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WEALTH MANAGEMENT

Preparing Your Children for Their Inheritance

Parents often worry about the impact that their wealth will have on their children. While access to and knowledge of this wealth can be a positive thing, there's always the risk that the security provided by the money might lead to complacency and entitlement. If the child becomes aware of assets held in trust for their benefit too early, for instance, they may not benefit from the life experiences that would otherwise build the character and maturity needed to be good stewards of the wealth in the future. Will they be able to develop a sense of self-sufficiency and push through adversity, knowing that the money is there to bail them out of a tough spot?

While trustees have traditionally been obligated to provide young beneficiaries with information about their trusts when they reach the age of legal maturity, many states have enacted statutes that give trust settlors the option of delaying disclosure of the existence of the trust until a time of their choosing. These "silent trusts" can afford parents extra time in which to ensure their children are emotionally and intellectually prepared for the responsibility that comes with the family wealth. However, if not handled with sensitivity and thoughtfulness, such a tactic can lead to feelings of anger and resentment once the truth is revealed.

ESTABLISHING A SILENT TRUST

In some states, such as Delaware, trust settlors may include specific language in their trust documents that allows the trustee to withhold information from the trust beneficiaries for a certain period of time.[1] Exactly how long the information may be withheld is largely up to the settlor, but are typically related to the following criteria:

- The age of the beneficiary
- The lifetime of the settlor or settlor's spouse
- A specific date or term of years
- A specific event that is certain to occur

Generally speaking, wealthy parents tend to be pessimistic about their children's ability to handle the family wealth. More than half believe that their children will not be ready until they are 30 years old, and more than a quarter think they will not be ready until they are 40.[2] However, withholding information about trust assets for too long could backfire, especially if parents make no effort to educate their children about proper wealth stewardship during the silent period.

While the appropriate length of the silent period will depend on a number of unique factors, such as the size of the family's wealth and the relative maturity level of the children, advisors should caution parents against making the period excessively long or overly restrictive. It is important to convey to parents that the length of the silent period is less consequential than what they do during the silent period. What matters is that parents, with the help of their trusted advisors, use the silent period to communicate with their children and devise a plan that will ensure the children are ready to accept the responsibility of the family wealth when the time comes.

FACILITATE OPEN AND HONEST COMMUNICATION

Parents often find it difficult to discuss their wealth with their children. It may be that they are reluctant to discuss passing on their wealth because they would need to confront the reality of their passing away. They may be worried that introducing a financial dimension to the parent-child relationship will undermine their emotional bond. Perhaps they simply fear giving up their control of the wealth.

[1] Delaware code 3303c
[2] U.S. Trust, U.S. Trust Insights on Wealth and Worth (2012)

Whatever the reason, an advisor must recognize this obstacle and work with the parents to overcome it as soon as possible. Open lines of communication between the generations are the basis for sustaining family wealth. Failing to establish a dialog between parents and children will ultimately lead to consequences at the time of transfer — both financial and personal — such as unnecessary taxes, costly settlement fees and family discord.

Advisors can help facilitate an intergenerational dialog by leading the family through a series of communication exercises. These exercises are intended to create a framework that defines and delineates the roles and perspectives on both sides of the discussion so everyone involved understands each other's objectives. This involves:

- Defining the values that the older generation wishes to pass on to the younger one
- Identifying the skills and experiences the younger generation will need to uphold those values and allowing them to practice these skills and learn from their mistakes
- Understanding the interests and passions of the younger generation in order to best engage them
- Developing a comprehensive plan of action that provides a framework for shared decision-making

These exercises should begin as early as reasonably possible. These early discussions should serve as a forum in which parents and children can work together to define what the wealth means to them, both individually and as a family. It can also serve as something of a reality check to parents, either assuaging their concerns or highlighting maturity issues that may require more proactive intervention.

Defining Family Values

Tying the wealth to a particular set of values can give it more meaning and help children see the money as not just a means of acquiring things, but as a vehicle for working together toward a shared purpose.

Children may not share the same passions or vision for the wealth as their parents, so these values should be abstract and conceptual. Sharing high-level values minimizes the risk of alienating children with a mandate that seems too prescriptive or limiting. For example, while entrepreneurship or philanthropy may be compelling values to pass onto the next generation, advisors should recommend that parents be flexible and refrain from specifying a specific industry or charitable endeavor that the children may have no interest in.

Identifying Critical Skills

Once values are determined, advisors can help parents identify the critical skills that children will need to learn in order to uphold those values. For example, in the case of entrepreneurship, they may need to develop technical skills, such as budgeting and investing, as well as soft skills, such as managing people and negotiating.

The goal here is to determine how best to equip the children with the life skills they need to achieve self-sufficiency and confidence. Putting these skills into practice is a crucial step toward creating their own identity apart from the family wealth.

Incorporating Children's Interests

Parents with significant wealth may find it hard to view their children as autonomous adults instead of young children. Advisors should remind parents that this process must be a dialog and that children need to be involved. Children must feel a sense of ownership and buy into the vision that is created for the wealth. A wealth-transfer strategy will not be successful without a good understanding of what motivates and interests the younger generation.

