, demonstrated how threats to generational wealth extend far beyond poor investment choices or improper financial planning. It outlined a methodology for prioritizing and mitigating a broad range of risks and used a family case example to demonstrate that process.

FOX initiated this follow-on study, in partnership with Harris myCFO, to build on the 2006 research and to take a deeper examination of risk based on the lessons of the recent market crisis.

After 15 years of relative prosperity, most wealth-owning families were unprepared for such a dramatic turn of events. While no one can predict how they will respond to a crisis until it hits, it is possible to **develop a process for managing risk** to diffuse reactive, irrational decision-making. Many families are still reorganizing and recuperating from the market downturn and determining the best actions to manage the likely events to follow – regulatory and tax changes in almost every country, realignment of compensation structures across many levels of financial services, even changes in public attitudes toward wealth.

This study outlines the best strategies and techniques for managing downside risks while emphasizing the importance of capitalizing on new opportunities for wealth enhancement. It also identifies a management process for the family that ensures thoughtful deliberation during times of crisis or uncertainty. Current actions and strategic planning have an ability to profoundly affect the lives of generations to come. While no one can control the future, families that commit their time and financial resources to nurturing their long-term goals take a proactive rather than reactive approach to the future and have a higher probability for sustaining wealth.

Introduction

In the summer of 1974 the patriarch of one of America's great families addressed his adult relatives. His purpose was to explain why it was that he had just instructed the family's trustees to sell all their stocks and to invest only in bonds and cash. The patriarch acknowledged that all across America panicked investors were dumping stocks in a hysterical frenzy, but he emphasized that this was not what he was doing. He had given the matter much thought, was proceeding in a calm and orderly manner, and his only regret was that he had not acted sooner.

The patriarch spoke about how American corporations had become complacent, how the U.S. could no longer compete in the world markets, and how our economy was being bled to death by inflation. The evidence was clear that Germany and Japan were out-competing us on every front, and the Soviet Union was more powerful than ever.

The patriarch acknowledged that there was nothing he could do about the decline of America, but there certainly was something he could do about the decline of his family's capital, and he had done it. Other families might stubbornly stick with their stocks and watch their wealth disappear, but his family could sleep soundly at night knowing their capital was safe. When the patriarch finished speaking, his family burst into applause, grateful that their fate was in such competent and thoughtful hands.

For the family, the patriarch's decision was a cosmically tragic error. By 1985, the family was poorer than they had been in 1965. And that was in absolute dollars. In inflation-adjusted terms, the family's buying power had dropped by two-thirds. And since many more family members had been born than had died over those two decades, the per capita wealth of the family was a small fraction of what it had been. In the 1960s, the family was a dominant presence in its home city and was known and admired across the U.S. and Europe. By the turn of the 21st century, no one knew their name.¹

As in 1974, the past year provides a critical opportunity to evaluate how families respond to uncertainty, how they make decisions and, most importantly, their ability to manage risks for long-term wealth sustainability. Unfortunately, this example from 1974 could just as easily been set in the fall of 2008. More than three decades later, reactions to an uncertain, volatile economic climate suggest that there is still much to learn about managing critical risks. Not only do many families need to improve their decision-making processes, they need to be more proactive in planning for the unknown, rather than waiting and responding reactively.

To help families fulfill this mandate, Family Office Exchange (FOX) spoke with wealth owners, family office executives and wealth advisors about their response to the economic downturn. Their actions varied from extreme measures to relatively small changes. Intrigued by the families that weathered the market crisis well with little emotional upheaval, FOX brought together 20 industry experts to discuss and debate what risk means for families of significant wealth and how the recent economic events have changed how families must approach both risk mitigation and opportunity analysis.

1. Source: Modified from Greycourt & Co., Whitepaper No. 46, Is It Different This Time, 2009

The lessons from the Thought Leaders Roundtable and the observations and interviews over the past year are examined in this publication. While there are many contributing factors to long-term wealth, there are several risk-planning practices that stand out as critical strategies for success, chiefly:

1. The willingness to communicate fears and concerns about the future and to reach consensus about key risks both within the family and with advisors.
2. The ability to continuously scan the environment and concentrate on addressing the most strategic risks.
3. The discipline to design internal processes for managing threats and identifying wealth-enhancement opportunities.
4. The recognition that wealth comes from risk-taking and the benefit of fostering a culture of calculated risk-taking in younger generations.

Families that recognize these characteristics are best prepared to manage and embrace change and understand that **risk is not something to be "solved."** These families practice effective family risk-planning by developing a culture that balances the management of threats with the recognition of opportunities.

To be a good risk manager requires an ability to separate the possibilities of tomorrow from the limitations of today and accept that the future is beyond anyone's control. While it is impossible for any multi-generational family to be able to identify and anticipate all the potential risks they face, the goal should be for the family to have the appropriate structure and culture to handle known risks in a proactive manner and be able to capitalize on unanticipated opportunities that result from a changing environment.

Unexpected events force families to re-evaluate their structures and processes. People are motivated to make significant changes during a time of crisis than they are during more predictable periods. The fear and angst that many families have experienced may be the motivation that allows them to make changes that will benefit the family for generations to come. This study will examine how to translate that nervous energy into productive outcomes.

"The unexpected occurs with a far greater frequency than most of us acknowledge. Preparing for these unexpected events and situations, and being ready to take advantage of them, is the risk management goal."

– Felix Kloman, Risk expert and author of
"Mumpismus Revisited: Essays on Risk Management"

I. Engaging the Family

Family leaders and advisors must channel owners' current interest in controlling risk into an effective risk-planning process that defines risk in experiential terms and manages risk through a formal process.

The recent market and economic crisis destroyed wealth, challenged bedrock tenets of economics, and revealed significant limitations in standard risk-management practices. In the long run, the crisis will help safeguard the wealth of future generations of families that embrace its lessons about risk and take steps to improve the way they communicate about and manage risk. Leading families are using heightened awareness of economic and financial matters to encourage family members to address challenging, longstanding, and frequently sensitive family risks.

Developing a better process to manage risk begins with the ostensibly simple task of opening new dialogues and improving communications within the family and with advisors about risk. As families are discovering, the key to effective communications—and a prerequisite for improved risk-management results – is the ability to plan for multiple perceptions of what “risk” really means.

Capture Current Willingness to Address Risk

Family leaders and advisors can use heightened family awareness of risk to strengthen risk-management processes.

Advisors know that clients are paying much closer attention to the impact of the economy and financial markets on their wealth sustainability goals. Family members are more willing to engage in discussions of risk and more willing to address key decisions. Heightened sensitivity allows family leaders and their advisors to foster behaviors and build new processes to sustain wealth for generations to come.

One of the greatest risks facing families, arguably, is complacency. For many families, conversations about risk can be sensitive and uncomfortable; improvements in the economy and financial markets, no matter how modest, provide a convenient excuse to avoid difficult conversations. The crisis reveals fundamental challenges in risk management that families must address if they hope to sustain wealth over multiple generations. Families that fail to take systematic action will remain exposed to the potentially destructive effects of extreme events, as well as the more common challenges related to predictable family transitions.

“The first step in the risk management process is to **acknowledge the reality of risk**. Denial is a common tactic that substitutes deliberate ignorance for thoughtful planning.”

– Charles Tremper, Risk Author

Starting the Conversation about the Impact of Risk

Effective communication about risk requires advisors and family leaders to have meaningful conversations about how unexpected risks impact the family. Families approach the topic of risk from a completely personal perspective and they are afraid of losing financial security or impacting their current lifestyle. They approach risk management and risk-taking from an experiential point of view, and often become frustrated when their advisors use complex equations and technical terms to explain an event that has such a significant impact on their lifestyle.

To effectively engage owners in identifying future risks, advisors must address risks and opportunities in the experiential terms with which owners are comfortable. This approach may take more time, and will certainly take more effort, than neatly laying out the family risks in quantitative terms. However, this approach may encourage the family to take a more active role in the risk-planning process, so the results will be more robust and more likely to meet the family's true needs.

Although advisors are encouraged to adopt a broader perspective of risk—one that includes the “lifestyle” perspective common to wealth owners—they may wish to initiate conversation on more familiar terrain. For some owners, it may be easier to start conversations with investment and financial issues first before tackling the more sensitive family communication and relationship issues. For other family members, it is the reverse sequence.

Once the family becomes used to a process for addressing risk, they can then expand the scope of issues to cover. For the risk-planning process to truly impact the family's ability to sustain long-term wealth, it is crucial that the family find a way to manage the issues that can be difficult to discuss. As one wealth advisor states, “Families often have an 800 lb. gorilla in the room and ignoring it doesn't do them any service.”

Fortunately, families and advisors are starting to develop new tools and techniques for discussing uncomfortable topics. One such technique is scenario planning.

“Families can have a meaningful conversation about ‘What keeps me up at night?’ A discussion of deeply-felt personal fears can change the future for the family.”

– 2006 FOX Risk Study, Recasting the Central Role of the Family Office as Risk Manager

Risk-Planning Technique: Scenario Planning

Scenario planning is an effective strategic planning method that has been used for decades by corporations, countries and communities around the globe to envision possibilities about the future not normally contemplated in the course of more conventional risk-planning. It is a particularly useful process to apply in family systems where considering or even conceiving of certain possibilities can be difficult, sensitive or painful, because it gives family members permission to talk about “undiscussable” fears, and “what ifs” in a productive, positive manner. Importantly, scenario planning bridges the gap between the academic approach to risk and the personal experiences that so often drive decisions within families.

Scenario planning enables family members to prepare for an uncertain future and discuss aspects of that future that they may otherwise be inclined to overlook. They are able to identify the “key uncertainties” that have the greatest potential to impact their family. Once these key uncertainties are named and the ramifications of not planning for them are played out in scenario story lines, the family quickly becomes aligned around the need to proactively address those possibilities in their planning efforts. **Applied correctly, scenario planning urges owners not to look at how they want the future to unfold, but to examine different possibilities for how the future *might* unfold.** By examining potential scenarios, owners can better envision future risks and proactively set about planning for them.

