

FAMILY DIALOGUES ON THE RESPONSIBLE STEWARDSHIP OF WEALTH: **A GUIDE**





ADVISING FAMILIES ACROSS GENERATIONS

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About STEP

STEP is the worldwide professional association for those advising families across generations. We promote best practice, professional integrity and education to our members. Our members help families plan for their futures: from drafting a will or advising family businesses, to helping international families and protecting vulnerable family members.



Know how **Know you**

About IQ-EQ

IQ-EQ is a leading global investor services group with over 3,400 professionals across 23 jurisdictions. Within its Private Wealth and Family Office segment, its talented and highly qualified professionals have extensive experience of working with multi-generational families, their family offices and advisors to provide trust and fiduciary services to suit every stage of the family's wealth planning and management strategy.

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INTRODUCTION AND PURPOSE OF THIS GUIDE

The landscape for wealth-owning families is evolving, becoming more complex and interdependent in the face of a current uncertain climate. ‘From shirtsleeves to shirtsleeves in three generations’, the proverbial saying, is front of mind of many wealth generators concerned about whether the next generation of family members will sustain and grow their inheritance. Simultaneously, income and wealth inequality has risen in most advanced economies in recent decades. The COVID-19 pandemic has thrown into stark light the reality of extreme and rising inequality and is driving disparity further with adverse economic, social and political consequences. The pandemic’s costs are being borne disproportionately by the less affluent, with greater exposure to health risks and job losses. Many reflect on what can be done to help, while providing for their family’s needs.

Responsible stewardship is interwoven throughout the fabric of society. It informs the way we plan for our immediate and long-term needs, the needs of our current family members and future generations. Stewardship helps us reduce our negative footprint and increase our positive contribution. It encourages us to consider how we can give our time and resources, sustainably run our businesses, mitigate harm and increase positive impact through our investments, and make better consumer choices. Family-owned wealth and businesses, by nature, have a long-term view and are particularly well placed to align their interests with those of our communities, countries and planet.

Stewardship is related to trusteeship. In the legal context, trustees have responsibilities to preserve and enhance assets entrusted in their care for that property’s beneficiaries. Stewardship principles align with family objectives to protect and enhance their wealth for current and future generations of its members. Although there is no single ‘right’ approach to family wealth planning, trusteeship and stewardship embody the concept of responsibility of those entrusted with assets to care for them on behalf of beneficiaries.

This Guide seeks to engender a discussion on responsible stewardship and what it means for wealth holders. It does not attempt to provide answers, but rather to provoke thought and raise awareness of the opportunities available to wealth owners to be guided by stewardship principles and values. It is a living document, offering insights into how responsible stewardship can guide decisions to help families plan. It aims to be a resource to facilitate a discussion within families embarking on or furthering this journey directly or with the support of trusted advisors, whose role is to raise the right questions and help families get the answers. Readers may use this Guide to facilitate a broad discussion around family governance and planning during a family retreat or roundtable. We hope that it will provoke discussion and enhance the understanding and fostering of stewardship for wealth holders globally.

The authors particularly envision the Guide's use by members of STEP to help in the discussions advisors need to have with families about responsible stewardship and the many positive things a focus on the area can achieve.

Responsible stewardship of wealth often means taking a long-term and holistic view, affecting decision-making in many areas. There is little question that advisors to wealth and business owners have not always helped their clients to make the right decisions grounded in responsible stewardship. The authors hope that this Guide will assist STEP members and others in seeing the value of a long-term view and one in which all stakeholders' interests can align.



STEWARDSHIP FOR FAMILIES



Responsible stewardship means different things to different people. The Merriam-Webster dictionary defines stewardship as ‘the careful and responsible management of something entrusted to one’s care’. Commonly accepted stewardship elements include values, intention, responsible planning and management, prudence, accountability, equity, compassion, inclusivity, long-term orientation and responsibility for protecting assets and legacy over time.

In embarking on the exploration of protecting and enhancing family wealth for current and future generations, advisors and families would benefit from being mindful of the following:

ONE SIZE DOES NOT FIT ALL

Families are remarkably diverse in terms of their history, size and scope, field of interest, values and mission. If there is one key takeaway for users of this Guide when it comes to stewardship, one size does not fit all. Although there is no single set of best practices that can and should be applied, stewardship for families means asking how the family can thrive and continue to grow while enhancing its wealth and the well-being of the family and society in the long-term. Well-stewarded families balance their actions to benefit and sustain future generations as well as the present. Responsible stewardship of wealth requires holistic planning and recognition that all stakeholders’ interests can align with those of the family.

LONG-TERM FAMILY PLANNING

Families know that planning is essential in principle, but does their mindset provide the estate and business planning opportunities that need to be undertaken or are advisable? Many families become 'stuck' in a situation where family principles or control patterns might be 'good' for one generation at a point in time but not for the next or the one after dictating what happens next in terms of planning for the future. Can families become nimbler and adaptable to societal and generational change in their longer-term planning?

