

Morgan Stanley

WEALTH MANAGEMENT



Wealth Education

Family Governance



An Introduction to Family Governance



What is Family Governance?

Family Governance is understood to refer to the joint decision-making framework designed to maximize the value of a family's *human capital* across generations.

Family governance is about two essential matters:

- 1** The effort to **drive alignment within the family** around a deeply held set of shared and defining family values.
- 2** The understanding that there inevitably will come a time when **the family will disagree about a matter of utmost importance to the family.**



Family Governance can help a family **identify important personal and family issues**, discuss in-depth solutions for their needs, and create flexible, long-term objectives and shared goals for both present and future generations.

Why is Family Governance so Important?

Implementing a system of Family Governance can help:

- Foster transparency
- Adopt a shared family vision and path to follow
- Build and preserve legacy
- Create or maintain the continuum of family rituals/traditions
- Support succession planning
- Establish how decisions are made and who will be involved



Family Governance is Driven by Values

A **values-based approach** to wealth planning recognizes that the family's values and philosophy are at least as important as estate and/or tax considerations.

Shared values and goals can result in **more collective power and focus** in business, philanthropy and other areas of life than any individual family member can have on his or her own.

So, what does successful family governance look like?

- Strong, multi-generational alignment around common goals
- A culture of accountability
- Objective performance measures and business goals
- Family Governance strategies that can enhance effective communications across generations





Discovery Exercise

Start with your own personal introspection:

- How do you see yourself?
- What are your general interests?
- Do you have any hobbies?
- Is there a cause that is important to you?
- What does your family care about?
- What do you care about?
- How do you view your legacy?



NOW ASK YOURSELF:

What values, convictions and goals do you share with your family?



Creating a Family Mission Statement



What is Family Mission Statement?

A family mission statement is a document that reflects a family's articulation of its **shared values, vision for the future and collective sense of history or legacy**. For some, this formal governance structure and mission statement is essential, as it can be a powerful and unifying experience.

Family mission statements should indicate:

- The form and rationale for selecting an agreed upon family governance structure
- How it will assist in long-term wealth preservation and values transfer



Does My Family Need a Mission Statement?

Family mission statements are often the starting point for helping a family address the challenges of intergenerational wealth transfer.

If successful, a Family Mission Statement can...

- Unify a family around shared values
- Align a family's values with financial goals
- Function as a family's flight plan, destination and compass



What to Consider When Creating a Family Mission Statement

Avoid common pitfalls and ask the right questions to design an impactful Family Mission Statement.

Common mistakes to avoid:

- Using language that is too general or platitudinous
- Failing to integrate the statement into the life of the family through reviews and regular meetings
- Failing to involve the younger generation in the process

Important questions to consider:

- Should I have a facilitator? If so, should it be a relative or non-family representative?
- Who should be included in the process?
- How do I integrate it into the life of the family? (E.g., through family retreats, etc.)



Discovery Exercise

Ask Yourself:

- Would a family mission statement be useful in your family dynamic?
- What would your mission statement look like?
- How would we handle a situation where our values don't align?





Family Governance Structures



Ad Hoc Decision Making vs. Normative Family Governance

Ad Hoc Decision Making

- Decisions are made for a particular cause or reason
- Decision-making is typically not transparent or collaborative
- **As a result**, it becomes easy to attack the decisions on the basis that it was:
 - A. made without due deliberation,
 - B. it was not consultative or
 - C. that it was motivated by personal animus.

vs.

Normative System of Decision Making

- Decision making that is rule bound, transparent and repeatable
- Typically employs a family council or other decision-making body
- **As a result**, decisions are more likely to be immune to the attacks typically brought against the Ad Hoc approach.



DID YOU KNOW?

The **benefit of a governance system** is that it may make it more likely that decisions will be respected by family members over time.

Types of Family Governance Structures

When it comes to family governance, there is no “one size fits all” approach. Different families have differing needs, values, goals and objectives.

SOME COMMON FAMILY GOVERNANCE STRUCTURES INCLUDE:

1

Family Council

2

Advisory Board/
Outside Advisory
Board

3

Trustees

4

Family
Assembly

1 Family Council Structure

The Family Council structure is an entity composed of family members to address family issues, business issues and the intersection of the two.

The purpose of this structure is to:

- Provide an organized forum within which to make decisions
- Articulate the family's values and vision
- Educate family members about the history of the family and business, along with the responsibilities and obligations tied to both
- Serve as the vehicle within which to anticipate, air and resolve family conflict

2 The Advisory Board/ Outside Advisory Board Structure

Usually composed of at least one or more non-family members (at least some of whom may not also serve as trustees), this structure helps identify and prioritize issues objectively, and then recommends resources to address them. Usually there will be some family members on the board as well.

