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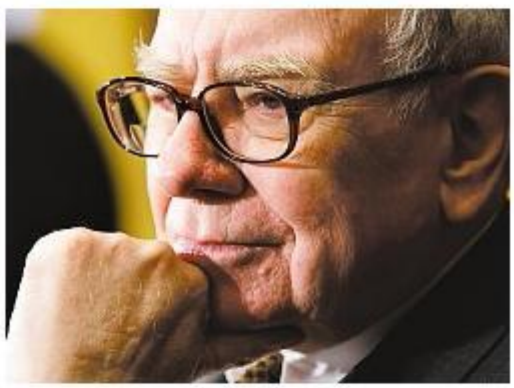
Planning ahead a capital idea

Michael Nairne, Serious Money



Alex Wong, Getty Images Files

Billionaire Warren Buffett has given only a modest portion of his vast wealth to his children.

You can't take it with you. As aging Baby Boomers confront the harsh reality of actuarial tables, this adage takes on real meaning. Planning today must go beyond retirement and embrace the fact that we all eventually, as Shakespeare wrote, "shuffle off this mortal coil." Wealthy families in particular, due to the size and complexity of their balance sheets, need to soberly consider the implications of this final certainty.

At the most fundamental level, affluent family heads can do two things with their investment capital: They can either spend it on themselves or give it away. To the extent they decide to give it away, they can either give it to family members or to society, and intertwined with this decision, they can choose to do it while they are alive or upon death.

Although this simple paradigm helps clarify the macro alternatives, it does not help with the challenges inherent in evaluating potential trade-offs or the ultimate decisions on how much to allocate to each option and when. As a consequence, heads of many wealthy families don't develop a strategic capital-allocation plan and simply let exigencies and ad hoc decisions determine where their capital ends up being allotted. Lost opportunities, excessive taxes and family discord are frequent consequences.

The starting point for any capital-allocation plan is determining what assets are required to fund the retirement-lifestyle needs of the family heads. This is a critical question for anybody, rich or otherwise. Yet of the hundreds of affluent individuals and couples that I have met over my career, only a handful can answer it. Sometimes, it is wilful ignorance: "What I don't know won't worry me." Or, it could be unconscious avoidance: "I don't really think about aging and death." Sometimes, it is procrastination: "I know it's important and I'll get around to talking to my advisor someday." And sometimes, it is blind faith: "We have lots, we'll never run out." Regardless, if someone doesn't know what they need, they don't know what they can give away or when.

Today's sophisticated software allows wealth managers to meaningfully answer the question of how much capital will be needed for retirement. By combining probabilistic forecasting with historic stress testing, scenario analysis and contingency planning, retirement capital requirements can be estimated. In fact, pension plans that need to determine whether they are in a surplus or deficit position relative to their projected liabilities go through a similar process.

The next step is to allocate the giving amounts -- how much to the family and how much to society. Warren Buffett famously has given only a modest amount to his children, paid for his grandchildren's education and allocated the vast bulk of his wealth to a handful of charitable foundations. There are no right or wrong answers here -- personal values are what matter.

Of course, beneath the surface there are many complexities. For example, techniques to minimize tax or augment giving through insurance have to be evaluated. Where the parents have a business or cottage they want passed down to the next generation, there are family issues to consider as well.

A strategic capital-allocation plan isn't built in a minute. It requires analysis and the thoughtful assessment of options. In one family, for instance, where one spouse was an avid art collector while the other was very philanthropic, we prepared and discussed dozens of projections, based on different portfolio configurations and capital allocations, to develop a plan that optimally met their needs. Most importantly, from this dialogue a shared commitment on how to spend and give away their money was born, something every wealthy family should strive for.

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