An Introduction to Scenario Planning

Goals of Scenario Planning

- Create shared space for the family to think together about the future, consider the “what ifs” and discuss difficult topics
- Challenge closely-held mental models and assumptions about the future
- Demonstrate that there are multiple outcomes to be considered
- Live the future in the present; make issues feel more real to the family and elevate their importance
- Make planning and risk-management strategies innovative, robust and adaptive
- Shift from a reactive, problem-solving orientation to a proactive, creative orientation toward the future

Common Insights from Scenario Planning

- Continuing to do what we’ve always done may not work
- Outcomes that we commonly advocate are not the only possibilities and could have negative consequences
- Outcomes we fear could turn out positively
- Outcomes that we don’t dare discuss could occur
- Factors that we are ignoring are critical
- There are ways forward that we haven’t considered

Sample Scenario Story Lines

- Sudden death of the patriarch or matriarch
- Cash sale of the company business
- Launch of a private equity business after the sale of an operating company
- Unprepared/under-qualified next-generation family member takes over family business

“Nobody can predict [the future], therefore one should not try. The only relevant discussions about the future are those where we succeed in shifting the question from ‘whether something will happen’ to the question: **‘What will we do if it happens?’**”

– Arie de Geus, former Head of Strategic Planning, Royal Dutch/Shell

II. Identifying Critical Family Risks

While no one can prevent unexpected events, steps can be taken to determine where these events might arise and to rank the most important risks for the family to address.

Many wealth owners are uncomfortable addressing risk because it requires acknowledging uncertainty and highlights the limits of their control over the future. Additionally, most families have a negative perception of risk-planning because they only concentrate on risk when a crisis occurs. At that point they are in a reactive mode, unable to make healthy decisions or filter through the range of possible threats on the horizon without becoming quickly overwhelmed.

To be effective, risk-planning has to be an ongoing process that is incorporated into the family's decision-making process. It requires recognition of uncertainty, but it provides a system for prioritizing and cataloguing both short term risks as well as broader external or environmental factors that can affect a family's long-term wealth sustainability. It is not feasible to tackle all family risks simultaneously nor is it logical to put the same efforts, time and capital toward mitigating each one. A proper risk-planning process enables a family to narrow in on the most critical issues that can affect their future to then determine how they can control or mitigate the effects of these issues.

Definitions of Risk

Upside and Downside Risk Factors



“The essence of risk management lies in maximizing the areas where we have some control over the outcome, while minimizing the areas where we have absolutely no control over the outcomes.”

– Peter Bernstein, *Against the Gods*, 1996

Acknowledge Risks and Uncertainties to Uncover Future Possibilities

All families face a wide range of risks that can impact their future. Within this range there are some issues that they can easily identify as likely to occur and other issues that are truly unanticipated. One of the difficulties in discussing and managing risks is that families are faced with a vast number of issues to consider.

To address these difficulties, families should separate the issues that are known to be a risk from those that are uncertain². While most families can easily create a list of the risks that threaten their wealth sustainability, they may have difficulty readily identifying the uncertainties that could also pose serious threats to achieving their long-term goals. The latter requires more abstract thinking about how the family enterprise is connected to broad external influences that they cannot control – as one member said, “the unknown unknowns.”

Once a family has identified the known risks and brainstormed about potential uncertainties, they can then envision the type of controls they will need to put in place to manage the range of risks they may face.

Examples of Risks and Uncertainties

Known Risks	Areas of Uncertainty
Individual life expectancy	Family dynamics
Business success or failure	Entrepreneurial instincts
Spending patterns	Interaction of asset classes over time (i.e., correlation)
Tax policies	Systemic risk in the financial markets and infrastructure
Market returns	Major shifts in government policy or role
Inflation	

2. A framework for differentiating between risk and uncertainty is that risk is the “known unknowns” and uncertainty is the “unknown unknowns.” One example of a critical “unknown unknown” is a family that holds a concentrated position in a highly-regulated industry. There is no way of predicting how new regulation may impact their investment.

Isolate the Core Family Risks to Strengthen the Risk Management Process

A family is likely to have a long list of existing and potential risks. In most cases, however, only two or three of these issues disproportionately affect family unity, financial security and long-term wealth sustainability. It is critical for the family to identify and manage these core risks rather than try to tackle the entire list at one time. It is common in family situations with multiple owners for family members to place different levels of importance on different risk factors. For example, one family branch may feel that geography has become a major roadblock to family cohesiveness, while others in the family who travel frequently are not concerned about that factor.

It is critical not to allow smaller, trivial matters to distract the family at the expense of more significant issues. Families have to focus on their known risks and identify the one or two issues with the greatest potential for harm. In the same way, they must pinpoint the external factors and categories of influences beyond the family’s control that could lead to significant problems (such as political instability or government regulation).

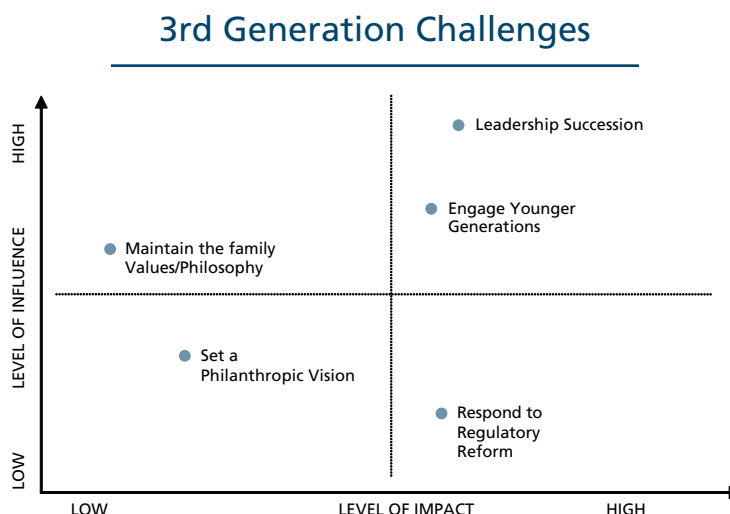
To narrow down both categories, the family can apply the following questions:

- Of the known risks, what are the one or two things that could most dramatically impact the family’s future?
- What are the internal or external influences or factors that could lead to significant setbacks?

Isolating these core risks and acknowledging their potential impact affects how family members view the future and make decisions.

The following matrix, from the 2009 FOX Global Family Council discussion shows common factors that impact third-generation family groups. Each family risk is placed on the matrix according to the level of influence the family has over the risk and its potential impact.

Risk Mapping Critical Challenges



Risk Planning Tool: The FOX Risk Roadmap

The FOX Risk Roadmap is a tool for analyzing both the broad categories of risks and the more specific problem areas that the family must address. The Roadmap has been designed to help families clarify and organize their thoughts around risk. It is intended to be shared with family members for discussion purposes, as a technique to generate further conversations about types of family risks. The blending of individual views into a shared perception of the most critical risks that need to be managed is imperative for every family enterprise.

A Risk Inventory Tool

How to Use FOX Risk Roadmap Effectively

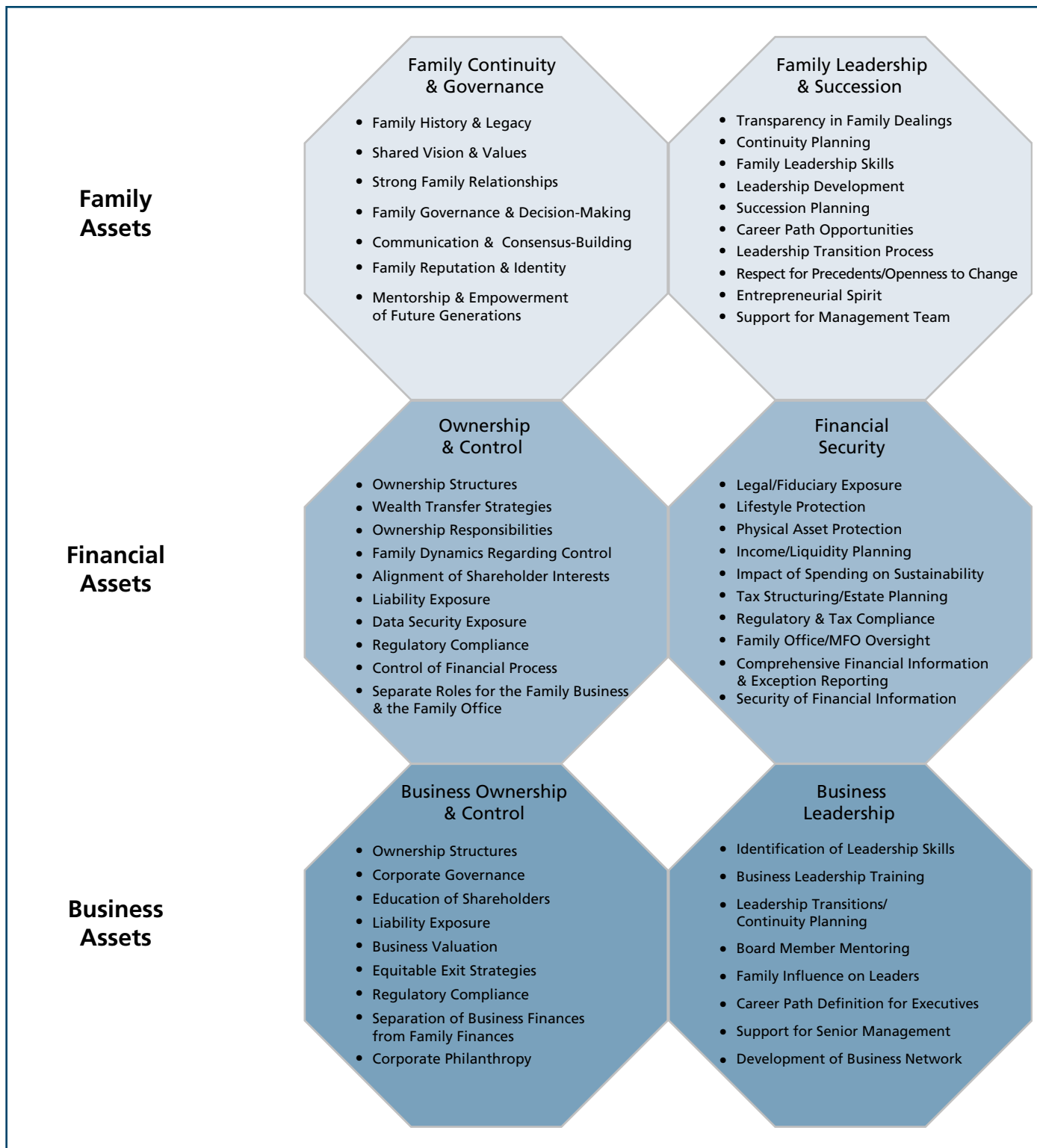
Families and advisors need a way to inventory the potential risks that can derail the goals of the family, which may or may not involve wealth sustainability. The FOX Risk Roadmap updates and builds upon the risk matrix that was first published in the 2006 FOX study, *Recasting the Central Role of the Family Office as Risk Manager*. The tool serves as a roadmap for assessing both the known risks that families face and outlines the categories of potential unknown risks that could impact their future.

