Podcast Transcript

Creating Tailwinds for the Successful Family

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Kattman: Today, we're diving into real world success stories that show how BakerHostetler's proprietary Fintech application, FinClar changed the legacy management estate planning experience for families so they can collaborate more effectively with their financial, legal, and tax advisors, make clearer decisions during the planning phase, streamline implementation and ongoing plan maintenance, reduce long term costs and postmortem delays, and most importantly, prepare the next generation to understand and steward the family legacy with purpose. I'm Amy Kattman, and you're listening to BakerHosts.

Joining us today are partner John Forster, and Of Council, John DeStefano, private wealth attorneys. Let's listen in.

Forster: So, today we're really talking about the part of legacy management that people tend to call the soft side, but interestingly enough, this element of legacy management, a social capital side of it, if you want to think about it that way, seems to be of the most interest to families. And it is funny, over my 30 years

when I've spoken with families, they've always leaned in at the end of our conversations and said, listen, I'm sure you know how to optimize a financial outcome. I'm sure you know all the tools of the trade but let me tell you what the most important thing is. And the most important thing to me and my wife is that our children remain independent and that they basically meet their ambitions wholeheartedly, and that the capital not destroy the fabric of our family. And so, suddenly it is, well, what are those things and how do you get to those things and what are they. But suddenly, those have been identified as the most important things, and at least in my experience, the least amount of time is spent on such. So, that can lead into this dialogue between me and John DeStefano. John, go right ahead.

DeStefano: Sure. Good. And you're right, Jon. We know that lasting family legacies are sustained by something more personal; the family's values, its story, its identity. But conventional planning typically focuses on other things. As you said, finances perhaps exclusively. Why does that disconnect exist and what consequences do you see play out in practice?

Forster: So, I think the reason the disconnect exists is because the advisory team that is providing basically the instructions around planning, and not the fault of their own, but are focused on optimizing a financial outcome. Whether it be the life insurance advisor, the investment team, the accountant, or the lawyer, their businesses are structured such that the measuring stick is a financial outcome, whether it is assets under management or lawyers performing certain transactional tasks. And so, the consequence of that is, that is where all the time, energy, resources are placed as opposed to on these other areas, which are really left to no particular advisor. If you were to break down their roles and responsibilities, I doubt you'd find this in anybody's queue. And so, that is really the consequence of misalignment is the family isn't directed in that way. And what I would tell you is, at least in my opinion, planning is principally predicated on really, intentionality. And so, if you don't know why you're doing the planning that you're doing if you don't really have an end goal, you can't possibly hit the mark.

DeStefano: Yeah. And I think how this plays out also is the next generation doesn't understand what the family has done. If they have a plan in place there is not necessarily a why that is evident. Do advisors typically coordinate with each other in conventional planning?

Forster: So, that is another area that is really misaligned for the family. So, most of the advisors tend to work in a fairly siloed fashion. The investment team delivers their advice, the accountant theirs, the lawyer theirs, the risk managers, insurance folks theirs, and the outcome there is that the information is siloed. It lacks aggregation. And so, the family really, including the next generation, doesn't have any visibility into their own affairs. And so, to your point about communication, it is hard for the family to share what is happening when, frankly, I'm not even sure they know what is happening. And so, I think there needs to be a change in how the model works for families. There can't be the trusted advisor. There needs to be the trusted ensemble, and they need to have almost an effect.

If you want to think about it this way, John, a chief integration officer and maybe even a chief onboarding officer so that people start off with the same information and the information is integrated among the advisors. So, if you were to take a particular task like creating a trust, somebody else knows they're funding it, somebody else knows that they're filing a gift tax return, somebody else knows filing an income tax return. There is a dominos effect here.

DeStefano: Yeah, that is right. You mentioned before that clients lean in to you after the meeting to tell you what they really care about. What is really important to them. And so, I think we recognize that wealth includes more than money. It includes things like family well-being, positive, healthy relationships, sense of purpose in work and just in life. And you talked about how maybe there aren't these clear frameworks to help cultivate or sustain that broader definition of success. How do you see clients successfully design and implement a framework that works for individual family members? So, on an individual basis they can self-actualize but then maintains the cohesion of a single family unit.

