

# Trusts & Estates®

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The Hand We're Dealt In . . . HIGH-NET-WORTH FAMILIES

By Anna Nichols

## Revising the Conversation About Risk and Risk Taking

Seize this moment to help clients face their assumptions and fears—and to plan well for the future

The recent market crisis destroyed capital, challenged bedrock tenets of economics and revealed significant limitations in standard investment management practices. But for families of significant wealth, there is a silver lining. In the long run, this crisis will help safeguard the wealth of future generations because it will change how families and advisors communicate about and manage risk.

Since 2001, the relative prosperity and market optimism provided little incentive for families or their advisors to evaluate risk management practices. If anything, easy access to inexpensive credit and a plethora of new investment options in an expanding global economy pushed conversations about risk to the bottom of the priority list. Once the market environment dramatically shifted, as it did at the end of 2008, the flaws of past practices became apparent, as did the disparity in how families and advisors perceive and even define risk.

Family Office Exchange (FOX), in partnership with Harris myCFO, recently published a report, “Managing Threats and Opportunities through Effective Risk Planning,” which outlines the findings of a nine-month study into how wealth-owning families define and manage risk. Prompted in large part by reactions to the financial crisis that began in late 2008, FOX and Harris myCFO spent the better part of 2009 interviewing more than 70 wealth owners, family office executives and wealth advisors on their risk management practices and decision-

making process during the volatile economic times.

With almost half (46 percent) of surveyed families reporting a reduction in spending during the past year and 25 percent noting cash flow or liquidity constraints, it comes as no surprise that attitudes towards risk and risk taking have changed.

Problem is, many advisors have not revised their approach to the routine client-advisor risk discussion to address this shift. To determine ways of bridging that communication gap, FOX and Harris myCFO brought together 20 industry thought leaders for a day-long discussion and analysis of what risk means for families of significant wealth and how successful families work with their advisors to handle known risks in a proactive manner and even capitalize on unanticipated opportunities created by a changing environment. (See “A Healthy Appetite,” p. 46.)

### An Experiential Perspective

Risk means very different things to different people, often depending upon personal context. To some, “risk” implies opportunity; to others, volatility or threat. Obviously, multiple, contradictory definitions make meaningful conversations between advisors and family clients challenging.

Compounding the communications problem: wealth owners think of risk taking and management in personal terms, focused on their own (and their family’s) financial security and lifestyle protection. But advisors tend to intellectualize risk, often viewing it in analytical or statistical terms. While some clients find a degree of comfort in the quantification of future uncertainties, many family members become frustrated when



Anna Nichols is the director of research at the Family Office Exchange in Chicago

advisors use complex statistics and technical terms to explain options or events that have such personal meaning and impact on their lives.

Because it is unrealistic to ask family members to separate their emotions about the future and discuss risk and risk taking in impersonal terms, the onus is on advisors to change their approach to communications.

To be effective, advisors must go beyond the standard conversation about assessing individual risk tolerance or asking clients to choose from a standard set of descriptors (risk averse, risk neutral, risk taking) and have more substantive conversations that address the threats and opportunities of the future from wealth owners' experiential viewpoint. They also have to push clients to

## A Healthy Appetite

*Strategies to help families regain their taste for (appropriate) risk*

In the wake of one of the country's worst financial disasters in 50 years, financial families were understandably shaken. While these economic conditions make it easy for advisors simply to encourage fami-

lies to focus on capital preservation, risk taking is equally essential if families hope to maintain wealth for generations to come.

To assist advisors in helping families strengthen

### Summary of 35 Wealth Owners' Views

- Share the fears and failures of family leaders and entrepreneurs running the business
- Hold an open dialogue around the context of the term "risk taking"—what does it mean to different family members?
- Participate in scenario planning about future outcomes with all family members
- Encourage travel and language skills at an early age
- Ask children about their dreams for the future
- Generate scenarios for family members to experience failure
- Educate younger generations on smart risk taking
- Recognize that a person's risk taking may switch to risk aversion at a later age, or vice versa
- Develop a disciplined process for analyzing risk and opportunity
- Avoid "analysis paralysis"

### Summary of 20 Wealth Advisors' Views\*

- Document the historical risks taken by the family, including those that were unsuccessful
- Separate the "sleep-well" assets from risk-taking assets (alternatively the "stay-rich" from the "get-rich" assets)
- Limit concentrated risk taking to investments with which the family is very familiar or has conducted extensive due diligence
- Encourage risk taking in mission-driven philanthropic ventures
- Clarify the role of owners, directors and managers in the future of the enterprise
- Share enough information about the enterprise for owners to evaluate the risks involved
- Build positive self-development plans for each owner
- Require a portion of each owner's lifestyle to be financed by personal income
- Create incentives that encourage qualified owners to take entrepreneurial risks
- Provide owners with access to relevant educational experiences

recognize that risk is not an enemy, not something that can or even should be wholly eliminated, but rather balanced and used as a mechanism for wealth enhancement and growth.

