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Managing Sudden Wealth

How to Make Wise Decisions After Receiving a Financial Windfall

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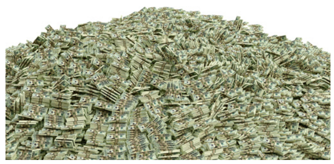

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Key Takeaways

- A comprehensive financial plan is vital for growing and preserving your newfound wealth.
- Surround yourself with a team of trusted advisors who will act solely in your best interest.
- Remember, you are the most essential member of the team and the final decision-maker.

You've just received a significant sum of money! Chances are you're feeling both excited and overwhelmed. Your head is spinning with ideas, but you're not sure where or how to begin. The good news is there's no rush. The best thing you can do is take your time—embrace the moment and create a plan that will help you preserve, grow and protect your new wealth while avoiding irrational decisions.

This guide walks you through the planning process and assembling your advisory team. It also highlights common financial mistakes and tips for avoiding them.

Five Steps for Sudden Wealth Planning

Your first impulse may be to spend or make promises to others, but that may not be in your best interest. Even if you're used to handling your finances, now is the time to be careful. Sudden wealth can turn even the most cautious person into an impulse buyer. It's important to limit the urge to spend or invest until you have a plan.

A well-designed financial plan provides a framework for managing your redefined financial life. It helps you balance competing priorities and understand how different actions can impact your goals so you can make informed decisions. It can also help you minimize potential income and estate taxes and clarify what you want to do with the funds. Below are key questions to consider as you start the planning process:

Step 1 **Evaluate Your New Financial Position**	Addressing the windfall upfront is essential for managing your new wealth effectively. • How much did you receive, and how will it be paid? • What is the estimated tax liability, and what can you do to minimize it prudently? • Where will you put the money until you have a plan? • What are your short- and long-term financial needs and goals? • Do you have a trusted team of advisors who can help you manage the windfall?
Step 2 **Develop a Prudent Investment Plan**	You'll likely need to formulate a new investment strategy with your investment advisor's help. • How much should you set aside for general living expenses, taxes and other shorter-term goals? • What type of investment return do you need to accomplish your longer-term goals? • What level of volatility are you willing to accept when investing? • If the risk and return profiles don't correspond, how do you reconcile the two? • How can you restructure your portfolio to maximize the after-tax return?

Step 3 **Determine Your Insurance Needs**	Being wealthy exposes you to new and unique risks (lawsuits tend to look for deep pockets). • Do you have a personal umbrella liability insurance policy? • Do you have the right type and amount of coverage (homeowners, disability, long-term care)? • Should you increase deductibles? • Will you need a personal articles policy for expensive purchases such as jewelry or artwork? • Should you consider using life insurance to cover your potential estate tax bill?
Step 4 **Assess the Impact on Your Estate Plan**	Estate planning is about more than transferring property. It's about minimizing the short-term burden and maximizing the long-term positive impact on your heirs. • Do your current estate planning documents accurately reflect your wishes? • Are there any new/unique assets that need to be addressed? • If not part of your current estate plan, should you consider setting up a trust? • Who will manage your finances and make health care decisions if you're unable to do so? • What, if any, strategies should be used to minimize future estate taxes?
Step 5 **Decide If You Want to Give Some Away**	You may want to give gifts of cash or property to loved ones or charities. Formalizing your plan will help you evaluate requests and say "no" when appropriate. • Do you want to pay for a loved one's education? If so, how much and how will you pay? • How will you handle requests from loved ones to borrow money? • How much of your new wealth do you want to allocate to charitable gifts? • Do you want to make gifts during your lifetime or at your death? • What strategies make the most sense for your charitable gifts (e.g., Donor Advised Funds)?

Once you have your plan, it's essential to review it regularly. An effective financial plan is one that evolves with your life. You'll likely need to update it as your personal and financial circumstances change.

Assembling Your Advisory Team

Fortunately, you don't have to create, implement and monitor your plan on your own. Experts are available to help you with all of your financial needs. If you don't already have them, now would be a good time to engage the following professionals. They can work with you to address the financial, legal and tax implications of your new wealth:

Certified Financial Planner™ (CFP®)	Typically plays a central role in the design and implementation of your overall financial plan and helps coordinate the other members of your advisory team
Tax Accountant	Advises on federal and state income tax issues as well as gift, estate, and inheritance taxes
Estate Planning Attorney	Offers guidance on how to transfer your assets before and after your death, and drafts your will and other estate planning documents
Insurance Professional	Evaluates your insurance needs and recommends specific coverage such as life, property and casualty, and umbrella policies to protect you and your assets
Investment Advisor	Provides advice on the different types of investments and helps you create a diversified investment portfolio that reflects your goals, time horizon and risk tolerance

Remember, YOU are the most essential member of the team. Your needs and objectives drive the conversation and the actions taken. Be sure you work with competent and knowledgeable professionals with whom you can have an open and honest relationship.

