**OUR RETURN TO WHAT REALLY MATTERS**
**IN ESTATE PLANNING**

. . . and the end of our exploring will be to arrive where we started
and know the place for the first time
-- T. S. Eliot

Christopher P. Cline
Riverview Trust Company
900 Washington Street, Suite 900
Vancouver, WA 98660
chriscline@riverviewbank.com
(360) 759-2478

Estate planning just seems to keep getting more complicated, even as more and more laws are passed that purport to make things simpler. Income versus estate taxes, state versus federal transfer taxes, decanting (and what can you use it for, anyway?), shelter trusts vs. portability. Just at the point when fewer people than ever are subject to the federal transfer tax system, the income tax rate goes up, causing a new set of challenges.

This presentation is an attempt to go back to first principles; to explore what clients really worry about, and the ways that we can reexamine those worries. It will start by looking at the factors that make people happy (and those that don't). It explores the growing science of behavioral economics to see what lessons estate planners can learn. Next, it looks at what may be the most important aspect of estate planning: control (and the consequences for the lack thereof). We then discuss the impact to our practice of these psychological issues, and how we can adjust our approach to take those issues into account. The paper then applies these ideas in three different areas: planning generally, trust drafting and family philanthropy.

The hope is that this paper will help us re-explore the issues that always matter, but to view them in a new way. By doing so, we can pursue even better relationship with our clients, and help them make sense of this new financial landscape.

## A. In Search of Happiness.

Our concern here is with the motivations of clients doing their estate plans. By identifying the motivation, we can hopefully improve the drafting of the plan itself, as well as the communication between the client, her beneficiaries and her advisors. Most clients at least say that they want their beneficiaries to be happy. After all, no one creates a trust and funds it with a significant amount of assets to ensure that a beneficiary is <u>un</u>happy (though to hear some beneficiaries talk, that is the case!). However, the grantor has decided that, for whatever reason, the beneficiary will ultimately be happier if she does not have unrestricted access to a large amount of assets, at least in short run.

But what does it mean for a beneficiary to be happy? In the past few years, a new "science of happiness" has developed, one that seeks to define happiness and the way to recreate it. Perhaps turning to those new resources may help solve the problem.

### 1. The Science of Happiness

Several books have come out in the last twenty years about happiness: what it is, how it can be pursued and nourished, what factors create roadblocks to it.[1] A glance through some of these books may help to answer the question how a trustor may be able to make a beneficiary happy.

#### a. We Can't Adequately Predict What Will Make Us Happy

To begin with, our perception of what we need to be happy dictates how we behave, how we pursue our goals. However, it turns out that we're really bad at forecasting those needs. In fact, it is this inability of people to accurately forecast their future feelings, and therefore their unrealistic expectations of what will make them happy, that is the subject of a book all by itself.

People make many mistakes in trying to predict the future. First, they think they have far more control over future events. Indeed, "the one group of people who seem generally immune to this illusion are the clinically depressed, who tend to estimate accurately the degree to which they can control events in most situations."[2]

Second, people's memories tend to be faulty, and that same shortcoming that "causes us to misremember the past and misperceive the present is the very same shortcoming that causes us to mismanage the future."[3] For instance, information acquired after an event alters the memory of the event itself. Our brains, after having experienced something, will fill in "facts" that didn't actually exist, with the result that we build a past that never happened. As a result, each of us "is a counterfeiter who prints phony dollar bills and then happily accepts them for payment, unaware that he is both the perpetrator and victim of a well-orchestrated fraud."[4]

Further, we don't pay attention to things that don't exist; the absence of negative consequences, for example. As a result, we "tend to treat the details of future events that we *don't* imagine as though they were *not* going to happen."[5] In other words, we fail to take into account both how much imagination fills in and how much it leaves out. So, for

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[1] *See, e.g.*, Layard, *Happiness: Lessons from a New Science* (2005), and Gilbert, *Stumbling on Happiness* (2006). *See also* those books listed *infra* at note 34.
[2] Gilbert, *id.*, at 22. *See also* Myers, *infra* note 34, at 26 – 30.
[3] Gilbert, *id.* at 78.
[4] *Id.* at 89.
[5] *Id.* at 101.

example, if a person is asked to imagine what would happen in the two years after a child died, the only answer he or she tends to give is negative (thinking about how terrible he or she would feel) without thinking about the good things that might happen during that period.[6] Put another way, many people who don't live in California imagine that they'd be happier if they did. Yet Californians aren't any happier than anyone else. This is due to the fact that people who live elsewhere imagine California with so few details.

We also suffer from a lack of true imagination: "most of us have a tough time imagining a tomorrow that is terribly different from today, and we find it particularly difficult to imagine that we will ever think, want, or feel differently than we do now."[7] Instead, we tend not to start with a blank piece of paper and list the pros and cons of future events; rather, we simulate them in our imaginations, "pre-feeling" them, and then note our emotional reactions.[8] As a result of all these responses, we "mistakenly conclude that we will feel tomorrow as we feel today."[9] In short, we fail to recognize that our future selves won't see the world the way we see it now.[10] If anyone needs proof of this statement, he or she should simply try to imagine how the future looked in 2007 as opposed to now.

As if that weren't enough, we are overly selective about what we tend to use as facts to support our conclusions. We control the sample of information to which we choose to be exposed, and therefore indirectly control the conclusions we reach. In fact,

> "We pay more attention to favorable information, we surround ourselves with those who provide it, and we accept it uncritically. These tendencies make it easy for us to explain unpleasant experiences in ways that exonerate us and make us feel better. The price we pay for our irrepressible explanatory urge is that we often spoil our most pleasant experiences by making good sense of them."[11]

By extension, prospections and retrospections can be made to agree, despite the fact that neither accurately describes our actual experience. In other words, the theories that lead us to predict that something will make us happy also lead us to remember that it did, eliminating any evidence of their own inaccuracy.[12] The conclusion to all this is that memory is "less like a collection of photographs than it is like a collection of impressionist paintings rendered by an artist who takes considerable license with his subject."[13]

In addition, we treasure our own uniqueness, often to our detriment. Most people see themselves as different, with the result that the average person doesn't see himself or herself as average. Most students see themselves as more intelligent that other students,

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[6] *Id.* at 101-02.
[7] *Id.* at 114.
[8] *Id.* at 120.
[9] *Id.* at 125.
[10] *Id.* at 147.
[11] *Id.* at 191.
[12] *Id.* at 210.
[13] *Id.*

business managers as more effective than average managers, and so on. And this tendency isn't limited to positive experiences: most people claim to be more generous that the average person, but also more selfish. We don't see ourselves necessarily as superior, but always as *unique*.[14] As a result, we can fail to look to the experiences of others as adequate indicators of what our own future experiences will be. Put another way, the information we need to make predictions about our future happiness "is right under our noses, but we don't seem to recognize its aroma," with the result that "we often reject the lessons that the emotional experience of others has to teach us."[15]

