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On Watch

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The 10 Deadly Sins in Estate Planning

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IT IS A SUBJECT THAT ONLY LAWYERS, ACCOUNTANTS AND INSURANCE SALESMEN SEEM TO ENJOY DISCUSSING. Estate planning requires us to face our mortality. Woody Allen once said that he didn't mind dying; he just didn't want to be there when it happened. If you focus on death, you won't accomplish your dreams. But, if you view estate planning with a focus on life, you have the best chance of accomplishing your objectives.

Following are 10 contributing factors to failure to undertake thoughtful estate planning, potentially wreaking havoc on family harmony and business success. Although focused on business owners, the sins can apply regardless of the nature of the family's wealth.

1 | **Procrastination** – There seems to be no greater spoiler of our philosophies than continued delays in putting them into effect. Don't delay. Planning for the future is like anything else that is difficult. You cannot pay someone to lose 10 pounds for you. Only you can do it. Inaction will not improve the situation with time.

Story continued inside ...

Story continued from front ...

2 | Wishful thinking – You have to play with the hand you are dealt. You may have children who are interested and capable of handling the responsibilities you may choose to give them; others may not be. These are realities – competency, willingness, motivation, support. They are facts to which you do not always pay enough attention. But they exist, and you simply must face them.

3 | Saving pennies on advice – There is simply no substitute for the best advice when it comes to estate planning. If you want cheap advice, go see your bartender. But the advice won't sound so good in the morning. The real cost of advice is not what you pay for it, but what you pay when you take it and find out it was incomplete or wrong. The second cost is the opportunities you miss when you lack the confidence in the advisor necessary to act on the advice.

4 | Trying to skin Uncle Sam – You won't gain a better seat in heaven by telling St. Peter that you skinned Uncle Sam. Saving taxes is worthless if it simply adds more stock certificates to your feuding or incompetent children's arsenals. At least Uncle Sam takes his share and goes away happy.

5 | Confusing equality with fairness – Fair treatment isn't always equal treatment. Your children's financial successes and failures will and should vary based on their individual abilities, opportunities and luck. If you compel a common financial destiny, you risk destroying the fairness and family harmony that you so desperately seek to achieve. Your children can stay together as a family without forcing them to be business partners.

6 | Failure to share your philosophies – It makes for a good TV soap opera: On the way home from its patriarch's funeral, a family stops by the lawyer's office for the reading of the will. Inevitably, someone gasps, "How could the SOB do that to me?" No one bestows material possessions on heirs out of spite. We give as an act of love. But when they're nailing the lid on the box, you're in no position to explain why you did what you did. Your dreams and philosophies are the fuel of your estate planning. You should share them while you are alive. It can't be done afterwards through paperwork.

7 | Hoping for consensus management – If consensus is a requirement for decision making, an estranged minority can always exercise a veto. Rarely can a business function for very long if it is governed by a committee of individuals who each have their self-interests at heart. The classic case is two siblings who each inherit half of the stock and cannot agree on day-to-day operating details, much less strategy and future direction. Since Dad and Mom diluted power to act, the siblings must resort to lawyers and the courts to dictate "consensus."

8 | Failure to teach and to test – The best way to see if your estate plan works is to test it while you are alive. If you don't know how your kids will handle money, give them a little dose and watch what they do with it. There is no greater joy than watching your children rise to the occasion and properly handle their responsibilities. But you must explain, teach and test to avoid surprises.

9 | Not keeping the plan up to date – Estate planning must be done in pencil, not ink. Family members get married and divorced; have children; develop likes, dislikes, and new skills. Financial markets go up and down. Legislators change the tax code. Nevertheless, you have to do the best you can based upon the facts as they are. Then, you must constantly review your plans to keep up with changing circumstances.

10 | No outside review –You must seek periodic review by objective outsiders. Your directors and advisors can play a crucial role assuming they are fully aware of your wishes. After you're gone, they can be a surrogate spouse for your grieving widow or widower, a surrogate parent for your children, a surrogate boss for your employees.

