At BBH, we believe that the primary objective of investing is the preservation and growth of our clients’ wealth. It is difficult to challenge this fundamental definition of investment success, yet a more robust definition should take into account the desire to preserve wealth for the benefit of future generations as well as the present one. For most investors, once the obvious needs of lifestyle, retirement and healthcare are met, the desire to preserve and grow wealth encompasses goals related to children, grandchildren and philanthropy. The good news is that the mechanics of wealth transfer – estate planning, tax strategies, trust structures, etc. – are well-established, and, with appropriate advice, easily implemented. The bad news is that even with this preparation, transferring wealth is a difficult proposition, and success requires a substantial investment in educating and engaging the next generation. Families need to transfer values along with wealth if they want the next generation to not only preserve, but benefit from, financial freedom.

And there is a substantial amount of wealth to be transferred. As the value of financial and real assets continues to recover from the depths of the global financial crisis, the net worth of American households has risen to a record level of $85 trillion as of March 31, 2015, up $30 trillion in the last six years. That unprecedented level of wealth, coupled with an aging generation of Baby Boomers, implies that a substantial amount of wealth planning and wealth transfer will take place over the next few decades. This poses a substantial threat to those families who don’t embrace the necessity of educating the next generation, but a huge opportunity for those who do.
A BRIEF HISTORY OF WEALTH PLANNING

The successful transfer of wealth is not a new preoccupation. In 1758 Benjamin Franklin printed a short treatise entitled The Way to Wealth, originally included as a preface to his Poor Richard's Almanacs, but reprinted many times thereafter, and even long after his death. It is arguably the first American writing on the subject of personal finance, and is the source of such famous aphorisms as “early to bed, and early to rise, makes a man healthy, wealthy and wise,” and “keep thy shop, and thy shop will keep thee.” “If you would be wealthy,” says Franklin in the guise of Poor Richard, “think of saving as well as of getting.” Along with Warren Buffett, Benjamin Graham and David Dodd, Franklin’s The Way to Wealth deserves a spot on the bookshelf of any serious investor.

Benjamin Franklin himself translated these precepts into a book for children entitled The Art of Making Money Plenty, believing that it was never too early to begin learning the concepts of sound financial management. In order to make the learning experience enjoyable, Franklin cast the book in the form of a rebus, or word puzzle, which he hoped would attract and retain the attention of his young audience. This text, too, was widely printed well into the nineteenth century, either as a book or, more often, a broadside. These formats were made to be mounted, framed and hung on the wall, and we know from contemporary evidence that such images did indeed hang on the walls of children’s bedrooms.

So interest in preserving and transitioning wealth and teaching one’s heirs about that wealth predates the founding of the nation. The challenges associated with that education were not new even then. In his famous Inquiry Into the Nature and Causes of the Wealth of Nations, printed in 1776, Adam Smith noted that “in commercial countries, therefore, rich, in spite of the most violent regulations of law to prevent their dissipation, very seldom remain long in the same family.” It is remarkable that Smith was able to make this observation about the difficulty of preserving wealth across generations even within an English legal system that was designed to prevent the dissipation of wealth. Concentration of wealth and social stability were important to the durability of the monarchy. Yet even when the law was on the side of wealth – even when the government wanted wealth to remain in a family across multiple generations – it was still hard to accomplish.

And nothing seems to have changed over the last few centuries, except that the legal system is no longer as supportive of wealth preservation as it was in Smith’s day. We still live in a world in which the failure of wealth transfer gives rise to such clichés as “shirtsleeves to shirtsleeves” in three generations. The first generation creates the wealth. The second generation, having witnessed the blood, sweat and tears that accompanied that creation, typically remains a good steward of the wealth, or even enhances it. Yet the third generation, bereft of the direct experience of creating the wealth, usually presides over its loss, and winds up in shirtsleeves once again. The fact that variations on this adage recur across cultures (for example, the Japanese go from “kimono to kimono” and the Dutch from “clogs to clogs”) speaks to the universality of this dynamic.

