When It's Time to Transfer Financial Decision-Making

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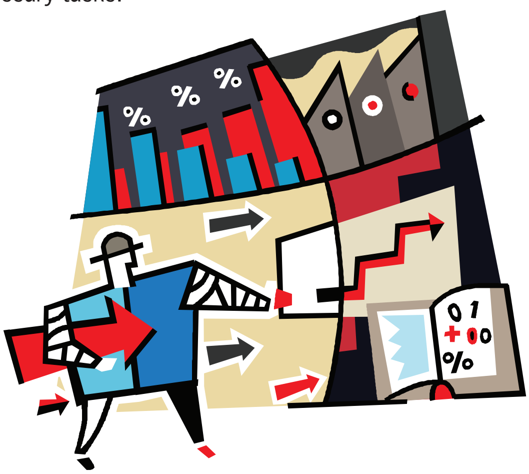
Article Highlights

- A lack of planning for transferring control over financial decision-making can undermine a person's portfolio and result in a loss of financial security.
- The best way to start the process is to gather and organize all important information and documents—doing so will help identify gaps.
- Family members and friends can be asked to take on the role of agent or trustee; a professional, however, will have more expertise and more time to handle the necessary tasks.



"Failing to plan is planning to fail." Alan Lakein

For individual investors who pay close attention to their financial affairs, planning for a time when they can no longer make sound decisions may seem like a remote possibility and an unnecessary step. However, these same investors may have the most to lose if they fail to properly plan for this possibility. As time marches on, illness can result in the inability to make important financial decisions, cognitive impairment can mean loss of sound judgment and a sudden stroke could mean a complete loss of capacity to make decisions. Thinking about the possibilities that aging can bring should make it clear that a lack of planning can result in catastrophic consequences including:

- Undermining years of careful work building a portfolio;
- A loss of financial security for the older person, spouse, or loved ones; and
- Loss of control over who makes decisions.

To get a sense of the loss of control that could occur, consider the case of someone who loses capacity to make decisions due to a stroke. If there has been no prior planning, there must be a formal judicial proceeding in which the court—and not the individual—chooses a guardian to make financial decisions. Besides losing control, the court process can be long, expensive and can delay critical financial decisions. A good resource for these issues is "How to Avoid Guardianship for Your Clients and Yourself!" by Lawrence Frolik on SSRN.com.

On the other hand, proper planning can ensure financial security, improve family harmony and simplify matters for future decision makers. To plan for the transfer of decision-making over financial affairs, the following steps are necessary:

- Get organized,
- Identify objectives,
- Consider options,
- Choose representatives, and
- Build a plan.

While this article focuses on transferring financial decision-making authority, the planning process should also include establishing an estate plan, creating health care directives and powers of attorney for health care decisions, planning for long-term care and stating desires for final disposition. A good resource on these broader topics is "Planning Ahead, Who Will Make Decisions For You?" from the Minnesota Board on Aging (www.mnaging.org/en/Advisor/Brochures.aspx).

Getting Organized

Organizing current records and documents is the best way to begin the process. It will help identify gaps, make it easier when others are included in the planning process and, most importantly, will provide critical details to family and professionals in the event that an individual cannot communicate this information. Consider putting together a folder or notebook that includes the following:

- ***Personal information:*** Include place of birth, addresses of all real estate and key numbers including Social Security, Medicare and driver's license.
- ***Important contacts:*** Contact information for all immediate family members and others involved in decision-making, including powers of attorney, trustees, executor, attorneys, financial advisers, accountants and insurance agents.
- ***Financial records:*** A recent statement from all investment, retirement and bank accounts, along with records of beneficiary designations (and contact information). Also copies of insurance policies, records of recurring bills and a copy of the latest tax return.
- ***Medical Information:*** Copies of health care directives and health care powers of attorney, insurance information, health issues and medications.
- ***Legal documents:*** Copies (and location of originals) of the will and trusts, as well as powers of attorney and beneficiary designations.
- ***Important papers:*** A copy (and location of originals) of birth certificate, military service records, deeds, insurance policies, stock certificates, a spouse's death certificate, marriage certificates, Social Security cards, automobile titles and divorce decrees.
- ***Log-In Information:*** User names and passwords for all online banking and other digital assets, such as personal websites, Facebook accounts, etc.