To avoid these 10 fatal errors, you must continually address them. It does not get easier, and the issues don't get clearer. But there is no greater gift that you can leave to your spouse and children than a well-thought-out and executed plan, which is current and understood by all.

Excerpted from an article by the same name written by Ross W. Nager and Léon A. Danco, Family Business *magazine, Spring 1993. For a copy of the full article, please contact Ross Nager at RNager@sentineltrust.com or 713.630.9646.*

TRUTHS FOR TRUSTEES

LESLIE KIEFER AMANN, J.D.
Lead Fiduciary Officer

The role of a trustee requires a high degree of prudence and judgment and a surprisingly intimate relationship with the beneficiaries. Friends and family members often seem amazingly willing to accept the role without understanding the required investment of time and talent, or the potential liability for their omissions or mistakes.

A trustee has a fiduciary duty to the beneficiaries and must be able to make investment and distribution decisions with complete impartiality – a tall order indeed for a friend or family member serving in the role. Duties and responsibilities are defined in the trust instrument and state law – both are mandatory reading – and include:

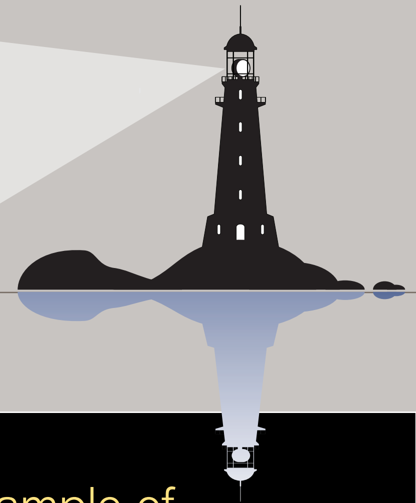
- Determine a prudent investment objective and invest to meet the needs of the beneficiaries consistent with the purposes of the trust.
- Follow specific rules for engaging, compensating and overseeing advisors and managers.
- Prudently manage *all* trust assets. Concentrated positions, interests in family entities, oil properties, ranches and residences always require special attention.
- Safeguard trust assets and do not comingle them with non-trust assets or personal funds.
- Communicate with beneficiaries in ways specified by law.
- Maintain and retain meticulous records and ensure proper tax reporting.
- Zealously protect beneficiaries' privacy.

Despite the complicated nature and risks of the job, it is common for trust documents to prohibit a family member or other individual trustee from receiving compensation. Unfortunately, that does not excuse poor performance or shield the trustee from legal liability for omissions or mistakes.

For a copy of her in-depth paper on trustees' duties, please contact Leslie Kiefer Amann at lamann@sentineltrust.com or 713.630.9614.

CONFLICTS OF INTEREST -

Eliminate or Illuminate?



ANTHONY J. DETOTO
Senior Vice President

What are your most trusted advisors' incentives and motivations?

A senior Senator indignantly accuses a Wall Street juggernaut of placing its interests ahead of its clients. "Your firm's priorities are your shareholders, personnel compensation and corporate coffers. Gone are the days when you can portray yourselves as working on behalf of your clients." Is it political grandstanding? Sure. Are there conflicts of interests that affluent families should ignore only at their own peril? Certainly!

Through the years I have developed numerous helpful questions when thinking about **advice** and **advisors**, including:

- How do I know you have my best interests in mind?
- How do you ensure clients have equal access to opportunities?
- What is your growth strategy?
- What is your ownership structure? Why might you be sold?
- Who pays you? How has that changed over time?
- How can I evaluate your performance?

You probably can't eliminate all potential conflicts, but you should try to identify and understand them. I believe that these questions, when augmented by "tell me a bit more about…," will fill in a lot of the blanks.