The history of wealth transfer is sobering. Roy Williams of the Williams Group conducted a 25-year study of wealth transitions in families, and on the basis of interviewing 3,250 wealthy families concluded that 70% of wealth transitions fail, where failure is defined as involuntary loss of control of the assets, whether through taxes, economic losses, litigation or any other financial reversal. Williams’s study went further to uncover the causes of these failures and found that most of the causes resided within the family itself.¹

Causes of Failed Wealth Transfers

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Breakdown of family communication and trust</td>
<td>60%</td>
</tr>
<tr>
<td>Inadequately prepared heirs</td>
<td>25%</td>
</tr>
<tr>
<td>Failure to establish family mission</td>
<td>12%</td>
</tr>
<tr>
<td>Poor legal / tax / investment advice</td>
<td>3%</td>
</tr>
</tbody>
</table>

This is both good news and bad news. The good news is that only 3% of the failures in Williams’s study was a result of bad

¹ Source: The Williams Group

Source: The Library of Congress
technical advice. Although estate and tax laws change from time to time, a commitment to continuing education and best practice means that clients usually get suitable and accurate guidance from advisors on technical issues. The bad news is that families are usually on their own for the other 97% of the cause of failures. Both investors and their advisors should recognize and address these challenges if they are genuinely interested in the preservation and growth of wealth in the long run.

**BEING GOOD WITH MONEY**

We all want our children to be “good with money,” but that phrase is used far more often than it is understood. Being good with money is a concept that is most readily identifiable in its absence. Someone who spends everything he inherits and winds up with nothing and reliant on welfare is clearly no good with money. Yet being good with money is more multifaceted than that simple and obvious counterexample. Being good with money requires the ability to obtain it, save it, invest it and yes, spend it. It is an exercise in balance.

Hetty Green was clearly good with money, at least in the traditional understanding of that concept. Born in New Bedford, Massachusetts in 1834, Hetty was the daughter and granddaughter of prosperous whalers in an era in which the economy ran on whale oil. Upon the death of her father in 1864 she inherited the sizable sum of $7.5 million, while still a single woman. She married in 1867, but not before requiring her husband to sign a pre-nuptial agreement that her wealth was hers alone. Preserving and growing the family wealth was important to Hetty. She managed her own finances carefully, investing in Civil War reconstruction bonds when no one else would, and then later in the debt securities of a new-fangled technology called railroads. On more than one occasion Hetty went toe to toe with Edward H. Harriman, the creator of Union Pacific Railroad and half the namesake of Brown Brothers Harriman & Co., on the terms of a particular bond issuance or matter of corporate governance. Hetty usually won. She more than held her own in a very male-dominated world of Wall Street, and when she died in 1916 she left an estate valued somewhere between $100-200 million, or $2-4 billion adjusted for inflation. Hetty Green was, in her day, the richest woman in the world, and undoubtedly good with money.

Or was she? Throughout her life she refused to pay for heat or hot water in her homes, considering them excessive luxuries. Every extant picture of Hetty Green has her in a black dress, because it didn’t have to be laundered as often. Indeed, some of her biographers conclude that she only ever owned one black dress at a time, because why would you need two? Her oldest son Ned injured his leg as a child, and, rather than take him to the hospital Hetty set his leg on the kitchen table. Needless to say, poor Ned developed gangrene and lost his leg not too long afterward. And, in a story ripped from today’s headlines, Hetty refused to live in Manhattan because she couldn’t justify the price of real estate. Instead, she lived in a series of boarding houses in Brooklyn, before moving to Hoboken in 1898 to avoid the city taxes that would have been imposed on her when the five independent boroughs came together on January 1 of that year to form New York City. In her old age she refused a hernia operation because it cost $150, and that decision may have very well hastened her death.

Hetty wasn’t that good with money after all. She certainly knew how to preserve and grow it, but she didn’t really know what to do with it once she got it. Her miserly ways earned her the sobriquet “The Witch of Wall Street,” and no less an authority than the Guinness Book of World Records lists her as the greatest miser of all time. This isn’t quite the legacy we would want for ourselves or our children, and not quite the balance that “being good with money” requires.

**PREPARING HEIRS**

If we are to avoid the cautionary lesson of Hetty Green you need to define “being good with money” more broadly, to include knowing how to obtain it, grow it, spend it (here’s where Hetty fell short) and give it away. How do we ensure that the next generation learns that balance and develops a healthy relationship with wealth? The answer is simply stated, but more challenging to implement: If we want the next generation to be responsible, give them responsibility with wealth as early as possible, but only to the extent that the price of tuition (experience) is not unduly burdensome.

