AB BERNSTEIN

LIFESPAN RESEARCH FOUNDATION

WHEN ALL THINGS AREN'T EQUAL

How to Divide Assets without Dividing Your Family

How do you split up a pie? If everyone wants dessert, it may make sense to cut even slices, but some at the table may want larger or smaller pieces depending on their appetite.

Now imagine it's not a pie; it's your family's wealth and everyone has different needs—or has made different contributions to the family's success along the way. How you plan to divide assets among family members in the long run may seem as easy as dividing a pie, but some families find it extremely complex. We have seen families struggle with defining what's fair, particularly when individual members have different needs and desires. Most often, we see families default to splitting assets equally, even when it may not best satisfy their goals.

Consider this case. A wealthy business owner has two daughters: one has been successfully involved with the business and has built wealth of her own while the other pursued a fulfilling—but not lucrative—career as a social worker. The owner would like to exit her business and retire. How does she transition ownership in a way that acknowledges one daughter's contribution to the business while helping the other daughter meet future needs?

We at Bernstein are often asked to help quantify what the size of a business owner's estate may be decades from now and the amount each beneficiary could receive, assuming an equitable split. Recently, more clients have been asking us for guidance in creatively addressing their legacy goals, beyond the standard "equal share" approach. Such decisions are not just about dollars and cents.

For additional perspective on the powerful family dynamics surrounding such decisions, we sat down with Bob Waldinger and Marc Schulz at the Lifespan Research Foundation. They offered the benefit of insights gleaned from their collaboration at the Harvard Study of Adult Development, along with their own clinical practices. This article represents the second in a series we are co-authoring with the Foundation, sharing their work and perspective.

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BERNSTEIN: We're seeing more and more wealthy clients who are contemplating an unequal division of assets among children. If this is something you as a parent are considering, how do you broach the conversation with family members?

LRF: This goes back to the meaning of money—which we know you at Bernstein focus on intensely: what does this money mean to the people who are bequeathing wealth, and what does it mean to those who are going to inherit?

The first question families should ask is, "What are the family's long-term goals?" Ensuring everyone's well-being is generally front and center, but one additional goal is often overlooked: How do we distribute wealth in a way that is likely to foster harmony in future generations and avoid dividing inheritors from each other? Inheritors are going to need each other long after the first generation is gone. Parents want to be remembered in part by how they contributed to their children's relationships with each other.

Parents often "discuss" inheritance with their children by simply stating the facts of what is in their estate plans. But inheritance is worthy of a deeper conversation—a real back-and-forth about everyone's hopes and needs so that family members can learn from each other and come together. These conversations could start with values and see where they are aligned. If families can clarify what's most important to each person, other decisions can flow from that. What are the primary goals that are shared? What are the differences? Being curious about others' point of view, asking questions, listening carefully—these practices will yield a much better understanding of the needs and interests of all family members.

The "north star" that guides these discussions should be how you want the next generation to get along. Parents need to think about how their decisions will shape roles and define relationships for the future.

BERNSTEIN: Over the years of the study, you have seen many changes in lifestyles across generations. How do these changes impact decisions about inheritance?

LRF Families in the 21st century are more diverse and more geographically spread out than ever before. Women are in the workforce in greater numbers than they were 50 years ago and are more frequently the wealth creators in families. Timing of when to have children has changed with shifts in social attitudes and practices as well as advances in medical sciences, so that even siblings who are close in age may be in vastly different stages of family life. The greater flexibility in life paths and life choices for both women and men means that inheritors may be leading very different lives than their parents did, and may have different needs and priorities than their siblings. Conversations about estate planning can offer opportunities for more dialogue, for greater understanding, and for increased closeness among family members.

Looking back at the lifestyles of the first generation of people in the Harvard study we see the roles of spouses and children following a more traditional pattern. Wives were rarely involved in family businesses. Except for military service and travel, most family members stayed relatively close to the parents. Important conversations were conducted in person.

Parents could often observe firsthand how their children were faring as adults and test their abilities to protect the family legacy.

Today, families are less bound by geography and traditions. Children may move far away to pursue careers or other personal goals. For some, it may be a priority to create their own story based on unique experiences. Communications are less frequently conducted around the dinner table and more often through e-mail or social media.

Children's decisions to pursue interests at a distance from where they grow up can impact how parents determine what is fair. For example, is being physically present when facing family challenges of greater value than connecting by phone or other means? Is such physical presence more deserving of a greater share of the inheritance?