REPUTATION BUILDING AND PROTECTION

Increasing interest and transparency around private wealth have injected a whole host of additional challenges for wealth-owning families. Families increasingly have to weigh up not only business and tax risks but also reputational risk. It can take one tweet or ill-advised comment to taint a family. What should they do if the family wealth is associated with historic actual or perceived wrongs that may not chime with the family values they now hold? Families are increasingly being called to provide reparation personally or may be shunned for their philanthropy because of this. Here, discussion within families about balancing the 'we' with the 'I' can be significant. Sometimes the interests of the family as a whole need to

be considered before those of any individual family member who may have personal political or other interests that are not aligned with the interests of the family. Family decisions need to consider more than just whether a step they are taking is strictly legal – aggressive tax positions are an example of where short-term tax savings may harm the family and its business in terms of reputation and short-change the communities within which the family lives and works.

PUBLIC GOOD AND CREATING LEGACIES

What do we want our legacy to be? How do we want to be remembered by others? What choices can wealth holders make to create the legacy they want to leave behind? There is a long history, particularly in the US, of wealth-owning families (e.g. the industrialists in the early 20th century) investing their wealth in infrastructure projects for long-term profit and engaging in philanthropy projects of their own choice. Have we already moved towards a more collaborative, government-guided approach? Will current trends to provide social good alongside governments in private/public partnerships take hold across the world? And how can our client families engage with the most impact and positive social effect? Harnessing multi-generational skills, education and energy can be a real force for good in cementing families' relationships with a common purpose using diverse and innovative approaches.

FAMILY DIALOGUE TOPICS

DIRECT RESPONSIBILITIES TO ONE'S FAMILY

The responsible stewardship of wealth requires a clear focus on the family itself and how the family and the assets they are interested in are protected. Suppose a family does not take steps to ensure continuity in family wealth and businesses. In that case, the family will be unable to take further steps to benefit a wider group of stakeholders. But when focusing on the family and its assets, having an eye to approaches that take into account the interests of all stakeholders can help inform the decision-making process and the structures the family uses concerning asset protection and succession planning.

Intra-family issues

Mental health and capacity

This is a critical topic for those advising wealth-owning families, given the growing importance of these issues for the families such advisors serve. The simple fact that people live significantly longer than they used to increases the circumstances in which mental health and capacity issues arise. How families structure their assets, governance approaches and succession plans can have psychological effects of real importance for family members. Responsible stewardship requires that these be considered part of the planning process. Impacts of family mental health and capacity are seen most often in:

- **Decision making** – Can the person make the decision in question, i.e., do they have the mental capacity legally to do so? Different jurisdictions have relevant laws: the US and the UK are good examples of established systems with separate courts and modern legislative frameworks.

Can the person make the best decision receiving (a) the facts most relevant and (b) the support they might need as an individual to make it? That is, is their mental state or particular circumstances taken into account to ensure they can participate in a valuable way? Can they use a trusted proxy or attorney under a power of attorney to act for them?

- **Autonomy** – Has the person been treated as a valuable member of the family, or have they been side-lined or dismissed as less able to contribute? Is that fair in the circumstances? Sometimes it can be, but a once-and-for-all decision is rarely the right way forward unless the person has a severe degenerative condition resulting in their having lost mental capacity forever. Even then, their circumstances may change.

Have mental health issues such as addiction been enabled or effectively endorsed as a means to keep the matter quiet, or as a perceived kindness rather than facing the problem? Are advisors expected to pick up the pieces or act as a proxy for other family members?

- **Stigma** – Is the family's ability to deal with the perception of weakness or being out of kilter with accepted norms as a result of a mental health issue (or even a degree of unusual thinking or eccentricity) impaired by social mores or culture (including their religious or political beliefs)? How can that family be encouraged to broaden its thinking? Is that the role of the professional advisor? It is a sensitive question!
- **Legal steps** – Has a formal assessment of capacity or mental health by a qualified medical practitioner occurred (danger of 'quacks' here or professional advisors' or family's informal assessment)? If so, is expert legal advice being taken in the most

appropriate jurisdiction on financial aspects (i.e., where the person's assets are situated) and on health and welfare aspects (where the person is living, which may be more than one country).

- **Dealing with the many 'what-ifs' that families face** – What if a family member develops dementia before their children learn how to manage the family wealth? As people live longer today, is it responsible to hold and manage assets until death, only then to pass it on to children without equipping them to handle a successful transition? Or is it more responsible to involve the younger generations earlier, have them learn to invest, develop entrepreneurial skills, be responsible consumers so that they know how to manage the wealth they inherit with your guidance? Discussing these matters within the family early on, stress-testing the family's asset protection and succession planning, addressing in advance issues associated with the ageing process and changing demographics and other topics are critical to the responsible stewardship of wealth.

