



Regions Wealth Podcast

Episode 10: Sudden Wealth: What to Know

Sudden wealth often comes with strings attached. We already know that a high percentage of lottery winners fall prey to sudden wealth syndrome and have a difficult time knowing what to do with a windfall. However, those who achieve sudden wealth through inheritance may have just as much difficulty knowing how to manage a windfall successfully. In this episode, Chief Investment Officer Alan McKnight joins us to discuss strategies for how to manage a lump sum of money.

Episode Transcript

Anne Johnsos:

Welcome to Regions Wealth Podcast, the podcast that tackles life's challenges with financial experience. I'm your host, Anne Johnsos. Baby boomers are set to pass on to their children a mind-boggling \$68 trillion. That's the biggest generational wealth transfer ever. Most windfalls of cash come with strings attached. Sometimes they're obvious like tax payments. Other times, they're not. What do you need to look for, and how can you protect yourself? Joining me in studio is Alan McKnight. He's the chief investment officer at Regions Bank. Alan, thanks for being here.

Alan McKnight, Chief Investment Officer, Regions Wealth Podcast

Thanks for having me today.

Anne:

In this episode, we're talking about new money—what to know. We've taken frequently asked questions from a bunch of people and developed a character who needs your help. Let's listen.

Gwen:

Hi! I'm Gwen. I'm 44, married, and a mom of three kids: Brooklyn, who's 4, Jana, who's 9, and Brixton, who's 12. It feels completely surreal to say this, but a few months ago, my husband Dave and I inherited a lot of money. Just over a million. We were gobsmacked. The money was left to us by his uncle Jim, who just passed away in April. Jim was always good to our family, but we live out of state from the rest of the family, so we didn't get to see him as often as we'd like. Jim never got married or had kids. When he died, we figured the estate might be split across the family and we'd get something small. But to get that much money was just... unexpected, to say the least. Jim did well for himself, but no one had any idea he was doing that well. So now... I guess we're millionaires. I mean, this is a good problem, right? It's just that we have no plan, or even a frame of reference for how to make a plan, to use this money wisely. Don't get me wrong — Dave and I are good with money. We're quite comfortable, but



we're conservative with our spending. We're not going to run out and buy a speed boat or something... although I bet Dave would love that.

Anne:

Alright let's go straight to your reaction. They just got a million dollars, making them millionaires. What do you say to Gwen?

Alan:

First and foremost, it's a wonderful problem to have, but it can create a level of stress without the preparation that is needed. And understanding really what does this amount mean, how much can we actually utilize — to the preface — what are the tax implications? How do we understand our spending patterns with this? And just an understanding of what it may mean for the benefits to the family.

Anne:

So along those lines, what's the number one mistake made among those who suddenly come into a large sum of money?

Alan:

We think of it as twofold, and the first one is one that doesn't sound like it's going to be an issue for Gwen and her family, which is going out and spending all the money without a plan and without an appreciation for taxes. It's the, "I want to go buy that boat. I want to buy the house. I'm going to use all this money, and it's free money. It's just money that literally is a windfall. So it really doesn't matter how I spend it" without an appreciation for what that may mean, and the benefits that it can accrue to your family. Second, it's the, "what can we leverage?" As a segue from that, of "what can we do now? What are the opportunities that we now have for our family, whether that be for the goal of education saving, retirement saving, health saving for later on?" Those are all these opportunities, and there are tradeoffs associated. So don't do the first, and spend a lot of time on the second.

Anne:

So no boats, no big houses, but lots of planning?

Alan:

Lots of planning, lots of assessment around, "What do we have today?" They note that they have a comfortable life. They are not big spenders. But what would this allow them to do? What would this allow them to achieve later in life that they may not have considered early on? But without that plan, you can almost be handcuffed with the stress of doing something wrong. And that's the emotional/psychological element to all of this, which is, "if I do nothing, it's better" rather than taking that first step in preparation and planning around what they can achieve with this money.



Anne:

So that first step sounds like it should be getting a financial planner.

Alan:

The first thing they should do is reach out to their tax advisor and understand what the tax ramifications will be for this new money, understand what the implications may be for them, and understand what if any changes it may be to their tax bill going forward.

From there, they can then go with a financial planner—their advisor they may already have on staff. And they very easily may have a plan in place today, but this is just augmenting that. Maybe that pulls forward retirement. Maybe that means that we can do more for our children than we had originally planned. Maybe that means that we can do some other things with the family and have other opportunities, travel or otherwise. But without that plan in place, many clients find that they just don't do anything, and they just hope that somehow things work out.

Anne:

What about estate planning?

