THE PARENT TRAP:
Avoiding Common Multigenerational Wealth Planning Pitfalls

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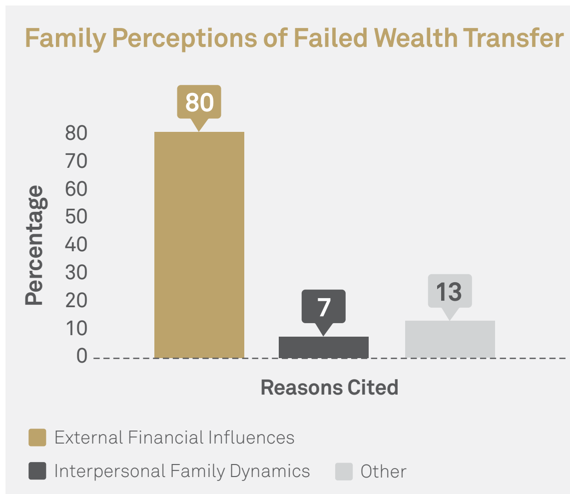
Sixty percent of family fortunes are squandered due to a lack of communication and trust. Only three percent disappear due to poor wealth planning.[1] This is a statistic that should make every advisor sit up and take notice, especially those working with high-net-worth (HNW) clients and families.

It is even more shocking when compared to what families thought would be the reason for their dynastic demise. Nearly 80 percent believed investment strategies, financial constraints or the macro economy would be the likely culprit. Only seven percent correctly guessed interpersonal family dynamics.



"We refer to it as the challenge of transition, in which different generations in different life stages experience the unique emotions associated with each," says Mark Tibergien, Chief Executive Officer of BNY Mellon's Pershing Advisor Solutions. "There will be feelings of finality or celebration depending on their frame of reference, and their decisions won't always be rational." Therefore, he adds, the rate of wealth transfer success can "decrease by orders of magnitude."

[1] "Preparing Heirs: Five Steps to a Successful Transition of Family Wealth and Values." gsb.stanford.edu. 2004.

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Advisors are in a prime position to play a central role in generational wealth management for HNW clients and families.

While there are increased opportunities for entering this space, awareness of the potential pitfalls is key.

"One of the big reasons wealthy families tend to blow it is that the kids aren't prepared or the parents haven't talked to them about it," says Rod Zeeb, CEO and Co-founder of the Appleton, Wisconsin-based Heritage Institute, an organization dedicated to preserving wealth for multiple generations.

Unfortunately, he adds, it means the advisor responsible for the multigenerational wealth planning may end up as the defendant in the lawsuit to come. "If the advisor is the one who does the planning, and it blows up, the family members will be looking for someone to blame."

So, how can advisors avoid this scenario?

Through original research and interviews with financial and generational experts, BNY Mellon's Pershing, in conjunction with Beacon Strategies, examined the factors critical to success in sophisticated and sustainable multigenerational wealth transfers, along with obvious and not-so-obvious traps for advisors to sidestep when dealing with this lucrative, yet complicated market.

The focus was on HNW individuals and families which, for the purposes of the analysis, were defined as those with between $5 million and $25 million in investable assets. The results, including the most surprising and significant challenges to multigenerational wealth planning and what to do about them, are detailed in this whitepaper.

Looting the Legacy

Warren Buffett said it best, "A rich person should leave the kids enough to do anything, but not enough to do nothing." This saying is particularly relevant to self-made wealth and the type of legacy these individuals leave behind.

The first generation earned the assets so they tend to be responsible stewards of the money. This is what Luke Dean, Financial Planning Program Director at Utah Valley University, refers to as "savers to a fault."

"As great savers, they were able to accumulate significant wealth and hang on to it," explains Dean. "They're usually fiscally responsible."

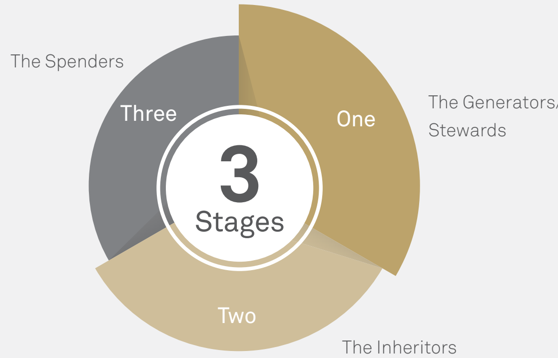
The second generation inherits the wealth. Because they observed the blood, sweat and tears of the first generation, they tend to be respectful of the sacrifice it took.