CASE STUDY

BERNSTEIN: We recently worked with a family who sought our guidance in adjusting their estate plan in light of some recent changes in priorities. Paul and Marie are entrepreneurs running their family business. They have two children, Dan and Catherine, who are both married. Dan's children are school-aged and Catherine has a preschooler and a newborn with special needs.

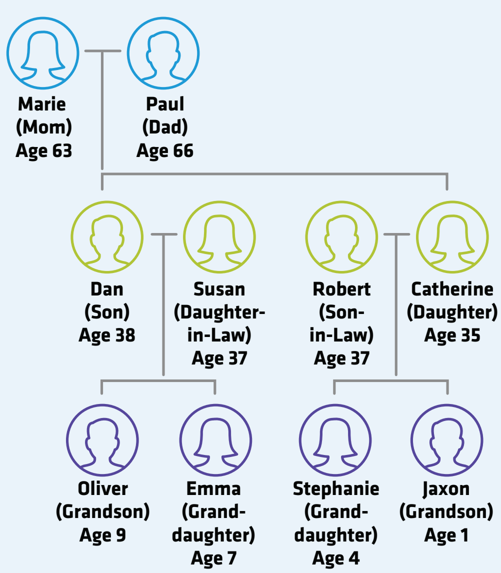
Dan and Catherine have both been involved in the business; however, Catherine recently left the workforce to care for her newborn son. Previously, Paul and Marie's primary goals were to fund their grandchildren's education and ultimately transfer ownership of their business to their children. Now they are exploring other options, including a potential sale that would result in after-tax proceeds of about $60 million.

Paul and Marie came to Bernstein for help thinking through the financial aspects of their situation, including:

- Providing for their new grandson's needs
- Helping Catherine achieve financial security
- Funding their grandchildren's education
- Helping Dan start his own business after the sale

ENTREPRENEURS DIVVY UP AN UNEXPECTED WINDFALL

- Paul (66 years old) and Marie (63 years old) are selling their business for $60 million, after taxes.
- They had accumulated $2 million in retirement accounts and $500,000 in savings so they now have a total of $62.5 million.
- They have a son, Dan (age 38), in the business and a daughter, Catherine (age 35), who is employed outside the family company.
- The have four grandchildren.



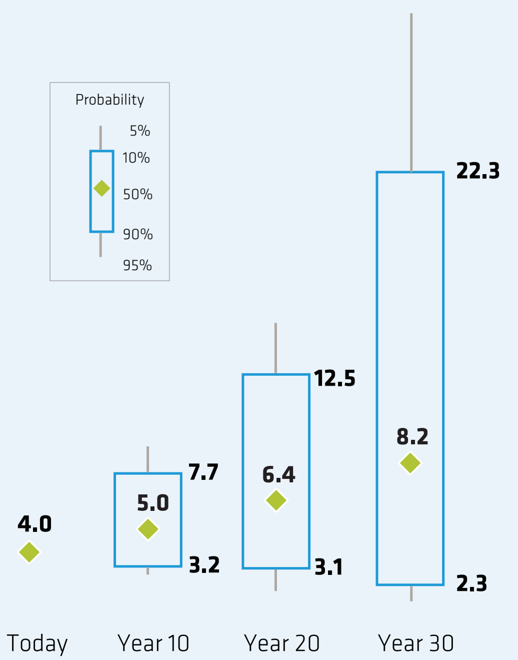
PRIMARY GOALS

- Support lifestyle spending of $400,00 per year, after taxes, adjusted for inflation
- Make gift to Dan to start new business ($1 million)
- Fund trust to support Jaxon, their special needs grandchild ($4 million)
- Ensure they seed college savings for three other grandchildren ($450,000)
- Establish annual gift plan where they make annual exclusion gifts to children and in-laws ($120,000 total, per year, adjusted for inflation)

To address their financial questions, we turned to Bernstein's proprietary Wealth Forecasting System. This tool is designed to illustrate the long-term financial implications of near-term economic decisions by quantifying the trade-offs of various strategies over time. Using our Wealth Forecasting System, we can solve for the amount of funding for vehicles like a Special Needs Trust, which will fulfill the beneficiary's lifetime spending needs with a high level of confidence—even if we experience higher-than-expected inflation and poor market outcomes.

RANGE OF SPECIAL NEEDS TRUST VALUES*

70/30 Allocation (Nominal, USD Millions)



Even after accounting for 30 years of distributions, the trust contains sufficient assets to support Jaxon over his life expectancy.