Identifying Objectives

Determining the appropriate course of action will depend on the individual's unique circumstances. Specific considerations include:

- The size and composition of the estate;
- Financial, retirement and estate planning objectives;
- Desire to retain personal control for as long as possible, or willingness to delegate some responsibilities earlier to gain a level of comfort;
- Whether to provide agents or trustees a great deal of decision-making flexibility or a fairly rigid or limited structure;
- Whether decision-making capacity is already compromised;
- Whether family members or others can step into the decision-making role; and
- Concern for costs for professional advice.

Considering Options

There are a number of potential arrangements when getting others involved in financial affairs. A person who still has the capacity to make financial decisions may want help due to health concerns, extensive travel or a variety of other reasons. For example, paying bills can be transferred to a daily money manager, an accountant can be hired to prepare tax returns and a financial adviser can be brought in to help make investment decisions.

Some individuals may also ask family members or friends to become involved on an informal basis to help by performing some of these tasks or attending meetings with professionals. These informal relationships can work, but they certainly are not substitutes for formal arrangements for transferring control—which are only available for an individual who still has the capacity to make decisions.

Getting informal help from family and friends has the advantage of preparing the person for a more formal role later and allows the successor to learn about assets, unique issues and objectives. For the experienced investor, it may also be an opportunity to create a mentor relationship. The disadvantages of involving family on an informal basis include:

- Lack of skill or time to handle the responsibilities,
- Disagreements with other family members who are not involved, and
- Lack of the legal accountability that would exist with an agent or trustee role.

When considering the options for formal arrangements, the primary tools are powers of attorney and trusts. However, another option is a joint account. This can be appropriate especially with a spouse; however, this alternative gives full control of the account's assets to the joint owner and means that after death the joint owner inherits the account.

Powers of Attorney

With a power of attorney for asset management, the "principal" delegates certain authorities to an agent. To employ this tool, the principal must have the mental capacity to enter into the agreement. If capacity is in question, it is important to document an individual's competency when the document is signed.

The most common form is the durable power of attorney, which grants an agent broad powers with respect to asset management and decision-making. The power will generally continue until revoked, terminated or at the principal's death. The durable power of attorney should specifically state that it will survive the principal's loss of capacity.

The durable power is effective when it is first established. Another option is a springing power of attorney, which becomes effective at the time the principal loses capacity. At first blush this may seem like a better option, but it is quite difficult to draft the conditions in which the power becomes effective as well as verify whether the conditions have indeed occurred.

One of the limits of the power of attorney is that the courts typically construe these documents narrowly, due to modern protective statutes designed to prevent financial elder abuse. One way to ensure effectiveness is to have the agent use the power with financial institutions involved to see if they have any issues honoring it. Another is to draft the document to be very specific, especially for decisions around special issues that may come up and that involve such powers as:

- Making Medicaid spend-downs;

- Making gifts;
- Funding, defunding, creating or revoking living trusts;
- Making elections for tax or retirement plan purposes; and
- Dealing with insurance contracts.

A key consideration is who should be named the agent, as agents are granted broad powers. Be sure that the individual has both the requisite skill and available time to handle the responsibility. There are a number of ways to provide safeguards, including:

- Choosing two agents who must act jointly to sign checks and take other actions,
- Choosing a successor agent in case the individual is no longer able to continue the responsibility, and
- Requiring the agent to provide a regular accounting to the principal as well as an independent accountant or attorney.

Revocable Living Trust

The durable power of attorney alone is sometimes not sufficient for transferring control, as actions of the agent may be construed strictly and narrowly by the courts and financial institutions may be reluctant to deal with the agent (both problematic if the principal is incapacitated). An alternative is to have both a durable power of attorney and a revocable living trust. Both the trust and the durable power of attorney can be relatively inexpensive arrangements to set up and administer.

A trust is a much more flexible vehicle with respect to investing assets and making necessary distributions (including distributions to other trust beneficiaries). When structuring the living revocable trust, the trust identifies the grantor's instructions for the property held in trust. Typically, at the time the trust is established, most or all personal and financial assets are retitled to be held in trust. Waiting to fund the trust can be problematic if the grantor becomes incapacitated. A way to address this concern is to give the agent with power of attorney the ability to fund the trust or withdraw assets from the trust as necessary. It may even be appropriate to empower the agent to change the terms of the trust or revoke the trust if necessary.

With a revocable living trust, it is common for the grantor to be the trustee initially; family members or professionals can be identified as contingent trustees. The grantor can simply step down and appoint a contingent trustee or transfer control at incompetency. The trust should require an independent determination (by two named physicians) of incompetency.