Dean says, "It can all go to heck with the third generation," he notes, adding that any kind of inheritance is often squandered because it was given versus earned. This likelihood increases the further successive generations get from the original wealth creators.

This behavior is similarly seen in recipients of large insurance payouts, Dean adds, and a variation of the shirtsleeves to shirtsleeves cliché where the first generation accumulates wealth, the second generation enjoys it and the third generation spends it.

“Only it isn’t just shirtsleeves to shirtsleeves, but uniform across different cultures and geographic regions, meaning it could be clogs to clogs and ox carts to ox carts, for instance,” says Myra Salzer with The Wealth Conservancy, a Boulder, Colorado-based wealth management, financial planning and wealth coaching firm. “It’s universal human behavior.”

“I have Chinese proverbs from 2,000 years ago that say wealth never survives three generations,” agrees Zeeb. “This is not a new phenomenon; it’s not a tax issue, it’s a people issue. Knowing that—knowing about shirtsleeves to shirtsleeves—if you don’t do something different as an advisor, it will devastate the family, which means trouble for you.”



Monarch to Mentor

Mitigating the effects (or avoiding them altogether) begins with family delegation.

One of the biggest issues Zeeb sees when dealing with wealthy families is reluctance on the part of matriarchs and patriarchs to relinquish control.

“Are they willing to step out of the role of making all of the decisions and telling everybody what to do (and having them do it) and into the role of a wise sage who family members come to for advice?” he asks. “They have to move from a monarch to a mentor.”

When the monarch dies, surviving family members may lack good judgement and an intentional decision-making process and the aforementioned blowup may be inevitable. To successfully transition to mentor, the parents must be open to some degree of vulnerability while taking a step back.

“These are two huge issues for monarchs, but they’re areas in which advisors can help,” Zeeb adds. “First generation, self-made individuals are used to being in control and they don’t like giving it up. They’ll look at their friends’ children and say, ‘Oh, they can handle that’ but then look at their own kids and say, ‘No way.’ Giving up control means mistakes will be made yet they don’t recognize that we all make mistakes because we’re human.”

It’s what he lyrically refers to as “preparing them for the road of life, rather than preparing the road of life for them.”

Indeed, understanding and effectively addressing negative consequences is critical to intergenerational wealth transfer success.

"Too often, even with families with $5 million in assets, parents take the easy way out by writing the check rather than letting their children feel the pain of having a learning experience," Salzer says. "The kids get blamed for being unprepared and it's not their fault."

One of her clients had absolutely no conflict resolution skills simply because his parents "bought him out of every uncomfortable situation." A conflict with his boss led the parents to buy the business, and an issue with his landlord led to the parents buying the rental property.

"He's now had multiple divorces as a result," Salzer adds. "It's an extreme example, but the sentiment is very common among wealthy clients."

By creating opportunities for family members to be included in the wealth planning process, advisors can ease the transition from monarch to mentor. Whether it's suggesting ways to start a family conversation about philanthropic giving or helping clients begin to delegate limited decisions, a small effort can go a long way toward laying the groundwork for a smooth transfer of wealth in the future.

Transactional Traps

Competence on the part of the advisor is critically important, of course, but no amount of technical know-how will matter if the reason for a particular intergenerational money move isn't clear to all involved.

For instance, purely transactional gifting for the purpose of tax mitigation can mean big problems in the long run if little else is taken into account.

"The wants, needs and individual situation of the person receiving the gift must be carefully considered," Salzer warns. "This is my gripe with certain trusts, such as dynasty trusts. The client is giving money to someone extremely young and, in some cases, not even born. The client may have no idea what the recipient's unique needs will be. In many cases, neither the advisor nor estate planning attorney bother to inquire about the individual receiving the gift."

Another issue is that the parents give equally rather than fairly—an important distinction. Some heirs might be in the family business and some may have a more philanthropic bent. Others might reject a conventional work structure and schedule altogether, requiring different giving strategies and amounts.

