Family charter essentials

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Family charters are an important component of the family governance structure. They are documents that families can use to help them with building guideposts, decision-making rules, and codifying their values, mission, and vision. Family charters can also help define the relationship between critical resources of a family such as the family office.

This paper looks at several key areas that families should consider when developing or stress-testing a family charter.

What is a family charter?

A 'family charter' is a written statement that serves as a record of a family's heritage, culture, ambitions for future success, conflict resolution guidelines, and ambitions for future success. Many families, particularly those with family offices, will be familiar with the concept (also known as a 'family constitution' or 'family protocol').

By whatever name, this document, at its core, will be the family's mission statement, providing some clearly stated aspirations for current and future generations. A family charter also typically sets out broad principles around governance management, and the use of family assets and profits. It might also include specific policies on things such as investment, education, the family business, and the resolution of conflict within the family.

What does a family charter look like from the family's perspective?

A family charter is a humanistic, as opposed to a legalistic, document. A lot of family wealth is held in legal structures, which are constituted by shareholders' agreements, trust deeds and other documents that are drawn up and interpreted by lawyers.

These structures, while very important for commercial and legal reasons, may not resonate with the family in the same way as a family charter, which is expressed in non-legal terms and often encompasses and embodies emotional considerations rather than just purely legal, financial and commercial ones. This is not to say that a family charter cannot be drawn up by a lawyer. In many cases, they are. But fundamentally, it is not a legal process.

Why use a family charter and what are the potential pitfalls?

The context here is that we are in the middle of the greatest transfer of wealth in modern history. In addition, many families are unprepared for this transition of value and power. Much of this wealth has been created in only the last generation, particularly in countries that do not have long, deep histories of wealth aggregation, such as in the Asia Pacific region. Many families and their advisers are in new and unfamiliar territory; territory for which traditional estate planning techniques are not fit for purpose.

Many estate plans are designed and executed by family members or close family advisers, neither of who may be experts in the field. A family charter is intended professionalise and organise family wealth. This exercise brings in experts and defines their roles, powers and responsibilities, all in one document. The family charter essentially binds together all the other documents in a way that can be clearly and easily accessible and readable for the family.

What are the major components of a family charter?

By its very nature, a family charter is a bespoke document. But while there is no template, there are certainly some common themes that will emerge organically as members of the family and business engage in dialogue among themselves and with the advisers.

Usually there will be a mission statement. It is also quite common to document the history of the family, including a family tree. Additionally, there is a structure chart, as well as a map of all of the main assets and liabilities, and the ways they are held.

Often there will be an assessment of risks relevant to the family, a summary of strategic assets, identification of the family leaders, decision-making protocols, an organisation chart, and allocation of powers and responsibilities. It is common to have a section dedicated to the family business that will reference the shareholder agreement, voting rights, dividend policies, etc. Then there might also be employment policies, profit distribution policies, dispute resolution procedures, conflict of interest procedures and contingency plans.

Such things as media policies, family meeting protocols, and codes of conduct can be included in a family charter. At the back of the document, there might be a section containing references to key documents, such as trust deeds, shareholders' agreements and business plans.

What does implementation look like?

When external advisers are involved, they need to have a baseline understanding of the family dynamic, its core values and its assets. The family charter needs to embody the personal ethos and principles of the family. From experience, it takes a long time to really understand the family dynamics and objectives. The best outcomes occur when discussions begin well in advance of any trigger events, such as the death or incapacity of a family leader, or the sale of a family property or business, or other liquidity event.

If any of those events is anticipated in the near future, or even the medium term, that is a good time to start the discussion, if it has not happened already. The occurrence of those events is usually a good motivator.

The discussion needs to be a meaningful exploration of the family dynamics. It takes time and effort to have those conversations with family members and then to document the conversations and all the circumstances relevant to them.

Often the patriarch or matriarch initiates the process, but this is not always be the case. What is important is that there be genuine engagement with all stakeholders, including family members (both incumbent and rising generations), the management team within the family business, trusted advisers, etc. The process can involve a range of professionals, including lawyers, but is often best led by someone trained in the science of human behaviours, such as a psychologist.

Most important is the depth and quality of the engagement with the wider family. That is, what differentiates a successful outcome from a less impactful one. From experience, where family members are simply informed about the purpose of a family charter and what it contains and then asked to sign off on it, the results generally are less successful than where family members are involved in deep, meaningful and robust conversations, with the benefit of full disclosure of all relevant information.

That is not to say that the views of the founder or creator of the wealth, or of its current stewards, are not very important. But in our experience, that command-and-control structure does not always lead to the best outcome.

Instead, we believe that getting together with family members, both collectively and on an individual basis, and conducting a series of interviews in a facilitated way, is the best way to start the process. The results and the data produced by those interviews is then recorded and presented back to the family.

