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When Your Child's a Spendthrift

If you want to leave money to a kid who's a reckless spender, don't just hope for the best. Plan for it.

By JENNIFER HOYT CUMMINGS

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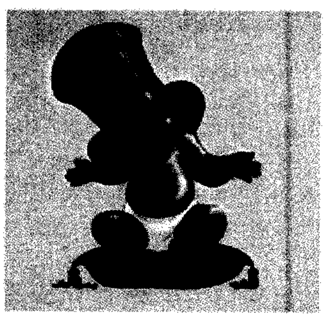
Wealthy families often breed reckless spenders, leaving many parents in a bind when they are devising their inheritance plans.

These parents need to develop a plan that monitors their prodigal sons and daughters while respecting their independence and giving them room to mature. It's a delicate balance, but parents who employ innovative financial training, carefully chosen trustees and cleverly written trusts can find there's hope for their high-rolling offspring. Here are some tips:

Create an Investment Firm

The first step for parents is to make an honest assessment of their children's financial acumen. One way to do this is to set up a family investment company that controls the inheritance, suggests Timothy Belber, a family wealth consultant with Madison Group, based in Denver.



Douglas B. Jones

He helped do this for a couple who had concerns about how their children would handle an impending inheritance. The couple put their three children on the board of the company, and had them interview investment advisers and hold quarterly strategy calls. The company also paid for financial education programs for the children. Mr. Belber instructed the parents not to talk on these calls, and to just listen to how their children handled themselves.

The parents were surprised to discover that the two children they worried about most—a teacher and a social worker—asked great questions and excelled. However, the child they had expected to be well-equipped to handle an inheritance, a son who worked in finance, showed he had real trouble handling his own money. "He was very literate in the mechanics, but he didn't understand how to be an owner of wealth," Mr. Belber says.

Having the investment company helped the parents spot these problems early, and they've been able to use this as a trial run for when the children inherit a much larger sum after the parents' death. Not all families have to make such elaborate preparations. Simply including children in meetings with financial advisers can go a long way.

Parents should also help children deal with the psychological effects of inheriting great wealth, which may require the assistance of a therapist. For many people there's a lot of guilt associated with the inheritance because it wasn't earned, says Nathan Dungan, a wealth coach and president of Share Save Spend LLC, based in Minneapolis.

Pick Right Trustees

Many spendthrifts could benefit from having two trustees manage their inheritance. The first should be a corporate trustee, who will control the purse strings and can play the "bad cop" role when necessary. Corporations that provide trustee services include U.S. Trust, Wilmington Trust and BB&T, but there are also plenty of smaller firms.

More Dollars Than Sense

Tips on setting up a trust so that parents can protect their assets from free-spending or other problem heirs

- **Structure** the trust so that a spendthrift or other problem heir can't get title to a home. A trust can buy real estate on behalf of the heir.
- **Set up** the trust so that the child's creditors can't access the inheritance.
- **Be aware** that a trust could go on for a hundred years or more, so don't make the clauses too specific or narrow.
- **Expand** on legal jargon in the trust with a letter explaining your decisions.
- **Consider** "opportunity distributions" for children who want to take on special projects, like studying abroad.

Source: WSJ reporting

The second trustee is a co-trustee, who will report to the corporate trustee on the beneficiary's progress in improving his or her financial acumen. This should be someone who knows the child well but isn't too close to them, like a longtime family friend, accountant or attorney. Experts say not to assign this role to an immediate family member because of the potential friction. "As a sibling do you want someone glaring you down at Thanksgiving because you didn't give them money?" says Kemp Stickney, chief fiduciary officer for Wilmington Trust.

Parents may want to consider making the spendthrift child a co-trustee as well, a role that could serve as a kind of apprenticeship, suggest Jill Dodd, head of the trust and estate practice at Manatt, Phelps & Phillips in San Francisco.

Getting help from outside the family is especially crucial for children whose money woes stem from substance-abuse problems.

Mr. Dungan, of Share Save Spend, says that was the case for a drug-addicted client he began working with about five years ago. At that time the man was in his mid-20s, in and out of work, and had no permanent address. He would stop by his mother's house periodically to pick up cash from his trust. His mother, who was also his trustee, knew that some of the money was going to buy drugs. "It was really impacting my relationship with my son to have to be the money police in addition to just trying to be the mother," she says.

Mr. Dungan set up a system through which the son would regularly stop by his mother's investment bank to pick up a pre-paid debit card. If he had a relapse, his mother and Mr. Dungan would cut him off from the card. The son bristled at first, and it hasn't been a smooth path, but he eventually moved to a different region so he could get away from friends who were doing drugs. He's working as a DJ and taking classes at a community college. He sends a monthly budget to his mother's bank, which transfers what he needs to his checking account.

"I would say it's the most optimistic I've been in really long time," his mother says.

Think About Trust Rules

Some trusts include clauses that hold money back if the heir isn't behaving. The clauses should use generic language that doesn't single out individual children by name. It's also a good idea to give the trustee the ability to pay bills, like rent or medical costs, on behalf of the child if necessary.

From here, the clauses become a delicate balance of honoring the parents' goals for their children, without putting too many restrictions on the trustee. Some parents get extremely specific in how their children can access the money, such as stipulating that the child must have a full-time job to get distributions.

Experts advise against getting so specific, saying overly rigorous guidelines can box in both the child and the trustee. A good way to find middle ground is to be clear that it's not the parents' intention to create a trust that will provide the sole means of support for a child in good health, says James Marion, national fiduciary advisor executive at U.S. Trust.

The worst thing parents of reckless spenders can do is simply hope for the best. "Giving money to someone who can't handle it, in the hopes that it will improve their financial situation, is kind of like trying to put out a fire with lighter fluid," says Nathan Workman, an estate lawyer based in Charlotte.

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