Questions to consider regarding mental health and capacity

- What is the professional advisor's role in addressing mental capacity and mental health/welfare of the family and its members? Advisors should explore issues of professional conflict and overstepping boundaries. Professional conflicts are becoming more and more sensitive for practitioners on the ground with regard to their overseeing authorities.
- As professional advisors, can we encourage healthy conversations and facilitate our clients' realisation that mental capacity and mental health are important topics that may negatively impact their ability to preserve and be responsible stewards of family wealth?
- Can family leaders come to the table and bring others with them under the guise of building the family unit's strength or group, by endorsing resilience and openness to reduce the stigma and secrecy often associated with mental health and mental capacity issues?

Mutual support may be absent in some families: can this be used as a tool to build consensus and strength?

- What is the role of trustees? Professional trustees for wealth-owning families often feel this is not a subject they can tackle, and they may be asked to make decisions for the benefit (or otherwise) of a beneficiary who may lack capacity or have a known mental health issue. How can they be assisted in their role and the discharge of their professional duties by other professional advisors?
- How can professional advisors get access to unbiased, helpful information about mental health? Can we provide access to those resources, and if we can, how do we assess the best ones to put forward? What are the good practices and due diligence that advisors should follow in order to provide advice that is applicable, timely and properly delivered?
- How do the structures families use for asset protection and succession planning help address risks associated with mental health and related issues?

The reality is that guiding wealth and business owners about responsible stewardship requires advisors who recognise that no one has all the answers. An effective advisor can raise the right questions with families and help identify experts to bring into the dialogue to help the family to navigate complexity. Sensitive and important issues, like mental health, capacity and others need to be addressed, and several resources are available to STEP members to help them with the families they serve.

Mindful succession

Surprises are for Halloween...

Ensuring that the family understands the family's asset protection and succession structure to minimise unhappiness, loss of assets and disputes can be an important part of responsible stewardship. Many families do not understand their asset protection and succession plans and do not realise that *no plan is a plan*. If a wealth or business owner has not yet put a succession plan

in place, they may not realise that a succession plan is in place – it just may not be the plan that is desired and that would reflect a responsible approach. If an individual dies or becomes disabled, something will happen to their assets, likely under the laws of the country in which they live or the countries in which assets are located. As a result, families need to understand the ‘what-ifs’ and their relation to the family’s asset protection and succession plan. What happens if Mum or Dad pass away? Are the arrangements in place, such as to help keep the family and its financial and business interests together? The earlier discussions on this can occur within a family, the more realistic it is to have asset protection and succession structures evolve into something truly effective for the family.

The ‘checks and balances’ in asset protection and succession structures

Asset protection and succession planning often involve using a trust or other structures involving third parties in the family’s affairs for the long term. Responsible stewardship requires understanding the conflicts of interest trustees and others have and ensuring that there are ‘checks and balances’ to ensure, for the long term, the safety of structures adopted and the family’s ability to exercise the right oversight. How trustees, directors, protectors and others are removed and replaced is critical. There are often tensions here between tax and asset

protection objectives and the family’s desirable retention of control.

There is no single approach to governance that is the ‘right’ one. Critical is for the governance approach in place for a family to be well understood, adaptable to changing circumstances and monitored on an ongoing basis.

Taking account of personal

circumstances leads to more positive outcomes. Effective asset protection and succession plans need to reflect the family involved. There are no standard approaches that can fit all family circumstances. The more discussion there is between advisors and families about the specific personal circumstances of family and non-family stakeholders, expectations and otherwise, the more suitable an asset protection and succession plan can be.

Asset protection – what does it mean?

Often, the term ‘asset protection’ refers to structuring approaches designed to protect assets from creditor claims. In fact, the term ‘asset protection’ is much broader and takes into account an ever-changing and growing range of threats, including political risk, marital claims, family discord and much more.



Family welfare

A family that takes care of itself in all aspects is best positioned to take care of other stakeholders, including employees of family businesses, communities and the world.

Therefore, responsible stewardship should take a long-term view and involve the younger generation as early as possible to ensure continuity and achieve objectives well beyond the basics of 'family welfare'. Failing to consider family needs and mismanaging expectations, whether realistic or not, can hold families back.

Equipping the next generation to succeed as effective stakeholders

It is often the case that families focus their efforts on preparing the younger generation for roles in the family business. Although this can be important, responsible stewardship requires a broader vision to prepare the younger generation. A successful family needs more than just a few younger-generation members who can be involved in operational or governance roles in the family business. All family stakeholders need to be prepared for a broad range of functions, including roles as responsible shareholders, trust beneficiaries and otherwise.

