FAMILY WEALTHREPORT

GUEST COMMENT: Charles Lowenhaupt On Parents, Trustees And Complex Questions

Charles Lowenhaupt, April 7, 2017

This month, family office consultant Joe Reilly interviews Charles Lowenhaupt of Lowenhaupt Global Advisors on his concept of freedom from wealth, the Institute for Wealth Management Standards and why inheritors are being prevented from achieving the American dream.

Family Wealth Report does not necessarily endorse the views stated in this article but is delighted to share them and welcomes reader responses.

The question arises when it comes to handing wealth to children: which role is easier - that of the parent or the trustee? As this article explains, it is not an easy one to answer.

The following commentary is from Charles Lowenhaupt, founder and chairman of Lowenhaupt Global Advisors and a luminary of the wealth management industry; he is a familiar figure for many of our readers and has commented in these pages before. He is the co-author of Freedom From Wealth, published by McGraw-Hill. (He was interviewed by Joe Reilly, regulator contributor to these pages - and FWR awards judge - [here.](#))

In this article, he gets into the basics of how, and in what ways, to share one's wealth with children, and how the questions can rapidly turn complex. We thank him for adding to debate; readers can respond by emailing tom.burroughes@wealthbriefing.com

Joe Reilly: You have always taken a bit of a different perspective on wealth management, starting with your concept of "freedom from wealth," which you discuss in your excellent book of the same name. Why would someone desire to be free from wealth?

Charles Lowenhaupt: The starting question for any wealth holder is "What is your wealth for." An answer I often hear is "preservation and enhancement", but that is not what wealth is for. That is what you do with wealth to make sure it is there to serve its intended purposes. Multi-generational wealth should always be managed to ensure that wealth holders or wealth inheritors become all they can be. In other words, wealth is for self-actualization. Yet, the burden of managing significant wealth – stewardship, responsibility, the details of investment management – usually impede self-actualization. Freedom From Wealth is what everyone needs to put wealth in its place and live life to the fullest.

Joe Reilly: You recently wrote a white paper that posited that many inheritors are prevented from achieving the American Dream. This is counter-intuitive, to say the least.

Charles Lowenhaupt: I wrote that perspective with Mark Rank, whose book *Chasing the American Dream*, is one of the great studies of the subject. Mark is renowned for his understanding of poverty in America. He was surprised that I thought wealth inheritors had as much trouble chasing the dream as those without money. As Mark defines the dream, it is the freedom to pursue self-actualization with passion. It is a journey and not a destination, and it requires optimism and a sense of financial security.

More often than not, the wealth creator redefines the dream as having wealth and then hands the dream to his child on a silver platter. The American Dream is the dream of everyone – everywhere on the planet – to self-actualize. Freedom From Wealth is completely consistent with achieving the American Dream.

At a recent family wealth conference, for example, an audience member raised his hand and asked: "Should I give equal amounts to children? Or should I give unequally depending on what they need?" He wanted to know what was "fair," since he wanted to be sure the children thought of him as fair. That question is one of the fundamental issues a client will ask about in estate planning and always requires a conversation.

So at the conference, I answered he should decide whether "equal" meant dollar-for-dollar equality or need-by-need equality. I suggested if one child went to medical school and another did not, he might decide to pay for school without giving an equal amount to the other child. I concluded it was really a question of what "felt right" to him. How might he best maintain family harmony by treating everyone "fairly?" There are no rules, I said.

After the presentation, he came up to me. He said he was the sole trustee for the children of a friend and was trying to decide how to make trust distributions. In fact, I had inadvertently given him the wrong answer! A trustee has a duty to follow the trust instrument and the intention of the trust creator. As a trustee, there are rules grounded in fiduciary standards. His job was not to do what would "feel right" to him as parent, but instead to follow the rules - to be a responsible fiduciary.

The trustee's challenge is to understand and communicate the rules. That starts with answering the question, "what would the trust creator want" and confirming that the trust instrument itself allows what the creator would want. Would the trust creator want needs met equally even if that was not dollar-for-dollar equality?

What the trust creator would want starts to answer the question "how to proceed." But the next step, often the hardest, is to make sure that all of the beneficiaries know the rules. When everyone knows the rules, they are fair. So that Trustee needs to communicate with the beneficiaries and build sound process around that communication.

