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INTERVIEW: What Is A "Family Bank" And What Are The Benefits Of Having One?

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At a time of extended longevity and increased family interdependencies, Brian Luster, a principal and co-portfolio manager of New York-based Abernathy Group II Family Office, speaks to Family Wealth Report about the benefits of creating a "Family Bank" - a construct that exists on paper and typically combines an LLC and an irrevocable trust.

Steven Abernathy and Luster co-founded The Abernathy Group II Family Office in 2011. The firm advises affluent families on multi-generational asset protection, wealth management, and estate and tax planning strategies.

What is/are the fundamental purpose(s) among wealthy families to establish a “family bank” of this sort?

There are three reasons to establish a Family Bank – to keep assets within the family, to support a legacy of enduring values, and, to bring thoughtful stewardship to the family’s endowment.

The “Family Bank” isn’t a place, rather, an on-paper business structure, often with specific conditions attached to its loans outside of interest rate, payment schedules and other standard loan features.

These provisions typically reflect the values and beliefs of the lender – such as supporting education, entrepreneurial endeavors, or other expenditures deemed worthy by the lender, who is most often the patriarch or head of the family.

While the underlying legal entity of the vehicle is a Dynasty Trust, how is the rest of the construct then structured and how might this vary among families?

After formally creating the legal entity to "house the assets," the structure of managing the family endowment is customized to the unique needs of each family. Typically families establish a governing committee, consisting of senior family members (often consisting of the grantor and another senior family member for long-term guidance), one or more junior family members (who are on track to become senior family members), and outside council (such as a financial advisor, family attorney, trustee, or a senior member of the family office).
The endowment, while always ruled by the original trust documents, may have created flexibility empowering the current committee more freedom in making loans and gifts to heirs.

What type of family (in terms of size or net worth, for example) would benefit the most from adopting this vehicle? For which types may it not be so appropriate?

Families that have specific values that they would like to pass along to their future generations would benefit strongly from a Family Bank. These values must be able to be influenced via economic incentives. Examples of choices/values include: education, entrepreneurship, community service, charitable giving, pursuing ones' passions, protection of assets from spouses, and having children, to name a few.

Theoretically, there is neither a minimum nor an income cap for the Family Bank; however, if outside vendors, such as a third-party loan officer, attorneys, and others are being employed either on a per diem or full-time basis, it is important that the family bank structure does not create any slippage of the fortune by its very existence.

A family enterprise (i.e. family engaged in managing its wealth like a business, most likely via a family office) with as little as $5 million could reap the benefits. However, if there is not enough capital for the structure to be self-sustaining, it's a poor idea. This isn't to say, however, that a well-managed family enterprise could not create one at a later date.

I understand that an important element behind the idea of the vehicle is to incorporate family values and to incentivize younger family members. Can you give an example of this?

In addition to promoting the values of the family, younger family members can be motivated in a variety of ways. Forgiveness of loans, based on specific criteria, is one. A Family Bank can provide access to cheap capital, with little or no recourse based on outcomes. So, if a spirited, first-time entrepreneur fails, he or she will not have the potential outcomes of a failed business hitched to a traditional loan such as bad credit and ongoing debt.

If education is valued, and an heir successfully completes a level of higher education and/or gets certain grades, the loan could be forgiven 100 per cent - quite different than a traditional bank. Depending on the family's altruism, heirs may be encouraged to join a helping profession (i.e. teaching) that does not pay a high salary but makes a contribution to the community. The Family Bank may match the salary 100 per cent (or a certain percentage) tax-free. The trust documents will spell this out.

Loans can also be made available at lower interest rates from the bank for significant purchases—buying a home, perhaps. In that case the Bank could issue an interest-only loan; thus, the Family Bank owns the home. If the couple gets divorced, the Family Bank will put a lien on the property and take possession of it—therefore the ex-spouse will have no claim. Should there be disparate assets between the spouses, this is particularly useful in keeping property in the family. And the titling of the home will be irrelevant since it's owned by the Bank from the get go.

How aware do you think the majority of wealthy families are that this type of vehicle exists?

Members of the mass affluent, that is, those with between $5 million and $20 million, could reap the benefits, however, it is difficult to say how many among them know about and implement a Family Bank within their wealth enterprise. Among the mass affluent who know if its existence, there may be a preconceived notion that this is for the extremely wealthy, such as the Rothschild family, where patriarch Mayer Amschel Rothschild established five distinct family banks; one for each of his sons.

Does each of the family members have to agree to the terms of the "bank," and is the structure easily amendable?

Ultimately, the terms of the "bank" are dictated by the verbiage of the trust documents. Most documents are written in a way to empower the trustees or "governing committee" to have more leeway, yet in other instances, the grantor has been so restrictive, so as to effectively "control his assets from the grave." Best practices would allow the trustee to have more flexibility, yet keep the spirit of the original grantor's wishes intact.

If there is a degree of flexibility for the "governing committee," it is worth asking what the review process is to amend the structure. It might be as simple as a democratic vote among them, or, if the grantor is seeking "beyond the grave" control, certain changes may not be an option.