This tool is organized into three primary groupings: family assets, financial assets, and business assets. All families have family assets and financial assets; the third category applies only to those families that still own and operate a business. Across these three groupings are 12 categories of risk, each containing a multitude of risk considerations. Depending on the family size, generation, and source of wealth, a family may need to consider most of the categories on this roadmap or just a few.

Since a comprehensive list of key risks can be overwhelming, it is recommended that a family or family office share this tool with the family board first, in order to narrow down the list to include only those that are most relevant for owners to review and consider. To get the most from this inventory, FOX recommends that the Family Council or governing board members take the following steps:

1. Ask the Family Board to identify the categories of risk that have the biggest potential impact on the family and are most likely to occur.
2. For each selected category, focus on two questions: "How prepared is your family now in this area?" and "How important is managing the risk in terms of overall impact on the family?"
3. Present the suggestions from the Board to family members, and ask them to identify other critical areas of risk that have not been included.
4. After developing the list, each family member should rank the risks according to level of impact. Tally the feedback from the group into a critical issues list for review and affirmation by the family.
5. Place the most critical risk areas on a Risk Matrix (see example pg. 14)
6. For each area that a family selects as important and in need of attention, develop a checklist of practices and activities that they might pursue to mitigate the risk.
7. Revisit this roadmap as a part of an on-going risk management process in order to measure the family's success at mitigating past risks and identify any new "problem areas."

A Comprehensive Roadmap of Risk and Opportunity





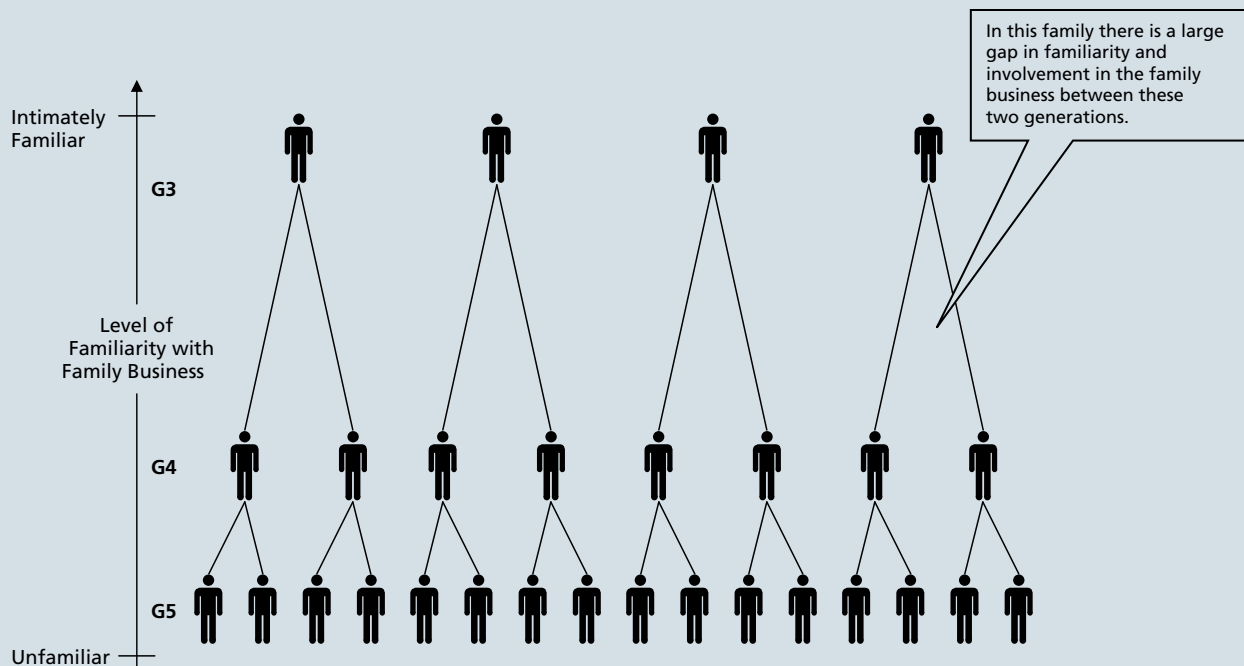
To view an expanded checklist for each of the above twelve categories, please see page 33.

Case Study: Identifying the Critical Issues

Background

By the mid-1990s the Mason Family³ was late in their business life cycle. Ownership had recently transferred from a relatively small group of third-generation family members to their children and grandchildren. In contrast to the relatively small group of G3 owners who had an intimate knowledge of the family business, the younger generations of shareholders consisted of a large number of family members who did not have a deep understanding of the business or their own family history. Moreover, the company lacked internal leadership and a formal governance structure. The family did not know the extent of the challenges that the business faced, but they could see that the company was declining and even facing obsolescence. It was at this point that they decided to designate a single G4 family member as the CEO to turn the business around.

Exhibit vi: Business Familiarity by Generation, Mason Family



Bringing the Family Onboard

One of the first tasks of the new CEO was to prepare the family for the radical changes ahead. After two centuries, family members were set in their ways and the CEO found it difficult to break old habits. The CEO made an effort to communicate and explain each new business strategy and acquisition to the family but, in the end, it took a business crisis to convince the family to make significant changes. Specifically, the crisis convinced a few key family members to support the CEO and agree to reorganize the business, giving the CEO broader latitude to identify and address critical risks.

Identifying the Key Risks

The CEO identified the following key risks that were preventing the business from moving forward:

- Lack of knowledge about the business within the family
- Too many family members on the Board who lacked the proper experience
- Lack of next-generation involvement in the business

Taking Action

One of the first actions the CEO took was to change the company’s board of directors. Initially there were 11 family members, many with no business experience, on the board when the CEO took over. The CEO hired a search firm to find outside board members, took 9 family members off the board, and added new family members onto the board who had business experience.

The next change was to establish much more formal and in-depth communications between the business and the family. This meant giving family members more opportunities to become informed about the company through written communications and an in-person meeting once a year. In 2001 the CEO also established a family council whose focus was exclusively on the family’s activities, identity, and values. This reinforced a clear delineation between the business and the family.

Another significant change was to create a leadership development program for promising family members in mid-career who were not currently working for the family business. These family members were brought onto the company board in pairs and did an apprenticeship for two years. This gave them the opportunity to learn about the business, learn about the current leaders, and to become informed shareholders.

Summary of Key Risks and Actions, Mason Family

Critical Issues	Strategies
Lack of knowledge about the business within the family	Establish formal and in-depth communications between the business and the family
Inexperienced board of directors	Bring in outside board members, take off inexperienced family board members, add experienced family board members
Lack of next-generation involvement in the business	Create a leadership development program for promising family members

III. Strengthening the Family Culture

Risk-taking is essential for sustaining wealth across generations, yet attitudes toward risk-taking can change dramatically over time. Families must therefore work continuously to create a culture that promotes an entrepreneurial spirit and encourages a positive attitude toward risk-taking.

Every family has a legacy and history that shapes their perception of risk and their approach to decision-making. In families with significant wealth, this legacy is strongly influenced by the characteristics of the wealth creator and the history of the family business. The influence of the founder is felt profoundly by the second generation and remains significant into the third generation. As families enter their fourth generation and beyond, however, the influence of the founder wanes. By generation four, family members are unlikely to have developed a relationship with the founder or the business legacy. As each generation becomes further removed from the initial business decisions that led to the creation of wealth, it becomes easier to lose the original spirit of entrepreneurship unless it is consciously preserved in some manner.

Family members who are born into wealth also tend to be more risk averse than family members who witnessed the entrepreneurial activities and risk-taking that were critical to the success of the business. Family members that see themselves as wealth creators will be more comfortable as risk-takers, and family members who viewed themselves as inheritors will be more averse to risk-taking strategies. Those born into wealth are often focused on avoiding risk and perceived threats to lifestyle, particularly if they believe that they are unable to recreate wealth if lost. In their determination to preserve wealth, many overly-conservative owners actually contribute to the erosion of wealth by failing to take reasonable amounts of risk needed to maintain wealth over multiple generations. Many put liquid assets into trusts with extremely conservative provisions with the intention of preserving the family's wealth over the long-term. Unfortunately, such well-intentioned measures often have unintended consequences.

"Progress is dependent on taking risk... taking risk is the defining element in human existence. We should relish, not avoid it; balance, not eliminate it."

– Felix Kloman, Risk expert and author of
"Mumpsimus Revisited: Essays on Risk Management"

Promote the Family Legacy and Inspire a Risk Culture

Storytelling helps preserve the family legacy, maintain the spirit of entrepreneurship, and develop a risk culture that is critical to success. An understanding of the family's history and the risks family members took to create wealth provides guidance to younger generations on how to weigh different opportunities and helps reduce the anxiety around taking actions and accepting the consequences.

