BALLENTINE PARTNERS

Wealth Management

Wealthy But Illiquid

BALLENTINE PARTNERS | ROY BALLENTINE, ChFC, CFP®

The combination of risk concentration and lack of liquidity poses significant challenges for wealth management, and for the preservation of wealth. If you are the owner of a private company, a top officer, director or major shareholder in public company, a principal in a private equity, hedge fund or real estate investment firm, you could be facing these very risks/challenges/problems.

Under certain conditions, illiquid wealth can quickly evaporate, or worse – assets can suddenly start to behave like liabilities. If you are successful, then you are wealthy – on paper. Illiquid assets carry a high potential for risk on the balance sheet. But individuals who hold illiquid assets tend to have many wealth planning opportunities too.

Most wealth advisors are focused on gathering and managing large pools of liquid assets, and don't have the desire or the skills necessary to properly advise a family whose assets are mostly illiquid. As a result, wealthy families with illiquid assets are often unaware of the scope of their risks and opportunities. Ballentine Partners specializes in working on illiquid wealth situations.

To understand some of the risks, consider these questions:

- If you had died yesterday, and the estate taxes payable in your estate suddenly came due, how would your estate raise the cash necessary to pay the tax? If your assets are mostly illiquid, remember that, as a general rule, estate taxes must be paid in cash within nine months of the date of death.
- If you had died yesterday, what challenges and concerns would your executors, trustees, and family members face as they try to manage the illiquid assets on your balance sheet?
- If you had become disabled yesterday, who would take over your family's financial management duties? How would you cover your family's financial needs, and your needs for medical care if your assets are illiquid? How would the value of those assets be affected?
- What portion of your personal balance sheet is liquid and protected from the risks of your business? How do you feel about that? Remember that if you have signed a personal

guarantee for any business loans, then all of your personal assets are probably exposed to business risk.

- What is your plan for passing your illiquid assets intact to the next generation? How do you know that the plan will perform as intended?
- Are your estate documents written with this goal in mind?
- Did you select a state jurisdiction and governing law for the trusts created that are appropriate for your estate goals?
- If your business has outside investors, how would those investor's react to your death or disability?
- If your death or disability is likely to cause a sharp decline in the value of the business, how will that affect your estate's ability to raise cash quickly?
- What is your company's management succession plan? How strong is your successor's ability to lead and manage the business?
- If your illiquid assets are subject to a shareholder agreement, LLC agreement, etc. , would your executors, trustees and heirs have the same rights you have with respect to the management of the assets? If their management rights are restricted, how does that affect your heirs?
- Do you have business partners? If yes, and a partner dies or becomes disabled, is it likely that you will wind up in business with your deceased partner's spouse or children – or the trustees, attorneys, and accountants representing any of those individuals? How do you feel about that?
- If a deceased partner's estate needed immediate access to cash to pay estate taxes, how would you and your business be positioned to respond? Your business partner's financial planning (or lack of planning) is a risk factor for you because if a partner dies, becomes disabled or insolvent, your partner's problem could quickly become your problem.
- Have you personally guaranteed any business debt? If so, are you the "deep pocket?" If you are, then the lender can come directly after your personal assets if it chooses to do after an event of default (unless you managed to negotiate a marshaling agreement with the lender).
- If you have personally guaranteed business debt, how are you going to eventually convince the lender to release your guarantee? If you die with the guarantee in place, what are the implications for your estate? Will the guarantee be used against your estate?
- Imagine that one of your partners becomes insolvent and creditors are able to attach his or her assets. One of the major assets is your partner's share of your business. How would that affect your ability to manage the business?
- The good news is that families that hold significant illiquid assets have wealth planning opportunities that are not available to other families. Ballentine Partners has deep skills and experience in identifying and capitalizing on those opportunities. Wealth planning opportunities with illiquid assets can include:
- Finding creative ways to use the family's business interests to prepare the next generation of family members to become responsible and knowledgeable stewards of the family's wealth. This is a key issue which many families tend to overlook. In the long run, the success of the family's wealth planning depends upon the skills of the next generation.
- Using the family's business interests to teach the next generation important lessons about the

family's values. Most successful privately-owned businesses were founded by someone who had a specific set of core values and beliefs about how to manage the business, and how to treat employees and customers. Passing those values on from one generation to another should be a key goal in the family's wealth management strategy.

- Teaching family members about the family's philanthropic values and activities. Many business-owner families are closely identified with a charity that the family has supported for a long time. By encouraging family members to become involved in the family's philanthropy, members of the younger generation can learn valuable skills that they can apply to many other aspects of their lives. (Ballentine Partners has written a separate paper on this important topic. A copy is available upon request.)

- Illiquid assets are often difficult to value. The family may be able to transfer a large amount of wealth in a tax-efficient manner through creative use of business interests, trusts, and valuation metrics.

- Properly designed and fully funded buy-sell agreements can fix the price of an illiquid asset for gift and estate planning purposes, and can also provide cash to cover estate taxes.

- Creating customized investment vehicles whose future value and performance will depend upon the performance of the family's illiquid investment assets. For example, the author's firm has used customized investment vehicles to fund charitable trusts and to fund gift trusts for the benefit of future generations. (The customized investments are private agreements between individuals and a family-owned entity, or between family-owned entities.)

- If the family holds any offshore business interests, there may be an opportunity to defer US tax on some or all of the income from the offshore business activities.

- Using creative agreements to fund the purchase of life insurance that can help to provide cash to pay estate taxes, and to prevent illiquid assets from being sold during estate settlement.

- Sale and lease back arrangements with illiquid assets (especially real estate) between the current owner and the next generation of owners. This type of arrangement can help to keep illiquid assets in the family and pass them on to the next generation in a highly tax-efficient manner.

- Creative financing arrangements, such as private annuity contracts and special installment sale promissory notes that are cancellable upon the death of the note maker. When properly used within a family setting, these types of financing arrangements can facilitate the transfer of illiquid assets.

- Asset protection is generally easier and more effective with illiquid assets than liquid assets. Illiquid assets can be protected through entities such as corporations, LLCs and limited partnerships, and through private agreements containing transfer restrictions.

- The family business interests can create a "family bank" whose purpose is to make loans to family members for business purposes, or for any purpose that the family decides is worthwhile. This is a concept that many of our clients have adopted.

- The family business interests may serve as an incubator for new business ideas. Some of our clients have actively encouraged this by setting up family-run private equity pools that are managed by members of the rising generation.

Working together on private equity investments can provide a family with opportunities to build skill and understanding.

This is only a partial inventory of planning ideas for families with illiquid assets. Assisted by a team of capable advisors, a wealthy family holding mostly illiquid assets, can eliminate or mitigate most of the risks and find ample wealth planning opportunities. To ensure successful strategic leadership to the family and its advisors, it is important to have a lead advisor with the deep financial planning skills necessary to identify, analyze and optimize issues and opportunities.

About Roy C. Ballentine, ChFC, CFP®

Roy is the Executive Chairman and Founder of the firm. Roy dedicates his time to thought leadership, strategic oversight of client engagements, and coaching and training our team members.

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