How Wise Investors Pass on Their Wealth and Their Values

You've probably read or heard about an heir squandering their entire inheritance. The case of Cornelius Vanderbilt is one of the most dramatic.

When Vanderbilt died in 1877, he was the richest person who had ever lived in the United States. Within fifty years of Cornelius' death, one of his descendants died penniless. When more than a hundred of Cornelius' descendants met in 1973, none were millionaires!

The sad Vanderbilt story of wealth melting away is the story of too many families who build wealth. In fact, it's so common that we have a saying about it. The American version is "shirtsleeves to shirtsleeves in three generations." Many other cultures have similar sayings.

The first generation—and maybe that's you—has known hard times and has worked and sacrificed for a better life. By their later years, they can afford a comfortable lifestyle and have assets to pass on to their then-adult children. Many people transfer their wealth but not the virtues and values that helped create the wealth. If the next generation receives the fruit from the trees, but you do not pass along the "root system" and "healthy trunk of the tree," the virtues and values that created it, that's where the trouble starts.

The second generation, also maybe you, remembers the parents' sacrifices. They remember harder times and respect the value of hard work and wise investing. They build on what they were given and hand the wealth off to the third generation.

But the third generation, probably not you, never knew hard times. They've known only wealth and haven't seen much sacrifice. Instead, they too often spend their way through their inheritance. Worst of all, they have no family model of the virtues and values that enabled their grandparents to build wealth.

Wealth manager Roy O. Williams and his partner Vic Preisser are experts in understanding reasons some families remain intact and grow generationally—and why others crumble and disintegrate. They painstakingly researched and interviewed 3,250 families with an average net worth of $20 million. They further studied the nearly 1,000 families of the original 3250+ where the wealth creators had died and attempted to transfer the wealth and family ties forward.

They found that 70% of the time, the family and the wealth did not survive even one generational transfer! And by the second transfer, over 90% of the families and their wealth were no longer intact. "Indeed, 70 percent of wealthy families lose their wealth by the second generation and a stunning 90% by the third."

That sad fact doesn't tell us much about why it happens or how you can do better. To begin to understand that, let's review the common ways people transfer wealth to their heirs.

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Three Ways Investors Approach Legacy Wealth Transfer

My experience is that wealthy people have three ways to deal with the transfer of wealth to their heirs. Some don't plan at all; they decide that what happens after they're gone is not their problem. Others attempt to influence or control how the next generation will act. A smaller number intentionally prepare their heirs to manage their inheritance wisely.

Leave it up to fate and the heirs

A surprising number of wealthy people decide that what happens in the next generation is not their problem. They figure that their job is to build the wealth, set the example, and plan the estate so that the maximum amount of wealth passes through probate to their heirs. After that, it's up to the kids.

Sometimes leaving it up to the heirs happens by default. Many but not all of us may have the extra three decades that Laura Carstensen predicts. Heart attacks and accidents take people before they've arranged their affairs. Some people slip into dementia or wasting illness before they put things in order. And some people just keep putting it off until they die.

That is courting disaster. Your heirs can't have the investment savvy you've developed over decades. If they have no experience or knowledge of how to manage wealth, things can get ugly fast. Your heirs could act in two dangerous ways. Perhaps they'll be frozen, like deer in the headlights, or they'll act like every day is their birthday and they suddenly have lots of money to spend.

Drifting, not acting, leaving things up to the heirs, needlessly endangers them and the wealth you've spent a life time accumulating. You've heard that "failing to plan is planning to fail." You can do better. It takes courage and it takes time, but you can do it. You've spent years building your wealth; now finish the job by spending the necessary time to assure that your work and sacrifice will have the effect you intended.

Consider another common mistake before studying the best way to educate and train your heirs and structure the inheritance so your heirs will maturely administer and develop what you leave.

Try to influence or control the way the next generation will act

Many people hire a smart trust attorney in an attempt to protect the inheritance. They try to limit the risk of their heirs' making terrible mistakes or squandering their parents' hard-earned wealth. One good practice is to tailor the investments to the abilities and inclinations of the heirs.

Perhaps your heir doesn't have the temperament for rental ownership or even for managing any investments. He or she wants investments to be in "set it and forget it" mode and not require attention or involvement. You can use a 1031 exchange to convert your asset to a single-tenant triple-net property.

If your "heir" is a church, synagogue, or charity, your skilled trust attorney can structure your estate to maximize your tax advantages and the non-profit's ultimate benefit while disinheriting the tax man. Charitable remainder trusts and other vehicles provide many options. Talk to several smart counselors.

Those are effective ways to facilitate transferring wealth to the next generation because they can limit or influence the way those who receive your money will act. Some people attempt to influence the way their heirs will act by regulating the amount that they pass to their children and grandchildren.

Warren Buffett has some strong and clearly stated ideas about how much of his billions of dollars should pass to his children. In 1986, Buffett told *Fortune* magazine that he didn't believe in giving his children "a lifetime supply of food stamps just because they came out of the right womb." He wants his children to make their own way, and he wants to support them. Buffett thinks that the perfect amount to leave his children is "enough money so that they would feel they could do anything, but not so much that they could do nothing."

Most people who attempt to control their heirs' actions do something different than Buffett. They hire attorneys to craft complicated trust documents. That may work in theory, but it doesn't always work in practice. Not even the best attorney can consider all the possibilities. Some clever heirs or their attorney may be able to "game the system."