The relatively simple task of passing down the stories of past family achievements and, especially, past failures is a powerful method for intentionally cultivating the capital in the family – not just financial capital but the human, intellectual and spiritual capital as well. This recordkeeping enables family members to recognize how they, as individuals, fit into the larger family legacy. It gives depth and meaning to the family wealth and defines it beyond monetary terms.

A strong family legacy needs to be reinforced by family stories. When owners are educated on making choices and given real decision-making opportunities, which are within their control, they learn the valuable lessons that accompany trial and error and living with the results. A connection to the family history grounds their decision-making and gives context to those choices. A strong family legacy combined with a well-designed process for family education provides owners with the capability and character to take action in the face of crises or when opportunities arise.

Value of Family Storytelling⁴

Why Tell the Family Story?

- Preserve the thoughts, values, and principles of the wealth builders
- Build a legacy archive for future generations
- Strengthen the family legacy through education
- Build pride in the family history
- Develop strong bonds to support family governance
- Preserve valuable family myths, stories, legends, and anecdotes
- Continue philanthropic endeavors

Create a Risk-Taking Culture to Support Family Legacy

“[Sustainability] is always about culture; that is the secret sauce. Family culture is what creates long-term success.”

– Family Office CEO

Along with a clear understanding of their past, families that successfully sustain wealth over multiple generations take proactive measures to identify new sources of family capital. These families strive to create an internal culture that fosters risk-taking and entrepreneurial pursuits. They often invest in a formal educational process that teaches family members how to evaluate opportunities and develop structured business plans for effectively communicating, launching and maintaining new ventures. A family that does this well creates a culture that balances caution with encouragement and pushes family members to pursue their passions through planning and hard work.

Families that support individual members to reach their maximum capacity are also willing to embrace experimentation, uncertainty, and the possibility of failure. Even while acknowledging that new family ventures may fail, and establishing controls for limiting the impact of failure, these families appreciate the lessons that failure teaches. Finally, families that are most successful at developing a risk-taking culture are those that recognize that culture is dynamic. The family’s history, the legacy of its founder, and the lessons of its founding business can each fade with time, changing the very culture of the family in the process. Families that wish to preserve a risk-taking culture over time actively “manage” the family’s culture through deliberate effort. A few such strategies are documented in the table on the following page.

Strategies for Creating a Risk-taking Culture

Strategies Identified at the 2009 FOX Thought Leaders Roundtable	
Develop a Culture and Shared Goals that Promote Risk-taking	<ul style="list-style-type: none"> • Define a risk-taking culture for the family • Document the historical risks taken by the family, including those that were unsuccessful • Develop a shared vision for what the family can do together to preserve the family legacy • Commit to goals that require risk-taking and discourage “standing still” (One family’s goal is to regenerate family assets every 50 years) • Serve as a source of regenerative wealth in the local community or multiple communities
Create Financial Strategies and Structures to Promote Risk-taking	<ul style="list-style-type: none"> • Separate the “sleep-well” assets from risk-taking assets (alternatively, the “stay-rich” from the “get-rich” assets) • Assess the risks of concentrated wealth in family businesses and include business assets in risk-planning analyses • Limit concentrated risk-taking to investments with which the family is very familiar or has conducted extensive due diligence • Encourage risk-taking in mission-driven philanthropic ventures • Commit enough money philanthropically so that no owner can rely on inheritance to maintain their lifestyle • Build a base of liquid wealth that allows risk-averse shareholders to sell their shares to other owners
Define Roles for Future Family Leaders and Risk-takers	<ul style="list-style-type: none"> • Understand the value of both stewardship and risk-taking roles in the family • Clarify the roles of owners, directors and managers in the future of the enterprise • Share enough information about the enterprise for owners to evaluate the risks involved • Assess the risk tolerances of owners using scenario planning • Put family business assets in the hands of owners and managers who are strategic risk-takers
Encourage Risk-taking in the Next Generation	<ul style="list-style-type: none"> • Build positive self-development plans for each owner • Require a portion of each owner’s lifestyle to be financed by personal income • Develop messages to moderate personal consumption • Make owners hungry for personal success through role-modeling experiences • Help each wealth owner define his/her risk-taking appetite using a hierarchy of needs approach • Encourage risk-taking and allow children to make mistakes; accept failure as a natural outgrowth of risk-taking • Permit parents to raise their own children without being controlled by generation-skipping trusts
Provide Resources and Structures that Encourage Individual Risk-taking	<ul style="list-style-type: none"> • Create incentives that encourage qualified owners to take entrepreneurial risks • Build milestones around each new venture to focus on being successful • Provide owners with access to relevant educational experiences (e.g., business schools) • Encourage owners to get the education and experience required to make concentrated bets in new ventures

Developed by Thought Leadership Participants in June, 2009.

Case Study: Ensuring the Family Legacy

Background

Over the last 150 years, the Carter⁵ family has successfully reinvested their capital to create substantial wealth four different times. Today they are a seventh-generation family that has grown to more than 400 people. They have always had a very strong sense of family legacy with formalized structures for family member education as well as regular, scheduled family gatherings and social events to build strong intra-family relations. These opportunities for working and playing together as a family are so imbedded in their family culture that many family members do not even recognize them as being exceptional or unusual.

To accomplish their financial goals, the family, starting with the first generation, separated a large portion of their assets outside the business to be reinvested in other businesses. This allowed them to build liquid assets outside their core company and prevented them from being financially tied to the performance of a single company or industry. To this day the family continues this practice and controls several major operating companies.

Elements of a Positive Risk-taking Culture

One main reason that the Carter family has had such success in regenerating their wealth over the past 150 years is that the family fosters a positive risk-taking culture in every generation. Some of the specific elements that contribute to this culture are listed below.

“Tight-loose Framework”

While family members grow up with a strong sense of family unity, legacy, and history, the structure of the family also encourages individuals to prosper and follow their own paths in life.

Family Summer Camp

For the past 13 years the Carter family has held a summer camp for young family members as part of their annual family gathering. This camp provides the opportunity for cousins who are normally dispersed around the world to build strong, positive relationships which will translate well to the boardroom in the future.

Family Education Programs

On-the-job training is a key element of the Carter family’s education programs. If family members so choose, they have opportunities to sit in board rooms, evaluate potential business acquisitions, and serve on various committees. These are real work experiences and provide far more practical knowledge than simulations or classroom training.

Leadership Selection

Older generations intentionally and proactively push the next generation to be successful, but not necessarily to serve the family. This results in new family leaders whose true passion is to guide the family, not those who feel they were obligated to serve or pigeon-holed into their role from an early age.

Older Generations Able to Give Up Control Gracefully

Past family leaders and members of the older generations are careful to listen to the next generation of leaders and give their advice if asked, however they do not attempt to control the family or tell the next generation what to do. This gives new family leaders the freedom to make their own choices, knowing that they have the support of past leaders

IV. Developing a Framework

Families must build processes that will enable them to make effective decisions during times of both stability and duress.

“What can I do to prevent this from ever happening again?” This is a question that many families are asking of their office executives and wealth advisors as they assess the damage wrought by the recent market crisis. Although no family is completely insulated from external crises—such as a severe collapse of global financial markets—their response to such crises, including their ability to make effective, in-the-moment decisions, can determine how well they weather the storm.

Families that have an established, formal process where they continuously (and habitually) monitor threats to their long-term goals and search out the opportunities that will advance those goals are able to withstand a crisis with far fewer scars than families lacking such a process. These are goal-focused families that have committed their time and money to develop risk-management processes that enable them to manage the unknowns and prevent short-term, short-sighted mistakes.

Commit to a Formal Process for Managing Family Risk

Emergency response teams have formal processes and procedures that allow them to make decisions under stress and move forward in the face of extreme adversity. These processes outline how decisions are made and establish a chain of command that determines who will make these decisions. It is a means of proactively addressing chaos to avoid the confusion and dangers that can otherwise take over at times of turmoil. The decision-making process is well-constructed and dependable.

In the same manner, families can commit both their time and financial resources to create a formal risk-management structure that guides their decision-making process in any financial or emotional environment. To provide real value, this cannot be a reactionary exercise that the family attempts to construct during crisis situations, but must be in place and functioning prior to the occurrence of a crisis. To give the process authority and make it actionable (as opposed to theoretical), it should specify concrete measures for how decisions are made, how choices are evaluated and identify the decision-makers.

Proper risk-planning is a collaborative process that involves family members and their most knowledgeable and trusted advisors. The process is time consuming, but well worth the trouble, and roles for each party should be clear and expectations well-defined.

“Predicting rain doesn’t count; building arks does.”

– Warren Buffett

Develop “Muscle Memory” to Prevent Reactive Decision-Making

An outgrowth of a well-structured process is the development of new capabilities and opportunities. Just as professional athletes practice relentlessly to build the muscle memory that gives them the ability to consistently and mechanically kick the goal, families can also practice to develop the “muscle memory” required for making effective, rational decisions even during times of extreme stress.

Most families have a reactive approach to risk, addressing it only when a crisis occurs. But when the family and their key advisors are disciplined to continuously and consistently incorporate risk management into their strategic planning process, the family will eventually develop an instinctive ability to evaluate threats to their long-term goals and identify new growth opportunities.

A well-designed, well-refined risk-planning process that automates decision-making and controls for emotions answers the question, “How can I managed the unexpected for the best possible outcomes?”

Below is a list of effective risk-planning techniques that can be implemented in an on-going risk-planning process.