Anthony recently participated on a panel addressing 50 wealthy families. He was invited because he worries about advisors' conflicts and in part because he spent his formative years on the dreaded "sell side" – working for a firm with product, investment banking and proprietary trading. For more information, contact Anthony DeToto at adetoto@sentineltrust.com or 713.559.9578

A Sample of Undisclosed Conflicts

Behind-the-scenes relationships, like trade execution and back-office management – may bias manager selection

Creating products that are sellable, but not necessarily what are best for the customer – maximizes advisor's profits

Promoting cookie cutter solutions – allows advisor to control its costs, thereby maximizing its profits

Advisor's desire to build customer base – could cause inappropriate risk taking with client money to generate outsized returns in the short term

Fear of losing clients – causes previously above-average managers to become "closet indexers"

Promoting advisor's ability to negotiate manager-fee discounts – Creates risk that manager selection may be biased in favor of discounters (rather than performers) in order to justify the advisor's fee

As described in my April strategy piece, *Sentinel Horizons*, I have been bearish on most asset classes. However, within asset classes, there are always areas of opportunity. In this article, I highlight my perspectives on real estate.

REAL ESTATE OPPORTUNITIES

Putting the Pieces Together

BRUCE L. SWANSON, Ph.D.
Chief Investment Officer

I agree with consensus views that, despite poor fundamentals, operating income in all but the office sector will bottom in 2011 – a view consistent with a slow, but steady economic recovery. While the recovery in real estate prices has been fueled by the V-shaped credit recovery, prices will be driven by other factors going forward:

- Real estate loan losses have only just begun – While only 6% of all commercial mortgage-backed securities are delinquent, one-third are with a special servicer or on a watch list, meaning they are default candidates. The distressed real estate debt opportunity still lies ahead.

- The credit market recovery has fueled a narrow real estate rally, which is evidenced by transactions in high quality properties for which debt and capital are readily available. It is a mistake to extrapolate from these transactions to the broader market.

- Loan maturities and defaults usually mean many distressed real estate sellers. Yet, they are hard to find due to regulatory forbearance, near-zero LIBOR interest rates, and atypical maturity extensions. While these factors have reduced loan losses (and vulture return prospects), they have only delayed the inevitable.

- Although the weight of foreclosed inventory will depress residential prices near-term, record housing affordability will drive appreciation. Over the next three years, the recovery in housing prices may be stronger than the commercial real estate recovery.

- U.S. REITs might score highly on strategic factors, but they score poorly on what counts: absolute and relative value. They are overvalued in their own right and relative to other real estate sectors. Avoid domestic REITs and seek private and/or international alternatives.

- The second-quarter turmoil corrected the worst excesses in the currency and international public real estate markets, particularly in Australia, China and Europe. While few bargains exist, there are greatly enhanced risk/reward prospects for non-US public real estate.

Accordingly, our list of favored strategies includes:
1. Private real estate strategies involving controlling debt positions that can convert to ownership
2. Private senior mortgage loans
3. Leveraged acquisitions in "hard-Euro" countries
4. U.S. distressed residential mortgage opportunities
5. REIT preferred shares and non-US real estate securities for investors restricted to the public markets.

Discriminating real estate investors can find a range of attractive strategies both in the U.S. and overseas, as dollar strength and capital market turmoil, particularly in Europe, introduce new complexity and opportunity.

To learn more about these excerpts from Dr. Swanson's speech to the Private Wealth Management Summit in June, 2010, contact Anthony DeToto at adetoto@sentineltrust.com or 713.559.9578.

Sentinel Trust Company provides custom integrated planning, investment, fiduciary and administrative solutions to affluent families and their closely held businesses and entities.

Founded in 1997 as the successor to two 40-year old, investment-focused family offices, today Sentinel offers the stability of an institutional firm, the entrepreneurial spirit of a young firm, the personal feel of a family office and the in-house technical skills of independent planning and investment management firms. **For further information**, please contact Anthony DeToto, Senior Vice President, at adetoto@sentineltrust.com or 713.559.9578.

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