So, while planning is necessary, it isn't sufficient. Planning is most effective when you combine it with intentionally preparing your heirs to manage their inheritance wisely.

Prepare the heirs

A smaller number of wealthy folks invest some of their time and energy to prepare their heirs to be wise stewards of their inheritance. A 2012 US Trust survey found that more than half of wealthy Baby Boomers had not fully disclosed their wealth to their heirs. Thirteen percent had not told the heirs anything about the wealth they would be inheriting.

Preparing your heirs to receive your assets and manage them wisely will not happen automatically. It's something you must work at. It is hard. Remember that everything worthwhile you've ever done was hard.

The wisest wealthy people I know increase the odds of successful wealth transfer by preparing the inheritance for the heirs and preparing the heirs for wise wealth management. The details vary, but being intentional, preparing the inheritance, and preparing the heirs are always present. Before we consider how this works in real life, though, let's review why intergenerational wealth transfer fails so often.

Why Wealth Transfers Fail

Roy Williams' excellent book, *Love and Money*, has much solid advice about communication, goals, values, and trust. Williams investigated the experience of 2000+ families over a 20-year period to discover why so many smart, savvy, hard-working people who had built wealth, failed to pass that wealth along.

You might guess that the problem was poor estate planning. But poor legal/tax/investment advice was a factor only 3% of the time. Almost all the time (97%), the problem was in family dynamics. Some families didn't communicate. Others didn't take the time to prepare heirs to manage their inheritance. And others didn't demonstrate and articulate family values that could guide the stewardship of wealth.

That data, along with what we know about how people approach wealth transfer, provides ideas about what to do now to assure that your life's work—that is, your wealth—will wind up in competent hands when the time comes.

A Better Way

Effective intergenerational transfer of values and wealth begins with the end in mind, a vision of the family legacy. Roy Williams identified failure in family dynamics and values as the cause of almost all the failed transfers. He goes further and breaks that out into three main reasons:

- Breakdown in family communication and trust
- Failure to establish family values, sometimes called a family mission statement
- Inadequately prepared heirs

Let's consider how to defuse each of those reasons.

Family communication and trust are vital

Williams says that "breakdown in family communication and trust" accounts for 60% of the failures. Communication problems aren't one-time events. More often, they're a pattern where parents simply don't talk to their children about money, business, or what's important to them.

In one family who successfully transferred both wealth and values, the parents talked to the children constantly about personal and family matters. They discussed business at the kitchen table and answered their children's questions. Today, those children, now adults, use regular conference calls to continue that kitchen-table experience.

Family values matter

Williams' language is "failure to establish a family mission." Some people might phrase that as "family values," but the idea of mission shows purpose and direction. By whatever name, they account for 12% of the failures. Parents whose children absorb their values do two important things

First, the parents live the values, they set the example. Second, parents tell their children what they believe and why. You need both. Neither setting the example alone nor explaining values alone is adequate.

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Preparing the heirs is essential

Williams identifies "inadequately prepared heirs" as the cause of 25% of the failures. Recently, one of our clients expressed his worry this way.

> My kids graduated from colleges that I would've never even considered applying to. They both have Masters degrees and yet they're dumb as a bag of hammers about money. I understood more in junior high about the value of the dollar than my kids and their spouses all put together.

Your children probably won't learn what you know and value unless you help them. Your heirs are never too young or too old to learn your heart, and your vision. When you involve them in every part of the business, they learn skills and values at the same time.

Make sure they're in the room when you talk to your CPA and investment advisors. Even though you and they may be uncomfortable initially, it is better for them to learn before they make costly mistakes. Encourage them to ask questions. Have a dialogue with them about important things. They can have a say, without necessarily having a vote. Here are a few things you should discuss.

- Why are we investing?
- What is the purpose of wealth?
- Who are we?
- What do we stand for?
- What will we do to close the transaction?
- What won't we do to close the transaction?

When you involve your heirs in managing your investments, they will make mistakes. Hold them accountable for those mistakes and help them learn from them, so they will grow into courageous and prudent managers of wealth.

Good professional advice is required

Williams ascribes only 3% of failures to "poor legal/tax/investment advice." It is the smallest percentage of wealth transfer failures, but it's still important. The chapter, "Team Up with a Great Broker," in *Building Legacy Wealth* offers guidelines in how to select a top professional adviser of any kind; a broker, an attorney, CPA, and other advisors.

Many wealthy people use charitable remainder trusts, a personal foundation, a family limited partnership, or similar vehicles to accomplish their legacy wealth transfer goals. These estate planning and asset management tools can enable you to accomplish several goals. While you're alive you can provide income for the balance of your heirs' lives, retain control or influence, involve and/or train and maybe even pay heirs, reduce taxes, and move assets to the people and or charities of your choice. After you've passed, your estate planning will influence the heirs and how the assets are deployed.

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Each tool has different benefits and quirks. Some people are charitably minded; others, not so much. You can buy life insurance to replace much or all the wealth if the owner wants to both donate and also provide for family. Thousands of trust attorneys and wealth managers can provide appropriate, customized, and confidential counseling on these important topics.

You've worked hard to build your wealth. Take the time and make the effort to assure that your hard work continues to benefit your family for generations.

Excerpted and adapted from the chapter, "Transferring Your Legacy Wealth" in *Building Legacy Wealth* by Terry Moore. CCIM

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