From there you have a skeletal framework from which you can start to put together a family charter, then go through various iterations until it is finally agreed to and approved by the family.

This is not to say that it is a set-and-forget process. A family charter is a living document. Unlike a trust deed or a shareholder' agreement, which, in most cases, are hard to amend, a family charter will evolve over time and should be updated and constantly referred to in family meetings.

Other best practices to help build a family charter: An iterative approach

In terms of putting a family charter together, the process is often as important as the outcome. Getting to know the families before drafting is key to building trust and rapport. That can take quite some time because the things the family members will be asked to discuss often give rise to historical controversies or tensions. Nevertheless, spending time with the family to help win their confidence as well as understand a little bit more about them and how they think is worth the effort.

Getting everyone to buy into the purpose of a family charter and to be comfortable with the process of creating it is the first big milestone. From there it is really a question of just sitting down and asking each family member a series of questions, starting with some simple headline queries, such as: Does the family member see merit in staying together as a wealth collective, or is it better to fragment the wealth, with each family member managing, or branch managing, that wealth on their own?

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In many cases, the latter will be the best outcome. There should be no preconceived notion that the very best thing for a particular family is to collectivise and professionalise their wealth because, in some families, individuals or branches are better off doing their own thing.

So the first fundamental question to ask is: Do they want to stay together as a collective? If the answer is yes, another threshold question would be: Do they want to extend that collective from just the aggregation, accumulation and creation of wealth to other aspects of their lives, such as philanthropy or preservation of lifestyle?

Once the answers to those questions are sorted out, you can then get down into the details around how and in what to invest and how to carry out the distribution process. How the questions are framed along those lines will be important. Further, within each sub-question is a whole 'nother level of detail, all of which will be distilled down into the family charter, where they will be subject to a whole series of decision-making protocols.

How does a family charter fit into family governance?

This is one area where we see a lot of misunderstandings and mistakes. One of the fundamental errors in the creation of family charters is the failure of inexperienced advisers to distinguish between rules and principles. Family charters should contain principles, not rules. If they do contain rules, then such rules must not duplicate, complicate or contradict rules in other documents, such as shareholders' agreements and trust deeds. That is a common mistake.

A principle is something intended to internally motivate a family to do, or not do, something in a particular way. A rule, on the other hand, externally compels the family to do things someone else has deemed to be good or right, and compliance, or lack thereof, carries consequences. Rules control processes and outcomes; principles guide them. Rules are contained and clearly articulated in trust deeds, shareholders' agreements, contracts and the general law. Principles, on the other hand, are more flexible. This is why they are much more appropriate in a family charter, which, of course, is not a legally binding document.

Documents that contain binding rules, such as shareholders' agreements and trust deeds, need to be identified and recognised by the family charter, and may not be replaced or even manipulated. The family charter should just address or attempt to address situations that may arise in the interpretation of governing documents and help guide the exercise of judgment in relation to such documents. So, where discretionary powers are involved or exercises of judgment is required in connection with the interpretation of rules, the family charter can help.

For example, most trust deeds grant very broad powers of investment, allowing managers to invest in just about any type of asset that falls within common investment parameters. A family charter can require the application of an environmental, social and governance (ESG) lens to investments made by the trust fund.

Another example could be in relation to distributions. Trust deeds generally have rules about when and how distributions can be made. The family charter can enable the family to tailor the approach taken to distributions to ensure that certain things happen, or are encouraged, before family members can receive distributions. Prenuptial agreements, tertiary education and clean living might all be prerequisites under a family charter.

Implementing a family charter: Case study

To understand the family dynamic purely from an emotional and psychological sense, it is great to have someone on the team who is professionally trained in the science of human behaviours (as opposed to a lawyer).

For this reason, if brought in early in the process, we will sometimes recommend engaging a registered psychologist who has experience guiding families through the transition of wealth and power from one generation to the next. But in cases of having to go it alone, we have met with family members, sometimes over a period of several months, to gain insight into the family dynamic.

Once that process is completed, what is usually produced is a slide deck that sets out a framework for the family charter. It will not be a framework of legal concepts, but a snapshot of the family, including its history, current state and aspirations for the future.

At that point, we would do a legal review of the current structure, probably make some recommendations around how that legal structure could be optimised, and then reform the current legal structure.

Upon completion, we set about creating the family charter based on the psychologist's assessment of as to the family's aspirations and emotional and human capital, and incorporating the various legal structures, processes and documents for which some time has been already spent reviewing and reforming.

Once a first draft is in place, there would be another meeting with the family to discuss, debate and, if possible, approve it right then and there. Generally, however, there will be various iterations that will be passed around and discussed among family members before the document is agreed upon and adopted as a guide for future interactions with each other and the management of the various assets to which it refers. **FS**

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