Forster: So, let me give you an example that recently I ran into. So, I was in Italy, in the Tuscan countryside, spent some time there. Mostly it is agricultural and much of the land is farmed, whether it be for wine or for other agricultural purposes. And when you go to visit a family there, let's say that you go have a wine tasting. It happens to be a family vineyard. There is a certain respect for the land that seems to be part of the family's core values, if you will. And so, first you walk into the wine tasting room. And literally the room is filled with pictures of the family from inception, dating back generations, every family member is identified and the people that are in the current generation can tell you their story. This is how my family got here. This is how they actually got the land. They were tenant farmers. The land was eventually sold to them because the owners got too old, didn't have a family. They passed it along to their kids. They decided that it would be a vineyard, etcetera. And the consequence of that is the enormous amount of storytelling among the family.

So, the story is passed along, and the story is about how they came to this particular spot in life, going all the way back to however the land came into their hands. And families generally don't leave the area. One son or daughter usually agrees to stay on the farm and continue the farming with the generation one and the rest of the family does not disperse to far reaching parts of Italy or elsewhere in Europe. They actually literally live 10 or 15 minutes away. And so, the families never really disperse, and the farm is a centralized place and it is actually super important for people if they want to have stability to, oddly enough, have a place and we'll get to that later. But so, it is a grounding place where the family comes together, knows all their family stories and there is communication between generations.

DeStefano: Yeah, just even hearing that it sounds like communication is key here.

Forster: So, communication to your point is the backbone of planning. Interestingly enough, in the 80s, Harvard did a study as to why this concept of shirtsleeves to shirtsleeves in three generations. Why do the dollars dissipate by the third

generation among successful families? And the answer is, they found, not what you would think. Not confiscatory taxes, poor investing, bad decision making, taken advantage of, none of those things showed up. What showed up was a complete breakdown in communication among the family. Nobody really knew what the overriding purpose of the resources was, and they really weren't prepared to take over any kind of stewardship. And so, to your point, communication, or lack thereof, is a pretty costly element to the planning process. And going back to your first question, it doesn't tend to be in anybody's queue.

DeStefano: Yeah. And I think it is a difficult conversation for many families to have. It might be even taboo for parents to talk to their children about income and wealth. So, how do you overcome that headwind? Or I guess what does it look like?

Forster: So, at least as in our own practice, we have a module called the Visionary Journey. The Visionary Journey is meant to capture the tactical planning that we all do with the social capital element of the planning that no one seems to be doing. So, first of all, in the Visionary Journey, forget about getting generation one and generation two aligned. Oftentimes we find generation one hasn't even had the conversation. Husband and wife have not yet decided, should we give our son or daughter capital? Should we lend it to them? Are we buying them their first house? Are we making annual exclusion gifts? I didn't think we were. I thought were going to make them work for it. I thought we wanted W2 matchers. No, I thought were giving them money. Why should we do that?

And you're like, wait a minute. These two aren't even on the same page about what they want to do. So, step one in the Visionary Journey module is getting the couple on the same page about what they identify they want their resources for, which is really a matter of identifying your core values. Once you decide what your North Star is, then you can decide how you want your capital to support that North Star. So, for example, John, if you said your North Star was entrepreneurialism then maybe we're going to focus on that as a purpose. If you said, hey, it is really well-being, maybe we're going to focus on that as a purpose. And so, I think you have to identify what your core values are. There is not going to be one. There may be three but maybe even among the three, there is a prioritization.

DeStefano: That is right. And I think you're talking about something related to, say, more purposeful trusts, whereas we know conventional trusts are typically focused on controlling distributions, minimizing taxes, but they rarely convey the why behind wealth or encourage beneficiaries to live out these values that you might be talking about. How do you design a trust that balances the legal precision with this personal meaning?

Forster: So, it is a great question. Again, now you're getting, hey, let's get into a bit more granularity and how do you affect this outcome we're seeking, more communication, deeper communication about legacy? And so, to me, step one is we identify the fact that there is a lack of communication. We identify the fact that the advisory team is not likely to focus on that. Where can we pick this up?

