

KNOW HOW BULLETIN

DO WE NEED A FAMILY CONSTITUTION?

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The terms ‘family constitution’ or ‘family charter’ are widely used, but have different meanings to different people. This article examines how a family should decide whether such a document might be helpful and how to ensure that it meets their particular circumstances, needs and preferences.

Family constitution. Family charter. Family protocol. Family mission and governance statement.

These terms are often used by advisers who specialise in family businesses and succession planning and the fact is that all of these terms, and probably a few others as well, can be used inter-changeably. For now we’ll settle on the term ‘constitution’.

But why have one? What do they look like? How do you get one? And what do you do with it once you’ve got one?

A STATEMENT OF PURPOSE

A constitution enables a family to put in place guidelines and parameters that help the family to make key decisions about the use and investment of family wealth. It provides a framework which helps family members reach agreement and resolve differences on key issues, promoting family unity and reducing the potential for damaging disputes.

Perhaps the most crucial need is to agree the broad purpose of the wealth i.e. what, and who, it is for. Clear objectives are crucial to the successful management and deployment of family wealth. In the absence of a defined purpose, family members may have many different interpretations and might not realise why others hold different views.

This is particularly important if there is a family business, a family estate or other ‘heritage assets’, where optimising economic value is not the only consideration.

The constitution might, for example, articulate the reasons for maintaining a business in family ownership, the circumstances in which it might be sold and the criteria for family involvement in the management. This applies equally if the family is committed to an art collection or a philanthropic foundation, or is in any way using its wealth to benefit the community, so that non-financial considerations become important factors in key decisions.

The constitution will also help the family to make decisions about how funds might be allocated between individual members and the factors which influence those decisions, such as their respective contributions to the family wealth, or particular personal needs.

Even where there are no ‘heritage assets’ as such, and the family’s wealth is represented by a diverse portfolio of equities, real estate, private equity etc. it can be helpful to set down thoughts on matters such as:

- Whether the family expects wealth to be shared equally or on the basis of what is ‘fair’. If the latter, this will mean reaching a common understanding of ‘fairness’
- How to balance distributing income and growing capital for future generations
- Whether funds should be set aside for special purposes, such as supporting individual or collective enterprises, investing in start-up businesses, developing the talent of family members or providing for hardship
- The extent of commitment to charitable causes or ‘impact’ investment

DECISION MAKING AND GOVERNANCE

Having defined the purpose, a family will often wish to include the structure and processes for decision making and governance. The constitution may stipulate channels of communication, which help to keep family members informed and involved. It might also define processes to be followed in the event of disagreements or disputes.

There is often a variety of different decision-making bodies, including trusts and companies each with their own trustees and directors. They each have their own legal responsibilities specifically defined in their respective trust deeds or articles and this, along with the number of potential decision makers, can complicate the process.

All decisions will be subject to a number of influences. These include commercial factors (judged by decision makers), the legal rights of the parties, the wishes of the family (often expressed through a 'family council') and the terms of the constitution itself. It is therefore critical that processes are put in place to ensure decisions take into account all of these influences and that they are fairly represented to the relevant decision makers.

A DOCUMENT THAT SUITS THE FAMILY

Having said all that, what a constitution ends up looking like and what goes into it won't be the same for every family. At one end of the scale, the best thing for the family might be a one or two page document setting out a few 'guiding principles' which it wishes to record.

At the other extreme, a lengthier constitution could include: a potted history of the family and how it acquired its wealth; statements of purpose, vision, values and beliefs; detailed provisions which set out when, how and under what circumstances wealth will pass to future generations or charity; the respective roles of family members; and the terms and mechanics under which a 'family council' or 'family assembly' might operate.

A constitution may be a legally binding contract between family members, or it could be a 'morally binding' declaration of intentions without necessarily having legal force.

Ultimately the goal is the same. A constitution is the culmination of a family's efforts to agree and set down in writing the purpose of its wealth and how its members would like to see that wealth applied in the future. What goes into it entirely depends on what the family decides is right for them, what it is they want to agree in writing and how the process of drafting the constitution unfolds.

IT'S THE JOURNEY

The process is frequently even more valuable than the end result. Too often, questions about what the wealth is for and who should control it only come to the fore in times of crisis, such as on the death of a founder, or on a significant business event like an external bid to buy the business. Faced with the need to act swiftly, families rush to find a quick, short-term usually imperfect solution. This can lead to a divided family, resentment and future conflict, if some family members believe their interests have not been given due weight.

If, however, the family starts its discussions early on, facilitated where necessary by an external adviser, they can take time to work out where differences lie and agree a common approach. Even if they cannot agree, they will at least get a better understanding of each other's point of view, which may help take the heat out of future differences.

The family will find it easier to discuss and agree points of principle before they become a personal issue for family members. A common example is whether or not family members should enter into pre-nuptial agreements. This topic is much better debated when it is an issue of principle rather than when an individual family member has announced his or her engagement. Equally, if the family has already agreed the circumstances under which it would be prepared to sell the family business, it will have a much clearer idea of what to do when it receives an unsolicited bid from a prospective purchaser.

A third example is dividends. There may be times where the family would rather retain profits for investment or to build up a 'war chest' in times of uncertainty, and other times when they would prefer profits are distributed. Again, agreeing the broad principles in advance means that family members know where they stand and can plan accordingly.