This approach likely will take more time, and certainly will take more effort than neatly laying out the family risks in quantitative terms. But because it's

more relevant, it should help prevent misunderstandings that can lead to poor decisions. By taking the time to learn the family's point of view and asking, "What keeps you awake at night?" an advisor should be better able to meet the family's true needs, leading to greater client satisfaction and stronger client-advisor relationships.

their resolve to take appropriate risks, the Family Office Exchange (FOX) and Harris myCFO, brought owners and wealth advisors together to discuss strategies for creating a risk-taking culture.

Input came from 35 wealth owners participating in the FOX Fall Forum on Oct. 22, 2009 in Chicago and from a roundtable of 20 industry thought leaders held on June 23, 2009, also in Chicago.

### \* The participating thought leaders were:

- *John Benevides, president of Family Office Exchange, LLC, in Chicago*
- *Joseph Calabrese, president of Harris myCFO, Inc., in Chicago*
- *Gregory D. Curtis, managing director and chairman of Greycourt & Co., Inc., in Pittsburgh*
- *John P.C. Duncan, principal of Duncan Associates Attorneys and Counselors, P.C., in Chicago*
- *Bryan D. Dunn, president and CEO of Kinship Trust Company LLC, in Northbrook, Ill.*
- *Sara Hamilton, founder and CEO of Family Office Exchange, in Chicago*
- *Dennis T. Jaffe, partner in Changeworks Global, Inc., in San Francisco*
- *James Kane, president of HUB International Ltd., in Chicago*
- *Ken D. Mindell, senior vice president, treasurer and director of investments at Rosewood Management Corporation, in Dallas*
- *Steven Oyer, managing director at Family Office Exchange, in Chicago*
- *W. Jackson Parham, Jr., partner and chief investment officer at Eton Advisors Wealth Management, in Chapel Hill, N.C.*
- *James Reiss, private family office consultant, in Boston*
- *Amelia S. Renkert-Thomas, of counsel to Withers Bergman LLP/ Withers LLP, in New Haven, Conn.*
- *Margaret Vaughan Robinson, owner of MCV Consulting, in Houston, and senior consultant to Family Office Exchange, in Chicago*
- *Douglas Rogers, chief investment officer at Laird Norton Tyee Trust Company, in Seattle*
- *Mark B. Rubin, senior managing director at The Schonbraun McCann Group (SMG), in New York*
- *Sharon Schneider, philanthropy director at Foundation Source, in Chicago*
- *Scott D. Welch, senior managing director, investment research & strategy, at Fortigent, LLC, in Rockville, Md.*
- *Lex Zaharoff, managing director and head of investment advisory strategies for HSBC's Private Bank-Americas, in New York*
- *Michael Zeuner, senior executive partner at GenSpring Family Offices, in New York*

— Anna Nichols

## From Theory to Action

Reframing the risk conversation to reflect emotional or experiential perspectives is not easy, especially with family clients who have multiple decision makers who have different views on risk taking. For many families, conversations about risk can be sensitive and uncomfortable. An advisor is in the difficult position of balancing clients' emotions surrounding risk with solid financial

By prioritizing assets for designated purposes, you can balance the needs of both conservative and proactive family members.

and risk management principles. They are responsible for helping clients reach long and/or short-term goals. Yet, many advisors are either unaware or wary of delving into the emotional issues that often help determine end performance.

No one should completely throw out statistical principles in favor of a purely emotional approach to risk management. But it is possible to apply techniques that allow an advisor to provide financial expertise and insight while respectfully acknowledging the sensitivities surrounding risk and risk taking.

One method that has gained prominence during the past few years involves prioritizing assets for designated purposes such as wealth preservation, lifestyle spending, and risk taking. This objective, or goal-driven approach, is a way to balance the needs of both the conservative and the proactive family members and help prevent conflict between them. Designating a solid portion of family assets to ensure that basic needs and obligations are secure (sometimes referred to as the "sleep well" assets), while assigning a separate portion of assets for aspirational investing, allows risk averse family members to feel more comfortable and also satisfies family mem-

bers who are more opportunistically inclined.

Some advisors are adopting scenario planning to reframe their risk discussions. This is a broader, forward-looking means of examining risk that involves analyzing multiple paths or possible scenarios for the future and focusing on "scenario diversification," that is to say creating legal and/or financial structures that will meet long-term goals under multiple scenarios. It's a particularly useful approach to use because it gives family members permission to talk about taboo fears and "what ifs" in a productive, positive manner. By examining potential scenarios, family members can better envision future risks and work with their advisors to plan for them.

## The Time Is Now

If timing is everything, then there has never been a better moment to introduce a new approach to evaluating and managing risk. The fear and angst that many people have experienced during the past 14 months are powerful motivators for change. While it can be easy to focus on the tactical response to the economic downturn, it's also critical for families and advisors to step back and examine the strategic questions this crisis raises: How can our risk management processes be improved? Where did our process fail? What can we do to prevent or curtail the damage from unexpected events that are beyond our control?

Family leaders and advisors can leverage heightened awareness of economic and financial matters to encourage family members to address these questions and make changes and process improvements. Clients are paying attention now. But that window of opportunity may be limited. As markets improve and clients' interests shift, the motivation for change fades. The time to foster behaviors and build new processes is now.

Families and advisors that commit time and resources to this effort will be far better prepared to handle the next cycle of unknown or unexpected risks that are bound to follow this current economic climate.