Meeting the expectations of younger generations and others in the family

Timing is critical

Despite expectations of receiving inheritances, longer lifespans also mean that the next generation may themselves be entering their twilight years before acquiring the family wealth. Is this responsible stewardship? Some families address this issue by adopting a strategic plan that family members will receive certain amounts upon specified milestones. Often these will be linked to attaining a particular age – 18, 21, 30, 45, for example; but they can also be linked to life events – marriage, contribution to the family business, a decision by an individual to pursue a career path acknowledged as consistent with the family's values/objectives.

Clear signposting of wealth transfers and any conditions to be met can defuse intergenerational tensions that can otherwise arise within families. As part of inculcating a healthy relationship with wealth, some families opt to loosen any conditionalities associated with wealth transfers once family members have attained a particular age or have the requisite life experience.

A not untypical example might be a family member who receives assistance in young adulthood to acquire real estate, sufficient allowance to lead a comfortable life without sapping ambition, and family contributions towards education costs, but where material wealth transfers of capital are deferred until 40+.

It is not uncommon (and is perhaps healthy) for younger family members to perceive any fiduciaries or senior family members' advisors with a degree of scepticism. It is suggested that for confidence in family governance and any fiduciary structures to be maintained, it is important that not all transfers of wealth be subject to continuing trusts or conditionalities. Part of the wealth should be accessible to family members (where circumstances permit) on an absolute and unfettered basis. Family members should be allowed to fail, succeed and make mistakes in equal measure with their families' support. Not to avail family members of this degree of autonomy might represent a failure of effective stewardship that risks family members becoming imprisoned in a gilded cage.

Messaging and timing of that messaging

If the older generation has decided to 'give it all away', is it not fair to communicate this to children at a very early stage? What are some ways to encourage age-appropriate communication within families on important topics such as expectations in the succession process? Similarly, relevant to families is a potential trend among the younger generation who are motivated to 'give it all away' and have their equivalent 'giving pledges', as illustrated by the membership organisation Resource Generation and its 'redistribution pledge'¹ and in articles such as 'The Rich Kids Who Want to Tear Down Capitalism'².

¹ <https://resourcegeneration.org/redistribution-pledge/>

² Beery, Zoë, 'The Rich Kids Who Want to Tear Down Capitalism', The New York Times, 27 November 2020
<https://www.nytimes.com/2020/11/27/style/trust-fund-activism-resouce-generation.html?referringSource=articleShare>

It is not only in the area of 'expectations' that the many psychological issues in and around wealth may well need to be addressed if there is to be a focus on responsible stewardship. In family 'retreats' and other circumstances, having psychologists involved in the planning process can be invaluable. Among others, topics that can be explored include:

- helping families better understand their values, attitudes and beliefs about wealth to better cope with self-limiting or self-destructive behaviours at the centre of their relationship with wealth;
- preparing family members emotionally and psychologically to cope with wealth (some who inherit wealth refer to it as a 'burden') and how to let it go over time as part of wealth transfer to further generations, particularly when family businesses are involved; and
- helping families bridge the communication and trust gap for building a shared vision and purpose among disparate family members and generations.

Developing family 'elders'

In a world of changing demographics, many families fail to prepare for family members living much longer than was the case even a decade or two ago. When and how the younger generation takes on a more active role in the family wealth and business is important to consider, as well as how this will impact those in the older generation and what 'retirement' means. Responsible stewardship of wealth can mean that the older generation's role is well-planned and understood. For the successful family, those family members who can become trusted 'elders', sharing their experience and knowledge in support of the younger generation and governance transitions, can be key.

RESPONSIBILITIES BEYOND THE FAMILY

Taking care of those who care for us

Families that have managed to protect and preserve their assets and businesses

across generations are often those who have recognised the synergies achieved by ensuring that those who take care of the family and contribute to its success benefit from concrete steps the family takes to protect them. This includes employees of the family businesses, personal staff and many others. It is important to explore a number of questions with families, including:

- What methods exist for families as stewards to support and promote the business employees' welfare and working conditions for whom they are responsible as shareholders?
- How can advisors helpfully signpost the families they work with, given that families are usually looking for personal advice, not advice on how to run their businesses day to day?
- To what extent should advisors demonstrate that their professional practices strive to set a good example by paying living wages, providing benefits and looking after their people?

The role of the family business and stewardship

Purpose and meaning

The sustainability of a family business may become vulnerable as leadership passes throughout the generations. How can family leaders create and leave businesses that continue to thrive and provide ongoing wealth to sustain and enhance the younger and future generations' well-being? How does stewardship contribute to this objective?