How do families accomplish this in practice? The tactics vary from family to family, and a discussion of the topic with advisors or other families engaged in the process can be enormously helpful. As follows are a few examples from my own experience of how some families (real names redacted) have sought to tackle this challenge with varying degrees of success. The Welch family has four young children, 8-year old twins, a 6-year old and a 4-year old. This is far too young, one might conclude, to begin...
an education in the concepts of wealth and money management, but it is never too early to introduce the basic concepts. Each of the children receives a nominal weekly allowance for helping mommy and daddy out around the house – picking up toys, making the bed, cleaning the bathroom – whatever routine task is appropriate for his or her age. The kids learn the obvious lesson that money comes as the result of work, and as a result of their contribution to the well-being of the family.

Once a week the family loads up in the minivan and drives to the local dollar store, where the kids are given free rein to spend that week’s allowance on just about whatever they want. On the first few trips, the kids spent all their money on the very first thing they laid eyes on. The prospect of having their own money under their own control was just too much to bear, and it didn’t take long on these early trips to the store to drain this very young next generation’s financial wealth. But something interesting happened before too long. After a few disappointing purchases of toys which broke or became uninteresting before they even returned home, the children became savvier buyers. Trips to the store took longer as options were considered, real wants were examined and price was compared to value before a decision was made.

A final twist in the Welch family’s example is that, upon returning home after a trip to the store, dad matches whatever money is left over. The kids are under no pressure not to spend, but they tangibly experience Benjamin Franklin’s adage that “a penny saved is a penny earned.” These children are too young to appreciate the mechanics of financial markets and investing, but the simple lesson that unspent money can lead to future money is a powerful one. Once again, dad had nothing to worry about after the first few trips to the store, but before too long he found himself having to ante up when the gang returned to the kitchen table to count their savings.

In this case, the kids are learning about saving and spending money at their own pace, with real money of their own, while at the same time observing the vicarious lessons on offer by watching what their siblings do. When one child spent all his money on a toy that broke within minutes and then watched as dad matched the savings of his more disciplined older sister, the object lesson was as undeniable as it was painful. The next step for this family is to introduce the basic concepts of investing (through a savings account), compound interest (an admittedly tricky lesson when there is precious little interest to compound at present) and the importance of philanthropy.

That’s a lesson in earned wealth, albeit it on a very small scale. How might a family educate slightly older children, particularly in the area of inherited wealth? The Robbins family includes two teenage boys. At the age of 13 each son received a lump sum of $3,000 from an entirely fictitious “Uncle Louis,” which they could use for whatever purpose they wanted. The size of the bequest is arbitrary, but the intent is to make the gift large enough to be meaningful and to allow the scope for spending, investing and giving without depleting the funds entirely through any one choice. Uncle Louis doesn’t really exist, and the boys know that. The character is merely an exercise in parental poetic license that helps to remove the overtones of parental oversight or continued control of the funds. The parents really do want the boys to do whatever they want with the money, with no strings attached and no concern that the money really belongs to mom and dad. By the way, Uncle Louis is a third generation fictional device for this family. He has granted both money and education to three generations of Robbins family teenagers and counting.

This is a different sort of experience than the Welch family, where the kids are “paid” for “work.” Behavioral finance teaches us that it is human nature to treat money differently depending on where it comes from, where it is kept or for what it is intended. Our language reflects these differences. Retirement money, play money, plastic money, rainy day funds, new shoes money and silly money are each very different concepts, and even though ten dollars is ten dollars no matter what label it carries, there is an obvious benefit in mentally segregating these funds. One wouldn’t want to confuse retirement funds with play money, for example. For families that need to deal with the label “inherited money,” it is important to give children a firsthand experience of what that’s like. Hence the creation of Uncle Louis and his magnanimity.
$3,000 is a lot of money for a 13-year old kid, and the overwhelming temptation is to blow it. In this case, both boys gave into that temptation with part of the funds, but then realized what it felt like to spend money thoughtlessly. That visceral experience led to introspection, rare territory for most teenagers. With both of the Robbins boys, that led to an appreciation of planning for future purchases, saving part of the money to have enough for these purchases, and even giving part of it away. The older of the two boys surprised his parents by giving $500 of his “Uncle Louis” money to relief funds following Hurricane Sandy.