Alan:

Estate planning is a critical component to that. So if you think about the three legs to the stool — if you have an accounting plan and what they may mean with a CPA; if you have a legal plan, estate planning, trust planning, and what that may entail; and then financially, what does that look like? What does your investment advisor think? And how do you bring those all together to come up with that cohesive plan? Because in many cases, if that estate plan was based upon your prior financial situation, it doesn't capture this new money and what that may mean, and really where you want to direct those assets. And now maybe legacy is a part of that and a component that before wasn't feasible.

Anne:

Yeah, it sounds like now would be a great time to revisit that plan and make some updates. Okay, let's hear more from Gwen.

Gwen:

Right now, the money's just sitting in our savings account. We know we're going to have to set aside money for taxes. I have no idea how much that will be, though. I guess we have nine months to worry about that. We'd also like to use a little bit to pay off some debt, maybe get a jump on paying down some of our mortgage. But the rest we'd like to keep in savings. This is clearly a once-in-a-lifetime opportunity though, so I want to be sure we're playing it safe here. We're hoping to keep the money set aside for the kids' college and our retirement. Dave's younger brother, John, also inherited the same amount. Almost immediately, he went out and bought a new home. Spent it all on a house with five bedrooms, six bathrooms, and an



inground pool. He'd previously been renting. Now he's in a panic, calling Dave up, talking about how he's worried about next year's taxes, not to mention the property taxes on his new McMansion. I think he got so caught up in the excitement that he didn't really think. There's so much to think about here. This is just all so unexpected, and we feel like we've been caught a little flat-footed here by the opportunity. You know, we want to be cautious and avoid making mistakes, but I'm wondering if we're being too cautious by leaving the money in our savings account.

Anne:

Well, Gwen brought up taxes, so clearly that's something that she knows she has to think about. And they're playing it safe by keeping the money in their savings account. But are they playing it too safe? What can they do differently to make the most of their windfall?

Alan:

It requires them to think about what the opportunity set may be. So savings may be the best alternative, depending on how much liquidity they have there, what the penalties would be if they were to extract it early, and what rates of return they can generate from it. So they should look across the landscape to say, "Where can we put the money? Where can we generate a reasonable return without having to take on any undue risk?" But at the same time, not forego return at all just to keep it ring-fenced and off on the side. I think there are multiple ways they can do that via a savings account, a Money Market account, treasury bonds and bills—things that they know they will be able to utilize when they need it. But it really is understanding what those opportunities are, and which one they may want to choose depending on their current situation and what's available to them.

Anne:

Windfall aside, is it common for people to miss out on the opportunity to maximize their funds because they're concerned about risk?

Alan:

It is. In many cases, people don't do anything, because it feels better. And the behavioral economics side of it is one that if I do nothing, it's better than taking action, even if I don't have a real plan around why I'm not doing anything at all. Because that is a choice. In many cases, clients that we meet with don't have a real appreciation for what the opportunity set may be, and how they may be able to migrate between savings account, Money Market account, investment account; may be able to generate a higher level of return. And then conversely, what is their cost of debt and what other expenses may they have that would match off to that?

Anne:

Gwen mentions using some of the money to pay down part of her mortgage and investing the majority. Is that a smart move, or would it be better to pay off all of her debt?



Alan:

It really depends on the rates, and the rate that they have for the current mortgage, and what they're able to generate from an investment portfolio or from a savings account, a Money Market account. Every client is different in that regard, depending on their credit, their history, what they were able to utilize there. So they need to sit down and look at the differential between those to say, "Is it worth paying down this debt?" Or, if we have a really low cost of debt, the ability to invest and to make the additional amount off of that investment portfolio. But that's where sitting down in a specific basis is critical, because there are so many variations of those. But doing that work—because you may assume one versus the other solely based on history and rates and returns change all the time. And it could look very different today than it did even six weeks ago.

Anne:

I know it varies state by state and federally and according to income bracket, but how much should Gwen and her husband anticipate saving for taxes?

Alan:

Well, The Beatles said, "One for you and 19 for me, because I'm the tax man," but it really does differ on a state-by-state basis and a scenario-by-scenario basis. That's why it's so important that you actually meet with an advisor, a tax advisor, and your financial advisor, because your very specific scenario could differ. And don't assume anything, because many cases you'll get these wonderful sets of advice from friends, from family, of "this is what I'm doing. That's what you need to do." Go talk to a professional. Because in many cases, you can put yourself in a really bad state following their advice and assuming they have the same income you have, have the same ownership of different assets that they have, or even what their specific state requirements are.

Anne:

So, I feel like we're finding all these red flags for poor Gwen. She mentions they have nine months before taxes are due. Should she keep the tax funds in her savings account in the interim, or could she do something to earn a bit of interest during this time? Or should she put it aside? What would you tell Gwen?