Although it has been the prevailing view of the last 50 years, the concept of 'shareholder primacy' (a theory in corporate governance that maintains that shareholders should receive priority over all other corporate stakeholders) was not always prevalent. Evidence suggests that prior to the 1970s, a retain-and-reinvest approach to corporate resources that helped companies grow gave way to a downsize-and-distribute theme favouring value extraction over value creation. This approach, coupled with advances in technology making stock trading quick and easy, arguably led to short-

termism, and is criticised as contributing to corrosive consequences for society, including income inequality and employment instability, all contrary to the long-term interests of the companies involved and, it can be argued, to shareholders as well.

Stewardship focuses on the success of a company in the long term. The role of the steward is about preserving and enhancing value over time. In a review of 32 Japanese companies that have existed from 200 to 1,400 years, Professor Haruo Funabashi, in his book, *Timeless Ventures*, identified eight essential principles evident in each of these businesses that created endurance and success for these corporations:

- 1 Leadership driven by clear values, vision and mission.
- 2 Long-term viewpoint and strategic approach.
- 3 The importance of people and human merit systems.
- 4 Customer-oriented.
- 5 Socially minded.
- 6 Continuous innovation and improvement.
- 7 Frugality and use of natural resources.
- 8 Embody and generate culture/legacy.

Stewardship in business can help family businesses to defy the ‘shirtsleeves to shirtsleeves’ trend.

The Chinese phrase for business, ‘*sheng yi*’, comprises two words denoting ‘life’ and ‘meaning’. Within this, businesses are living entities, an interdependent part of society and purposeful. The inclusive approach to business is at the heart of stewardship. A ten-year study of 50,000 brands³ between 2001 and 2011 revealed the world’s 50 fastest-growing brands that built the deepest relationships with customers and achieved the greatest financial growth. The study established a cause-and-effect relationship between a brand’s ability to serve a higher purpose and financial performance.

In 2019, 181 CEOs from the world’s largest corporations, forming the Business Roundtable, signed a *Statement on the Purpose of a Corporation* that is an express departure from their previous adherence to shareholder

primacy. The purpose of business involves taking responsibility for businesses’ impact on all stakeholders, on the basis that investing in employees and communities creates long-term value for the corporation. This shift is based on the premise that a broader view of corporate purpose, which encompasses a responsibility to society beyond just shareholders, enables brands to focus on creating long-term value that serves shareholders, employees, customers, communities and suppliers.

Open dialogues on movements like B Corps and ‘triple-bottom-line’ philosophy (people, planet, profit) encourage responsible stewardship.

B-Corp certification is a third-party standard that embodies the stewardship principles and is granted to companies that satisfy social and environmental performance standards, legal accountability and public transparency. Notable B Corps include Patagonia and Brazil-based public company Natura. In addition to the B-Corp movement, certain jurisdictions have introduced benefit corporation legislation, specific legal forms of companies designed to incorporate mission and values into corporate form in a legally binding manner. Initially introduced in the US in 2010, benefit corporation legislation has been enacted in 38 US states; Italy (*societa benefit*); Colombia; Ecuador; and British Columbia, Canada. Legislation is moving forward in Australia, Argentina, Chile and Canada. The legal form is designed to support mission-driven and socially conscious businesses encouraging longer-term sustainability business strategies.

Long-term view

Implicit in stewardship in business is an intention to work towards long-term sustained success, which can help the family business survive succession throughout the generations. It requires a choice to move from compliance with regulation and reporting requirements to commitment to stewardship, a topic expanded on later in this Guide concerning tax transparency. Family businesses often struggle to maintain long-term shareholdings of their businesses throughout the generations. Each new generation brings more beneficiaries into ownership, increasing fragmentation and making succession more difficult. However,

³ Stengel, Jim. *GROW: How Ideals Power Growth and Profit at the World’s Greatest Companies* (Crown Business; December 27, 2011)

generally, they tend to be more long-term focused and value-oriented than non-family businesses, and managers of family businesses are more often willing to make sacrifices for the company's long-term health and benefit the full range of stakeholders.

With greater attention to the long-term, well-stewarded companies may contribute to better and more sustainable performance, financially and otherwise. Stewardship can be an effective way to build organisational resilience. A balance is required between the short-term and long-term deliverables to mitigate the risk of focusing on the short-term to the detriment of the corporation and shareholders in the long-term.

The role of sustainable and impact investing

According to the United Nations' Principles for Responsible Investment, stewardship is an inherent part of an investment manager's fiduciary duties:

*'Fiduciary and other duties exist to ensure that those who manage other people's money act in the interests of beneficiaries. As a critical tool for addressing sustainability risks in portfolios and maximising overall long-term value, stewardship is considered to be part of investor fiduciary duties.'*⁴

While sustainability has become on trend, much 'greenwashing' has occurred, labelling investment products as more environmentally sustainable than they are. A new EU regime on sustainability-related disclosures in the financial sector is coming into force in 2021 that imposes environmental, social and governance (ESG) disclosure-based requirements on investment firms and fund managers that market within the European Economic Area in an effort to drive sustainability in the financial markets.