### b. Money Can Kind of Make Us Happy

Knowing our shortcomings, are there any indicators in the experience of others that might be helpful? To begin with, money alone does not always equal happiness. When looking at standards of living, incremental increases in income once a person is safely above the poverty do not result in incremental increases in happiness.[16] Indeed, Americans who earn $5 million are not much happier than those who earn $100,000.[17] Nevertheless, although we don't get happier with more money, we continue to seek it. According to Adam Smith, most people only want happiness, which means that most economies can grow only if people are deluded into believing that the production of wealth will make them happy.[18] In other words, the production of wealth serves the needs of an economy, not an individual. In fact, the false belief that more money means more happiness is a "super-replicator," because holding that belief causes us to engage in the very activities that perpetuate it.[19]

However, in some cases money can certainly add to happiness. A report in the Proceedings of the National Academy of Sciences[20] posits that people's emotional well-being increases along with their income, up to about $75,000 per year. This report, based on surveys of 450,000 Americans conducted in 2008 and 2009, shows that the increase in happiness levels out at $75,000; however, increases above that (say the increase from $100,000 to $200,000) realizes an improved sense of success, even if they aren't happier day to day.

These "side benefits" to money can be seen in other more subtle ways. One factor is "social comparison:" a majority of people surveyed would rather make $50,000 a year when those around them are making $25,000 on average, than make $100,000 a year when those around them are making an average of $250,000. Happiness as measured by income, in other words, can be more a function of comparison rather than absolute dollars.[21] We also compete with ourselves: a dollar rise in expected income causes a rise of at least forty cents in "required income," which means that, if I get a dollar increase

[14] *Id.* at 229.
[15] *Id.* at 233.
[16] Layard, *supra* fn. 1, at ch. 3. *See also* Gilbert, *id.* at 217-18.
[17] Gilbert, *id.*, at 217.
[18] *Id.* at 219, citing Smith.
[19] *Id.* at 220.
[20] *Cited in* "It's Official: Money Buys Happiness . . . sort of," The Oregonian, p. A-1 (9/7/2010).
[21] Layard, *supra* note 1, at 41-42. *See also* Myers, *infra* note 34, at 56 – 62.

this year, I'm happy, but next year my benchmark is higher.[22] We are on a "treadmill," with the result that we get used to material possessions and subsequently overinvest in acquiring them (a process of "habituation"). In fact, this competition can be seen in a difference between generations: whereas an older generation in 1950 found that one car and three bedrooms in a house was adequate for happiness, those numbers increased to two cars and four bedrooms in 2000.[23]

A recent Wall Street Journal article points out that "[w]hat matters a lot more than a big income is how people spend it."[24] Research indicates that: (a) giving money away makes people more happy than spending it on themselves; and (b) if they DO spend it on themselves, they're happier using it on experiences, like travel, than on acquiring more material goods. This can be counterintuitive; most people think that experiences, like big vacations or attending expensive concerts, are fleeting, while material goods last. Professor Thomas Gilovich points out, however, that we quickly take material goods for granted (after a brief thrill of acquiring them), but that experiences tend to meet more of our underlying psychological needs. This is so because experiences are often shared with others and help form a bigger part of our identity. An important trip is "something you'll always remember and talk about, long after all your favorite gadgets have gone to the landfill." This conclusion emphasized in other research as well.[25]

The studies on philanthropy are particularly telling, because they revealed that people who donated to charity were happier, in poor and rich countries alike. The key seems to be the perceived impact of a person's donation: if the donor sees the donation making a difference in someone's life, it makes the donor happier, even if the gift is small.

Finally, it will come as little surprise that savings are good for happiness, while debt is bad. However, "debt is potentially more bad than savings are good." It's more important to get rid of debt than to save, from a purely happiness perspective. So although money can buy experiences which can lead to happiness, going into debt to have them is not the way to do it.

### c. Other Happiness Factors

If money itself does not create happiness, what does? One author has identified a "Big Seven" of factors (the first five in order of importance): family relationships; financial situation; work; community and friends; health;personal freedom; and personal values.[26] "Work" is important[27] because it gives purpose and helps create a sense of community. Satisfaction increases with higher-status jobs, those that also add to the greatest level of control (discussed in more detail below). It is most effective when

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[22] Layard, i*d.*, at 48-49.
[23] *Id.* at 139.
[24] "Can Money Buy Happiness?" Wall St. J., R-1 (11/10/14).
[25] *See* Achor, *infra* note 31, at 54.
[26] *Id.* at 62-63.
[27] *See, e.g.,* Myers, *infra* note 34, at ch. 7; O'Connor, *infra* note 34, at 208 – 216.

"flow" is achieved; when work challenges are equal to the worker's skills.[28] Marriage and parenting are also important; as everyone knows, broken families are an enormous source of unhappiness.[29] Further, those who are religiously active, or who consider themselves "spiritually committed," have a higher level of happiness (although these studies are primarily based in North America, and so are somewhat localized). It is specifically linked with enhanced joy and strength in time of crisis.[30]

Social relationships are particularly important. According to one study, there is only one characteristic common to the happiest 10 percent among us: the strength of their social relationships. In fact, our need for social support is biological: lack of social contact can add 30 points to an adult's blood pressure reading.[31]

On the other hand, five factors have a relatively low correlation with happiness: age, gender, looks, IQ and education (except to the extent that education results in an increase of income).[32] In addition, there are six factors, closely linked to the Big Seven, that apparently explain 80% of the variation between happiness in different countries: divorce rate; unemployment rate; levels of trust; membership in nonreligious organizations; quality of government and fraction of the population believing in God.

In short, a purely economic analysis fails in truly tracking happiness. It does not take into account the real benefit of the "internal" reward of a job well done, favoring instead elaborate contracts for economic compensation. It does not take into account "loss aversion;" the fact that people hate a loss more than they value an equal gain. Finally, and as we've already discussed, humans behave inconsistently, failing to forecast their future feelings.[33]

#### d. Happiness as Self-Awareness

Several authors have pointed out things we already knew but always forget: that happiness is within our own control, and not the control of outside forces.[34] One author[35] looks more at how individuals can take control of their happiness themselves, so it has less immediate applicability to estate planning. However, the lessons learned can be helpful. First, O'Connor reaffirms that money does not bring happiness (after a person is lifted above the poverty line).[36] In fact, people in Latin American countries, where income levels are much lower but family ties are much stronger and the pace of life much

[28] Myers, *id.*, at 127 – 138.
[29] *Id.* at 156 – 166.
[30] *Id.* at ch. 10.
[31] Achor, *The Happiness Advantage*, 176-77 (2010).
[32] Layard, *supra* note 1, at 62 – 63. *See also* Myers, *infra* note 34, at ch. 4 (discussing the "demography of happiness," and in which he points out that age can be a factor, in that some older people, those that exercise at least, are happier).
[33] Layard, *id.*, at 140-43.
[34] *See, e.g.*, O'Connor, *Happy at Last* (St. Martin's Press 2008); Myers, *The Pursuit of Happiness* (HarperCollins 1992); and Seligman, *Authentic Happiness* (The Free Press 2002).
[35] O'Connor, *id.*
[36] *Id.* at 42.

slower, are "pretty high on personal happiness."[37] Americans, on the other hand, are only in the middle of the happiness pack worldwide, despite having the highest per capita income.