So, number one, things like the Visionary Journey or prophylactic coaching, then number two, once we've identified what is important to your point, typically, when people come in to create trusts, Johnny, you know this, they come in because they've been told by their tax advisors, they should come in. Hey, you're going to pay a confiscatory amount of tax. It is at least 40% at the base level, and it could be higher depending on which state you live in. And so, you need to do tax planning. Again, optimizing a financial outcome. So, they come in and in their mind is get me a tax plan, John.

And so, oftentimes the focus isn't on core values. The focus is right away on financial outcomes. So, usually we'll just pivot into what they want. Let's just lean in. That is what they've asked for. And so, we might create a trust principally to mitigate taxes, maybe it is pre-exit they're about to sell a business or go public, whatever it may be. And then it may be that after the trust is created, you go back and you start to iterate with the family and try to pull out of them, why did we really create this trust? Can you tell us what the purpose was? And the reason that is, John, and you know this as well, is when lawyers draft trusts they're usually focused exclusively on the tax code. So, the trusts are drafted with very broad rigor, meaning usually the trustee's only instructions when it comes to a distribution to a beneficiary is the following. You can give it to the beneficiary for their best interest. That means nothing to somebody. Or you can give it to them for health, education, maintenance and support. A HEMS standard which is right out of the tax code, health, education, maintenance and support also says nothing.

DeStefano: Right. So, if a child comes to you and says I want $5 million for a house. Right? You look to the trust language and it doesn't speak to it. It says best interests. What is the trustee going to do?

Forster: Exactly. That is a great question. Here is where John is pointing out. Here is where the rubber meets the road. Beneficiary calls up John and says, John, I want to buy a house in Malibu. It is $5,000,000. It is my first home. I'm 28 years old, fund it. And John is taken aback. Okay, let me see what cash we have available. I'll get back to you. And he runs over and opens up the trust and it says you can make a distribution for any beneficiary's best interest. It is purely in your discretion, and it is absolute. And go okay, like, what do I do? And I guess I should respond, because if John doesn't respond, that same beneficiary usually has what are called removal and replacement powers. Meaning if he doesn't like John's answers, John is fired. Bring in Bailey. What do you say to the $5,000,000 request?

And so, this is where the rubber meets the road to your comment, John, and to our way of thinking. You got one of two options, or maybe even three. Number one, make sure you have had prophylactic coaching, Visionary Journeys, and you've spoken to your children about what your expectations are if you're the trust creator. Number two, either identify those within the trust document itself as part of the language. This is the schematic around beneficiary distributions. This is, these are the guardrails, or you can do a letter of wishes saying this is why we did this and this is the purpose behind it, or some combination thereof. But you

really need again, going back to John's earlier comment, you really need to communicate what it is you're trying to do here. And I think there is no better communication than a child hearing their parents say this is what this trust is for.

DeStefano: And is that conversation typically had only once in the Visionary Journey? Is there some process that can be put in place where families can iterate?

Forster: So, to your point, we think a disciplined cadence is key. Anybody that has ever tried to master anything, playing the guitar, playing golf, whatever it may be, knows that you don't go out there and play a round of golf and, my gosh, I'm Tiger Woods. Who knew? Or get on the guitar and say, oh my goodness, I'm Eddie Van Halen, or I'm the greatest guitar player that ever lived. It turns out it was just a hidden talent. That is not a thing. Those people practiced for a gazillion hours before you ever saw them do whatever it is they're doing masterfully. And so, if this is that important to you, if in Maslow's hierarchy chart, this is at the top, having functional, ambitious, non-trust dependent children, then you need to invest some time and it needs to be a conversation that probably takes place at a minimum once a year and maybe more.

DeStefano: Yeah, some sort of discipline, cadence and repetition would have to be part of I think any process of helping someone learn something and take the reigns. Some…

Forster: So, just to speak to that for one second. So, that is why, and I'm not, this isn't a commercial for us, but that is why our process has been designed specifically this way. We run family meetings, we assist with advisory meetings called a Family Summit, and we democratize the data through a Fintech application called FinClar. So, families have access to their data. If they want to speak to one another about their affairs with full visibility, they can. They can have their own family meetings. They don't have to call in the troops and have people assemble all kinds of data. They have their data, and we have a disciplined program, the Visionary Journey and the Summit to serve as a tailwind in that process. It is a different process. Part of the issue here, John, is the process is pretty much episodic and transactional, typically between lawyer and client and that doesn't support this kind of legacy planning.

