

## **SPEED READING**

### **PLANNING FOR THE SUDDENLY WEALTHY**

Many planners target wealthy individuals as potential clients. Although wealth is usually accumulated over many years, it is sometimes acquired with little or no notice.

Suddenly wealthy clients represent a potentially profitable and desirable (albeit specialized) market. However, people who become suddenly wealthy also frequently present unique difficulties for financial planners, particularly if the client's wealth is in the form of cash or other highly liquid assets. The problems and opportunities of working with suddenly wealthy clients are discussed below.

#### **Sources of Sudden Wealth**

In my experience, there are four main sources of sudden wealth: (1) inheritance; (2) prize winnings (especially lotteries); (3) legal compensation for loss (including compensation for personal injuries and the wrongful death of a family member); and (4) divorce, particularly if one spouse receives a cash settlement for a share of the marital property.

#### **The Planner's Role**

For most people, sudden wealth is a stressful occurrence. In addition, since sudden wealth is unexpected, it is often accompanied by extreme excitement, in the case of lottery winners, or emotional shock, in the case of those who have experienced a death or divorce. If the recipient of sudden wealth also has limited experience in dealing with financial matters, as is often the case, all the elements exist for a demanding and potentially volatile planning engagement.

An adviser can add significant value to a planning engagement for the suddenly wealthy by understanding and being responsive to his client's emotional situation. In many cases, the suddenly wealthy client is not immediately able to focus on the decisions that must be made or the advice being given. In other cases, your client may feel the need to take immediate action, and your first task will be to urge your client not to make any hasty decisions.

Because suddenly wealthy clients may be emotionally agitated, planners should take a flexible approach during the first few planning meetings and pay close attention to their client's unique needs. Sometimes, it may be appropriate to encourage your client to talk on subjects of personal concern. On the other hand, you may sense that your client is prepared to take control of the situation immediately. In other

**SPEED READING**

cases, you may decide that providing basic financial education is your most useful service.

Regardless of your client's state of mind, you should try to determine as soon as possible if your client has any immediate financial obligations or if your client faces any nonextendable deadlines, such as an income tax election or a tax return filing date. If you have worked with this client before, this step should be relatively easy.

However, if the suddenly wealthy person is a new client, you will often have to perform some financial detective work. In my experience, it is best to start this process by reviewing your client's most recent income tax returns, looking for items that may alert you to the nature of his assets and obligations, especially hidden ones. It can also be useful to review your client's checkbooks.

If there has been a recent death, you and your client should begin the process of marshaling (i.e., locating and organizing) assets. This can be accomplished by asking your client to complete your financial planning questionnaire or by assisting your client with the questionnaire if necessary.

**One Step at a Time**

In planning for the suddenly wealthy, the ultimate goal of the engagement is almost always to develop an investment portfolio. However, the event that caused the sudden wealth has probably also affected other areas of your client's financial life, and all of these areas must be examined.

Cash flow planning, especially creating and implementing a budget, is often the first substantive area that must be addressed with a suddenly wealthy client. This can be tedious and sometimes frustrating work, but it helps lay a foundation for all financial planning that follows. In particular, your client's budget establishes expense levels, which in turn establishes cash needs. If you know your client's cash needs and if your client has sufficient assets to meet those needs, it is generally easier to design a suitable investment portfolio.

The estate plan of a suddenly wealthy client will also usually need revision if for no other reason than the new wealth has created a potentially taxable estate where none existed before. If divorce or the death of a spouse is the cause of the new wealth, the marital deduction is no longer available to your suddenly wealthy client, and this can have a significant effect on estate tax and probate exposure. Your client will

## **SPEED READING**

usually want to name new beneficiaries. In some cases, if your client has sufficient assets, it may be appropriate to consider establishing a program of gifting to reduce the taxable estate.

When your client receives sudden wealth, the need for life insurance may be substantially reduced. Thus, if you determine that the sudden wealth is sufficient to meet your client's lifetime living expenses (adjusted for inflation) and if the wealth is also sufficient to fund your client's other long-term goals (e.g., education for any children), your client may have no economic need to keep existing life insurance, except perhaps to provide potential estate liquidity. Your conclusions in this area will be different for each client, but these issues should be addressed.

For cases in which sudden wealth is the result of an accident or personal injury settlement, the award should be structured to be nontaxable (assuming that it is still in your client's power to do so). Structuring a nontaxable award can best be accomplished if it is characterized as payment for personal injuries, rather than as payment for lost wages or punitive damages.

Investment planning for a relatively unsophisticated, suddenly wealthy client is often the most challenging part of the financial planning process. We recommend that advisers develop these investment plans slowly.

One reason we favor the slow and cautious approach is that it allows time for the development of an educational dialogue between planner and client. Since your client must ultimately accept and implement your investment plan, your client must get to the point at which he at least understands the reasons for your choice of asset classes and the reasons for your recommended allocations within each class.

The unsophisticated client often tries to place the burden of making the final investment decisions on the financial planner. We believe that the planner who falls into this trap hurts his client, since such a planner deprives his client of the experience and education necessary to become financially independent. The planner also potentially hurts himself, since he is considerably more exposed to legal liability should there be a loss in his client's portfolio.

In any case involving sudden wealth, there is often a relatively mundane but important investment decision to make — how and where the client's wealth should be parked until it can finally be allocated and invested.

Because the amounts involved are often substantial, safety should be the utmost concern at this stage. The planner must be familiar with and

**SPEED READING**

be prepared to discuss with his client the various alternatives available for the temporary placement of large sums of cash. A planner may be reluctant to recommend that his client deposit amounts in excess of \$100,000 in any one financial institution, since amounts in excess of \$100,000 may not be eligible for federal deposit insurance. Money market mutual funds may actually be more attractive for the deposit of large sums, depending on the insurance coverage (if any) available through the fund, although even here it is usually desirable to diversify among several funds if the sums involved are large. Planners should expect to spend some time researching the available alternatives in this area. Short-term government investments should also be considered because of their safety features.

If your suddenly wealthy client is recently divorced, you should review that client's property settlement, at least in general terms. If you do not feel that your client received an equitable share of the marital property (for example, because the client relied on an improper or nonexpert asset valuation), you should at least discuss with legal counsel the possibility of asking the court to revise the property settlement.

A final note on working with the suddenly wealthy. Most planners who practice in this area are drawn to it because they have good interpersonal skills, which become even stronger as they work with suddenly wealthy clients. If you expect to work extensively with the suddenly wealthy, you might also consider taking one or more general psychology classes. These courses help develop skills that could be applicable to all of your clients.

**A Rewarding Practice Area**

In my experience, suddenly wealthy clients are among the most appreciative of all financial planning clients. They are also among the least fee-sensitive, since most clients in this situation recognize that they need objective, high-quality advice, and they have the wherewithal to pay for it. If you are up to the challenges of this unique market, the work can be most gratifying.

—Michael B. Allmon

Michael B. Allmon, CPA is the founder of Michael B. Allmon & Co., Certified Public Accountants (Marina del Rey, California). He was formerly the tax manager and director of financial planning services for an international accounting firm, as well as the director of tax and financial consulting services for a large independent accounting firm in the Los Angeles area. Mr. Allmon has a Master's degree in taxation from the University of Southern California. He is active in several accounting and financial planning organizations nationally and in the Los Angeles area.