

KIDS IN A CANDY STORE

A sudden influx of cash needs careful management and planning



BY GRANT McINTYRE

Between giddy spending and long-lost friends, clients who are unprepared for sudden wealth can be pressured into making decisions they regret later

An entrepreneur sells his business. A farmer sells a large parcel of land. A widow receives a significant inheritance. There are many ways in which your clients may find themselves the fortunate recipients of a large sum of money virtually overnight. But such an event can result in mixed emotions and lead to behaviour that puts that money at risk.

Clients who experience a windfall present financial advisors with a financial planning opportunity — a chance to ensure that this money will allow the client to realize his or her retirement, philanthropic or estate goals. At the same time, however, if the client does not receive good advice, that windfall can be squandered as quickly as it arrived.

Clients can receive large sums of money all at once through a variety of ways: the sale of a business; an inheritance; an insurance payout; a divorce settlement; a severance package; a commuted pension; even lottery winnings. And while most of your clients might receive sudden wealth only once in a lifetime, you can expect to deal with such a situation fairly frequently, especially considering what some experts are calling the largest intergenerational wealth transfer ever — the inheritances that baby boomers, the oldest of whom began turning 70 last year, will be leaving behind.

Stan Tepner, portfolio manager and first vice president with CIBC Wood Gundy, a subsidiary of Canadian Imperial Bank of Commerce in Toronto, points out that “sudden wealth” and “sudden money” are not necessarily the same thing. A lottery winner experiences sudden wealth; a business owner who liquidates a business or a parcel of real estate has not become more wealthy as a result, but has turned an asset into cash. In either case, that money has to be managed prudently.

“It might not affect [clients’] lifestyle,” Tepner says, “but it may affect how they make financial decisions.”

Tepner and Chris Reynolds, president and CEO of Investment Planning Counsel Inc. in Mississauga, Ont., agree: the most common risk among clients who experience sudden money is spending it all. A client with a sudden influx of cash experiences what Reynolds calls the “Kid in the Candy Store Syndrome.”

Adds Reynolds: “They’ll buy depreciating items such as extravagant cars and take the whole family on a great vacation.” Meanwhile, long-lost friends and relatives often come out of the woodwork, requesting loans or an investment in a business startup. Clients who are unprepared can be pressured into making decisions they regret later.

“Sudden wealth can be a very stressful situation for most

people,” says Tina Tehranchian, branch manager and senior financial planner with Assante Capital Management Ltd. in Richmond Hill, Ont. “People who inherit a lot of wealth often feel very scared of losing it and mismanaging it. People around them begin acting differently, and relatives and friends may have expectations.”

All three of these advisors agree on the first step for these clients: do nothing. Place the money in a savings vehicle and make no financial decisions until you and your client have revisited the client’s goals and how this money will affect his or her ability to reach those goals.

During this assessment period, you should talk about what’s important to your client and how this money might change your client’s perspective, Tepner says. Ask your client: “Do you want to look after yourself or look after others, such as your children or charities? Do you want to continue working? If you retire, how will you fill your time?” Then, put together a plan that shows how your client can achieve those objectives.

For example, a financial projection can demonstrate to your client that he or she is not as rich — and the money might not last as long — as thought originally. That’s why evaluating the situation before allocating any of the money is crucial.

Young entrepreneurs who come into sudden wealth, for example, require such a steady-handed approach. Entrepreneurial clients often are more interested in investing their windfall in a new business venture than in safe asset allocation, Reynolds says. And wealthy clients in their 20s or 30s have a longer time horizon for which to plan. So, making the windfall last well beyond retirement would be a greater challenge for this younger generation than for their older counterparts.

“Ten million dollars might look like a lot of money when you’re in your 30s,” Reynolds says. “But if you live to 80, it’s not as much money as you think.” Once clients have a clear picture of the extent of their wealth, he adds, they will have a better perspective and begin to gain some sense of control.

That initial planning process might involve other professionals, such as a tax expert, a lawyer and an insurance advisor. You also might recommend other experts, such as an elder-care specialist or a psychologist, Tepner says, depending on the needs of that client. You, in turn, should act as the quarterback of the team of experts.

And while counselling prudence is in your client’s interest, managing sudden money responsibly doesn’t mean depriving the client of the pleasure of celebrating his or her good fortune, Reynolds says. After the amount is safely locked away in savings, your client might choose to enjoy some “fun time,” usually a vacation, that can allow the client to reflect on his or her new situation before the planning process begins. But try to dissuade your client from making any major commitments before a sound financial plan has been created.

“The financial plan is the start of everything,” Reynolds says. “Look at the client’s situation first, and everything else should come second.”