DeStefano: Yeah. Shifting gears a bit, the concept of a family bank, it can be a compelling way to move more toward this act of stewardship that we've talked about and promote some of these core values. But if it is not structured right, of course it can also create confusion. How do you or how do some clients view this concept of a family bank and what do you think can be done to ensure that it reinforces good decision making across generations?

Forster: So, a family bank, really, at least the way we think about it, is this trust is not going to be there for distribution purposes, principally. Not to say that if there isn't a financial hardship, if somebody suffers a personal bankruptcy or if somebody has an extreme health event and needs capital, we're going to fund that. Most clients will say we're going to fund that. But on balance, we're looking to lend money.

So, if you, John, are a beneficiary, making a request for that $5,000,000 Malibu house, we'd say that sounds fine. No problem whatsoever. Please deliver a financial plan as to how you are capable of paying down that loan, how much of a deposit you are going to make, if any, of your own capital into the purchase of this house. And what will be the payment terms? Because they won't be varied. And then we would go from there. In other words, we would almost act like a commercial institution making sure that you have the ability to pay and that we have the ability to collect. And so, if it is a house or a business may require a business plan and a sources and uses statement in terms of capital, we're going to get that granular or the trustee will get that granular about these requests and there will be an expectation of repayment.

DeStefano: Yeah, this definitely shifts the paradigm then from what one would think of as just a trust beneficiary living on distributions or using those distributions to support lifestyle to one where the trust is really a catalyst, right? So, the expectation is that the beneficiaries live productive lives and if they want to access capital, they can for a home or whatever else, maybe at a preferred BFR or something like that, but that these aren't handouts. It certainly would encourage entrepreneurialism or self-reliance, that sort of thing as well. And I think it would create also the discipline process where we have capital decisions being made in somewhat of a commercial basis rather than just purely donative.

Forster: Correct. Yeah. Listen, everything sounds wonderful until it doesn't. So the shadow side of this great family bank and making sure people are responsible, nose to the grindstone kind of stuff is because I thought I had financial freedom, I opted to be a public school teacher and consequently, I don't make that much money, but I'd like to think that I'm following a social good and that I'm doing what I love. You could argue that you're punishing that person, because they'll never be able to borrow that much from the family bank as opposed to my other daughter who was an investment banker at a premier bank making a seven figure salary who can borrow the living daylights out of the thing. So, everything has a shadow saw. You have to again, as a family, decide what is it you're trying to accomplish here.

DeStefano: Yeah. As far as the family say cohesion, many are looking at shared assets for this. Vacation homes, perhaps an investment partnership where they co-invest in private equity or even other operating companies. People are looking at shared governance, right, family offices, family trust companies, or even these family banks. And again, not just as tools for growing wealth, but for fostering connection, right? This shared experience. But that can come with its own friction, right? Shared ownership, shared use, how do families structure and manage these resources in a way that promotes what they want, these positive things, but without leading to conflict?

Forster: So, again, a very good series of questions. And really once again, place like I told you in my Italian example, is really important to create stability, particularly family stability, interestingly enough. So, I don't know if you know this, but the average U.S. citizen moves 11 times during their life. College, post college, first job, family, they now are married with children, and they need another expansion of a

home. So, they move 11 times and many times they move disparate, meaning they don't stay where they grew up or even where their parents are anymore. Sometimes they come back when they have children because they realize they might need the help or the parents are brought to them because the parents now need the help, but usually that is involuntary. Hey, I need the help. I can't get along, I can't work a job, or the parent literally needs full time care and the kids coordinate. It is all involuntary.

And the same study shows that what brings stability to people, mental stability, interestingly enough, is a sense of place because while the world and your life are transitioning, having a sense of place that doesn't change, this is the home I grew up in. I'm making this up or this is our family compound, like the Kennedys in Cape Cod and it never changes. It is always there. It is always the same. That is actually a very grounding feature, and actually brings families together and to your point, forces them to work together, because obviously they can't maybe all be there at the same time. Maybe they don't want to be there at the same time, and then you have, again, the frictional elements that you identified.