Once documented, the constitution provides the record to remind family members what was agreed.

AN EVOLVING PROCESS

The process of agreeing the terms of a constitution and then setting them down in writing shouldn't be seen as a once-off event. A family may not get it right (whatever 'right' might be for the family) first time and there is inevitably an element of learning from experience. Learning from mistakes is an important part of both an individual's and a family's evolution and a constitution does not guarantee protection against this.

Similarly, as circumstances change, what was right ten years ago may become out of date. In this case the family can revisit the constitution to make sure it continues to be fit for purpose. It evolves as the family evolves and the constitution itself can set out a framework for when and how it should be reviewed.

Engagement at every level of the family is usually crucial to ensure all members buy in to the end result. If the process from the start involves all the people who can meaningfully contribute and who will be affected by the decisions taken, it is more likely to achieve a successful outcome. If this is not possible, and senior family members present it to the more junior members as a *fait accompli*, the risk of the family disagreeing and becoming divided is usually much greater.

For the same reasons, as younger family members enter adulthood and mature, the process should be revisited and this younger generation encouraged to take part. Younger members are likely to have different values and beliefs, shaped by a changing environment, and what was right for an earlier generation may not always sit comfortably with the next. Involving younger members at an early stage, even if initially only to observe family meetings, will help to educate them about the family, its history and values and how it makes decisions. It will put them in a much more comfortable and familiar position when they become part of the decision-making process.

There are some cases where the process may be complicated by the personalities involved, differences in age across a single generation and second or even third families with one common parent. Any process needs to be designed to work around such complications and the consequent sensitivities. If it is not possible to hold a conversation during the lifetime of the parents, there is every likelihood of a major dispute in the future.

However many times a family goes through the process, and even if the end result is a single sheet of bullet points expressing a handful of agreed principles, the mere fact that it has carried out the exercise significantly increases its chances of a successful and harmonious transfer of wealth.

APPLYING THE CONSTITUTION

What then? What does the family do with its shiny new or recently reviewed constitution? Does it sit in a drawer, largely forgotten until the next review, perhaps occasionally looked at to check points of procedure like the process for calling a meeting of the family council or how voting works?

Ideally not. Whilst a large part of the benefit can be found in the process itself, where the constitution really comes into its own is in the way its processes are implemented and, even more so, how its principles are applied.

If the family has taken the trouble to agree that there should be annual family assemblies, the whole exercise becomes devalued if those meetings never take place, or are only used to rubber-stamp decisions already taken elsewhere. Major decisions should actually be discussed and taken within the framework and spirit of the constitution, to ensure they have been fully debated and communicated and any objections addressed.

But the real potential of the family constitution goes beyond implementing processes and governance structures.

The family constitution provides the criteria against which the merits of a particular course of action can be judged. If it is on the table whenever important family decisions are being taken the family can use it to answer the question “is this course of action consistent with the purpose, as stated in the constitution?” If the answer is “no”, the family can either accept that it is not the right decision or agree why it can be justified by changed or unforeseen circumstances. The constitution also provides the means to challenge whether something which has always been done in a particular way (perhaps for long forgotten reasons) should continue to be done in that way.

Using the constitution in this manner provides a vehicle for healthy discussion and debate on an ongoing basis. This is especially valuable where the younger generation is still deferential to their seniors or where there are subtle differences which need to be regularly aired as a means of bringing generations together.

In this context, the family constitution provides valuable guidance for the development and training of the next generation. Not only does it set out the purpose of the wealth and family values, it helps introduce young family members to their future responsibilities, and the channels through which they can influence decisions. Families increasingly have development programmes for family members (often including individual mentors), and the constitution has a pivotal role to play.

If the family’s purpose is its direction, it’s the constitution which provides it with the means to stay on course and promote family harmony in the process.

FOR MORE INFORMATION



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Jeremy is a Director of Stonehage Fleming Law Limited. He is an English solicitor and for the last 15 years he has advised high net worth international individuals on all aspects of succession planning and personal tax.

Jeremy joined the Group in 2012 from the International Private Client team at Farrer & Co, having qualified as a solicitor in the Private Capital Group of Simmons & Simmons in 2003. Jeremy holds a Law degree from the University of Nottingham and completed his Legal Practice Course at Nottingham Law School. He is a member of the Society of Trust and Estate Practitioners.



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Matthew is a Partner of Stonehage Fleming and works across the Group developing business and relationships. He is responsible for Succession and the Next Generation.

Matthew joined the Group in 2002, having retired from his professional cricket career where he played for Kent CCC for 13 years. Since retiring from cricket, he has held various positions within the family business, including Managing Partner at Fleming Media and a Director of Ian Fleming Publications and James Bond Enterprises. Matthew was educated at Eton College and was commissioned into the Royal Green Jackets in 1985. He is a Director of the England and Wales Cricket Board, the NNUH and holds several external non-executive positions. Matthew was President of the Marylebone Cricket Club (MCC) during 2017.



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Before joining the Group, Lucy worked at Deloitte in the Family Enterprise Consulting division focusing on governance and succession planning for family businesses, having previously worked in their private client tax practice. Prior to this, she worked in Prime Brokerage at Barclays Capital. Lucy is a Chartered Accountant and won the Society of Trust and Estate Practitioners 'Young Advisor of the Year' award 2017/18.

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