The trust creator, usually a parent, has complete freedom to make the rules. The trustee, on the other hands, has the duty to follow them and communicate them.

Different worlds

These are two very different roles, and the contrast between the two is often quite stark.

So which role is easier? The parent or the trustee?

At first blush, the parent's role seems easiest - total freedom to do whatever you want. You get to decide how much and when to give. You decide the standards to be set. You choose a trustee. You decide the meaning of "equal." Yet, buried in that freedom is the impulse to be "fair," and there are no objective standards. There is no one-size-fits-all precedent. You also bear the burden of believing that a mistake can create unhappiness and family disharmony. The personal risks are great.

And what about the trustee's role? The trustee has standards, language and rules that must be followed. The trustee must also act as fiduciary to protect the beneficiaries. The trustee's analysis is not about what feels good, but is instead about what the trust instrument requires. The trustee's job is to communicate what the trust (and the trust creator) intends and to follow that intent. In some respects, this role may actually be easier than being a parent because there is no absolute freedom.

Either way, when it comes to that question about sharing the wealth with children, the answer is always: "It depends." It depends on who asks the question and in what capacity they are acting.

Joe Reilly: Most families view their foundations as adjacent to the family office, but you have, uniquely, argued for a more central role. Where do you see the foundation fitting into the overall family?

Charles Lowenhaupt: Community is central to making family wealth meaningful. We have never found a family that can be in harmony with its wealth if it is not fully engaged in a community. That can be accomplished through the family foundation, private charitable gifts, volunteer efforts in the community, or through ownership of a family farm. The challenge for any family is how to tie wealth and legacy to a community strategically to accomplish the family's purpose. That challenge must be addressed very strategically; how it is addressed should be as important to a family as how assets are invested or abstract notions of governance, next generation education, and balance sheet analytics.

Most SFOs see the family foundation as something they can administer efficiently. They administer investments and grant-making objectively, and they try to design governance processes to make family members feel engaged and productive. But too often they do not look at the strategic benefits of philanthropy in accomplishing the family's purposes for its wealth.

How badly philanthropy can be managed is reflected in an experience I had. A week or two after September 11, I was moderating a session for a conference in New York. The plan had been to put older people in one room and younger in another and ask both groups the same question. Considering the event and our location, I made that question: "How has the devastation affected your attitudes toward your wealth." The group of older people all talked about enhancing their foundations and giving more where needed. The younger all talked about buying private jets and looking for shrewd commodity investments. We brought the groups together and I asked why the old talked community and foundation while the young talked jets and commodities. A young person raised his hand: "The foundation is just one more way our parents control the money and us. Who wants to hear about that?"

How can families use a relationship with community to build the family engagement and functionality? Clearly the foundation should not be about control. A well-designed foundation, with a staff sensitive to the many needs of a family, can serve a family as well as, if not better than, a family office.

Indeed there are family foundations that do a better job of encouraging individuality, teaching process and polishing legacy than most family offices. A foundation can allow individuals to soar in vision without jeopardizing others by giving one family member the resources and support necessary to try an idea. A well run foundation can introduce disciplined process (investment process, operational process, structural process) in a non-threatening fashion to a group of relatives. A good foundation can help a family "rebrand" the family name (as has the Gates foundation) so every member of the family can take comfort in the family legacy.

Philanthropic foundations can do it all. We have helped families "unbundle" the family office in times of strife and disharmony, but then reunite harmoniously in the family foundation.

Joe Reilly: The Institute for Wealth Management Standards you started with Don Trone developed principals to guide the creation of standards for families. What was the driving motivation to craft these principals?

Charles Lowenhaupt: The morning after the Madoff story broke, I was meeting with a friend who had just retired as CEO of a large single family office. She was introducing me to a lawyer known in New York for his work with wealthy families. The family office executive told me that her family would have lost all of its liquidity (in excess of a billion dollars) to Madoff. The lawyer said "I represented 8 billionaires yesterday who are broke today." When I asked how that could happen, the response was, "We trusted Bernie."

It seemed clear to Don, my Lowenhaupt Global Advisors Global Council and me, that trust was a weak substitute for due diligence. Indeed, most industries have standards to ensure that processes are governed by objective tools.