Developing a Risk-planning Process

Effective Risk-planning Techniques

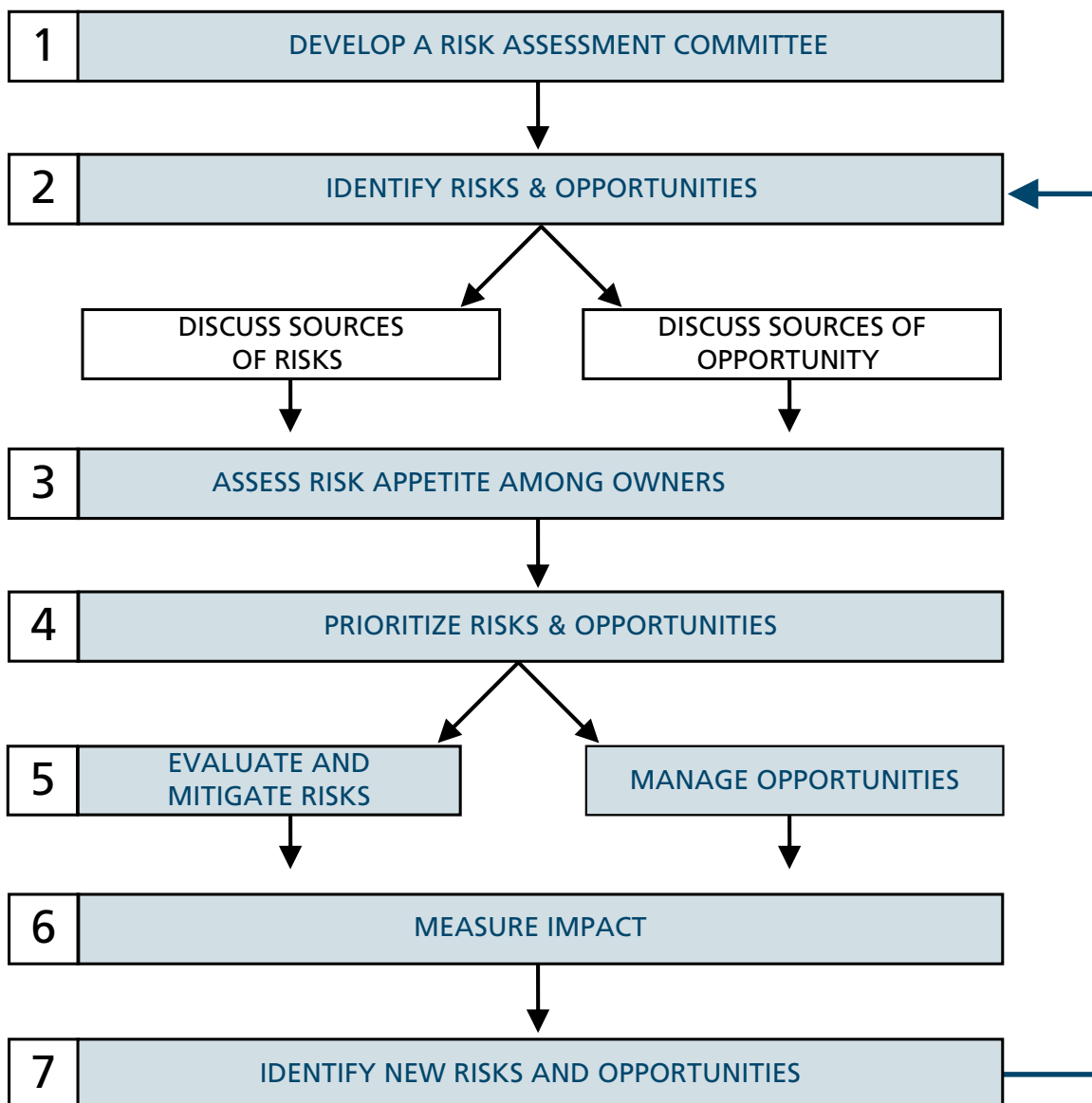
1. Develop a risk-planning council or committee and ask them to meet at least twice a year
2. Engage in a risk discussion with the family to identify sources of risk and opportunity
3. Assess and alter the risk appetite of the constituents
4. Assess critical risks and opportunities and prioritize areas of greatest risk
5. Develop mitigation strategies for highest priorities
6. Manage opportunities that have the highest potential impact
7. Conduct a cost analysis and develop a budget for risk management
8. Measure the impact of the management programs for financial and family outcomes
9. Document areas of success and vulnerability for discussion with the family annually

Risk Management Process

The following flow chart illustrates a process for managing risks and opportunities⁶. Families can adopt this process to analyze their own risks and integrate it into existing risk-planning activities.

Risk Process Flow Chart

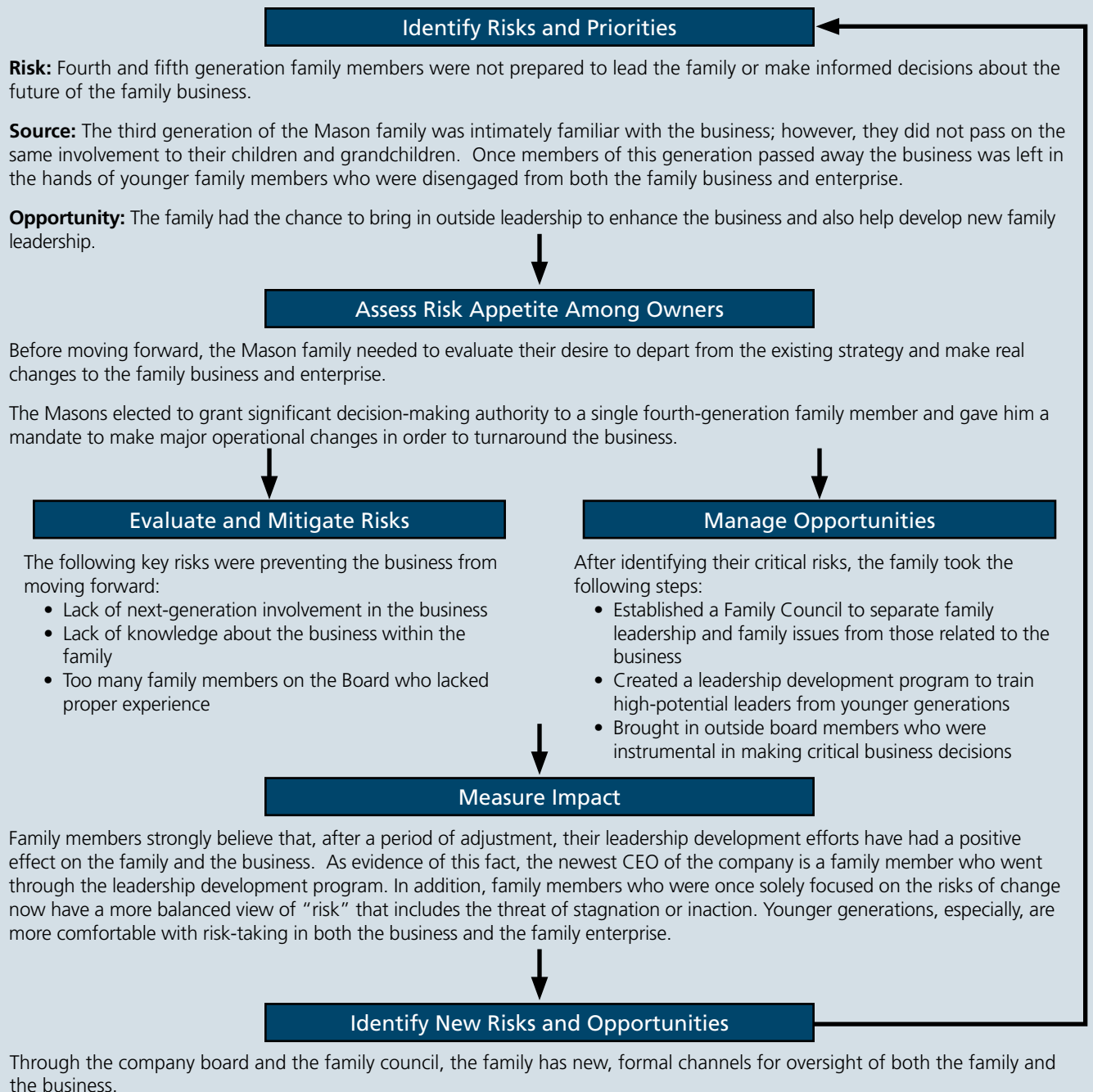
A Continuous Risk Assessment Process



6. Modified from *Managing Opportunities and Risks*, Tamara Bekefi, Marc J. Epstein and Kristi Yuthas, 2008 *Management Accounting Guideline*

Process in Action: Using the Mason Case

As examined in Section II, a key concern for the Mason family⁷ was the lack of involvement of the fourth and fifth family generations in the family business and the wider family enterprise. The family took several steps to re-engage its youngest generations and to resuscitate the business; these steps align with those illustrated in the Risk Management Process Flow-chart:



Risk Assessment Process - Tasks for Family Members and the Family Office

When creating a successful risk assessment process, family members work in tandem with the family office to coordinate decisions and actions. Family members make key decisions on the scope of the risk assessment and their level of commitment to the process. The family office implements the plan created by the family and ensures that family members have the proper expert support to carry out their risk assessment process. Below is a differentiation between the roles of the family and the family office in this process.