*Allocation is 70% stocks/30% bonds. Stocks modeled as 21% US diversified, 21% US value, 21% US growth, 7% US small/mid-cap, 22.5% developed international, and 7.5% emerging markets. Bonds modeled as intermediate-term in-state municipals. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 30 years. **Data do not represent any past performance and are not a promise of actual future results**. See Notes on Wealth Forecasting System at the end of this presentation for further details.

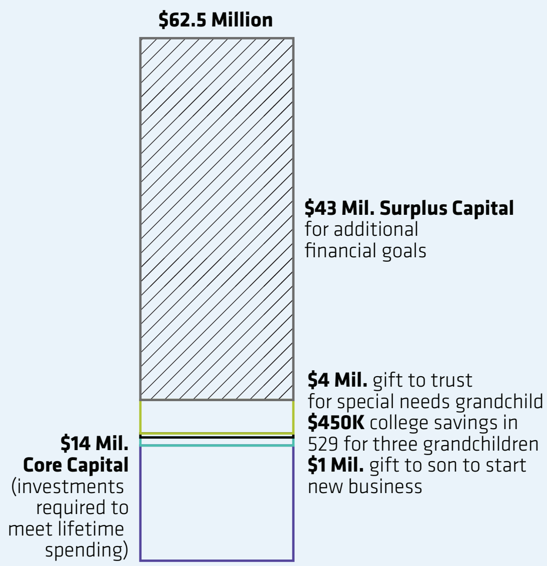
Our projections helped Paul and Marie understand that their goals were all likely achievable and allowed them to put some numbers around their financial objectives to make the situation more concrete. We confirmed that if Paul and Marie funded a special needs trust with $4 million today, even after accounting for $100,000 per year in after-tax inflation-adjusted distributions, in typical markets we still expect the trust to have $8.2 million in assets after 30 years.

The couple felt comfortable making a $1 million gift to Dan to help launch his new venture. To fund their grandchildren's education expenses, we advised Paul and Marie to make the maximum contributions to 529 colleges savings plan accounts for their other three grandchildren. The combined maximum contribution totaled $450,000. The couple were also inclined to support their children via annual exclusion gifts to them and their spouses—an annual expense totaling $120,000 per year, adjusting with inflation. Paul and Marie began to wonder about the long-term impact of these upfront and ongoing gifts. In a separate analysis, we were able to forecast their long-term financial picture.

> Our projections helped Paul and Marie understand that their goals were all likely achievable.

First, we quantified how much of the roughly $62.5 million Paul and Marie needed to set aside (given their risk/return profile) in order to confidently meet their $400,000 annual spending requirement for the rest of their joint lives. Our analysis indicated that they required just $14 million. After accounting for the upfront gifts, the couple would still have $43 million in surplus capital.

SPLITTING UP THE PIE



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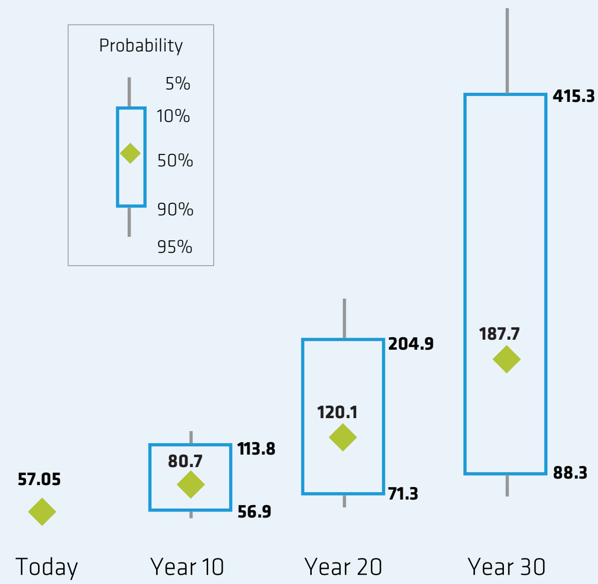
RANGE OF PROJECTED ASSET VALUES*

60/40 Allocation (Nominal, USD Millions)



The upfront gifts do not impede Paul and Marie from having a large financial legacy.
The couple should consider additional lifetime wealth transfer strategies to reduce estate taxes.