In the wake of Madoff, our Global Council drafted a set of principles that eventually formed the basis for objective standards for wealth management. Don and I founded the Institute to develop voluntary standards for private wealth holders that could be used as guidelines for wealth management. The Institute has now evolved into much broader fields under Don's leadership, and its successor is teaching throughout the financial service industry.

Process is protective, and standards can form the basis for process.

Joe Reilly: Last year you wrote in these pages that the next generation might need instruction in the concepts of noblesse oblige. How do you see wealth in relationship to the wider community outside the family?

Charles Lowenhaupt: Here is what I said:

The great dynasties are great not because they got and stayed rich. They are great because of what they did for their communities. Consider the Medici's, the Kennedys, the Rockefellers, and the Fords. Consistently, generation after generation, they lead and contributed intellect, resources or cash to their communities.

The wealth gap we see worldwide is obscene if we divide the world into the "haves" and the "have nots". Indeed if there is to be any purpose in wealth, it must include living in a world of peace and beauty and health. I believe no one can chase the American dream unless everyone can chase the dream. For many wealth inheritors, self-actualization must be helping the world become a better place either through philanthropy, volunteerism, political engagement, or creation of beauty or business.

Wealth comes from a community, so every wealth creator and his children should be sensitive to their role in a community. The very concept of a "dynastic" family creates a relatively artificial line between sixteenth cousins and neighbors. In any event, we have never found a family that can build functionality around its wealth without engagement in and recognition of the importance of community.

Joe Reilly: You are very active at the firm. What do you think is the biggest change you have seen in the industry since you began?

Charles Lowenhaupt: The biggest industry changes I have seen involve what I would call marketing. Charlotte Beyer and Sara Hamilton revolutionized the field by creating networks for wealth holders; Charlie Collier and Jay Hughes introduced the proposition that the rich have their own challenges worth addressing. Then what happened? "Family Office" evolved as a term meaning almost anything. The investment counselor evolved into the "multi-family office." The language of wealth became a language of burden – "stewardship", "governance structures", and "legacy". "Philanthropy" itself, the heart of private wealth, became a buzzword and left "charity" and "volunteerism" in the dust. Magazines are written just for the rich, and education programs are designed just for rich children.

The result is that wealth inheritors are being robbed of an opportunity to achieve the American Dream. In its place, the industry has tried to turn every wealth creator and wealth inheritor into a customer. That is what I have seen over the last 40 years.

Joe Reilly: Many entrepreneurs are strongly motivated to sell their businesses, and are encouraged to always keep an exit in mind. Do you think entrepreneurs should try to hold onto their businesses?

Charles Lowenhaupt: Joe, please give me the "standard" entrepreneur and I will answer that question. Again, for each individual business owner, the question is "What is the Wealth For?" Based on the answer, the next step is determining the strategies that can best accomplish those purposes. A business may help a child and grandchild self-actualize, but for others, it simply won't. The burden of running the business will not advance their personal development.

A business may bring a family closer to the community, and I know some owners who believe the role of the business is creating a family legacy of job creation and community building. That all sounds good, but it becomes slippery if the business is not run well.

Then there is the challenge of equal treatment of children, when one works in the business and the other does not. That requires a high degree of sensitivity to the definition of "equality".

An issue for the entrepreneur who has built a business is properly defining a "family business". There is no requirement that a privately-held business be a "family business". If it is a "family business" and if that means it will always be owned and run by family, then standards must be developed to define success in ways that younger members of the family can achieve. And the creator's legacy cannot be defined as creating wealth.

Among the most unhappy people I know are wealth inheritors who were brought into the "family business" by a father. Over time, the father decided that the inheritor could not run the business profitably. Or, the father suddenly decides that selling the business was a way to prove his own success in objective dollar terms. In either case, the wealth creator has left a 35- or 40-year-old child with nothing but a pot of gold, robbing him of his career.

Your question reminds me of the story of two brothers who owned a foundry. They had been clients since I was a young lawyer. One was 90 and one 92. The 92-year-old had a 60-year-old son working in the business. "How is the son doing?" my father asked. To which his uncle answered: "Give him a few years and he will be a pretty good foundryman."