The purpose of this structure is to:

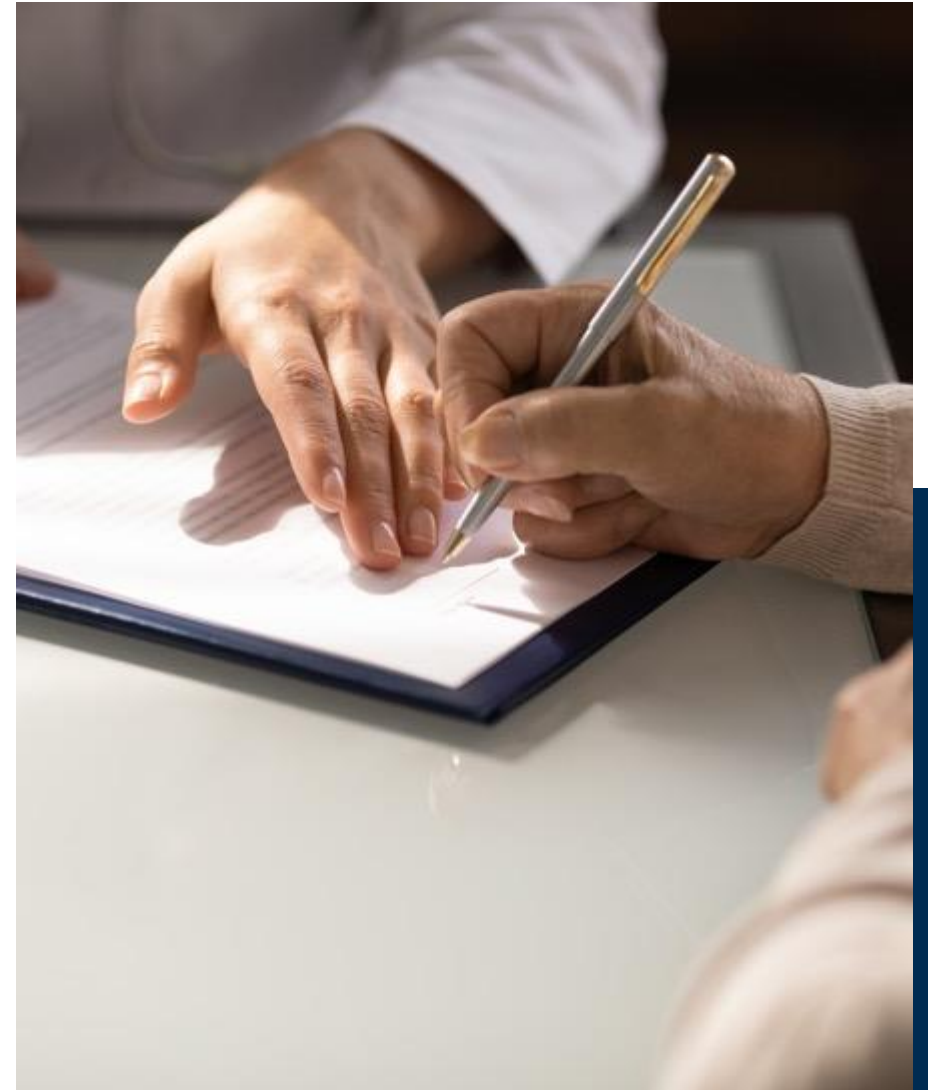
- Leverage the expertise of its various members to tackle complex and sensitive challenges such as investment policy and succession plans
- Give outsiders the opportunity to raise sensitive and important issues without the emotions and burdens of family baggage

3 The Trustee Structure

Trustees are individuals who are legally bound to hold and manage property on behalf of the trust beneficiaries.

The purpose of this structure is to:

- Focus on issues directly related to trust beneficiaries such as when to make distributions



4 The Family Assembly Structure

Typically, the largest set of family members, and the body from which all powers delegated to entities such as a family council emanate. It can also be thought of as a periodic forum or gathering that includes all adult family members (children may attend starting at a certain age, pursuant to family policy).

The purpose of this structure is to:

- Provide a group to which all decision-making family entities ultimately report; may be responsible for selecting family decision-makers
- Provide a forum to educate family members on the family business, family philanthropy or other family undertakings
- Provide updates on important events and milestones
- Reinforce the family constitution or mission statement, which provides a framework for the family culture

Other Helpful Family Governance Tools



Family Meetings

- Periodic gathering to educate family members on the family business, family philanthropy or other family undertakings
- A time to provide updates on important events and milestones



Family Retreats

- An opportunity for families to remove themselves from their day-to-day life and connect solely with their family





Family Governance Documents



The Purpose of Family Constitutions & By-Laws

Two of the more commonly employed Family Governance documents are Constitutions and By-Laws:

	Family Constitutions	By-Laws
What is its purpose?	<ul style="list-style-type: none">• Expresses how the family puts broad, aspirational principles contained in the mission statement into practice• Sets out a roadmap of what is important to the family and sets the future direction of the family• Typically express the family's general principles and philosophy• Often delegates decision-making authority to a specified group of family members, parceling out specific powers and responsibilities to individuals or committees	<ul style="list-style-type: none">• Usually address with greater specificity and particularity the actual workings of certain family structures and the management of family wealth• A more precise set of guidelines and regulations by which the family agrees to govern itself• Augments and enforces certain general expressions of the family constitution

When to Use Family Constitutions & Bylaws

	Family Constitutions	By-Laws
When to consider?	<ul style="list-style-type: none">• When you believe it's important to have a formal family governance structure• You want to create guidelines around spending and saving for future generations• You want to provide a formal set of guidelines for maintaining family trusts	<ul style="list-style-type: none">• You want to define the family governance structure in detail• You want to specify the management of family wealth• Your family is large and complex• Your family has a history of imprudent financial behavior

EXAMPLE:

Family Constitution

_____ Family Constitution.

WHEREAS, each of the parties hereto acknowledges that [name of patriarch], who died on _____, was the benefactor of the family wealth through his lifelong hard work and success and, as such, also acknowledges that his views and philosophy with respect to the management of the family wealth shall continue to serve as the guiding principles for the investment, consumption and management thereof; and

WHEREAS, [the patriarch] believed that the benefits to be gained by each family member from realizing his or her full potential through self-accomplishment far outweigh the benefits of financial support from the family wealth; and

WHEREAS, [the patriarch] also believed that the initiative, industry and ambition of a person easily could be impaired if not prodded by financial necessity; and

WHEREAS, the parties hereto subscribe to such beliefs and, accordingly, each wishes to avoid the use of the family wealth in a manner that might impair the desire of a family member to become a self-sufficient, productive member of society; and

WHEREAS, each of the parties hereto wishes to preserve a sense of family identity among the respective families of [the patriarch's] three surviving children, in order to provide a framework for the joint investment and management of the family wealth, and to impose certain limitations on the personal consumption and philanthropic or other uses of the family wealth; and

WHEREAS, in order to accomplish the foregoing objectives, each of the parties hereto desires to commit to the others to act in accordance with the provisions of this Constitution and the _____ Family By-laws (hereinafter, as amended and restated from time to time, the "By-Laws") promulgated pursuant hereto; and

WHEREAS, each of the parties hereto also desires to commit not to contest in a court proceeding or otherwise any action or omission taken or not taken in good faith by any fiduciary; whether acting as a trustee, investment adviser, general partner, director, officer, manager, business advisor or otherwise, with respect to any _____ family trust, partnership, corporation, limited liability company, foundation or other entity, as the case may be, if such action or omission is taken or not taken in accordance with the provisions of this Constitution and the By-Laws, and further desires to discharge, release and hold harmless any such fiduciary from and against any and all liability for any such action or omission; and

WHEREAS, each of the parties hereto, nonetheless, does not intend the provisions of this Constitution or the By-laws to limit in any way the authority or discretion granted to any such fiduciary pursuant to the provisions of the governing instrument of any such _____ family trust, partnership, corporation, limited liability company, foundation or other entity, to make independent decisions regarding the investment, management or distribution of the assets thereof or any other matter thereunder.

NOW, THEREFORE, each of the parties hereto agrees that the following provisions shall apply with respect to the investment and management, personal consumption and philanthropic or other uses of the family wealth:

EXAMPLE:

Family Bylaws

Section 1. Governance.

The Family Advisory Board, as described in Section 2 hereof, shall make all policies and guidelines regarding the investment and management, personal consumption and philanthropic or other uses of the family wealth. Specifically, subject to the further provisions of his Constitution, the Family Advisory Board shall adopt By-laws setting forth the following:

- (a) The general principles by which the Family Advisory Board will be governed in establishing its policies and guidelines.
- (b) The recommended policies and guidelines of the Family Advisory Board regarding the investment and management of the family wealth, including its recommendations with respect to the development and adoption of investment plans and strategies, the retention of outside investment professionals to assist in the development of such investment plans and strategies, and the periodic review thereof.
- (c) The recommended policies and guidelines of the Family Advisory Board regarding the personal consumption of the family wealth, including its recommendations regarding the purposes and levels of such consumption and the periodic review thereof.
- (d) The recommended policies and guidelines of the Family Advisory Board regarding the use of the family wealth for philanthropic purposes, including recommendations regarding the philanthropic purposes to which such wealth should be put and the levels of philanthropic support that are appropriate, and the periodic review thereof.

Section 2. Family Advisory Board.