Terms such as sustainable investing and impact investing are often used interchangeably, but they have different intentions. Sustainable investments look at a company's operations and determine whether they have positive metrics on issues of impacts (ESG ratings), or at least no negative metrics. Impact investing looks at the products and services of a company that

directly impact sustainability and social welfare. It is about actively creating measurable positive outcomes, rather than just minimising harmful outcomes. A company looking to target social and environmental issues through their offering still has to have sound ESG practices in their operations and focus on selling measurable solutions towards achieving sustainability goals. Impact and sustainable investing are often aligned with the younger generation's vision within families, encouraging involvement and stewardship.

Global issues such as climate change and social inequity expose companies to material business risks, which present risks to the long-term value of investments. In his 2021 annual letter to CEOs, BlackRock CEO Larry Fink advocates for stewardship in business from the investor perspective. He writes about the importance of long-term strategy, data disclosure on sustainability issues, purpose and climate change. Fink urges companies to follow purpose-driven sustainable practices:

*'The more your company can show its purpose in delivering value to its customers, its employees, and its communities, the better able you will be to compete and deliver long-term durable profits for shareholders.'*⁵

Shareholders guided by stewardship are committed to long-term value creation of the company. They engage with corporations in which they invest and share information on strategies and progress towards delivering long-term, sustainable performance that contributes to society's well-being. It is about finding the balance between securing short-term needs while remaining focused on the long-term view. In other words, how do we achieve returns for today's beneficiaries without poisoning the well from which our successors will draw down future returns?

Those advising wealth-owning families are particularly well placed to be a force for good. Trustees, asset managers and others have an opportunity to help families embrace the benefits of responsible stewardship. The growing evidence of sustainable investments providing long-term returns higher and safer

⁴<https://www.unpri.org/stewardship/about-stewardship/6268.article>

⁵<https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>

than those achievable through traditional investing approaches is compelling. With trustees concerned about their duty to trust beneficiaries, a growing understanding of ESG portfolios' resilience is critical.

The role of philanthropy

The relationship between philanthropy and stewardship

Although there is no universally accepted definition of philanthropy, a 2020 OECD research report on *Taxation of Philanthropy*⁶ (the OECD Report) identified custom elements across nation-states and defined philanthropy as:

'The act of giving by individuals and corporations to philanthropic entities with worthy purposes, and [e]ntities...engaged in activities in pursuit of those purposes, including by providing funds to other entities.'

Philanthropy is presumed to be aligned with stewardship. However, the traditional philanthropy model has certain limits that may undermine efforts to create lasting positive change. Several issues that donors ought to be mindful of in their strategies include:

- donations are typically one-off or short-term, limiting the implementation of long-term strategies needed to address complex issues;
- many donors are reluctant to fund operational expenses, weakening the charity's infrastructure and limiting their ability to attract and retain talent;
- donors drive non-profit objectives and priorities through restrictions tied to spending, which may not be aligned with public needs;
- donors often prefer to fund new projects rather than to scale up existing ones, creating redundancies and restricting impact; and
- success is often measured by outputs (activities) rather than outcomes (impact), which may not be comprehensive and reliable indicators of success. For instance, building a school is no guarantee of education received if plans are not put into place to ensure its operations are funded for the long term and that the target demographic are enrolled.

Engaging in philanthropy also comes with responsibility. Critics of contemporary philanthropy argue that it is undemocratic, as donors that make large gifts possess disproportionate levels of influence in determining where and how to allocate funds. If philanthropists fail to align with planned priorities, this influence may work against public policy in a relatively non-transparent manner. Responsible stewardship in philanthropy means conducting research and collaboration with the public sector.

Advisors have an opportunity to get families the support they need to make informed decisions. Part of the issue is that, by and large, advisors have historically adopted a neutral and often reactive approach to advising clients in their philanthropy, focusing on the legal and tax components of the planning process. However, increasing numbers of advisors are exploring the idea of departing from neutrality and directly raising values-based discussions around stewardship to inform and support the planning process.

Tax policies for philanthropy

According to certain estimates, philanthropy's economic contribution is as much as 5 per cent of global GDP.⁷ This illustrates the importance of philanthropy in society through its support for activities designed to contribute to the public good. Arguably, governments need philanthropy to support them in deploying public good, particularly at this time, given the depletion of coffers as emergency relief measures respond to the COVID-19 pandemic. The events of 2020 furthered the divide between the 'haves' and 'have nots', causing many to reflect on the role they want to play in rebuilding and contributing to creating a society where we want to live.