Roles of the Family and Family Office

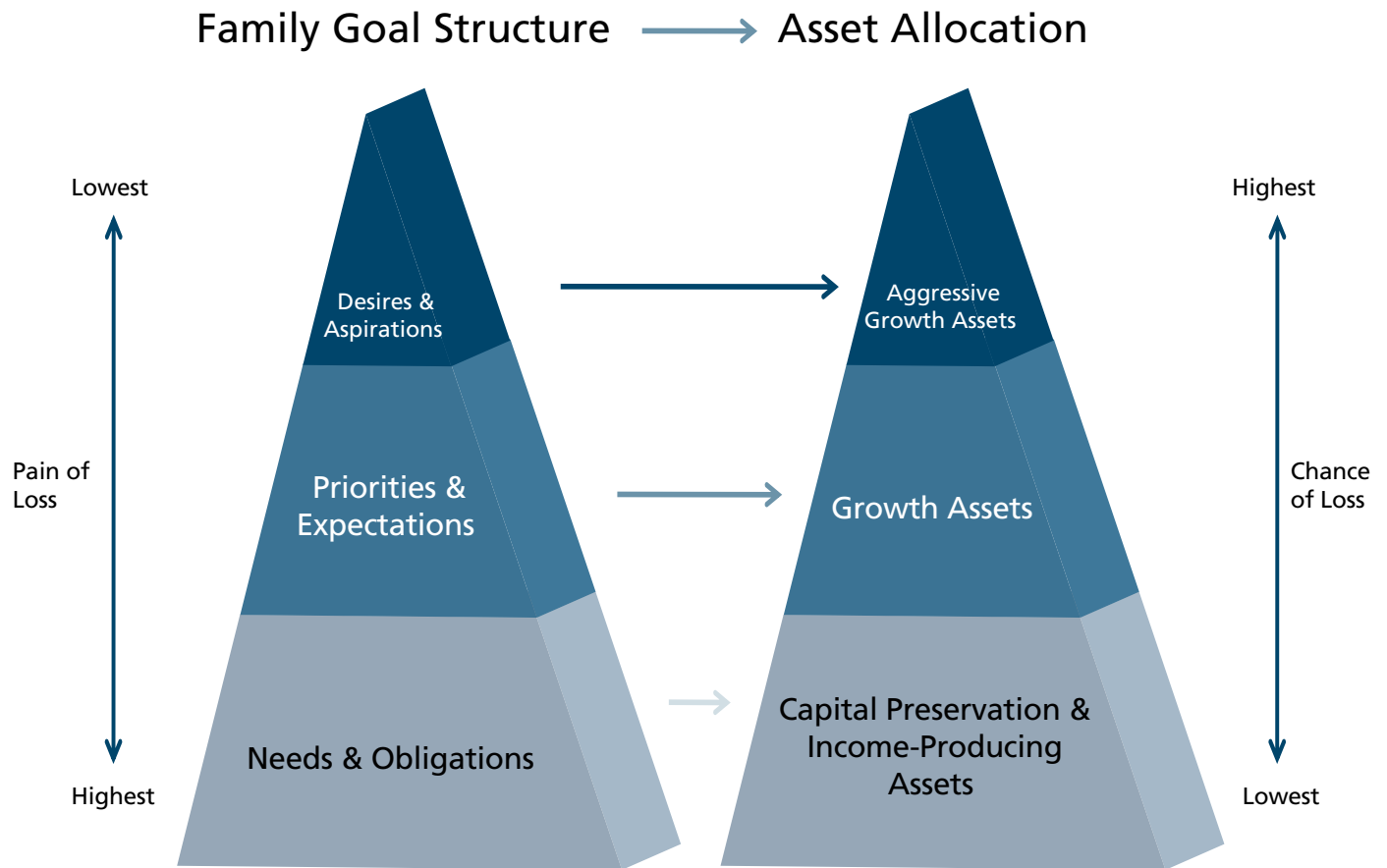
What the Family Has To Decide	What the Family Office Has To Do
<ul style="list-style-type: none"> <input type="checkbox"/> Agree to take time for strategic planning for the family enterprise <input type="checkbox"/> Recognize risk assessment as a critical part of the strategic planning process <input type="checkbox"/> Work as a family to identify critical areas of risk <input type="checkbox"/> Agree on an annual process to form a Committee to review and address the risks <input type="checkbox"/> Identify family leaders who have an aptitude for risk management and time to commit to the process <input type="checkbox"/> Identify what other professionals are needed on the Planning Committee based on the critical risks identified <input type="checkbox"/> Actively participate in the planning process, and take action as needed to minimize risks 	<ul style="list-style-type: none"> <input type="checkbox"/> Support the family's decision to create a Strategic Planning Committee with a Sub-Committee on risk <input type="checkbox"/> Select a Family Office Manager to spearhead this important assessment process (but separate from the Head of the Strategic Planning Committee – they become partners) <input type="checkbox"/> Provide input to the Family on where the critical technical risks are for the enterprise <input type="checkbox"/> Find an expert to facilitate the risk assessment discussion/process for the Family <input type="checkbox"/> Help identify the right professionals to sit on the Strategic Planning Committee and the Risk Sub-Committee <input type="checkbox"/> Call the meetings, monitor the process and measure the results of the planning process

Risk-planning Technique: One Multi-family Office Approach⁸

A goal-driven approach to risk management can help families address the fact that family members often have different levels of comfort with risk-taking. One such goal-driven approach is illustrated below. The two pyramids represent the relationship between personal and investment strategies. The personal goals are layered in a hierarchy-of-needs from most basic lifestyle needs to aspirational goals. These are mapped to particular asset allocation strategies.

This approach is a means of balancing the goals of both conservative and proactive family members and preventing conflict between those two opposing viewpoints on wealth management. Designating a portion of family assets to ensure that basic needs and obligations are secure (sometimes referred to as “sleep well” assets) allows risk-tolerant family members to take risk, while also ensuring a financial safety net should riskier ventures prove unsuccessful. For the risk-averse family members, having the bottom layer of the pyramid devoted to stable value, income-producing assets may free them mentally and emotionally to take more risk in the aspirational layer of the pyramid.

Mapping Personal Goals to Investment Strategies



8. Source: Eton Advisors, L.P.

Conclusion

"I do not believe in a fate that falls on men however they act; but I do believe in a fate that falls on them unless they act."

– Gilbert K. Chesterton, 20th Century English Author

While no one can guarantee the future, achieving long-term goals and sustaining wealth over multiple generations requires action. With the financial crisis still fresh in the minds of wealth owners, families are motivated to re-evaluate their structures and processes for mitigating downside risk and capturing upside opportunity. Wealth owners have a better understanding of their own reactions to extreme events and are now ready to make changes that will provide them with consistent decision-making even during times of stress or chaos.

Families that create and incorporate a process that complements the natural strengths of the family eventually develop an instinctual practice for managing uncertainty. They are not overwhelmed by fear-inducing messages to avoid risk, but have a healthy attitude about the challenge of managing uncertainties and weighing the opportunity costs of different choices. Families that take a proactive rather than reactive approach to the future are able to develop a risk-taking culture where heirs learn the skills to be successful decision-makers in a constantly changing world.

The rewards of a structured approach to risk-taking and risk management cannot be underestimated. Beyond the obvious benefit of risk identification and mitigation, a balanced risk-planning process opens up exciting new challenges and opportunities. It enables the family to appropriately allocate their time, energy and capital toward mitigating the biggest threats to their long term goals and seizing the right opportunities to enhance family capital.

Positive Outcomes from a Proactive Risk-planning Process

1. Provide stability and protect the family from short-sighted, reactive response to uncertainty
2. Allow the family to recognize, evaluate and capture opportunities for wealth enhancement
3. Improve communications between advisors and families
4. Prioritize risks and prevent the family from being sidetracked by less critical issues
5. Evaluate uncertainties and identify influential external factors that are potential sources of risk
6. Satisfy family members with different risk tolerances
7. Identify potential threats at an early stage
8. Surface family fears and discuss potential outcomes ("what ifs") in a productive manner

Addendum

A Further Look at the FOX Risk Roadmap

The following are checklists developed by the 2009 FOX Thought Leaders that correspond with the categories in the FOX Risk Roadmap found on pages 16-17. These lists are not exhaustive, but are a starting point for families after they have identified their key risk categories.

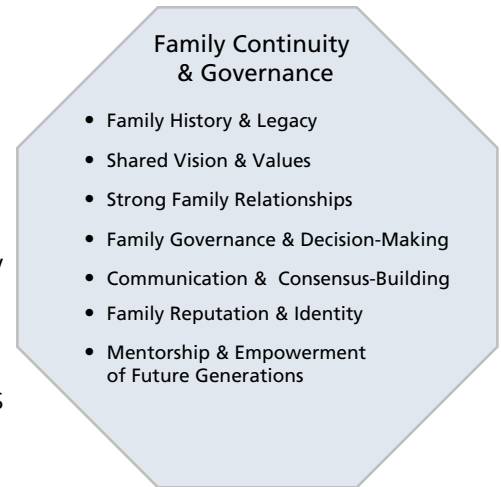


First Row - Family Assets

Family Continuity & Governance

Family Legacy

- Document the family history to help preserve the family legacy
- Share elder stories to pass on values to preserve legacy and learn from mistakes
- Document and revisit the family values that all family members can support
- Identify the “glue” that drives the desire for family unity
- Craft family-defined vision and mission statements
- Document senior generation expectations/desires of the family (recorded for legacy purposes)



Family Governance

- Assess the need for a family council (or appropriate leadership body) – create a forum for family matters to be raised and decisions to be taken around them
- Define a decision-making process for important family decisions and identify the important questions to be asked
- Promote optionality – the ability to “opt out” of certain endeavors without losing family status or loyalty (remember the farther from the founding generation, the less there is to connect with)

Owner Education

- Develop a process to provide mentors to younger generation owners
- Require family-wide training on communication skills, learning styles and conflict resolution
- Hold a family-wide gathering for all generations with both business and social components
- Create opportunities for the next generation to observe the current generation in practice
- Use scenario planning as an art, not a science, and remember that each experience needs to be tailored to a family’s capacity and interests at that moment in time
- Assess and optimize modes of communication (technology, individual communication preferences)

Family Leadership & Succession

Leadership Training & Transition

- Identify a clear leadership transition process that maps out the selection of new leaders
- Clearly define the criteria for leadership and communicate them (e.g. outside business experience)
- Develop job descriptions for leadership roles
- Create mechanisms for leadership development (e.g. internships, shadowing, etc.)
- Implement a term limit and process for elders to move on and next leaders to be selected
- Offer opportunities for young members to practice skills within the family (i.e. present to family a recommended charity, serve on foundation or investment committee, etc.)