(a) Composition of Members. The Family Advisory Board shall have three (3) voting members: the Executive Member, the Standing Member and the _____ Family Representative, as follows:

EXECUTIVE MEMBER. The Executive Member shall be a person having at least ten (10) years of experience in management consulting, law, accounting, and/or commercial or investment banking, or three (3) years of experience as a senior executive of a business with annual gross revenues in excess of Fifty Million Dollars (\$50,000,000). The Executive Member shall have one (1) vote on matters coming before the Family Advisory Board. _____ currently is serving as the Executive Member.

STANDING MEMBER. The Standing Member shall be a practicing attorney having at least ten (10) years of experience counseling wealthy individuals and families with respect to estate and tax planning and trust administration matters.

The Standing Member shall have one (1) vote on matters coming before the Family Advisory Board. _____ currently is serving as the Standing Member. _____ Family Representative. The three Family Line Representatives (as defined in Section 2(b) below) shall serve jointly as the _____ Family Representative,

and in such capacity, they collectively shall have one (1) vote on matters coming before the Family Advisory Board. _____ be cast based on the wishes of a majority of them (or all thereof if acting). Absent written notice to the contrary delivered to the Family Advisory Board, the spouse of such Family Line Representative shall attend a meeting.

(B) FAMILY LINE REPRESENTATIVES. Each of the families of [the child of [the patriarch], the spouse of such Family Line Representative, and the current Family Line Representatives shall die, resigns or becomes incapacitated, unless he or she has directed and filed with the Family Advisory Board, his or her spouse shall not serve as his or her successor, or in the event of the death, resignation or becomes incapacitated. In the event a

Section 3. Tenure/Removal/Appointment Provisions.

(A) TENURE. Except as otherwise specifically provided in Section 2(b) above, a person serving as the Executive Member, the Standing Member, the Special Member or as a Family Line Representative shall serve in such capacity until his or her death, resignation, incapacity (as hereinafter defined) or removal.

(B) RESIGNATION. A person serving as the Executive Member, the Standing Member, the Special Member or as a Family Line Representative may resign at any time and for any reason by giving written notice thereof, specifying the effective date of his or her resignation, to each of the other then acting members of the Family Advisory Board.

(C) INCAPACITY. As used herein, a person shall be considered "incapacitated" if, because of mental illness or deterioration, developmental disability or physical incapacity, he or she is not fully able to manage his or her personal or financial affairs. A determination that a member of the Family Advisory Board is incapacitated shall be made by such physician or physicians as shall be designated by such member at any time and from time to time (or in the absence of such designation, then by the physician or physicians then attending to such member) by written instrument delivered to the other then acting members of the Family Advisory Board.

(D) REMOVAL OF EXECUTIVE MEMBER. The Executive Member may be removed by vote of both (i) the Standing Member and (ii) the _____ Family Representative, if it is determined that reasonable cause exists for removal. Upon removal of the Executive Member, a successor Executive Member shall be appointed in accordance with the provisions of Section 3(h) hereof and, until such time as a successor is appointed, the Special Member shall serve on an interim basis in such capacity in accordance with the provisions of Section 3(g) hereof.

Being a Successful Steward of Wealth

Whether you are a designated Trustee or beneficiary, it's important to take this responsibility seriously.

Set yourself up for success by taking the time to:

1. Understand your family governance structure
2. Understand your family governance documents
3. Know your mission statement
4. Stay true to your (family) values
5. Attend family meetings and retreats
6. Continue to evaluate family values, mission and goals and make changes when necessary

Another aspect of good stewardship is creating an estate plan.



Special Planning Considerations

Blended families, children with special needs, and pets may require special consideration when putting together an estate plan.

Children:

If you have children with special needs or severe disabilities, it's important to make sure that any gift or inheritance they receive will not interfere with his or her eligibility for government benefits. The most common way to do this is through a Special or Supplemental Needs Trust, which provides that any assets held in the trust are intended to supplement, but not supplant, the governmental benefits your child is entitled to.

Pets:

Leaving a pet to a caregiver in a Will may not account for situations in which you might become incapacitated. Consider setting up a traditional or statutory pet trust to help ensure that they will be taken care of in the event something happens.



Conclusion



Take the Next Steps

Through proactive planning and honest communication, you can navigate the complexities of family matters to preserve a happy hearth and home.

A strong team is essential to take the next steps. Your financial advisor and estate planning lawyers can help ease the process.

Resources:

- Playbook: Your Guide to Life & Money, Family Matters: Invest in What Counts
- Estate planning law firm directories, i.e., [findlaw.com](https://www.findlaw.com), [nolo.com](https://www.nolo.com), [martindale.com](https://www.martindale.com), [lawyers.com](https://www.lawyers.com)*
- Your Financial Advisor

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