Choosing Representatives

Many people choose family and trusted friends to take on the role of agent or trustee. There are serious concerns, however, that these individuals may not have the available time or requisite skill to properly fulfill these roles. The following provides a list of financial professionals that can be helpful and describes some of the roles they can play.

Financial Advisers

For those who have always made investment decisions on their own, it may make sense to consider working with a financial adviser who can begin to take on some responsibilities for financial matters, provide advice as well as get to know the individual's unique issues and preferences.

When it comes time to transfer control, the new decision-maker may like the option of continuing to work with the same adviser who is now familiar with the family and the issues. Working with an adviser is also an important consideration for a couple when one individual is interested in investing, but the other is not.

Look for financial advisers who can help with transition planning, have a comprehensive view of financial planning and who have well-regarded professional designations such as certified financial professional (CFP), chartered financial consultant (ChFC) and retirement income certified professional (RICP).

Daily Money Managers

Daily money managers provide

Resources to Aid in Planning

Littell and Johnson recommend the following as aids in planning for the transfer of financial decision-making.

American Association of Daily Money Managers (AADMM)
www.aadmm.com

National Academy of Elder Law Attorneys (NAELA)
www.naela.org/Public

"How to Avoid Guardianship for Your Clients and Yourself!" by Lawrence Frolik
SSRN.com

For discussion that includes broader issues that should be planned for as you age:

"Planning Ahead, Who Will Make Decisions For You?"
Minnesota Board on Aging
www.mnaging.org/en/Advisor/Brochures.aspx

To find financial advisers with the CFP, ChFC or RICP certifications:

Designation Check
www.designationcheck.com

Go to the online version of this article at www.aaii.com/journal for direct links to these resources.

personal business services such as bill-paying, organizing financial and medical insurance records, and setting up paper and digital record-keeping systems. They do not take control of investment decisions, but offer important time-consuming support for routine daily tasks. They can be hired by the individual, an agent or trustee to handle daily financial management. Daily money managers can also help build a budget and address debt management, which can also have a positive impact on retirement security. The American Association of Daily Money Managers (www.aadmm.com) can provide more information on this discipline and help locate a professional.

Corporate Trustees

Another alternative is to work with a corporate trustee from a bank trust department or an independent trust company. Trust officers are experienced in handling such matters and will have an understanding of their impartial role, trust investments, tax considerations, trust accounting, budgeting and managing tax flow.

Corporate trustees can take on different roles:

- Sole trustee handling both trust administration and acting as investment manager,
- Co-trustee providing similar services, but working in cooperation with an individual (who may be the creator of the trust or a trusted representative),
- Financial adviser to an individual trustee providing investment services, or
- Successor trustee when an individual can no longer act as trustee, in which case certain trust services may be available.

Working with a corporate trustee adds expense, but a professional will minimize problems that could arise when individuals are chosen who do not have the professional expertise to fill the role or may not have the individual's best interest at heart.

Building a Plan

After gathering existing documents, exploring objectives, and considering alternatives, it is time to build a plan.

When looking for professionals who can help with planning, lawyers are required to draft powers of attorney and trusts. Elder care attorneys (www.naela.org/Public) have specialized training and are well qualified to assist with planning and executing documents. Attorneys who focus on estate planning are generally qualified for these tasks as well. Financial advisers who do comprehensive financial planning or retirement income planning are prepared to discuss these topics, help in the planning and offer resources for implementing the plan.

Here are some final thoughts to consider:

- Besides getting organized with documents, consider involving trusted family members in discussions of financial issues.
- Consider involving professionals in the process. Many choose family members for these roles in part to reduce costs, but poor decisions and bad feelings within the family can add costs in the long run;
- Use powers of attorney and trusts to avoid forcing a court to choose an alternate decision-maker, except in the rare circumstance that a court is viewed as the best option to look out for the interests of the incapacitated person; and
- Identify a suggested guardian in the will for the court to consider.

Conclusion

As the population ages, the incidence of cognitive impairment has increased dramatically. The absence of preparation of a contingency plan should one become cognitively impaired has dire consequences and can undo decades of careful financial planning, saving and investing.

According to the Alzheimer's Association, one in three seniors dies with Alzheimer's disease or another form of dementia.

Planning for the potential of transferring financial decision-making authority to someone else as one ages is an essential aspect of a complete financial plan. ➤

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