Alan:

The great thing is, she has multiple options. First and foremost, she needs to set it aside, but setting it aside or ring-fencing it can mean just in an account where you know that you're not going to actually utilize it, and you have that exact amount available. So it doesn't have to be something where you open a new account to do it; it may mean that it's just within an account, but you've actually conceptually ring-fenced it to understand, "I can't ever draw down more than this amount." Two, you need to examine what the options are with regard to interest. So there may be a savings account. There may be a CD. There may be an investment



account, a Money Market account. There are literally a litany of different options in terms of investments. The key component is liquidity and availability of funds so when she needs it, and they need it as a couple, that they have them available without any risk associated with that. But the continuum of what they may be able and willing to do based on what they already have is the core of it all.

Anne:

So, ideally you find a place where it could grow, but could never be diminished.

Alan:

That's right. And understand, what does that look like? And so you will forego some return for the lack of diminishment, but you don't then wake up one day and realize, "Gosh, I had set aside X amount. I only have Y now. I'm going to have to come up with that funding from someplace else." So there are options, and you can definitely generate some return. It's just a matter of what's available based on what you have. And two, psychological. There are some folks who would say, "That additional bit more is OK as long as I generate X return." Others would say, "I just don't even want to think about it. I just want to put it aside, and it will be here next year, and that's great."

Anne:

I understand both points of view. Um, I think this is important: Gwen says she and her husband are planning to use the money for her kids' college and for their own retirement. How should she decide what to put where, and how to allocate the money?

Alan:

It comes down to goal planning, and that's the foundation for really any good retirement or educational planning investing program. They should understand, what's the priority? For some couples, it's education first, and they would say, "We really want to ensure that our children have an education. We are going to fund it." And that's above and beyond their retirement. That really is the core component of their investment plan. Others would say, "We really want the retirement first. That's our first priority. We need to make sure we have that funded first, and then any additional assets we have could cover the goal of paying for our children's education." The only way you find that out is by sitting down and working through the assets you have available, what your plan is, what goals you have, and both members of the couple, both partners agreeing to that. And that agreement is really critical to say, "We both hold this as number one, and so therefore we're going to put this much into number one, and this amount in number two." Those percentages are never the same. There's not one model to say you have to put in 70% for retirement and 30% for education, or conversely 30 and 70. That's not the way it really works. It has to be custom to understand and appreciate what your specific needs are as a couple and what you want to achieve. And over time, it can change. And that's why a financial plan, a goals plan, and a goals framework evolves.



Anne:

And I want to point out that there are two sides to where you allocate, right? So you might think, well, if you don't pay for your kids' education, you're robbing them of something. But meanwhile, if you don't fund your retirement, who's going to pick up the bill when you need it? And that's going to fall on the kids. Right?

Alan:

That's exactly right. And life expectancies are just growing, and the costs associated with the late stage of retirement are even higher in life expectancy. So planning for that is critical. Life expectancies are in their 80s, depending on how old you are today. So the life expectancy tables differ if you're 75 versus if you're 25, and that's a critical ingredient to planning, which is how old are you? Or as a couple, what are the ages of that couple? And then what is your specific life expectancy and how long will you need these assets to be able to cover it? And if you don't have that, and you don't have a plan around that, again the likelihood of success is very low.

Anne:

At the end of these episodes, we like to talk about takeaways—something maybe an audience member would share with a friend. So if you could offer a takeaway to Gwen and Dave, even the brother-in-law John, what would it be?

Alan:

One would be appreciate what you've received. And it really is a blessing, and there's so many opportunities associated with it. So don't look past that, because it may be a bit stressful right now. But that's a great stress, and it's an opportunity to then look to the future. Number two is do the work right now for the immediacy of things such as taxes or additional expenses associated with receiving this money. Understand the explicit details of that over the next year or two years—whatever it may mean. And that can differ depending on the client. And then the final one is, set the plan around it. Now you've experienced it, appreciated it. Two, you've ensured and ring-fenced the money that you need, so there's not a surprise in the next couple of years. And then finally, look long term. What can this do for us? What are the opportunities that we have? Is it for our retirement? Is it for our children's education? Is it for a legacy at an institution or a philanthropy that means something to us? There are a host of different options for that, but without a plan in place and without that dialogue and what type of investments you utilize to get there, again it's a lost opportunity.

Anne:

And there's nothing wrong with dreaming a little, right?

Alan:

No. That is part of all if this is what can we now do that you couldn't do before? And that's an incredible place to be.



Anne:

Thank you so much, Alan McKnight, chief investment officer at Regions Bank. We have learned a lot. Thanks for joining us.

Alan:

Thanks for having me today.

Anne:

And thank you for joining us. Each episode we take on a new financial challenge with the help of a Regions advisor. Join us next time for more insight on Regions Wealth Podcast.

Anne:

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