The reason for this poor happiness showing is that Americans live in a culture of stress. Eight out of ten of our most prescribed medications are designed to treat stress. We are overworked, which is unhealthy, and we suffer from "affluenza," the disease that fools us into thinking that more is better. In our consumer culture, feeling good is set forth as the main purpose in life, rather than a by-product of living right.[38] Experimental evidence suggests that the happiest people don't buy into (pardon the pun) this consumerism: There is much experimental evidence to "suggest that the happiest people are those who work part-time, set their own goals, get involved in their communities, and participate in active leisure."[39]

Money is important not as a goal in and of itself, but only for what it can provide, mainly security. It can get you autonomy, security and the ability to enjoy life: "[p]ersonal control – the belief that we're in charge of our lives – is much more closely associated with happiness than money is."[40]

However, our own biology is one of the biggest roadblocks to this realization. Interestingly, pleasure and desire are different things in our brains, and our brains don't really care whether or not we're happy. The neurotransmitter dopamine, which modulates desire, tells us what we want and enables us to work hard to get it, making us believe that we'll be happier if we do, whether or not that's actually the case. Dopamine doesn't make us happy at all; rather, it gets us "activated and craving."[41] Indeed, our brain doesn't want us to be happy for very long, because a satisfied prehistoric human was in danger of being eliminated by natural selection. Our genes train us to be constantly searching for something better "by giving us a shot of pleasure."[42]

In sum, the three huge obstacles to happiness are the culture we've built for ourselves, our own biology and our own minds (which, as Gilbert also confirms, tries to cope with stress in ways that distort reality and can lead to self-destructive behaviors).[43] The solution is to develop a "new pilot," a new perspective based on mindfulness.[44] This is obviously a personal, not a fiduciary, journey. However, the research useD to map out that journey is the same as that used to arrive at the seven factors for happiness, described above.

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[37] *Id.* at 43. *See also* Myers, *supra* note 34, at 34 – 36.
[38] O'Connor, *id.*, at 30 – 41.
[39] *Id.* at 44.
[40] *Id.* at 45.
[41] *Id.* at 54 – 55.
[42] *Id.* at 55 – 56.
[43] *Id.* at 97.
[44] *Id.*

### 2. Age and Happiness.

In addition to this general subject of happiness, there are a couple of age-specific factors that are important for estate planning. The first has to do with the age at which people can change. We all like to think that we are able to "re-make" ourselves at any point in our lives, and perhaps some of us are. However, there is good evidence that if a person has not become the person he or she wants to be by age 40, he or she never will.[45] That is not to say that people don't evolve or improve, only that by age 40, most of the major personality traits are in place and probably won't change.

Several developmental stages impact happiness. First, adulthood is a time to develop autonomy, the most obvious measure of which is economic self-sufficiency. This development is marked by taking responsibility for actions and consequences and developing relationships with parents as adults. Second, individuals need the greatest economic assistance between ages 20 and 40. After 40, as already noted, receiving money does not impact a person's development (that is, they can either handle or they can't, but at that point their development won't be affected either way).

The other age issue that is important for this discussion has to do with "Generation Y," or the "Millenials" (which for purposes of this discussion are defined as those people born between the early 1980's and 2002). This group has some unique issues and personality traits. A Wall Street Journal article from 2006 discusses these issues in the context of business school admissions.[46] This group tends to be very opinionated and expects to be heard; "they also crave feedback and praise for their accomplishments." Further, this group likes structure and wants rules to follow; they "grew up with play dates and other organized activities." Because they've been "[d]oted on since birth," they expect extra attention, and as children of "helicopter parents," they still rely on Mom and Dad for advice and money Some schools are starting to see those parents appearing at college interviews and even with recruiters.

It's important to tread carefully when talking about an entire generation of people, because the risk of simply perpetuating inaccurate clichés is great. However, the article suggests that many in this group have been surrounded by positive feedback, self-esteem building and structure, and some have even been sheltered from failure. However, failure isn't something to be avoided: failure brings with it positive change across a wide range of experiences. After trauma, people report enhanced personal strength and self-confidence.[47] All of which is to say that allowing people to fail is the best way to help them succeed.

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[45] Stephens, *infra* note 68, *citing* Santrock, *Life Span Development* (Brown & Benchmark 1997). *See also* McCue, *infra* note 68, and Tate, *Conditional Love: Incentive Trusts and the Inflexibility Problem*, 41 Real Prop. Prob. & Tr. J., 445 (Fall 2006).

[46] "M.B.A. Track: Schools, Recruiters Try to Define Traits of Future Students," Wall Street J., p. B-6 (2/14/2006).

[47] Achor, *supra* note 31, at 110 -11.

## B. Behavioral Finance

This paper is exploring the effects of happiness and other psychological factors on our clients' and their beneficiaries' perceptions about estate planning, so let's turn now to the area in which psychology is the most evident: behavioral finance.

For the past three decades, investment theory has been based on two principles: (a) people make rational decisions; and (b) People are unbiased in their predictions about the future.[48] Modern portfolio theory and pricing models (like the Capital Asset Pricing Model) are built on these two assumptions, and are designed to provide insight in valuation, expected risk, and expected return.

These assumptions are not only important in determining investment, theory. They also affect estate planning because they form the basis of modern portfolio theory, which in turn is the basis for the Uniform Prudent Investor Act. The notion that people make rational, unbiased decisions in their investing, in other words, has now become law.

However, psychologists have for years questioned the validity of these assumptions. Further, colossal financial failures driven by the very people who created the assumptions (like the bankruptcy of Long Term Capital Management, two of the partners of which were Nobel laureates) demonstrate the shakiness of the theory based on these assumptions.

Instead, financial economists have now established that investors are often irrational. The field of behavioral finance, once thought to be a marginal area of study, now has its own Nobel laureates. Behavioral finance is the study of how emotions and cognitive biases affect financial decisions. This section will outline the nature of some of those biases and the impact they have on investors. Understanding these biases is important not just for providing investment advice, but also for understanding why clients make the estate planning decisions they do.

### 1. Thinking Fast, Thinking Slow.

As an initial matter, and as the prior discussion has shown, we aren't always rational creatures. We all like to think that, if we just use our heads, there are few problems we can't solve. However, research in the last ten years has shown that this may not be the case. In his recent book,[49] Nobel prize-winning economist Daniel Kahneman explains that our thought processes often can lead us astray.