Unique individual historical, economic and political backgrounds of countries impact the availability and scope of tax relief policies for philanthropic giving. To produce its report, the OECD surveyed 40 member states and participating countries revealed common elements. For instance, preferential treatment for philanthropy is available in almost all surveyed countries. Most offer direct tax relief

⁶OECD (2020), Taxation and Philanthropy, OECD Tax Policy Studies, No. 27, OECD Publishing, Paris, <https://doi.org/10.1787/df434a77-en>

⁷https://www.oecd-forum.org/posts/tax-support-for-philanthropy-striking-the-right-balance?badge_id=1420-tackling-covid-19

to qualified philanthropic entities for their activities, which can receive tax-incentivised gifts from donors, predominantly via deductions, and less frequently through tax credits and gift matching or allocation schemes. In addition, the OECD Report makes several policy recommendations:

- **Tax incentives for cross-border giving** – By and large, with some exceptions, such as the European Union, tax relief is not given for cross-border giving and operations. Given the rise of global poverty issues, climate change and health crises, such as the COVID-19 pandemic, cross-border collaboration may increase positive impact. The OECD recommends nations provide equal tax treatment to domestic and cross-border philanthropy in such instances. The rise of globalisation and the increasing complexity of social and environmental challenges extends beyond borders, and philanthropic strategies may benefit from understanding the broader perspective.
- **Aligning tax incentives with policy objectives** – The OECD Report recommends countries align underlying policy objectives and tax incentives for philanthropic giving. It suggests limiting eligibility criteria so that philanthropic support is limited to what is deemed to serve the ‘public good’.
- **Increased transparency** – The OECD Report also encourages greater transparency through improved data collection and public accessibility to reports and public register. Although this may help to serve better alignment with public policy, there may be unintended negative consequences, compromising the privacy of donors who may have legitimate security concerns. The Common Reporting Standard (CRS) raised concerns about human rights abuse risks for donors and beneficiaries associated with ‘unfavourable causes’. Under the regime, personal information may be shared with member states with poor track records for respecting human rights such as freedom of speech, freedom of religion, sexuality and gender identity may put at risk the personal safety of affiliated individuals.

Utilising philanthropic capital fully to maximise impact

Many individual or family-funded foundations and donor-advised funds distribute a small percentage of their capital annually. Certain jurisdictions, such as the US and Canada, have introduced mandatory minimum pay-out requirements for private foundations. These amounts are relatively small (i.e., 5 per cent and 3.5 per cent, respectively). Although, in practice, donors may distribute more than the minimum, the vast majority of philanthropic assets remain invested. Further, often invested capital does not serve the philanthropic mission and can work against it. Those deciding on investment strategy are commonly not the same as those running the grant-making programmes, increasing the chances of misalignment.

- **Investment strategy incorporating ESG** – Maximising the impact of philanthropic capital includes investing responsibly. Through the investment policy statement, philanthropic institutions/charities can set the framework to align the investment strategy with their purposes and strategic objectives, as well as all other traditional content, including return objectives, time horizon, risk appetite and liquidity requirements. ESG integration in the investment strategy, negative screening and investing with managers that engage in active stewardship with investee corporations can help strengthen the mission and positive impact of the philanthropic capital.
- **Impact investing** – Even in highly regulated jurisdictions, opportunities exist for impact investments with philanthropic capital, offering the potential for a return of capital and profit. Calls for more investment of philanthropic capital toward the UN Sustainable Development Goals through impact investing are growing, with several large foundations such as the H.B. Heron Foundation and the Rockefeller Foundation taking the lead. Grants are just one tool philanthropists have at their disposal and philanthropic capital is the ultimate ‘risk capital’. There is no return of capital associated with donations. Impact investing is a way to leverage philanthropic capital to de-

risk investments and scale solutions, and complements grant-making.

Taxation and responsibilities to the state

The payment of tax to sovereign governments has given birth to a large part of our private wealth professional industry. Navigating taxation regimes is a substantial part of how we connect with our clients. To what extent have attitudes changed towards the wealthy paying their tax? Increased transparency in the digital age is forced on many because of the perception that they are not paying their fair share. Tax avoidance is now a dirty phrase used in the same breath as tax evasion, despite the fact that only the latter is criminal activity. Educating clients about the change in attitudes at the grassroots and the state level, and their responsibility to report, may ultimately lead to them paying more tax, which is a key role for us to play. But we are not here to judge our clients – how do we navigate this landscape?

Suppose a family lives and operates predominantly from one or two states. What do they see as their responsibility for themselves and their businesses to contribute to state finances by taxation? Would many prefer to choose how they contribute, e.g., via their philanthropic activities, rather than pay tax to a government with whom they disagree about how they spend their budgets?

Over the last few years, wealth and business owners have witnessed a sea change in how tax laws and accompanying reporting requirements affect the asset protection and succession structures they adopt. Balancing privacy rights that can be important for family security against broad information exchange and beneficial ownership registries has become an essential element of advice to wealth and business-owning families. Within this complexity are some simple realities: today, more clearly than ever, families have only two choices – play by the rules of your country or get out. There is no third option of illegally concealing assets owned by a taxpayer – they must follow their country's laws or address their obligations and then relocate. A further reality is that families need to

ask themselves what governments have what information about their family and its assets. Issues such as corruption and other dynamics in some countries mean that responsible stewardship can include the need to consider where family members should live and how asset protection and succession vehicles should be structured and located.