In both the Welch and Robbins examples, personal experience with money provides a powerful learning opportunity for younger generations. The details of how these families educate the next generation aren’t as important as the basic concept that the presence of money and the freedom to make mistakes with it are the primary lesson. At the same time, money isn’t the sole teacher. The kids observe and learn from choices made by their siblings, and, although the kids make their own choices, mom and dad are there as resources as well. In both of these families, the parents provide information and guidance, but do not impose their own opinions on the choices the children make.

The financial cost of this education is small, and can furthermore be scaled up or down depending on the family’s resources. On the other hand, the investment of time, energy and attention are meaningful, but pay a handsome return in terms of better prepared heirs. Not to engage in this effort is a mistake, but it is a mistake that many families make intentionally. With the best of intentions, many families choose not to discuss matters related to wealth and investing, often out of a misguided desire not to burden the children with knowledge of the family’s financial wealth. Parents often fear that the presence of wealth might influence a child’s decisions about education, or skew their work ethic. If the positive examples of the Welch and Robbins family don’t provide proof enough of the benefits of engaging the next generation on these issues, consider the damage that wealth can do to families who don’t address these issues, and therefore raise heirs unprepared to deal with inherited wealth.

A few years ago, a teacher in her mid-40s inherited a sizable sum of money upon the death of her parents. She was raised in a comfortable middle-class household, and was therefore aware that her parents had enough money to provide a stable upbringing, a nice house and a good education, but was completely unaware that mom and dad were leaving their only daughter several tens of millions of dollars. The will stated that the parents didn’t want the money to ruin their daughter’s life, and that they were proud of the life and career she had built for herself without relying on the family’s financial resources.

What mom and dad failed to recognize is that this plan left their daughter completely unprepared to handle the emotional side of wealth, much less the technical aspects of hiring advisors to help her manage it. She resented the fact that her parents kept these details from her and concluded that they didn’t trust her. She began to question her choice of career and spouse, and ended up leaving a teaching job she formerly loved and divorcing her husband. In spite of her parent’s efforts to prevent money from dictating her life, she ironically fell into the very trap that dad and mom had desperately tried to avoid by not talking about money. The best of intentions led to the worst of outcomes.

Philanthropy offers a dynamic platform to engage the next generation and prepare them for handling wealth. First, and perhaps foremost, it allows the next generation to understand how the family’s wealth enables it to put its values into practice through the support of charitable organizations. Even better, if the children can become involved in those organizations through a contribution of time as well as money, they can see those values in action firsthand, and see how wealth helps to further those values. Philanthropy instills in children the sense that wealth serves a purpose beyond the physical and emotional comfort of themselves and their family.

Philanthropic discussions provide an opportunity to practice family dynamics – how to present ideas, how to critique proposals, how to think analytically and how to cooperate. All of these are valuable and portable skills that can be exercised through philanthropy. One of our clients who does quite a bit of public speaking attributes his love of and talent for that activity to an adolescence in which he routinely presented and defended grant proposals to his family foundation. Those skills have served him well throughout his life.
Participating in the family’s philanthropic efforts brings a host of more practical skills to the forefront as well, and exposes younger generations to the wisdom and insight of older generations that often include a broader group of people than just their parents. Learning how to interact with investment advisors, attorneys and accountants is a skill that might not directly appeal to the under-21 crowd, but the education that such interactions can provide is invaluable. One family foundation in Florida makes a point of including teenagers in the grant decision making process, and those teenagers grow up with a better familiarity with financial concepts and the role of wealth than most adults ever obtain.

Finally, early participation in philanthropic activity teaches the next generation how to give away money wisely, and giving money away requires as much skill as getting it and growing it. How to select worthy recipients, how to make sure that funds are used for the intended purpose, how to obtain accountability from recipients and how to deploy financial wealth as an expression of family values are all aspects of “being good with money.”