The central problem, according to Kahneman, is that humans have two ways of thinking: what he dubs System 1 (our fast, intuitive and emotional sides), and System 2 (our analytical sides).[50] System 1 thinking occurs automatically and involuntarily: we see certain facial expressions and we know a person is angry; we see 2+2 and we know

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[48] Nofsinger, *The Psychology of Investing*, 4th Ed. (2011).
[49] Kahneman, *Thinking, Fast and Slow* (2011).
[50] *Id*. at 20 - 21.

the answer is 4 (even if we try not to do math!); we see the letters "C-A-T" and we can't not read the word. System 2, on the other hand, is the way of thinking that allows us to determine the answer to 17 x 24. The first system requires no effort; it happens whether we want it to or not. This system, which helped our primitive ancestors quickly assess dangerous situations from harmless ones, is operating all the time: it continuously generates suggestions for System 2. System 1, although it generally is very good at what it does, has its biases. Further, it can't be turned off.

System 2, which is engaged when questions arise for which System 1 provides no answers, can be activated by a surprising event, or when you are monitoring your own behavior. It is the System that follows rules, compares objects on several attributes, and makes deliberate choices between options.[51] Unlike the first, System 2 requires a great deal of effort: when we try to multiply 17 by 24, our pulse begins to race slightly.

As a result, System 2 is lazy; it is typically in a comfortable low-effort mode, in which only a fraction of its capacity is engaged. It has trouble focusing on more than one thing, which can deplete its resources. For example, both self-control and cognitive efforts are System-2 efforts; and people who are simultaneously challenged by a demanding cognitive task and by a temptation are more likely to yield to the temptation.

These two systems, which ordinarily work well together, can occasionally conflict with each other. This occurs when we try not to stare at an oddly dressed person or try to force ourselves to read a boring book. And, perhaps most significantly, it happens when we invest our money. We rely on "heuristics," or rules of thumb, developed by System 1 and our lazy System 2 doesn't intervene.

### 2. Specific Aspects of Behavioral Finance.

Behavioral finance manifests itself in several different ways, causing irrational investor actions. Here are some examples.

#### a. Overconfidence[52]

Overconfidence can come in two forms, which can lead to any number of mistakes: Miscalibration (in which people believe that probability distributions are tighter than they really are); and The "better-than-average" effect (under which most people think they are better than average in any range of activities, which of course is mathematically impossible). Note how similar these aspects of overconfidence resemble the general issues that affect people's happiness.

Overconfidence comes in part from the illusion of knowledge. Everyone knows that when a six-sided dice is thrown, the odds of any one number coming up on that roll are one in six. However, numerous studies have shown that if people doing the predicting are told that the number four has come up on the previous three rolls, many of them will

[51] *Id.* at 36.
[52] Nofsinger, *supra* note 48, at ch. 2.

assume that the odds are either higher or lower than one in six for the number 4 to come up again. This despite the fact that the odds for any one roll are independent of any other (i.e., they are always one in six).

The information provides no additional insight; however, many people believe wrongly that it does…that they have more knowledge and therefore are more confidence in their predictions. Further, even when additional information provides some benefit to predictive ability (for example, forecasting point spreads in college football games), the predictor's confidence increase to a far greater extent than the benefits that the information provides.

Further, people become overconfident when they have the illusion of control (also an important factor in estate planning and discussed earlier). Several attributes lead to this illusion.

- Choice (e.g., people who choose their own lottery numbers believe they have a greater chance of winning than by selecting random numbers);
- Outcome sequence (e.g., early positive outcomes, like stock market gains, give investors a greater illusion of control than negative outcomes);
- Task familiarity (e.g., investors who are familiar with online trading feel that they have more control over it, and therefore believe that they will derive stronger returns);
- Information (already discussed); and
- Active involvement (e.g., people who participate more actively in a task will feel that they have more control over the subject matter of the task)

Note that this "illusion of control," although a huge drawback for individual investors, is a huge benefit to trust administration: The more beneficiaries are familiar with the process, given information about it, and actively involved in it, the more they will feel that they have control. The importance of real and perceived control are discussed in the next section.

#### b. Pride and regret[53]

People obviously seek to minimize or ignore the regrets from their past decisions and follow the pride they feel in making good decisions. However, this combination can lead to bad future decisions. The fear of regret and pursuing of pride can result in the "disposition effect," which in the investment world means selling winning investments too early and holding losing investments too long. For example, assume that a person wants to buy a new investment, but has no cash to do so. She must sell one of two investments: A (which has increased 20 percent in value) or B (which has decreased 20 percent in value). Selling A would make her proud to recognize the gains in her solid investment, while selling B would cause her to realize that she made a bad choice in buying it in the first place. There is significant evidence that more people in that situation

[53] *Id.*at ch. 3.

would sell A (triggering a pride response) rather than B (which would force them to face regret).

One factor that influences pride and regret is the setting of “reference points,” which in the investment arena refers to the selection of a prior stock price to be used in comparison to the current stock price. For example, assume that you buy a stock at $50. At the end of the year, it's worth $100. When you sell it one year after that, the price is $75. If your reference point is the date of purchase, in your mind, you've gained $25. However, if your reference point is the end-of-year high of $100, then you've lost $25. The choice of a reference point is critical in determining whether investors feel pride or regret, and can lead to even more difficult decision making.

#### c. Risk perceptions[54]

People perceive risk differently, depending on a number of factors. Most importantly, past outcomes play a huge role: People are much more likely to accept a bet if they’ve previously won money (in which case their bet is made using “house money” in their minds) than if they have previously lost (in which case either risk aversion or “trying to break even” kicks in). In other words, prior winners are often more willing to accept risk on a current investment, whereas the results vary for those who’ve just experienced investment losses.

## C. The Critical Importance of Control

All of this psychological research leads to one conclusion, which we estate planners have always known intuitively: nothing is more important than control. Control over your own circumstances leads to greater happiness, while erroneously assuming you have control when you don’t can lead to greater investment mistakes. However, in the estate and financial planning contexts, our clients can feel lacking in control: over their finances, the state of the tax law, their kids’ futures, everything. Whatever feelings of control we can give back to our clients will reap huge benefits for us, regardless of our professional discipline. Also, the more control we can give their beneficiaries (within reason), the greater the chances are that the clients’ estate plans will succeed.

### 1. Professional Benefits of Focusing on Control

Focusing on giving as much control to both clients and beneficiaries as possible provides us as advisors with two important benefits. First, and perhaps most importantly, control is what most of our clients are about. They didn’t get to be wealthy by allowing others to take charge or seeking out other opinions. They became successful by tightly controlling most aspects of their financial lives. If we can’t address that facet of their personalities then we aren’t very good at our jobs.

