

Protect Your Assets With a ‘Family Bank’

Teresa Sampleton, CFP®, CLU, ChFC, CLTC

Vice President

Sampleton Wealth Management Group

21 W. 38th Street

14th Fl.

New York, NY 10018

(212) 555-1111

tsampleton@sampletonwealthmanagement.com

www.sampletonwealthmanagement.com



By Helen Modly, CFP, and Sandra Atkins, CPA/PFS

One of the biggest drains on your account may not be the market but rather family requests for money that may never be repaid. Preserve assets—and emotional health—by setting up a “family bank” where loan requests are reviewed, approved of, and monitored.

Pity the poor widow. Left with a sizable portfolio, she thinks her financial future is secure. Little does she realize that one of the biggest threats to her future security is not the markets and not her health, but her own loving children, who think she has cash to spare. One by one, they quietly approach her for loans that will never be repaid. The guilt she feels from turning them down is worse than the fear created by the draining of her assets, but what’s a mother to do?

One possible solution in this familiar—and for most people, it is familiar—scenario might be for the widow to informally set aside a reasonable portion of her portfolio in a separate account and consider it the family bank. Although the amount she uses to seed this account will depend on her financial situation, she should remain cautious regardless. This account will always be registered in her name, just as her portfolio is now, but the expectation will be that these funds will be available to help her family from time to time. Her children may request a loan from the family bank at any time, using a more formalized process; a bit different than

hitting up mom for cash while she’s cradling her first grandson in her arms. By adopting a few basic ground rules, you can forestall years of emotionally taxing personal and family stress.

Written loan request

Anyone desiring to borrow money from the family bank must draft a written request for the loan. The request should identify the following items:

- **The amount of the loan requested.**
- **The repayment schedule desired.** Hopefully, this will be expressed as a specific amount over a fixed period of time. In some cases this might be a bit more vague, such as, “I’ll repay it as soon as my house/boat/car is sold,” or “Once I get a new job, I’ll begin to make payments.”
- **The intended purpose for the loan proceeds.** This needs to specify what the money will be used for (debts, education, acquiring a house or car, etc.).

- **A summary of any other outstanding loans from the family bank.** This should include any existing loans made directly by Mom before the family bank was established. In fact, it is a good idea to address any existing loans to family members, whether current or in default.

Approval by the bank's directors

Here's the really interesting part. The written loan request should be circulated to each of the family bank's "directors." The directors of the bank will be all those individuals with the privilege of requesting a loan from the bank. This might include only your children, or it may also include grandchildren or other relatives.

Any and all loan requests must be approved by the other directors. It is up to you to decide whether the approval must be unanimous, by majority, or in accordance with any other formula that fits the dynamics of your family. You, your partner, and the directors will decide how to track the repayment of loans and whether there will be any consequences to default. In some cases, there may be a punitive response. Some families simply say that individuals cannot request any future loans until the default is cleared. In any case, the directors should establish some mechanism for tracking the repayment of any loan.

At the outset, you may establish a limit for any one loan, or the total loans that can be outstanding for any one individual and any one time. You might also decide that no interest will be charged on these loans, or that a current market rate will be charged. Keep in mind that the money in the family bank is yours, and you can exercise your right to shut it down anytime you feel it is not working.

Once these ground rules are established, it is up to you to choose your advisor's level of involvement in the approval process. He or she may be useful as a third party consultant, but you may also be gratified to find that the family bank system is easy to execute more or less on your own.

Evidenced by a note

It can be emotionally difficult to request a signed promissory note from a family member, especially a child. It may be even harder to enforce such a note if the child defaults. By contrast, insisting on a signed note does not usually create any emotional tension for the other directors—usually the siblings competing for access to money. The signed promissory note creates a needed formality, with the expectation for repayment that often does not exist with family loans. Another safeguard may be to request that if the borrower is married, the spouse must sign the note as well. It is amazing how this stipulation can cut down on frivolous requests.

The benefits of sunshine

Make sure you keep an open line of communication with your advisor. As in most financial relationships, the benefits of transparency and accountability should never be underestimated. While you should feel comfortable making decisions as the director of your own family bank, there is real value to keeping your advisor well in the loop. If you choose to do so, you can even appoint your advisor as chief executive, while still retaining full veto power. By handing over the burden of loan approval to your financial advisor, you can keep emotional and transactional relationships with each child exclusive, while still creating a mechanism to help out. If the directors approve any loan that you don't care to make, you have the choice not to distribute the funds from your account.

Family members are likely to provide a much tougher degree of accountability to any borrower than you may be willing or able to exert. In many cases, the children will simply choose not to request a loan from the family bank when it involves this level of disclosure to other family members. And in the case of younger members who have not yet been able to establish a credit rating, or a sister just emerging from a divorce, access to funds via the family bank may be a tremendous advantage for getting on sound financial footing. After all, isn't this what families are for?

Not just for the ultra-rich

The concept of a family bank is just as appropriate for the moderately well-to-do as it is for the ultra-rich. Although originally developed in the family offices that serve the wealthiest families, it can solve the same family dynamic problems for families at a range of income levels. In the wealthy family, there is usually no real fear that the money might run out; rather, the issue is one of maintaining a sense of fairness for those members who would be eligible to request a loan. Another benefit is that the family bank as a practice offers valuable lessons to the adult children in how to function as a decision-making body, which is critical in order for wealth to be effectively managed in a family environment.

If your family's income is more modest, there may be a very real concern that you could jeopardize your own security simply because it is too hard

to say no. The family bank essentially puts the pressure appropriately on the borrower and removes you from the process of approving or monitoring the status of a family loan. It also forces a level of accountability among siblings or other family members that might be uncomfortable for you alone. This accountability often leads to a more professional level of interaction among siblings. Coupled with the fact that you retain full control over your accounts at all times and have the right to ignore any recommendation for making a loan, a family bank could be a real win-win for you and your family.

Helen Modly and Sandra Atkins are writers for the New York-based Horseshmouth, an independent organization providing unique, unbiased insight into the most critical issues facing financial advisors and their clients.

Sample: Not for Distribution