Advisors should meet with the children to get a better sense of their interests. This will allow them to provide parents with better guidance on how to refine the values and skills they wish to impart. In some cases, advisors may need to help both sides reach a consensus, either because of fundamental differences in what each generation values or subtle differences in how they define a particular value. Finding common ground is key. It is critical that the advisor remind both sides that doing so is necessary to preserve and maintain the family wealth and the opportunities it provides.

DEVISE A COMPREHENSIVE PLAN OF ACTION

Once the foundation of values, skills and interests are established and a consensus is reached, the advisor can help the family turn it into a plan of action.

Documenting Values and Wishes

Advisors may recommend that families work together to draft a ***family mission statement***, which can serve as a basis for future decision-making. Many family mission statements include a historical family biography that explains how the family's values contributed to the creation of the wealth and has influenced how it has been used. Most family mission statements also examine the relationship between financial assets and individual initiative, addressing how best to enjoy the benefits of the wealth while leading a productive, fulfilling life.

As the settlors of a trust, parents may choose to include a ***letter of wishes*** with their trust documents to reinforce their intentions for the wealth they leave to their children. While it is not legally binding, a letter of wishes can provide important context for a discretionary trustee when deciding whether or not a beneficiary's request for a disbursement is in line with the settlor's intent.

Settlors may also include a ***statement of intent*** in the trust documents to concisely describe the goals for the trust. This may reduce the risk that a court changes the terms of the trust at the request of a trustee or beneficiary if those changes violate the intent laid out in the statement.

Sharing Information

Though it depends on the family's circumstances, parents should look for an opportunity to broach the subject of wealth with their children early, so there is time to educate them about their responsibilities. This does not necessarily mean that parents have to disclose a full picture of the family's assets. An advisor should work with the parents to sift through the relevant information and devise a plan that parcels this information out in an appropriate manner. This information should be used to lay the groundwork for the conversations that reemphasize the connection between the family's wealth and their underlying values.

As children mature and show progress toward developing the skills that their parents have identified as important, more information and perhaps even the opportunity to participate in decision-making can be provided. Parents should start small, so as not to overwhelm their children, then broaden the amount of information provided over time as the children's skills and maturity develops. It is a good idea to progressively give more and more control over assets, too. By allowing children the freedom to practice making decisions on their own, they can learn from their mistakes in a safe environment.

Putting It All Together

Consider this example: John and Rebecca Smith have two children, Sara and Elizabeth, ages 18 and 20. They established Delaware-based trusts for their children, each of which contains $1 million in assets, and expect to ultimately pass assets upwards of $50 million to the children.

Because they were concerned that knowledge of the trusts and future inheritances might undermine Sara and Elizabeth's commitment to their education, they stipulated in the trust documents that the trust would be "silent" until the children turn 25. As such, the trustee is not required to inform them about the trusts and their assets.

John and Rebecca's advisor asked them to consider what kind of people they hoped their children would be by the age of 25. What would make John and Rebecca feel confident in Sara and Elizabeth's ability to handle the wealth? After considering this, John and Rebecca determined that they hoped their children would value self-sufficiency. As a business owner, John felt especially strongly about this. Also, both he and Rebecca believed it was important to give back to the community. They wanted their children to see that their wealth could have a significant impact on the well being of others.

Together, John, Rebecca and their advisor worked to identify what skills the children would need to develop in order to truly be capable of living up to the values of self-sufficiency and philanthropy. Some of these skills were fundamental, such as how to create a budget, how trusts work and how to invest properly. Others were more specific. John felt it important to equip his children with entrepreneurial skills, such as how to create a business plan and how to raise funds. Meanwhile, Rebecca identified skills important to philanthropic ventures, such as how to structure a charitable gift.

The advisor also helped John and Rebecca draft a statement of intent, explaining that they wanted the trustee to make future distributions with the goal of encouraging self-sufficiency and may supplement the children's income should they decide to pursue less remunerative careers. Additionally, they specified that requests for loans or distributions intended to support an entrepreneurial endeavor should only be made following proper due diligence, such as the creation and review of a business plan.

The advisor also met with Sara and Elizabeth to learn more about their interests, in order to find a way of linking their passions back to their parents' values. Sara expressed an interest in marine biology and oceanography, while Elizabeth talked about her love of video games. With this knowledge, John, Rebecca and their advisor were able to engage with the children regarding their values.

Rebecca introduced Sara to philanthropic opportunities related to ocean conservation, and together they identified, structured and oversaw several charitable donations to causes Sara found particularly meaningful. John worked with Elizabeth to help her understand the business side of video game development. Once he felt she'd grasped some of the important concepts of entrepreneurship, he offered her seed money to develop her own independent game, provided she devised a detailed business plan explaining how she would use it.

Over time, the advisor checked in with John and Rebecca to see how things were developing. Through her philanthropic work, Sara had met important contacts who were able to help her get closer to her dream of becoming a marine biologist. Rebecca was confident enough in her abilities that she no longer felt the need to be involved every step of the way. Elizabeth's video game project had failed, but the experience had helped her understand which aspects of entrepreneurship she needed help with. She and John were working together to shore up her budgeting skills for her next attempt.

CONCLUSION

A knowledgeable advisor can play an important role in helping wealthy parents and their children navigate wealth-transfer challenges. By facilitating open and honest communication and collaborating with the family — both parents and children — to devise a comprehensive plan of action, the advisor can play a significant role in preserving the family's wealth and maintaining intergenerational harmony.

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