Second, pulling together across disciplines to give back control to our clients is the best way to give them unified service and advice. Without a unifying theme, it’s too

[54] *Id.* at ch. 4.

easy for us as individual advisors to slip into our professional silos, focusing only on legal issues, investment advice or tax compliance. And, much as we'd sometimes rather not admit, we're smarter as a team of advisors than individually. Having a unified approach to our planning helps to bring that out.

### 2. Drawbacks From a Lack of Control

The new "science of happiness" research, discussed earlier, has solidified what many of us already understood. Control, not money, is a much greater determinant of happiness. The opposite is also true. When people lack control over a thing, they tend to become cynical about it and withdraw.

This cynicism appears in areas beyond estate planning. For example, the late David Foster Wallace, writing about youth involvement in the 2000 John McCain Presidential campaign, observed that:

> "The fact of the matter is that, if you're a true-blue, market-savvy Young Voter, the only thing you're certain to feel about [his] campaign is a very modern and American type of ambivalence, a sort of interior war between your deep need to believe and your deep belief that the need to believe is [ridiculous], that there's nothing left anywhere but sales and salesmen."[55]

He's describing a lack of control over the political process, but his sentiments could easily apply to the estate and financial planning fields as well.

In the area of investments, many financial advisors wonder why clients won't follow their advice and move out of cash and into the markets. But staying in cash is simply an indiciator of a lack of control. Investors have no information about, and therefore no control over their reactions to, those markets, so they withdraw from them.

We estate planners often complain that trust beneficiaries can be pessimistic or distrustful. We often attribute this behavior to character flaws, but how much of it really is simply due to the fact that they have no control over trust assets? Granted, the trust settlors didn't want them to have complete control, which is the whole reason for the trust, but is it possible that granting them at least a little control would alleviate some of the complaints? It's impossible to make broad generalizations in this area, but it is at least something to consider.

Finally, control can be simply seen as another word for risk management. Viewed in this light, a lack of control equals the lack of an ability to measure risk. For example, Peter Bernstein observed that

> "The revolutionary idea that defines the boundary between modern times and the past is the mastery of risk: the notion that the future is more than a whim of the gods and that men and women are not passive before nature. Until human beings

[55] Wallace, *Consider the Lobster* 229 (2006).

> discovered a way across that boundary, the future was a mirror of the past or the murky domain of oracles and soothsayers who held a monopoly over knowledge of anticipated events."[56]

According to Bernstein, the ability to master risk is what made us who we are: people who control their own destinies (or, at least, so we think!).

In other words, control can be seen as "mastery of risk;" not certainty, but rather minimizing the chance of loss as a person or group moves forward. It involves planning and information gathering. It involves a vision for a future and the ability to compare it to actual results. And the lack of this ability puts the client or his or her beneficiaries at the whim of fate.

### 3. Defining "Control"

"Control" has many different connotations, not all of them positive. Control can be defined in three different ways. First, there is control of external things (like control over others or control over circumstances). This type of external control, when exerted over other people, also can be thought of as "extrinsic motivation." Second, there is internal control over our attitudes and outlook. It is independence of thought and personal direction, not necessarily "self-control" (as in "will power"). Finally, knowledge is a type of control (or at least it creates the illusion of control, as we saw in the behavioral finance discussion, above).

Generally, extrinsic motivation, or rewards, actually decreases internal motivation in the form of personal productivity. There are only a couple of exceptions to this rule: motivating someone to undertake a boring activity, and getting someone to try something new.[57] On the other hand, more internal control leads to greater "self-efficacy,"[58] which is inspiring. Self-efficacy is a "better predictor of career selection and success than actual ability, prior preparation, achievement and level of interest."[59]

Further proof that self-efficacy is critical to happiness is the fact that happiness leads to success, not the other way around (it's not true, in other words, that a person becomes happy only after he or she becomes successful, a common misperception).[60] And becoming happy is within a person's control. In fact, research shows that behaving as though you are happy makes you happier.[61] In a "walking" study, undergraduates who walked in a depressed manner showed signs of depression, while those who walked in a "happy" manner showed the opposite. Another study showed that sitting in a slumped manner tended to make people more depressed, while sitting upright improved mood. Similar results occurred when commuters in trains and cabs struck up conversations with

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[56] Bernstein, *Against the Gods: The Remarkable Story of Risk* 1 (1996).
[57] Stephens, *infra* note 68.
[58] *Id.* (*citing* Bandura, *Self-Efficacy: The Exercise of Control* (1997)). *See also* Myers, *supra* note 34, at 113 – 116.
[59] *Id.*
[60] Achor, *supra* note 31, at 37.
[61] "Walk This Way: Acting Happy Can Make It So," Wall St. J., D-3 (11/18/14).

strangers and found themselves happier than those commuting quietly (the same is also true for people who strike up conversations with their local barista!).

One of the most famous happiness studies tracked the journals of 180 nuns, all of whom were born before 1917. When in their 20's, the nuns were asked to write down autobiographical journal entries. Fifty years later, researchers coded the entries for positive emotional content. It turned out that the nuns whose entries were more positive lived nearly ten years longer than those whose entries were negative or neutral. In fact, by age 85, 90 percent of the happiest quartile of nuns were still alive, as compared to only 34 percent of the least happy quartile.[62]

Further, research with entry-level accountants confirms the proposition that the more you believe in your ability to succeed, the more likely it is that you will. Of the 112 accountants surveyed, those who believed they could accomplish what they set out to do scored the best performance ratings ten months later. Put another way, a specific focus on your strengths during a difficult task produces the best results.[63] Feelings of control are important for well-being and performance. Among students, feeling in control leads to higher grades and motivation to pursue desirable careers. Among employees, it leads to more job satisfaction and better performance. Further, control at work spreads happiness everywhere: family, job, relationships.[64]

And research also confirms that actual control is less important than <u>perceived</u> control. The most successful people have what psychologists call an "internal locus of control" (another way of thinking of "self-efficacy"), the belief that their actions have a direct effect on their outcomes. People who *believe* that they have this internal control have "higher academic achievement, greater career achievement, and are much happier at work."[65]

In fact, the importance of this kind of control goes beyond job performance and outward success; it impacts our health as well. One sweeping study indicated that employees who felt they had little control over deadlines imposed by others had a 50% higher rate of coronary heart disease than their counterparts. In a study of the elderly, a group of nursing home residents who were given more control over simple daily tasks, like being in charge of their own house plants, not only became happier, but cut their mortality rate in half.[66]

Finally, if a person has sufficient information about a process or outcome so that he or she can respond based on that knowledge, then he or she has at least a feeling of control (again, demonstrated in studies of behavioral finance). This second type of self-control indicates that one’s involvement, even if it is only to be fully informed and without any actual control, can be empowering.

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[62] Achor, *supra* note 31, at 42.
[63] *Id.* at 74-75.
[64] *Id.* at 130.
[65] *Id.* at 131.
[66] *Id.* at 132.