THE ROLE OF THE STATE IN THE LONG-TERM FAMILY WELL-BEING AND TAX POLICIES

Policies fostering conditions for stewardship

Responsible stewardship is difficult for a family to adopt without government policies that support the structures and approaches families put in place. Governments that are able to understand the value to their economies of wealth and business owners and the need for consistent and reliable legal and tax systems will be well-positioned to retain the business and wealth owners who have so much to contribute to their economies.

How individuals live and work has been changing, and the basis on which wealth and business owners are taxed is often not fit for purpose. Mobile wealth and business owners need to live in countries with governments that can be trusted with information about their assets and where tax systems are fair, predictable and straightforward. Wealth and business owners need to invest in, and through, countries they can rely on and whose tax and legal systems encourage such activity. A nation does not need to offer the lowest tax rates globally to achieve success. But one can argue it does need to develop a long-term strategy oriented towards collaboration with responsible wealth and business owners.

Governments need to be clear in their commitment to attract and retain wealth and business owners to their economy, and wealth and business owners need to feel much better than they do today about paying their fair share of taxes.

Responsibilities of the state to wealth and business owners

Governments have responsibilities to wealth and business owners but do not always meet those responsibilities. An example of the failure to meet responsibilities is where the government attracts investment through certain tax policies, such as an exemption from tax for foreign investment, and then changes the rules once the investments are made. The complex ‘chop and change’ approach to tax and other policies does not serve countries well and chills the synergies that responsible stewardship of assets can achieve.

In many countries, the tax law has become so complex that only the wealthy can afford to take advantage of all the available deductions. Tax systems need to be hugely simplified, and corruption in tax systems, particularly in developing countries, needs to be addressed. Where it cannot be immediately addressed, interim approaches to addressing this need to be adopted with a view to ensuring that tax revenues are captured and go where they need to go. Governments also have to commit to providing more certainty on tax rules, stripping out of the system constant wholesale changes of approach.

Role of worldwide authorities (e.g., the OECD and the United Nations)

Organisations such as the OECD have been fundamental in achieving global change that supports responsible stewardship. Among others, the adoption of automatic information exchange as envisioned by the CRS has gone very far to reduce tax evasion and assist governments in obtaining the revenues they need to address their populations’ needs as a whole. Although far from perfect and still evolving, moves to tax transparency are, in general, positive. However, wealth and business-owning families have many legitimate concerns with growing transparency. Responsible stewardship requires dialogue between and on behalf of business and wealth owners and global authorities such as the OECD.

In addition, as countries introduce and consider additional taxes, such as wealth taxes, to fund the public deficits that the COVID-19 pandemic may trigger, additional risks of double taxation will arise. International organisations should play an active role to minimise this potential double taxation. For instance, wealth taxes, which some jurisdictions may introduce, are often not covered by tax treaties, despite the fact that the OECD Model Convention⁸ covers taxes on both income and capital. An initiative by the OECD to expand the treaty network by adding wealth taxes to the scope of tax treaties would be welcome. The OECD (and the EU) may also take steps to harmonise wealth taxes to minimise the double taxation risks.

The need for improved dialogue between wealth owners, governments and society generally

Advisors often observe a great deal of misunderstanding and mistrust between wealth and business owners and the governments and societies in which they live and operate. The reality of income and wealth inequality fuels populist governments and popular press narratives that blame wealth and business owners rather than explore how they can be a critical part of steps to address income and wealth inequality and many other challenges faced by our planet.

Although there may be differing views, wealth and business owners and their advisors are responsible for engaging in better dialogues with governments about how tax systems should best develop, and governments should do more to encourage such dialogue.

Advisors to wealth and business-owning families are particularly well placed to help communicate the need for improved dialogue, to engage with academia and others and to otherwise help wealth and business owners to be part of a process oriented to benefit all stakeholders.

This Guide was written by Philip Marcovici TEP and Gina Pereira TEP, with input from members of the STEP Responsible Stewardship of Wealth Thought Leadership Strategy Group. Now in its first edition, STEP's objective is to continue to build content for the Guide and to provide links to resources, both within and outside of STEP, that can assist STEP members and the families they serve in their work in the important area of responsible wealth stewardship.

As at the date of publication, the members of the Responsible Stewardship of Wealth Thought Leadership Group were Philip Marcovici TEP (chair), Russell Cohen TEP, Bryony Cove TEP, Toby Crooks TEP, Xavier Isaacs TEP, Gina Pereira TEP, John Riches TEP and Nicola Saccardo TEP.

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