These observations hold even where the magnitude of the family’s wealth doesn’t warrant a formal family foundation with board meetings, minutes and advisors. Families who express their philanthropy on a smaller scale, whether through a donor-advised fund or simply writing checks at the kitchen table, can still take the time to involve children in the process, with the ultimate benefit of better preparing them to understand and handle wealth of their own.

FAMILY DYNAMICS

A glance back at the analysis of failed wealth transfers presented earlier shows that, whereas 25% of failures in this particular study was due to unprepared heirs, a staggering 72% was due to obstacles within the family itself – either a breakdown of family communication and trust, or a failure to establish a family mission. In other words, the vast majority of failures can be attributed to issues other than poorly-delivered advice or inadequately prepared heirs. This is because many families spend most of their time considering the how of wealth transfer as opposed to the why. Families who do not take the time to define the purpose of their wealth run the risk of allowing their wealth to define them.

If we think about financial wealth not as an end in itself, but rather as a means to an end, very interesting questions arise, and discussing these questions gets to the “why” of wealth. What does the family want its wealth to do for the current and future generations? This leads to an understanding of family values and can lead to the development of a family mission. What difference does the family want their wealth to make in their lives, and will that difference be beneficial or harmful? Merely asking this question likely results in an improved outcome. Simply by acknowledging that wealth can be harmful prompts a family to pay more attention to that risk and increases the probability of avoiding it. How does the family want its wealth to impact the community in which they live, however broadly defined? Issues of philanthropy naturally arise as part of this conversation.

All of these questions lead to the fundamental challenge that most families face, whether they recognize it or not. As interested as mom and dad may be in transferring wealth to the next generation, what they ultimately want to transition is values. Stark examples of this desire are the statements made by two owners of substantial wealth: Warren Buffett and Bill Gates. Both have already committed the vast majority of their wealth to charitable ends. Buffett, when asked how much money one should leave to his children wittily answered, “enough so that they can do whatever they want, but not so much that they can do nothing.” In other words, it’s not all about the money. Gates has said that what he most desires to leave his children is the enjoyment obtained from the application of intellect and creativity to hard work.

In his book Wealth in Families, Charles Collier discusses four distinct kinds of wealth, and argues that families should acknowledge and nurture wealth in all those forms. First, a family’s primary form of capital is the human kind – the brothers, sisters, aunts, uncles and spouses that make up a family, and the unique abilities and talents they have and contributions they make. This includes a family’s health, happiness, ethics, morality and character. Intellectual capital is a second form and includes what people know, either formally or informally. When human
and intellectual capital is shared with the community, a third form of capital is fostered—social capital. Finally, good old-fashioned financial capital is a fourth form in Collier’s taxonomy.

Collier notes that most families only manage their financial capital, perhaps because it is the most easily observed and measured. Even if they recognize the softer forms of capital, they conclude that the best way to enhance them is to focus all their energy and effort on the financial side. Yet that causality is backwards. Only by paying attention to human, intellectual and social capital does a family nurture its financial wealth as well. Placing financial capital into a proper context and into proper priority is key to preserving and growing it.

Phrased differently, financial capital is best understood as a vehicle for expressing a family’s core values. That’s not a statement about giving everything away to charity and living in a tent—it’s a statement about the appropriate balance between different forms of capital and an appropriate allocation of that capital. Recognizing that variety and balance of capital allows every member of the family to contribute to its growth. Not everyone will be able to add to the family’s financial wealth, but everyone can help grow the family’s wealth when broadly defined.

The previous definition of wealth and capital is both broad and ambiguous, so let’s look at some action steps that might help a family put all of this into practice. These insights are drawn both from academic research as well as from the observation of the regular habits of families that succeed in transferring both wealth and wisdom to future generations.

1. **Write a mission statement for the family that spells out the purpose of the family wealth.** This is probably the single most important step in preserving wealth across generations. On the surface this seems foolish. After all, mission statements are for corporations and foundations. It is nevertheless instructive that seriously wealthy families have taken the time to draft just such a document, however brief. The Rothschild family mission, established over two centuries ago, is simply “Harmony, Integrity, and Industry.” In the 21st century, such a document helps to keep wealth in perspective, reminds the family that wealth is more than just financial and enables outside advisors to gain a thorough picture of what the family needs.

