



HIGH-NET-WORTH INVESTING

Why your family needs an investment policy statement

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Special to The Globe and Mail

Published Monday, Nov. 28, 2016 5:05PM EST

Last updated Monday, Nov. 28, 2016 6:48PM EST

A few weeks ago I met “Mike” for a working lunch. Mike is the second generation member of a high-net-worth (HNW) family, and the president of the family’s long-held operating business. He also oversees the family’s wealth, which is managed for the benefit of multigenerational wealth transfer.

Our conversation eventually made its way to long-term wealth planning. I brought up the subject of an investment policy statement, or IPS. Mike gave me a skeptical look and asked a simple question: “Why?”

He’s not the first HNW investor to respond in this way. A lot of smart, wealthy people think the goal of investing is obvious: to make money. The goal of risk management is equally obvious: to not lose money. Do you really need a 50- or 100-page document to tell you what you already know?

Over the past 30 years, I’ve met a lot of wealthy families. While each one is different, the most successful among them – that is, those able to thrive into the next generation (second, third or beyond) – all have some form of IPS. I think that’s a pretty powerful endorsement.

Does everybody need an IPS? Those with simple estates or few heirs probably don’t. But if you have a larger family, or if you’re looking to pass on complex assets to the next generation – anything from a family business to a family cottage – an IPS can help a lot.

So getting back to the question: Why an IPS? Here’s what I told Mike:

Defines objectives

An IPS defines the family’s long-term financial goals and forges agreement on those goals between generations. Why is the family investing? To what end does the family hold this or that asset? Which opportunities will the family seek out and which will it avoid? The “hashing out” of different objectives so everyone can get rowing in the same direction can be a very healthy thing.

Identifies risk/reward parameters

One of the core challenges many investors (HNW or otherwise) face is determining how much risk they’re willing to take on – investors often don’t know what their limit is until they exceed it.

A family IPS defines the family’s maximum VAR (value at risk) – how much downside the family is willing to accept in a year and from market peak to trough. It also sets forth an action plan for bullish/bearish market cycles, helping to steady the family when emotions come into play.

Gives guidance

On one level, an IPS is an accountability document. It provides guidance to the family’s advisers to create a mutual understanding about financial goals and the methods for achieving them. It gives everyone clear performance goalposts and gives clear incentive for advisers to perform.

An IPS also helps the family focus on well-defined objectives during periods of high financial stress and the emotions it brings with it.

This can be very beneficial for family cohesion. The IPS can provide clear, objective answers to the question of whether to seek new council, or stay the course.

Screens/filters opportunities

Successful investors (again, HNW or otherwise) know that investment success often isn't about the opportunities you seize, it's about the risks you avoid. The IPS can help by defining what kinds of opportunities the family is interested in and which it's not.

Doing so helps the family avoid "risk traps" hot stocks/hot sectors, trendy ideas, or even "pet ideas" raised by certain family members that tend to derail long-term objectives.

Prevents 'finger pointing'

Sometimes, when a family portfolio performs poorly, the main casualty is not the finances, but the family itself. Family members start to blame each other for poor decisions and settling scores becomes more important than solving problems. The IPS can reduce such conflict, as everyone signs off on the document and shares accountability for the details outlined inside.

I've seen it several times, where instead of pointing fingers at each other, families can point out deficiencies in the IPS and work toward changing them.

This defuses the emotional "bomb" in the room and helps focus people on the future, rather than the past.

An IPS sets the framework for investors' overall asset allocation targets, risk and return objectives, roles and responsibilities of the individuals and holds both the client(s) and the adviser accountable to the agreement.

The reward from excellent advice and strategic planning for the future of a family wealth plan can be life-changing and an IPS is intended to guide the family in the right direction of investment practices of their assets while reducing internal family conflicts.

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