Assess the capabilities of the professionals who are currently serving you. Your financial needs are more sophisticated now. Are your advisors capable of addressing these needs? Are you confident they will act solely in your best interest? If not, it's time to find advisors who will. Ask for referrals from trusted family members, friends, or colleagues.

Ten Common Financial Mistakes and How to Avoid Them

We've all heard the rags-to-riches-to-rags stories of people who acquired sudden wealth and then lost it just as fast. In many cases, it's because they made one or more of the following mistakes. With comprehensive financial planning, objective advice and a trusted advisory team, you can keep from being one of them.

1. **Giving in to the "urge to splurge"**
   Resist the temptation to make any significant decisions or spend lavishly until you take time to think about your dreams and develop a game plan. Of course, this doesn't mean that you can't treat yourself with some of your money—just don't go overboard.

2. **Failing to determine goals**
   Writing down your goals for your money helps instill a framework for future decisions. Consequently, you will be less likely to make emotional decisions that may be detrimental to your long-term financial health.

3. **Spending indiscriminately**
   Your wealth often represents an irreplaceable asset that must support your income requirements for many years to come. You may feel like a small purchase here or there won't hurt, but those purchases can add up quickly and increase the risk that you won't meet your objectives, or worse, that you will run out of money.

4. **Forgetting to account for costs**
   Depending on how you received it, taxes can immediately take a big bite out of your new wealth. Further, some big purchases can have high upkeep costs, such as your dream home's property taxes and maintenance costs.

5. **Believing that "money can buy happiness"**
   Studies have shown that not having to worry about life's necessities provides a certain level of contentment, but at some point, buying more stuff doesn't increase this contentment. However, spending money on experiences (memories) and things that enhance your social connections (relationships) can contribute to your happiness.

6. **Feeling a sense of guilt for your wealth**
   Sudden wealth often leads to a variety of emotional issues. Studies have shown that recipients of large amounts of money often experience anxiety, guilt and confusion as the realities of their new situations sink in. These emotions may cause wealth recipients to act irrationally in ways that range from reckless spending to withdrawing from friends and family.

7. **Being unable to say "no"**
   Family, friends and charities all have needs and desires that you may now be able to support. While others' needs may be valid, your wealth is finite, no matter how much you've received. It's important to develop guidelines (or even a mission statement) that describe the conditions under which you will give.

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8. **Investing "opportunistically"**
You may begin to receive offers for "can't lose" investment ideas and schemes. It can be easy to rationalize that you're playing with "house money" or can afford to take some significant risks. It's better to manage your wealth using a disciplined investment game plan, which may allow for some investment in more speculative, but well-vetted ideas.

9. **Failing to "trust, but verify" when working with outside advisors**
Unfortunately, wealth attracts attention, not always welcomed, and not always well-intentioned. You should be confident that any guidance provided by your advisory team is based solely in your best interest. To reduce the chances of fraud, stay informed, demand transparency, be comfortable asking questions, and only grant your advisors limited authority.

10. **Allowing your new wealth to change you**
Sudden money can provide you with a tremendous amount of freedom and redefine the lives of you and your family. But it can also change the behavior of you (and those around you) for the worse. The more you truly understand your values and priorities, the better you can deal with the emotional and relationship issues that will inevitably arise.

Getting Started

Many sudden wealth events cannot be predicted. However, to the extent you can anticipate such an event, like a business sale, you should prepare ahead of time. The earlier you seek qualified advice, the greater the opportunity to minimize potential income and estate tax consequences and set yourself up for long-term success.

After reading this guide, you likely have more questions. That's natural. After all, money doesn't come with instructions and receiving a financial windfall is probably one of the most significant events of your life. Cerity Partners is here to help guide you through the planning and decision-making process. Our advisors have extensive knowledge of and experience with all aspects of wealth management.

Together, we'll evaluate your options and choose a course of action that keeps you moving forward towards the future you envision.

Contact us to start the conversation today.

About Cerity Partners

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