Ongoing Feedback

- Survey owners on whether decisions are made in a transparent manner and communicated clearly
- Ask the management team if they are being adequately supported by family members
- Communicate shared expectations of family leaders to potential leaders
- Implement a feedback cycle – performance review process for leaders
- Develop mechanisms leading to mutual trust and respect
- Encourage open meetings/open information/full transparency

Personal Development

Assessment Process

- Reach agreement on the important balance between the nuclear family and the legacy family
- Ask each owner to identify his/her personal level of engagement in support of the family enterprise
- Consider Jay Hughes' notion of personal balance sheets and income statements



Skill-Building Process

- Require work/volunteer experience outside the family to gain valuable skills
- Tailor life opportunities to skills needed, but don't minimize the struggle!!!
- Identify training and development resources (inventory learning styles, coaches, communications training, career development program, personal assessment of skills and interests, etc)
- Offer a next generation learning seminar around financial stewardship
- Expand skills to include effect of power and influence, and social and business networks (concept of agency and hyper-agency)

Philanthropic Endeavors

- Use discretionary grant-making to allow each family member to express individuality
- Encourage group giving to reflect collective identity/goals

Philanthropic Legacy

Shared Vision

- Identify the shared values that provide the vision for the family's joint philanthropic activities
- Develop a clear mission statement for the collaborative philanthropic work that can be supported by all members of the family
- Develop a shared vision for next generation guidance/direction for philanthropic giving
- Incorporate expressions of philanthropy into family gatherings and rituals – volunteer together, site visits, fundraisers, etc.
- Support individual passions in family giving (without being divisive)
- Encourage (or require) community service



Alignment of Interests

- Agree on the metrics that will be used to measure philanthropic impact
- Require strategic philanthropic training and mentoring
- Assess staff and structure for alignment with long-term views and goals
- Recognize family members who have an especially strong commitment and give more of themselves personally
- Expand assets for philanthropy beyond financial – networks, skills, investment dollars

Governance Process

- Create a family board to oversee collaborative philanthropic activities
- Identify policies and practices for participation to keep discussions from being personal
- Establish clear measures for success

Second Row - Financial Assets

Ownership & Control of Assets

Ownership

- Define the purpose of “ownership” and the goal of ownership – for family, for individual
- Define: family member, voting member, family leader, active ownership
- Identify behaviors and attitudes relative to level of risk-taking
- Identify the attitudes and behaviors that define responsible ownership in the family
- Develop proper ownership structures to support the shared vision of the family and promote leadership development
- Create flexibility for family members to exit the system and go on their own
- Understand that control and ownership mean different things in the investment world than in the business world – need to be comfortable with uncertainty and a different definition of control and give advisors some freedom



Decision-making & Risk-taking

- Set policies on who makes investment and ownership decisions and who is provided information about decisions
- Use scenario planning to “test” implications and impact and to discover new opportunities
- Choose governance style: patriarch/oligarch/representative assembly/town council
- Decide whether to use a binding/non-binding decision-making philosophy
- Develop decision-making body with authority to act based on results of opportunity/risk
- Replace opinions with qualified expertise

Control

- Separate the family office (physically and financially) from the family business to diversify the family's assets
- Perform an internal control audit to ensure proper controls are in place
- Provide formal review of structures and controls to educate owners
- Facilitate the cultural shift away from command and control toward collaboration (bottom-up information flow)

Financial Security

Trust & Estate Planning

- Confirm that proper estate plans and wills are in place for all family members
- Educate trustees and beneficiaries on their fiduciary duties
- Evaluate the trustees' performance in meeting their fiduciary duties
- Separate administrative trustee roles from discretionary roles and give administrative roles to professional administrators
- Map out lifestyle/capital/liquidity requirements using personal/family cash-flow analysis
- Quantify spending levels and future rates of increase
- Identify key assets to preserve from those held for investment
- Specify the generational timetable that the family is hoping to preserve



Financial Audits

- Hire a professional to do physical/cyber security audit and provide recommendations
- Ensure system of internal controls is in place (including segregation of duties) to mitigate operational risk
- Use third-party professional services (e.g. CPA/consulting firms) to provide independent assessment of efficacy of controls
- Perform criminal/credit/etc checks on ALL employees
- Implement a process to aggregate ALL financial data
- Ensure assets are titled properly and adequately insured
- Identify processes for protecting/expanding wealth
- Develop processes for identifying and dealing explicitly with financial risks
- Develop processes for assessment, evaluation, monitoring, reporting back to owners about findings
- Institute controls of disbursement to avoid any temptation
- Compile and review, at least annually, a summary of all fees paid to advisors, including fees imbedded in pooled investment vehicles
- Look for cost effective approaches vs. costly, complex customization (especially with reporting)

Risk Assessment Process

- Develop a RCSA (Risk Control Self Assessment) tool to list all identifiable risks and related risk mitigants. Ensure employees and family members are familiar with tool
- Explicitly decide what risks warrant the purchase of insurance and which to self-insure
- Develop process for engaging family in "experiencing risk and opportunity" outcomes (where they "experience" the result of taking more risk and where they "experience" the result of limiting risk)

Wealth Preservation & Enhancement

Investment Process

- Formalize the process of investment decisions at the family level and implement an investment process that is used to support every household
- Conduct annual planning meetings with each household to discuss financial goals and spending levels
- Create/explain investment strategies in terms of objectives vs. risk/return characteristics
- Clearly delineate between individual vs. family investment objectives
- Define short and intermediate liquidity requirements
- Ensure comfort with liquidity and ability to deploy illiquidity effectively
- Revisit asset allocation and take advantage of tactical opportunities
- Create a strategic allocation/investment policy that could last over market cycles
- Determine the frequency of portfolio review and the conditions under which re-balancing will occur
- Take the family through a thought experience that forces them to think carefully about where investment risks are taken
- Perform background checks on investment managers
- Structure relationships with advisors to deal with conflicts of interest upfront
- Avoid frictional cost risk – paying too much for suspected Alpha
- Create an emergency Investment Oversight Committee that only meets when the family is considering a revision of their long-term investment plan
- Ensure alignment-of-interest-driven pricing models

Wealth Preservation & Enhancement

- Multi-Generational Timeline
- Investment Process
- Investment Goals & Objectives
- Asset Diversification/Concentration
- Asset & Strategy Correlation
- Non-Binary Investment Decisions
- Manager Due Diligence/Selection
- Ongoing Monitoring of Advisors
- Investment Performance/Analytics
- Risk/Return/Rebalancing
- Financial Leverage/Liquidity

Investment Structures/Strategies

- Create various investment vehicles for different family members to take different levels of risk and return
- Avoid building an investment strategy around 2008 (Would you rather have one bad year and 34 good years, or use a strategy that would only have worked in 2008?)
- Plan how the family will recover from an erroneous investment move
- Quantify the definition of “wealth preservation” over various points in time
- Create a policy governing “social investing” by family members (i.e. cocktail party investing)
- Employ qualified professionals to conduct due diligence

Opportunistic Framework

- Focus on the opportunities in the market now
- Support thematic forward-looking opportunism versus quantitative muddle

Interaction with External Environment

Peer Groups

- Identify a peer group of families who have similar goals and circumstances with whom the family can establish solid relationships
- Take a really good investor to lunch (external mentor)
- Join family affinity groups like FOX

Interaction with Media

- Select a family member to be the public spokesperson for the family
- Require social media education and training for family members
- Develop a group publicity policy that reflects the desired brand/reputation

Owner Education

- Encourage extensive training of family and family office staff
- Develop a skills inventory for all owners regarding their potential contribution
- Develop leadership coalitions to address family transitions
- Promote collaboration versus "herding of cats"

Internal/External Advisors

- Identify a network of external advisor contacts who can help the family reach their strategic goals
- Eliminate unqualified noise from external sources
- Isolate "systematic misinformation" put forth by some advisors (the delicate art of deliberately maligning the competition)
- Bring in trusted non-family members who can react to family issues more objectively
- Hire family office professionals who provide reassurances, not fear

Interaction with External Environment

- Participation with Peer Network
- Strategic Collaboration with Other Families
- Network of Trusted Advisors
- Transparency in Advisor Relationships
- Global Business Connections
- Local Community Involvement
- Religious Community Interaction
- Media Exposure for Family
- Personal Security Exposure

Third Row - Business Assets

Business Ownership & Control

Structures

- Develop ownership structures that allow the family to maintain control of their family assets
- Identify fair and equitable exit strategies for family members who may need to sell their equity shares
- Develop an internal market for shares
- Understand current ownership structures and define implications as these structures play out over next 1-2 generations
- Identify governance strategies that mitigate risk inherent in ownership structures
- Develop criteria for participation in family businesses and a process for evaluation and review of performance in family business



Liability Exposure

- Identify the liability exposure in the business and protect the family members individually from that exposure
- Assess (scenario planning) family succession for managing family business after patriarch/ matriarch are gone
- Perform an independent audit of compliance practices

Governance

- Build effective consensus methods for decision-making for multi-generations
- Identify an orderly process for conveying shareholder views to the governing board and management team
- Identify a corporate governance process that includes non-family board members to ensure external perspective
- Develop opportunities for family members to articulate their concerns (e.g. 5 year plan) separate and apart from the business
- Develop opportunities for management to plan separate from owners, then use Governing Board to balance the two views

Financial Performance

- Ensure a separate return on financed capital from return on management capital from investment in operating capital

Business Leadership

Succession

- Develop a written management succession plan to identify how leadership will be transferred
- Use external board members to enrich the expertise and decision-making skills of the management team
- Develop two succession plans for orderly transition and for emergency transition
- Recognize that leadership investment may require bringing in bridge leadership – if goal is to give next generation an opportunity to realize its passion for business and act on it (or to give business an opportunity to “regain its footing” after a major succession)



Leadership Training

- Invest in leadership training to ensure proper development of successors
- Employ personality profiling by individual and group to enhance communication
- Require that family members with an interest in business leadership get leadership and management training outside the family business
- Balance internal development of talent and external recruiting
- Articulate pathways for family employment and career development
- Promote a culture of strategy and leadership development within the business
- Implement a business plan for talent search – focused and ongoing

Business Operations

Strategic Planning

- Develop a clear business strategy that can be shared with owners and managers
- Develop a clear “strategic plan” with implementation process and monitoring
- Focus on strategic plans – construct the business plan to enable the board to balance strategic plan with the family 5 year plan
- Assess client loyalty and the risk of losing key clients
- Commit resources and formalize processes that will continuously encourage innovation of business product/service across all layers of the business



Management Talent

- Identify critical business skills and recruit talent needed to develop key business strategies
- Ensure promotions are based on merit to encourage and motivate non-family-member employees to make a long-term career commitment and to avoid turnover of good talent