### 4. Control and Others

If control is critical to happiness, it also is contradictory, at least when more than one person is involved. Our clients' habit of being in control often extends to the estate planning decisions they make. However, when the goal of those decisions is to make for happier and more productive beneficiaries, they may be more successful by giving control away.

For instance, many clients (and some advisors) believe that withholding information will help their heirs. The general idea is that if the heirs (especially the client's children) don't know the family has money, then they will go about leading a "normal" life. In other words, the knowledge itself will spoil them.

There are several reasons why this approach may be misguided. First, children almost always figure out the family has money, based on membership in clubs, vacations taken, the cars the family drives, and so on. Most clients won't want to deny themselves those things simply to create the illusion of a "normal" life. Second, plenty of children who were kept in the dark about money come out spoiled anyway (this is an entirely unscientific observation based on the author's experiences). Finally, we've learned that knowledge, if dispensed properly, is a form of self-control and can be used to help the heirs develop by getting them to ask the right questions and giving them the proper tools to handle the information.

### 5. Control and Financial Planning

Many of us work in both financial and estate planning. As this discussion has shown, control is critical in financial planning. As we've discussed, control is at least as important to a client's happiness as money is. If that's true, then several points follow. First, it is more important for financial planners and investment advisors to give clients control than it is to outperform the market. Chasing higher returns, while important, may actually be of less importance than planning for greater control (at least in terms of information). Most financial planners have had the experience of meeting with clients and telling them they would not be able to meet their financial goals, only to be genuinely thanked anyway. I think such gratitude comes from the planner giving them greater knowledge, and therefore greater control, over their circumstances.

In this economic environment, clients lack information about what all the data means, and they are becoming more cynical as a result. Giving them more information gives them the feeling of more control. As Peter Bernstein pointed out, mastery of risk is what separates us from our ancestors. This is a lesson all financial advisors can learn from. Helping clients master risk through information gives them more control.

On a more practical level, process is a way to give clients control. Clients' lives are already hectic enough, and simply handing them questionnaires to take home makes it worse. Our internal procedures, in other words, can add to or take away control from our clients. By taking charge of the paperwork yourself, you are relieving them of one more thing on their to-do list, and thereby giving them back more control

### 6. Control and Estate Planning

Control is also critical in estate planning, both for clients and their beneficiaries.. We all have stories of clients who want to control from beyond the grave. But as we've seen, trying to manipulate people using external motivation doesn't work. "Do X and you get Y" is a good way to get someone to try something new, but it's a poor way to make someone a more productive individual.

Next, knowledge is a form of control; the more knowledge a person has, the better off she feels. This may conflict with some clients' desire to keep their estate plans private. While withholding information can be important (e.g., when a beneficiary is too young to process the information, or has substance abuse problems), in general, clients should try to get a little outside their comfort zone and give as much information as is appropriate.

In other words, letting go of the urge to micromanage beneficiaries through money, but instead defining the purpose for the gift and allowing beneficiaries to define their own way of achieving that purpose, may create the greatest opportunity to achieve the goals a client seeks. We will discuss more concrete examples of doing so later in this paper.

## D. Reexamining Trust Drafting

The planning area with the greatest potential for change, in light of the issues raised in this paper, is that of trusts. Trust drafting and administration lies at the heart of everything we estate planners do. We use them almost without thinking about them, as though it were a given that they are a good idea. Indeed, there are those who believe that "trusts should be the vehicle of choice" for all individual gifts,[67] and others who will not work with clients who will not make extensive use of trusts.[68]

But the notion that trusts are beneficial may be flawed in some cases. To begin with, a common reason for trusts seems to be that the grantor wants the beneficiary to receive funds only when she is "mature" or "productive." However, a large number, perhaps the majority, of trusts allow distributions for health, education, maintenance and support. As one commentator points out, "[o]ur clients did not come up with these terms. We did."[69] We planners have allowed our words, often purely the creatures of the tax laws, to be substituted for our clients'. Other times we are merely scriveners, usually

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[67] Aucutt, *Structuring Trust Arrangements for Flexibility*, 35 U. of Miami, Phillip E. Heckerling Inst. of Est. Plan. §900 (2001) (hereinafter "Aucutt").

[68] Stephens, *Incentive Trusts: Considerations, Uses and Alternatives*, 29 ACTEC Journal 5 (Summer 2003) (hereinafter "Stephens"). For a more general discussion of increasing trust use, *see also* McCue, *Planning and Drafting to Influence Behavior*, 34 U. of Miami, Phillip E. Heckerling Inst. of Est. Plan. (2000) (hereinafter "McCue").

[69] Stephens, *id.*

because certain clients don't allow us meaningful input, with the result that we create trusts for dead-hand control by an already tyrannical grantor. Maybe the beneficiaries really won't benefit at all, but will simply play whatever games the grantor has devised in order to get trust distributions. In light of these flawed approaches, perhaps we should look for a different approach, one that incorporates the issues raised in this paper.

### 1. The "Purpose" of Trusts

We have discussed the importance of control in estate planning. But if a trust is to give greater control, its purpose has to be very clearly spelled out. Purpose in a document gives the beneficiaries knowledge about why the trust exists. Failure to define purpose is one of the biggest drafting flaws because it allows the beneficiary to say, "but Mom always wanted me to . . . [fill in the blank with greater expenses]" In fact, most planners would acknowledge that this is so.

However, even though we might recognize their importance, most drafters still don't seem to use "purpose" language. This has been a historical problem. Over 50 years ago, the Oregon Supreme Court noted that

> "[t]he difficulty in many if not most of these [abuse of trustee discretion] cases is finding the purpose of the settlor with sufficient definiteness to be helpful . . . The settlor's specific design in framing a discretionary trust is normally unexpressed or vaguely outlined."[70]

Two years later, Professor Edward C. Halbach, Jr., repeated those sentiments:

> "[t]oo frequently trust instruments provide no guidance as to the purpose and scope of the [discretionary] power. Although determining and assisting in the formulation of the donor's intentions is a primary counseling function, it is apparently one of the most neglected aspects of estate planning. A poorly defined discretionary power often results."[71]

Assuming that Professor Halbach, the Oregon Supreme Court and this paper are correct, and purpose language is a good idea for trusts, let's now turn to some of the reasons clients create them in the first place.

### 2. Why Trusts at All?

Although the uses for trusts seem quite broad, they really can be broken down into three categories: blatant manipulation, protection, and behavior modification.

[70] *Rowe v. Rowe,* 219 Or. 599, 606; 347 P.2d 968, 972 (1959).
[71] Halbach, *Problems of Discretion in Discretionary Trusts,* 61 Colum. L. Rev., 1424, 1434 (1961).

### a. Blatant Manipulation

Let's face it: there are many clients who create trusts simply because they can't stand the idea that their beneficiaries are having unauthorized fun with the client's money. The client will come up with all kinds of other reasons for creating the trust: the beneficiary is unable to handle money, the beneficiary married poorly, and so on. But, after talking with the client (and perhaps also meeting with the beneficiary) it becomes clear (to the advisor, at least) that these objective reasons don't hold water, and the truth is simply that the client wants to keep making the beneficiary dance even from the grave.