Okay, I'm on the other side of the country. I live in California. This house is in the northeast. I don't get to use it that much. I don't want to pay for it. There is a cost to having this house. There is light, heat, and power. There is real estate taxes, there is upkeep. And so, the questions start to come up about governance, reservation systems. Who gets to use it and when, or maybe I'm not using it. Do I still have to capitalize it? Or maybe the family should have capitalized it and created an insurance fund or something where there is, where that is off the table.

So, I think to your point, if you're going to have a shared resource, whether it be a house or private equity in a company or even a family foundation, there needs to be governance. There needs to be a family pact or an agreement. This is how it works. When we start to move into G2, 3, 4, so two becomes six, six becomes ten, ten becomes 20. And so, people need to understand how this works between one another, who can make decisions. We're going to improve it, et cetera, add a pool, whatever it may be and all of that comes with forcing children to become partners and work together. So, I think governance is really critical.

DeStefano: And it, sorry, go ahead.

Forster: The governance is really critical and back to your earlier point, communication is really critical.

DeStefano: Yeah, that is right and early communication, I would imagine.

Forster: I think families should take the training wheels off and let kids start to do things. In a family foundation setting, for example, you usually get G1 and G2 are going to manage this, make all the decisions. Maybe they let G2, generation two, make some decisions on the margins. You guys can decide what we do with $2,000 of the 200 million dollar fund and pick a charity or something. They should tell the kids that the parents are going to step back at the appropriate time. You meet

with the investment team. You decide what the investment objectives are. You decide where the capital is going. You make sure these charities are accountable to us. You do all that and you submit, in effect, a grant request. I'd like the capital to go here, there, wherever, because of my involvement or my, the importance of this issue to me.

DeStefano: So, like anything, earlier you start probably the better at it you'll be, but it will take I think the first generation looking to their children to say, okay, you're ready. We'll be there as an advisory board and we're here to talk to, but the time for you to start and take it seriously, it is now and not when you're 60 years old. And it seems that your structure here or our structure supports that between FinClar to democratizing the financial information, the Visionary Journey to get people on the same page on and about intangibles, and our Summit process bringing the family together every year. But yeah.

Forster: Yeah, I think that is right. I think if you're going to have a family, like by way of example, a family foundation, you should have a clear mission statement over that business. And maybe it gets modified when generation two or three get involved because they need to agree it can't just be your favorite charity, you're a Kentucky alum and therefore all the dollars are going to Kentucky. If the other kids never went there, they're not going to have the same affinity. On the other hand, if you broaden it and say, it is about education and what we are supporting here is scholarship funding for, making this up, underprivileged youths, then you start to or it is for research and development to study the genome projects. You can get as granular as you like and the more granular you get, the more it is easy, it becomes easier for your kids and grandchildren to stay within the guardrails and not get into an argument over hey, I want to give it over here, give it over there.

DeStefano: Yeah, that is right.

Forster: So, it becomes easier to, and the same thing with a shared property. If you say this shared property is really meant for the family to get together at least once a year, it is not, this branch uses it, then this branch. There can be some of that, but there also needs to be one period of the year where everybody or whatever number of people show up.

DeStefano: Right. It requires a lot of thought. It seems like what distinguishes. This prosperity over multiple generations, whether it is, family harmony, right, it is not an enigma. We know what it is. It is clarity around the finances, it is, and it is communication, right, about fundamental purposes values and putting this process in place to revisit all these things that we're talking about because I, it would seem to me a tall mountain to climb at any one point in time, and perhaps even impossible for a family to know today what the perfect plan is for 20 years from now and we have to iterate a plan people have to be dedicated to it, right? And conventional professional services are just not structured in this way to deliver on this promise of sustaining intergenerational prosperity.

Forster: The bottom line is I think it all starts with communication among spouses, among generations. Then the question is what process supports that? Aggregated data, a cadence around sessions, removal of silos among advisors. So, there is a flow of information and communication. And then to your point, John, implementation. Connecting this thought, well-being, to the use of our capital. It has to all, and so, if the process you are using is disparate and disjointed and lacks aggregated information, and doesn't really have a session around communication, then you can't, it'd be very hard for you to succeed, I believe, in managing a legacy.