2. **Engage all members of the family in understanding and defining core values.** Note that this isn’t an exercise in mom and dad telling the family what to do, or trying to set the parameters of how the family must function even after they’re gone. It’s not about restricting individual ambition or achievement, but about establishing core values that the family all shares. One of the best ways to do this is through an appreciation of the family’s history. Family history can act as a vaccine against indolence or complacency, and it helps to identify how the family has always expressed certain values, whether intentionally or accidentally.

3. **Allow all family members to participate in the preservation and growth of wealth, as broadly defined.** When a family recognizes that financial wealth is only one of many forms, those members that preserve and grow other forms of wealth are seen to be contributing as well. This is particularly important where the family’s financial wealth takes the form of a business. When some members work for the family business and others simply benefit from it, resentment can ensue unless wealth is considered more broadly.

4. **Ensure that various family members are filling appropriate roles in nurturing the family wealth.** It is dangerous to assign roles to various family members because it seems like a good fit without ascertaining whether or not the individual has the desire as well as the ability to fill a certain role. Families need to gauge genuine interest, match that interest with genuine need and make sure that the necessary education is obtained for the successful pursuit of those roles, be they financial, philanthropic or otherwise.

5. **Communicate clearly the intent and outline of estate plans.** This is an uncomfortable recommendation for many families, as the natural tendency is to keep these issues quiet, private and even secret from the next generation. Yet it is far more effective if the next generation of wealth owners knows about the first generation’s financial planning and why those plans are what they are. Without that knowledge and guidance, the next generation often spends time, money and energy trying to unwind the plans that mom and dad put into place, without the benefit of having mom and dad around to explain the rationale for what they did.

6. **Plan to transfer wealth based on readiness instead of age.** This, too, is perhaps controversial, as age is far more easily
determined than readiness. Wealth without preparation can easily be harmful instead of helpful, so families should consider distribution to heirs based on more subjective criteria such as completion of a college degree, or a period of successful employment outside of the family business. This poses a particular challenge to corporate trustees, but can be overcome by making distributions from a trust discretionary.

7. Create opportunities for the next generation to add to the family’s wealth. This allows all members of a family to understand and embrace multiple definitions of wealth and determine where they can best apply their talents and interests towards growing that wealth, broadly defined.

8. Encourage younger children in particular to become involved in the family’s philanthropic efforts. The benefits of philanthropy as a training ground are outlined previously, and the most basic concepts can be introduced at a young age. As a means of teaching financial concepts and aligning financial wealth with family values, it is hard to beat philanthropy.

9. Strive for family cohesion. A deep appreciation for family dynamics and cohesion is a common thread among families that succeed in educating the next generation and successfully transitioning both wealth and values. It forms the first element of the Rothschild family values. These families understand the various definitions of wealth and how members contribute to the preservation and growth of wealth in all its forms. The celebration of ritual and rites of passage – births, graduations, marriages, even deaths – is supportive of cohesion, as it brings the family together and serves as a reminder of core values.

10. Communicate. This point really underlies all the other observations in this article. Older generations have to model effective and open communication, demonstrate the willingness to address difficult topics, retain open minds and listen to the ideas and observations of the younger generation. The kids will hear what you say, but they will more closely watch what you do. In other words, be the change you wish to see in the younger generations!

CONCLUSIONS

Successful wealth transfer is hard to accomplish, and it doesn’t happen on its own. Appropriate legal, accounting and investment advice is necessary, but not sufficient, for families who want to transfer wealth, wisdom and well-being to future generations. Unless wisdom accompanies the transfer of wealth, well-being rarely follows. Left alone, money can ruin the lives of the next generation as easily as it can enhance them. Just as it is never too early to begin engaging younger generations in conversations about the meaning of wealth, it is also never too late. Early is preferable, but late is better than never. And these conversations are important regardless of the level of wealth. The tactics and details may change as zeroes mount up at the end of a portfolio statement, but the underlying precepts are universal.

It takes work to preserve and grow financial, human, intellectual and social capital across generations, but that commitment of time and energy offers the highest rate of return on investment we’ve ever encountered.

Appropriate legal, accounting, and investment advice are necessary, but not sufficient, for families who want to transfer wealth, wisdom, and well-being to future generations. Unless wisdom accompanies the transfer of wealth, well-being rarely follows.”