### b. Protection

Traditional "legitimate" reasons for trusts have always centered around protection: from the beneficiary's creditors, from the Internal Revenue Service, from other beneficiaries, from herself. It is this more traditional "protection" aspect that is often cited by those who emphasize an extensive use of trusts in estate planning.[72]

#### i. Protecting the Beneficiary from Herself

To begin with, trusts can protect the beneficiary from herself.[73] Perhaps most commonly, such trusts are created for minors, protecting the minor against her own lack of experience, either in investing or with unscrupulous advisors. Another subset of this type of trust is the trust designed for a person with disabilities,[74] either as a result of an accident, genetics or self-inflicted behaviors (like substance abuse). This trust is different from the minor's trust, because while the minor's trust probably only needs to last for a limited period, the trust for a person with disabilities may last for that person's lifetime.

#### ii. Protecting the Beneficiary from Others

Some trusts are designed to protect the beneficiary from others, primarily creditors (including, perhaps most importantly, future ex-spouses). Many times this second category is simply the extension of the first: a beneficiary who makes bad choices will need to be protected both from herself and from others. And the disabled beneficiary may have creditors who can be paid from other sources. This discussion also will not discuss the self-settled, or "asset protection," trust, which is a particular device with very specific drafting requirements.

Nevertheless, there is at least one area in which this type of trust is unique: protecting trust assets from division in a divorce action. In this context, the trust becomes primarily a segregation device. In separate property states, in which a judge in a divorce

[72] *See, e.g.*, Aucutt, *supra* note 67, at §901.
[73] As used in these materials, the feminine shall include the masculine, because it's been the other way around for too long.
[74] Note that, in this context, the trust for a beneficiary with disabilities does not include the so-called "special needs trust," designed to provide limited benefits without disqualifying the beneficiary from receiving government benefits. Although the impulse is the same, the drafting and administration are totally different.

action has significant discretion to divide assets between the spouses, having inherited wealth in a trust may help keep those assets from being added to the property of the marriage. In community property states, keeping inherited assets in a separate trust will help to avoid those separate assets from being commingled with the community assets.

### iii. Protecting the Beneficiaries from Each Other

In some cases, the enemy is not without but within. The trustor may want to benefit two or more beneficiaries who either don't now or may not in the future get along. The stereotypical example is the trustor with a second spouse and children from a prior marriage. The trustor may want the surviving spouse to have the use of the trust funds but ensure that any funds remaining at the death of the surviving spouse pass to all of the trustor's children only. Here, a trust is the standard solution to the problem.

A more specific offshoot is the trust that allows for joint asset management. This approach is particularly useful for closely held investments (businesses, real estate and so forth). While ownership and joint management can be worked out using ownership structures like corporations, partnerships and limited liability companies, trusts may be important when minors are involved or when unified management oversight is required. However, the implicit assumption is still that the trust is needed to keep the beneficiaries from clashing, or at least to provide a reasonable vehicle for resolving the clashes.

### iv. Protecting the Beneficiary from the IRS

Next up are those long-term trusts that are designed not for protection from the beneficiaries or others, but rather to ensure that inherited wealth is not subject to federal transfer taxes upon either distribution to or the death of a beneficiary. Such trusts are established to be exempt from estate, gift and (most importantly) generation-skipping transfer taxes. In this case, a trust might not otherwise have been used at all, or it may incorporate the types of protections discussed above. So, for example, a trust might be created for the lifetime benefit of the trustor's child, the assets of which pass in further trust for the benefit of that child's descendants at her death. This trust might serve two purposes: first, to ensure that, to the greatest extent possible, the trust assets are not subject to division as part of a divorce; and second, to ensure that there is no estate or generation-skipping transfer tax liability imposed at the beneficiary's death.

## c. More Current Reasons: Behavior Modification

A modern drafting trend is not simply to provide protection, but to influence behavior. When Warren Buffett announced that he was leaving a significant portion of his estate to charity many years ago,[75] the notion resonated with wealthy people across the country, and seemed to spark a greater concern about creating "trust babies" (those beneficiaries whose motivation is sapped by not having to support themselves). This

[75] *Cited in* McCue, *supra* note 68, at §600.

movement was further advanced by the increase of wealth held by high-tech entrepreneurs who were the product of middle class backgrounds.[76]

### 2. How Can We Draft Trusts that Make Beneficiaries Happier?

In light of all this information, how can we design trusts that both accomplish the grantor's objectives <u>and</u> make the beneficiaries happier as a result? Many would say that aiming for beneficiary happiness is a fool's errand. To begin with, if the real reason a client wants to create a trust is to blatantly manipulate her heirs, then it's very unlikely that the beneficiaries will be happy about it. Second, regardless of a grantor's intent, most beneficiaries hate trusts. Except in some cases of larger trusts set up primarily to save estate taxes, the typical beneficiary reaction to a trust (either expressly or through conduct) is that the trustee is standing between the beneficiary and her money. Most beneficiaries probably would disagree with a grantor's assumption that the beneficiary needs protecting from herself. Third, as the research described above shows, happiness is not a perpetual state that can be achieved through financial means. Rather, it is a fleeting condition that can be brought about more frequently only by pursuing a personal process of growth and satisfaction. In other words, trusts in the end are only about money, and money often can't address the real "happiness" issues

Finally, there are many trusts, the purpose of which is not to make beneficiaries happy, but rather to make them less unhappy. Let's face it, it's unlikely that children from prior marriages and second (or more remote) spouses who don't get along to begin with are ever going to be happy with each other simply because a QTIP trust is put in place at the grantor's death. The role of the trust in this case often is simply to referee disputes, to create a structure that might get them out of each other's way. To state the problem differently, we are often faced when drafting trusts with much more modest objectives than beneficiary happiness.

Still, there are a great many cases in which we can actually try to make beneficiaries more self-fulfilled, and therefore more happy, or at least satisfied that an uncomfortable situation has been rendered as tolerable as possible (which might be said to be a type of happiness). It is to these situations that we turn our attention.

### 3. Types of Trust Terms

The universe of trust distribution provisions can be divided into two large subsets: subjective and objective provisions. Since the only provisions that most beneficiaries care about are those that deal with what they get and when, reviewing the pros and cons of these two types with clients is very useful.

#### a. Objective Terms

There are generally two groups of objective trust terms: income-based and incentive-based. The income-based terms are the traditional group most estate planners

[76] Stephens, *supra* note 68.

are familiar with; under this model a beneficiary is entitled to all the income from the trust. There are a couple of modern offshoots, the unitrust and the adjustment between principal and income. Both, however, are based on the traditional notion, but with modifications to take into account the mandates of modern portfolio theory.