"I don't know how many times I've seen parents simply write a $14,000 annual exclusion check on December 31 only to be disappointed when the kids don't respond or thank them," she adds. "If something is given without heart it's going to be received without heart. If only the check came with a handwritten note about the legacy of the money and how grateful the parents are to have this abundance to be able to give to the children, it goes a long way. It fosters and draws in more communication rather than less."

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Death and Divorce

The good news is that divorce rates recently hit a 40-year low. The bad news, however, is that overall divorce rates remain high.[2]

Divorce has resulted in more blended families, and therefore more opportunities for accidental disinheritance, especially among the wealthy.

For example, “An advisor with a $15 million client never really got to know the spouse,” Katie Swain, Director of Wealth Solutions at BNY Mellon’s Pershing, relates. “Unfortunately, the client, at age 42 and with two children, passed away.”

In an extreme illustration of the need to update beneficiary information, the assets transferred to the surviving spouse. This spouse then remarried but retained the same advisor for additional wealth planning.

“Although the surviving spouse kept the same advisor, a relationship was never really built.” Swain says. “The spouse then passed away unexpectedly, and the new spouse in that second marriage gained control of the assets. The children from the first marriage, who were the offspring of the wealth creator, were completely shut out. They received nothing.” This scenario is often referred to as accidental disinheritance.

As with most issues related to intergenerational wealth planning, the problem stemmed from a lack of communication between family members and the advisor.

“Sprinkle trusts are just what they seem. Assets are ‘sprinkled’ to heirs a bit at a time over the course of their lives,” Swain continues. “One parent didn’t start the first payment until his sons reached age 70, with two subsequent payments at age 75 and 80. The children were extremely upset with the advisor for not informing them of the advanced time frame for the payments and for not advocating on their behalf with the parent.”

Advisors can’t simply check the box when working with their clients on estate planning. As too many horror stories attest, the original intent can easily get missed, especially when memories and marriages have long faded.

“It also involves personal mementos,” Swain notes. “Advisors don’t realize how much emotion is tied to family-owned art, jewelry, etc. Very often assets aren’t about monetary value, but what they might represent to the children, which is the love, acceptance, pride and approval of their parents. It gets complicated quickly.”

Emotions can be powerful and are a key reason Swain cautions against using one family member as a trustee or executor, noting that they’re incapacitated and often grieving and unable to focus on financial details at the time of a parent or spouse’s death. A corporate co-trustee or co-executor can work with the family member providing the expertise needed to move the estate plan forward according to the decedent’s wishes.

“When the family members finally realize that they’re overwhelmed, many decide to hire an attorney, which can add time and expense to the process. Naming a family member as sole trustee or executor adds to the stress and grief at the time of death, when they should be focused on other things.”

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[2] “Divorce Rate in U.S. Drops to Nearly 40-Year Low.” Time.com. December 4, 2016.

Four Areas of Potential Wealth Transfer Failures

Defeating history demands bridging past failures and opening the doors to communicating and building trust.

Looting the Legacy

The further removed successive generations are from the wealth creators, the more difficult it becomes to maintain the inheritance.

Monarch to Mentor

Successful legacies depend on relinquishing control. Matriarchs and patriarchs must move from a leadership role to that of coach, teacher and supporter—with the help of the advisor.

Transactional Traps

Support means more than money. Gifts and endowments given without thought are usually received without thought. Advisors must get to the why and move beyond simply tactical investment reasons, and parents should share their intent with recipients.

Death and Divorce

Modern families mean blended families. Keeping beneficiary information updated is an evergreen issue for advisors and their clients, exponentially so with those who are wealthy.

Conclusion

A thorough understanding of the four areas described—looting the legacy, monarch to mentor, transactional traps, along with death and divorce—can help advisors prevent destructive behaviors that can prematurely and unnecessarily disrupt an otherwise healthy and sizable financial legacy.

While the technical aspects of tax minimization and other sophisticated strategies required by wealthy families are critically important, special attention must be paid to the emotional drivers of individual and group dynamics. This can result in healthier, and therefore more sustainable, interpersonal relationships among the different generations, as well as satisfaction and success for advisors dedicated to this market.

Notes

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pershing.com

One Pershing Plaza, Jersey City, NJ 07399

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