Our long-term projections demonstrated that Paul and Marie were not jeopardizing their long-term financial legacy by making these gifts today. In fact, after spending and all the gifts, they would likely still have an investment portfolio valued at more than $187 million in median markets after 30 year (Display). Our analysis reassured the couple that they still have ample financial resources while prompting them to consider additional lifetime wealth transfer strategies in order to reduce their future estate tax liability.

*Allocation is 60% stocks/40% bonds. Stocks modeled as 21% US diversified, 21% US value, 21% US growth, 7% US small/mid-cap, 22.5% developed international, and 7.5% emerging markets. Bonds modeled as intermediate-term in-state municipals. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 30 years. **Data do not represent any past performance and are not a promise of actual future results**. See Notes on Wealth Forecasting System at the end of this presentation for further details.

BERNSTEIN: Beyond financial advice, we thought it was important to engage the entire family in a dialogue exploring the impact of having a special needs family member. How might it change everyone's priorities and goals, or perhaps even their relationships with each other? We asked LRF how they would open this conversation. Here was their response:

LRF: Giving people the space to talk about their reactions to this change is important. It may feel "unfair" to the parent of the special needs child, but it also may feel unfair to the other siblings. Give people the opportunity to talk about the unexpected challenge. The goal should be to talk openly and freely without generating more conflict. One strategy is to make the life challenge the common foe. Life can deal us unexpected things, and it's going to keep doing that. Remember that this isn't the only time when families are going to need to adjust. It might be a special needs child today but or an aging parent next time. How are you going to cope?

BERNSTEIN: By providing Paul, Marie, Dan, and Catherine a place to come together and discuss as a family, we were able to connect their financial decisions to their priorities in a way that was meaningful for the entire family.

Too often, we see that while there may be a desire among the senior generation to split the assets in an unequal way, the family reverts to an even split because it's easier. How can our concerns about relationships impact our ability to carry out what we would otherwise wish to do? Can you share what you've seen in your practice?

LRF: A critical first question for families is: are they willing to talk about these issues instead of just handing down a plan? In other words, will this be a top-down decision or is the senior generation willing to work on building consensus and buy-in among the family members? In some ways, getting buy-in means that everyone is engaged in sharing and listening to the concerns and priorities that arise. This process creates a wonderful opportunity to hear everyone's hopes for what life will be like in the future.

The conversation may focus on the planning, inheritance, and how the parents are going to pass on money, but there may be other ways that parents have helped kids along the way. This is a moment for reflecting on the past and thinking about the future. To start, parents can articulate "I want to be helpful, I want you to flourish, but here's what I worry about."

BERNSTEIN: Families are comprised of individuals from various generations which naturally means people in different phases of their life. How do our perceptions of "fairness" change throughout our lifespan?

LRF: Some in the senior generation will not have had this conversational experience with their own parents. Either they created their wealth all on their own, or if their parents had wealth, were just told about the inheritance plan or they learned about it when the will was read. They may have questions about how to set up this conversation. How do you start? Do you have a facilitator there to open up this topic with your children?

Even if they didn't inherit anything of monetary value, there may have been family heirlooms that needed to be divided—what were the issues that came up? Also, it's often helpful for the senior generation to recall what it was like when they lost their own parents. How did family dynamics change, and how would they like to see the dynamics in their own family evolve over time?

BERNSTEIN: Taking into account that perceptions of fairness may be shaped by our life stage, how can parents navigate conversations with children in a way that minimizes conflict and promotes family cohesion? What are some common areas of conflict that can arise in these conversations?

LRF: A lot of issues emerge in family discussions that center on the roles that siblings have played in families. For example, older children who were accustomed to being in charge of younger siblings may find it difficult to share authority as adults. Similarly, "baby" brothers and sisters may find it difficult to have their voices heard in family discussions. In some families, one child was favored over others, or one child was allowed "to get away with" more than others, or an older child was expected to babysit younger ones. These historical roles take on new meaning for siblings in later adulthood. Any perceived inequality growing up can lead to resentments that surface when discussing issues of fairness around estate planning.

Another area in which a sense of unfairness often arises is when aging parents turn to children for greater levels of support at home or in business operations. A child who is closer geographically, or who is single and perceived as more available, can be called upon to provide care in ways that other siblings are not. And parents' expectations may not align well with children's natural inclinations. For example, a daughter who lives near her parents may be close but can't tolerate other people's illness. She may be neither willing nor able to assist her parents. Or perhaps this daughter is accepting of the role to manage care and other health services for her parents at the end of life. But she also feels that her recommendations should take priority over those of siblings who live far away.

