Money and Meaning

By Stephen Goldbart and Joan DiFuria

Thinking Through Loans, Gifts and Bail-outs to Friends and Family

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There is little doubt that the financial downturn and credit freeze has resulted in an increase of requests to affluent families for loans, gifts, and outright bail-outs. Some of our clients have been overwhelmed by the sheer volume, and accompanying emotional intensity, of these requests. While the high net-worth family may want to be generous, they find themselves in a bind: How to reply to the very real needs of so many, particularly when the relationship has emotional value or is part of an important business partnership? No family is wealthy enough to say "yes" to all the requests, and many families have lost as much as 40 percent of the value of their portfolios during this radical economic downturn

Decision-making about financial requests from close friends and family, even during the best of times, is challenging and has significant psychological ramifications. With a close friend, family member, or close professional colleague, the vetting process is not always rational. Guilt about one's wealth, entitlement or uncertainty about one's wealth identity can have a dramatic impact on both the "what and how" of these financial decisions. If the wealth-holder funds one request over another, does that mean that he or she cares for the recipient more than those who are turned down? Should decisions to provide a bail-out to family members who are about to lose their home be viewed as morally correct simply because they are family? The high–net-worth family is always at risk of being perceived as a private bank, and when commercial banks are not lending, they may be seen as the only banking resource available. These seemingly simple requests create pressures that can destroy relationships. Feeling guilty and wanting to help loved ones is not uncommon, but it is often difficult to navigate between the different results dictated by our head and our heart.

Then how should the wealthy family vet a request when their heartstrings are being pulled? Consider Alex's story. His best friend, Tim, announced that he needed to move, because his income had so decreased that he no longer could afford his home mortgage. Alex was devastated: Tim had been a close friend and confidant since high school. If Tim moved away, a great source of daily emotional support would be lost. So Alex talked to his spouse and his financial advisor and decided to offer Tim a loan, with low interest to be paid at a later date. If Tim accepted this offer he would be able to keep his home for him and his family. Tim also wanted to protect Alex's long term stake: He was only able to accept this generous offer as long as Alex got a partial interest stake in the equity of the house over time. This was a win-win situation. At almost the same time, Alex's father had passed away, and as expected, was named the executor of the estate. He received a call from his distraught sister Jane, who was very upset after a conversation with their father's estate attorney. A promise Dad had made—that a $50,000 loan for each of her two children's education—would be forgiven at his death had not been written into the estate plan. In fact, it had been drafted three years prior by the attorney but never signed. The lawyer understood forgiving this loan had been father's intention, but could not execute based on intention. The lawyer suggested that Jane try to get a majority vote from her three siblings, as this was the only way he would agree to move forward and forgive the loan. Jane wanted Alex to convince her other two siblings to agree. After all, the other cousins had already benefitted from their Grandparent's funding of their college education. To add fuel to Jane's fire, her husband had recently been laid off from his job in the financial management industry. Alex was not sure how to proceed. Was Jane just trying to get more from the estate (she always was perceived as Dad's favorite), or was lack of signature the faux pas of father's ageing process?

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We have found that the wealthy family needs advice and structure for their decision-making. Here are some tips we offer to them:

- Have a financial plan that balances one's desire to be generous with preservation of money for your own present and future needs. With Tim, Alex was able to create an equity payout that took the risk into account, gaining more equity in the home if Tim did not perform according to the terms of their agreement.
- Think through the long term consequences of the potential giving behavior before making a decision. With Jane, the consequences were more emotional than financial, as her close sibling relationships were at risk.
- Develop a team of trusted wealth advisory experts to consult on giving plans. Be sure the team includes expertise on family dynamics. We have found that using outside expertise, in concert with a Family Council model, to be an effective way to handle significant requests. The wealth-holder can then say to potential recipients: "We have a method in place to fairly handle requests, given that we cannot provide funds for everyone." This is a great strategy to help neutralize the emotions on both sides, and to provide for a vetting process that takes the pressure off the giver.
- Listen to each request, but do not make an immediate decision. Alex received many other requests for financial help. He learned to say, "I can't make an immediate decision, but will review with my spouse and with our financial advisory group." Taking the opportunity to not immediately respond is a great pressure reduction strategy, allowing for a more rational decision. Although the recipient may feel a sense of urgency about their request, it is important that the giver step back and think through the benefits and liabilities of such request.
- Keep in mind that any loan should not create a long-term financial burden for the giver or receiver. Alex had learned the hard way. He had given a loan to another family member to help in the purchase of a new home. Alex was surprised when he continued to get additional monetary requests for the maintenance of the home. It became clear, only too late, that the loan recipient could not afford to maintain the home.
- Understand that one cannot take back what one has given to family and friends without risking bad will. Alex's sister not only insisted, but expected that her brother would come through with the

money needed to maintain her new home. Alex expected his sister to be responsible. Neither of these expectations was met.

- Most importantly, no family member or friend is entitled to your money. Often one's sense of commitment, loyalty, or obligation can make these financial decisions more difficult and burdensome. The bottom line is this: Do not discard your business savvy or common sense in the face of requests. However, as Alex did with Tim, you may choose to make a decision strongly influenced by emotions that are aligned with core values.

In conclusion: Employing a "lending strategy," with clear governance and values, is very helpful to handle the often complex interplay of financial and psychological issues involved in lending requests. Even with the best of intentions, financial rescues or bail-outs can backfire. It is important for the giver to not collude with bad behavior of the receiver. A person who has a history of overspending, lack of responsibility or accountability, is a risk not only to a bank, but also to the financial and emotional relationship with the giver. If the loan is set up so that the borrower has "skin in the game" (that is, has to perform certain acts or suffer negative consequences), the arrangement is more likely to produce a successful outcome for both parties.