DeStefano: Yeah.

Forster: And so, you have to, if you're a consumer, you have to ask those kinds of questions. What are your roles and responsibilities? Have you all worked together in the past? How have you worked together in the past? Do you meet collectively with the family? What kind of information can we expect from you? And of course, what does it all cost to implement? I think that is really the key is the family has to decide what their objectives are. Most families, because they're not sure what their objectives are, they focus on cost versus value and they just, once they know what things cost, then they'll say it is green lit. But the question is, are you getting what you want? And if that is never identified, then you'll never know.

DeStefano: In some ways, I think clients don't perhaps ask the right questions that then they're not asking their lawyer necessarily, what do I get out of this? What goals are we accomplishing? Maybe the questions are typically just, what does this cost? I want to check the box. So, what do you say to clients who say, look, I agree with all that, but I don't have the time. Clearly this is going to take time and investment, and I don't have either.

Forster: If a client or a family doesn't have the time, they're going to be disengaged, this isn't the process for them. Maybe they just do want to get things done in isolation and take them off their list like I hired an investment team. I hired a lawyer. I hired an accountant. My return is getting filed. My will is done. My investment team is managing and that is good enough for them. But again, if I look at Maslow's hierarchy of things that are important to people, typically what people tell me is the following. The following three things are the most important to us: our family, our resources, and our health. Period. Top three things. And so, while we don't deal in health, we deal in the other two, resources and family. And so, if those are the two of the three most important things, then maybe you need to reprioritize how you're going to use your time and your capital to get yourself in the position you think you want to be in, and it may take time. I'm not suggesting that somebody gets from point A to point Z in six months or even a year, maybe years, to do that.

DeStefano: Yeah, absolutely. I think the longer things go on in some ways, the better the plan gets.

Forster: Well, I really think there is a think tank called the Ultra High Net Worth Institute that is really trying to get the industry to realign towards a more client-centric

model. I think part of this breakdown as you were noting before is clients aren't really sure what they should be asking. Families aren't sure what they should be wanting. They know, but it is hard and it is hard to discern among the advisor groups who is going to do what and what should they expect from them. It is just, it is not a clear definition of services. You'll have an investment team saying they do comprehensive planning or holistic planning. Okay, what does that mean? That is not a term with a lot of definition to it or a lawyer who says I'll do an estate plan. What does that mean? I get a will? And so, unfortunately, I think part of the opportunity here is for the industry to, I think, realign itself with its, with the families that are using their services and come to more clarity over what people should expect and the vernacular around it, so people are speaking in the same terms.

DeStefano: That is right. Clients would certainly benefit from that.

Forster: We appreciate that. We think it is a discussion worth having and we think it is a discussion, unfortunately, again as I go back to the Ultra High Net Worth Institute, I think this is a discussion families want to have. It is interesting. Going back to my Italy experience, all the things that people claim they're chasing, family values, family history, family cohesion, I saw over there because that is exclusively what they focus on because they don't have a lot of resources. They have land. Come back to the U.S., people have deep resources, so they tend to focus all their time and energy on optimizing their resources. I'd like it in almost two ways. You put in your destination and ways will try to optimize your trip. So, it might take you through the worst possible route, the worst possible neighborhoods, 40 different speed bumps, but you get there a minute faster than you would have otherwise, had you taken a beautiful scenic route along the Pacific Coast Highway. And we both got to the same spot but really didn't get there the same way. And so, I would say that is really to me at the core of all of this. Those families spend all their time focusing on mission and tradition and history and the land as a shared experience and the consequence of that is that is that is exactly what they have. And so, I would just say that the family, I'm not suggesting you have to be mono focused on any one thing, but you certainly have to focus your time and attention on things that you deem to be important to yourself.

DeStefano: Wise and logical.

Forster: I appreciate that. Thank you for your time.

DeStefano: Thank you, John. Appreciate it.

Kattman: Thank you, Jon and John, if you have any questions for Jon or John, their contact information is in the show notes. As always, thanks for listening to BakerHosts.

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