Another common scenario is vacation homes. Parents may rely on one child to be responsible for a beach house that has been a gathering place for the family for several generations, raising issues about fairness when inheritance of the house is under consideration.

These decisions may not have been discussed with other siblings or may not have taken into account the needs and capabilities of the children. An older brother may be well suited to managing the financial aspects of the vacation property and ensuring that all members are treated fairly in using the beach house, but he has no interest, time, or patience for that work.

To avoid situations that can fracture relationships among siblings, parents should take into account their children's interests and abilities and consider them when making decisions about distribution of wealth. It is well worth the time and energy to make discussion of these issues a priority at family meetings—not just once but in multiple discussions to clarify parents' wishes, and the interests/needs of children, so that decisions about fairness are based on shared understanding.

BERNSTEIN: Given that our individual values and priorities shift over time, how might parents check in with their children to assess whether the current plan is still the best plan for the family?

LRF: As people get older, they are more focused on maintaining connections that they already have. Most want to ensure harmony, and keep their family together when they are gone.

Siblings at earlier stages of life may be less interested in staying connected, especially in the "identity-building phase" of their life, when they want to carve out a unique role. While it is common to be much more self-centered in early years, this self-absorbed behavior often changes with age. Children in their 20s see the world differently than children in their 40s.

Many people broaden their purview as they move into midlife. Parenting and experiences with younger friends and colleagues often prompt people to become more interested in fostering the well-being of the next generation and in keeping family ties strong. The concept of leaving a legacy may become more prominent at this stage of life. Notions of what people's roles and contributions are in the family may shift over time.

The implication of all these shifts is that discussions about inheritance and family roles may be helpful to revisit over time. Views evolve, and situations and priorities change, so thinking about financial planning, including inheritance, as an ongoing activity and dialog may be best. Legal imperatives that dictate that wills are written down in black and white at one point in time do not have to be the main driver of the timeline or process. If the process is viewed as an opportunity to learn more about each other, then folks are more likely to see the advantages of returning to it.

BERNSTEIN: When conflict does arise, how do you resolve it?

LRF: Very often the impulse is to withdraw from the conflict. But when conflicts get buried, family members tend to become more separated. Misconceptions, suspicions, and resentment often grow in the absence of open communication.

The reality is that conflict will always exist to varying degrees. Family members need to accept this reality and not withdraw from each other or "bury" the conflict. We advise our clients to talk honestly about disagreements, to ask questions and listen for each person's understanding of the facts and feelings underlying the conflict. Sharing in this way isn't always easy to do. It's often complicated. But the rewards can be life changing. These are opportunities to understand each other in deeper ways.

As we mentioned earlier in this article, conflicts can be a contemporary manifestation of something that happened many years ago. For example, younger siblings may carry resentment for older brothers and sisters because of how parents interacted with them years ago. Feelings about "favorite status" given to the firstborn may resurface and/or be unspoken. While the arguments may on the surface be about getting a fair share of the inheritance, underneath the surface the energy is about the "bossy" older brother taking over the estate planning process.

These sources of conflict and different perceptions need to be brought out and "named" in one-to-one discussions and in family meetings. Often, it is helpful to have a skilled person facilitate such meetings.

Conflict resolution is a process that needs to be continued over time. When discussions occur and decisions are made, it's important to document decisions. These notes are guideposts for future conversations and can be a positive indication of healthier, more supportive relationships in families.

BERNSTEIN: Parents understandably wish to approach estate planning and the division of assets in a way that avoids unintended consequences, such as strained relationships. We've learned that open, honest, and two-way communication with heirs offers the best chance of achieving these goals. It also requires that children relate with each other using the same open and honest approach. That means that the family may take time to arrive at the most beneficial plan for everyone. Given that individual circumstances and desires may shift over time, parents should consider proactively checking in with their children to make sure that the current plan is still the "best" plan for all.

Best practices include planning for a series of family discussions, rather than one "big reveal." We also recommend partnering with your financial advisor to dimension any financial decisions, especially gifts. The family may come to realize that while a gift may appear to have a large, near-term impact, over the long term there may be plenty of assets to achieve current goals and future ones that have yet to arise. Sharing this information with family stakeholders may help alleviate concerns.

Just as estate planning is best revisited regularly, family conversations require the same commitment. Ongoing communication and transparency around decisions is likely to promote the most family cohesion.

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