Performance Metrics

- Institute true information metrics – modeling/analytics

Shareholder Interests

Alignment of Interests

- Evaluate the alignment of family interests and business interests each year, and identify where individual shareholder interests are at odds with business interests
- Create “incentives” that align family interests (for multi-generations) with business interests
- Assess the dividend dependency of shareholders and its impact on growth of the business
- Develop an explicit valuation mechanism and exit strategy for family members that is aligned with ownership and control objectives



Shareholder Skills

- Assess skill sets and competencies of family members involved in operating the business and bring in managers with complementary skill sets
- Implement a process to balance other principal plans with G2 or G3 strategies (growth vs. maintenance)
- Develop family leadership skills and education for informed decision-making about the business
- Develop clear guidelines about the role the family will and will not play in operating the company

Risk Assessment

- Set privacy guidelines – entity to be used, NDA as a matter of course, electronic communications rule
- Evaluate the reputation risk for both the family and the business (if a family-controlled business)
- Be sure the family office is in place to manage the affairs of the family so that business managers can focus on the business execution

Additional Readings on Risk

Articles and Whitepapers

"A Flock of Black Swans"

Robert Seaberg. Journal of Financial Planning. March 2009

"A Modest Proposal: Let's End Conflicts of Interest in the Wealth Advisory Business"

Greg Curtis. Greycourt Whitepaper No. 24. 2003

"Beating the Odds: Improving the 15% Probability of Staying Wealthy"

Lex Zaharoff. JP Morgan - Challenges of Wealth Series. 2004

"Behavioural Finance: The Psychology of Financial Decision Making"

A multi-part series on behavioral finance (Barclays Wealth Insights). Greg Davies. Barclays Wealth. Barclays Bank PLC, UK. 2008

"Beyond Markowitz: A Comprehensive Wealth Allocation Framework for Individual Investors"

Ashvin Chhabra. Journal of Wealth Management. Spring 2005

"Creating a Goal-Based Wealth Allocation Framework"

Ashvin Chhabra and Lex Zaharoff. Journal of Wealth Management. Winter 2008

"From Entitlement to Stewardship: How a Prosperous Family Can Prepare the Next Generation"

Dennis T. Jaffe and Fredda Herz Brown. Journal of Wealth Management. Spring 2009

"Immigration to the Land of Wealth"

James Grubman, Dennis Jaffe, and Keith Whitaker. Private Wealth Magazine. February/March 2009

"Is It Different This Time?"

Greg Curtis. Greycourt Whitepaper No. 46. 2009

"It's the New Economic Reality. Work With It."

Paul Sullivan. New York Times. December 13, 2008

"Lessons from the Warwick and Chateau Chambord"

Charles D. Ellis. The Future of Investment Management. Charlottesville, Virginia. AIMR Conference Proceedings. 1998. pages 25-31

"Mapping Your Fraud Risks"

Toby J.F. Bishop and Frank E. Hydoski. Harvard Business Review. October 2009

"Principles of Wealth Management for Private Wealth Holders and Related Parties"

Lowenhaupt Global Advisors. January 2009

"Preparing Adult Children for Inheritance: Maintaining Harmonious Relations Across the Generations in Families of Affluence"

Joe Calabrese. Harris myCFO Whitepaper. 2007

“Raising Healthy Children in Families of Affluence: Meeting the Unexpected Challenges of Wealth”
Laura Kastner. Harris myCFO Whitepaper. 2007

“The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest”
Daylian M. Cain, George Loewenstein, and Don A. Moore. 2005.

“The Future of Investing: Evolution or Revolution”
Bill Gross. PIMCO. April 2009

“The Six Mistakes Executives Make in Risk Management”
Nassim N. Taleb, Daniel G. Goldstein and Mark W. Spitznagel. Harvard Business Review. October 2009

“What Risk Aversion?”
Lauren Foster. FTWealth. March 27, 2009

Books

Acceptable Evidence: Science and Values in Risk Management
Deborah G. Mayo, Rachele D. Hollander. Oxford University Press. 1994

Against the Gods: The Remarkable Story of Risk
Peter Bernstein. John Wiley & Sons, Inc. 1996

Capital Ideas Evolving
Peter Bernstein. John Wiley & Sons, Inc. 2007

Enough: True Measures of Money, Business, and Life
John C. Bogle. John Wiley & Sons, Inc. 2009

Inviting Disaster: Lessons from the Edge of Technology
James R. Chiles. HarperCollins Publishers. 2002

Mumpsimus Revisited: Essays on Risk Management
H. Felix Kloman. Seawrack Press. 2005

Raising Resilient Children: Fostering Strength, Hope, and Optimism in Your Child
Robert Brooks and Sam Goldstein. McGraw-Hill. 2002

Risk Engineering
A.V. Gheorghe, R. Mock. Springer-Verlag New York, LLC. 2008

The Fantods of Risk
H. Felix Kloman. Seawrack Press. 2008

The Theory of Money and Credit
Ludwig von Mises. 1912

World of Risk: A New Approach to Global Strategy and Leadership
Mark Haynes Daniell. World Scientific Publishing Co. 2004

About Harris myCFO



Harris myCFO has served as the contributing partner in the research and production of this publication and is the exclusive sponsor of this work. This role is consistent with their leadership in the family wealth industry.

Harris myCFO

At Harris myCFO, we view wealth management in terms of advocacy—on behalf of you, your family, your objectives and your values. We believe in listening before speaking, and understanding before advising. Since our establishment, we've been providing comprehensive family office guidance and services, including integrated and customized investment advisory, income tax planning and compliance, financial reporting, philanthropic advisory services, financial planning, concierge, and expense management for high-net-worth families and individuals across the nation.

Objectivity

Harris myCFO has built a strong culture that puts clients first. We believe that our most important role is to act as your advocate—helping you navigate the complexities, issues and challenges that come with managing significant wealth.

Rather than promote proprietary offerings, we provide you with access to a highly select and diverse group of carefully chosen and vigorously monitored investment managers who we believe can deliver superior risk-adjusted returns over time. Our professionals provide objective, unbiased advice and support on a fee-only basis, employing a completely transparent fee structure.

Integration

We stress the importance of using an integrated approach to planning because it is the best way to view the entirety of your financial situation and to provide advice that will empower you to achieve the full potential of your wealth. We ensure that seasoned professionals across financial specialties participate as a team and communicate with each

other on how these elements of wealth planning can work together to achieve better results than planning them individually.

True integration also incorporates other trusted advisors who are critical to your wealth management, including CPAs and estate planning attorneys—all working together as a single, unified team. Harris myCFO's unique approach affords you a range of compelling benefits not typically available from most family offices, including:

- Conflict-free advice
- Improved cost efficiencies
- A clear, single-minded strategic vision across all your advisors
- The opportunity to work with best-of-class providers for every aspect of your wealth management strategy

Technology

Harris myCFO invests in building and maintaining advanced reporting, analytic and information processing systems. Our robust platform delivers comprehensive, fully customizable reports that encompass your entire financial picture. As a result, you enjoy an at-a-glance view of every component of your overall wealth and how it is performing—both in absolute terms and relative to your overall plan.

Whether you need to outsource a particular project or financial specialty or are looking for a team that can fully integrate your wealth needs, Harris myCFO would be happy to talk with you about your specific situation.

Harris myCFO™ is the brand used by Harris myCFO, Inc. providing Family Office Services, Harris myCFO Investment Advisory Services LLC, an SEC-registered investment adviser and certain divisions of Harris N.A. and its affiliates that are national banks with trust powers. Not all products and services are offered in every state and/or location.

About Family Office Exchange

First in Meeting the Needs of Sophisticated Financial Families

Proper management of family wealth became its own emerging industry in the late 1980s, when hundreds of U.S. families became centi-millionaires overnight by selling their family companies to leveraged buyout firms. The recognition that private wealth ownership was a complex and important family business spawned the formation of hundreds of private financial offices, most frequently called family offices, to manage family assets and educate owners.

In this fast-changing era, Sara Hamilton worked at Harris Bank in Chicago, where she launched the first national conference that brought together wealth owners and family office managers who were running these private financial offices. Sara saw the need for a peer network for families with multi-generational wealth who were seeking an objective financial education about passing wealth successfully to future generations. She also recognized the need for an industry clearinghouse for training the family office staff and sharing best practices among professionals. With support from potential clients and the bank, that conviction led Sara in 1989 to create Family Office Exchange, or FOX as it is popularly known today around the world.

Today, a staff of more than 40 situated in Chicago and London serves family groups and advisors in 20+ countries, providing education, peer networking and advisory services to over 330 ultra-wealthy families and their family office staffs. These family office professionals serve more than 6,000 individual owners with shared ownership of assets and meaningful philanthropic work. In addition, FOX serves over 170 multi-family offices and advisory firms specializing in wealth management and specialized advisory services.

To this day, FOX remains true to its founding mission of member education and shared knowledge across a global network. The firm provides an impressive array of resources, including proprietary research on industry best practices and peer benchmarking, along with webinars on current trends, a library of articles and white papers, online discussion forums, peer roundtables and frequent educational forums, ensuring members always have a trusted source of knowledge. The knowledge amassed by FOX reaches beyond our staff to include members' insights and their recommendations of advisors around the world, who are committed to helping business-owning families and financial families be successful in managing their financial and philanthropic capital.

The typical client request was "Help me make this wealth a source of satisfaction and reward for the family and not a source of stress."

A Sampling of FOX Firsts

- The first thought leaders forums on the role of the family office as risk manager
- The first comprehensive benchmarking studies of family offices
- The first study of buying behavior of families with average assets in excess of \$300 million
- The first venture capital fund-of-funds designed for financial families to access top-tier venture funds
- The first foundation dedicated to the education of financial families about the stewardship of wealth
- The first consulting resource focused on the needs of the family office market
- The first survey of family office compensation and benefits
- The first industry "blueprint" for designing a custom family office
- The first educational toolkit designed to prepare individuals to be responsible wealth owners
- The first global online community for financial families



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