The second group, incentive trusts, has increased dramatically in popularity over the past twenty years. Indeed, a 1999 article in the *Wall Street Journal* discussed their use.[77] The article actually mentioned several incentive trust provisions, which are illustrative of the type of provisions common to the trust: matching earned income up to a specified amount; distributing a fixed amount for the beneficiary to start a business or professional practice; making a monthly payment for a "stay-at-home" parent; denying distributions if the beneficiary fails a drug or alcohol test; and making fixed distributions for each year in which a beneficiary has no driving violations.[78]

Such provisions have some at least superficial appeal and (at least in the case of drug testing) may be critical in caring for a beneficiary. They encourage or discourage positive or negative beneficiary behaviors. They are also easy to administer: show me your W-2 and I give you the money, pass your drug test and I give you the money. They leave no room for a trustee to be over-indulgent.

However, objective provisions also have serious problems. The traditional "income only" provisions are virtually useless in most settings, because they bear no relation to any goals that the grantor might have. The income might be too much or too little for purposes the trust was created for. The same is true for unitrusts and for income with the trustee ability to adjust between principal and income: neither relates to real-world client goals for the beneficiary. They are often as not short-hand solutions suggested by the drafter.

One variant of the "income-only" model has some relevance to real world goals, and that is the dollar amount, adjusted for inflation. That is, the beneficiary is to receive $100,000 per year, adjusted for inflation. This type of provision allows the grantor to establish a standard of living by creating essentially a salary from the trust. Inflation adjustment is obviously critical in this context to ensure that the beneficiary does not lose pace to inflation over time. Note that, in those cases when an "all income" provision is required (for example, in the case of QTIP trusts), a "greater of" provision can be used (i.e., the beneficiary shall be entitled to the greater of all net income or the inflation adjusted dollar amount).

Another problem with objective provisions is that they cannot adapt to the needs of a particular individual. For example, by promoting a daughter to stay at home with her children, they might discourage her developing her natural abilities in other areas. Further, by simply encouraging higher earnings, the trust terms might convince a beneficiary who wanted to be a school teacher to be a lawyer instead (god forbid!). To take this notion further, a document that specifically provides for one thing specifically

[77] *cited in* Stephens, *supra* note 68.
[78] *Id*.

excludes another. Behaviors not specifically set forth, but which may be equally desirable are not accounted for.

A third problem is that objective provisions, by their restrictive natures, do not allow for changing circumstances. The beneficiary who develops a debilitating illness that prevents her from earning at prior levels, for example, may find herself impoverished if the trust is not drafted broadly enough. In a more general sense, anyone who drafts a long-term trust with specific, objective terms and who thinks he knows what the world will look like 20 or 50 years from now is probably a little too smug.

Finally, and most importantly, a grantor who creates an incentive trust focuses on behaviors, but really doesn't seek to promote those behaviors per se, but rather something that the behaviors represent. For example, a client "is not really trying to encourage W-2 income, but rather productivity." Entrepreneurship is ultimately less important than "independence, ingenuity and innovation."[79] In other words, the grantor identifies certain behaviors that are a surrogate for maturity and drive. But by naming surrogates rather than the thing itself, the grantor runs the very serious risk of missing the mark altogether.

#### b. Subjective Provisions

So if objective provisions are inadequate, does that mean that we should favor subjective instead? Subjective provisions are those that require the exercise of discretion by the trustee in making certain value judgments. For example, the subjective standard most of us are familiar with is the trustee's ability to distribute principal for "health, education, maintenance and support." The trustee must decide what constitutes "support," which conceivably could include living in a shack or a mansion. This flexibility is seen by many as a significant benefit. At least one commentator has noted that objective, "incentive" provisions are not the solution to most family relationship problems, and so should not be the "first weapon out of the arsenal."[80] Indeed, the incentive trust works best "in the most desperate situations" (as an alternative to disinheritance for a beneficiary engaging in anti-social behavior, for instance).[81] Instead, discretionary trusts "should be seen as generally preferable to incentive trusts" because the increased flexibility.[82]

However, if a discretionary trust is to be used, several additional provisions should be added. First, the grantor should give clear guidance as to the exercise of the discretion. The grantor's intention "should be set forth in sufficient detail to tell the trustee what the [grantor] really wants."[83] Further, trustee exculpation should be added, including perhaps provisions that set forth how the costs of litigation are to be paid (such costs may be assessed, for example, against the beneficiary who brought it). These measures will ensure that the trustee will exercise discretion in a manner as close as

[79] *Id.*
[80] McCue, *supra* note 68, at §609.2.
[81] *Id.*
[82] *Id.* at §609.3.
[83] *Id.*

possible to that the grantor intended, and may do so with less fear that he or she will be sued for doing so.

Finally, even if such provisions are added, some problems remain. First, the more discretion given to the trustee, the greater the likelihood that the trustee will exercise it in a manner the grantor would not have agreed with. This may not be all bad, by the way. Second, discretion guarantees only flexibility, not success.

**4. Some Tentative Drafting Thoughts**

Having taken this little journey through the wilderness of happiness, can we draw any conclusions about the attributes that a trust might have if they are to work effectively toward the goal of making the beneficiary happy (or at least less unhappy)? There seem to be a few observations we can make. First, there are no hard and fast rules; given that we as a species are such lousy predictors of what will make us happy, it stands to reason that we are probably even worse at determining what will make others happy. Especially when we are running the drafting process through the filter of the parent-child relationship (which at best is a dark, murky place). However, there are some of the facts about happiness, described above, that might give us some inspiration:

<u>Use precatory language</u> Regardless of the purpose for which it is intended, any trust can benefit from a clear statement of the grantor's intent. This is an area of drafting most overlooked by lawyers, and at the same time is the most critical to the success of a trust administration. Such language should be included in a separate paragraph, so that there is no risk of a trustee or the court confusing precatory with distribution language. This precatory language might include:

<u>A statement of beneficiary preference</u>. Is this a trust primarily for the benefit of the current or remainder beneficiaries? Should one class be favored over another? Although this is sometimes very hard for a grantor to deal with, if such expressions of preference were used more frequently, many trust disputes would be resolved more quickly (to the extent that they are ever resolved at all).

<u>A statement of distribution preference</u>. Is education more important than other purposes, for example?

<u>Primary purpose for creating the trust</u>. In exercising investment discretion, for instance, should the trustee involve the beneficiary in the process in order to help educate him or her on asset management issues?

<u>Allow for greater beneficiary control and involvement</u>. As noted above, control is important to happiness. Therefore, consider the following:

A beneficiary can have control over the trustee identity. If it's true that people don't continue to develop beyond age 40, then it ought to be the case in many circumstances that a beneficiary upon reaching that age should automatically become a successor trustee or at least a co-trustee. Even if it isn't appropriate for the beneficiary to become a trustee, the beneficiary should at some point have the power to remove and replace the trustee, even if it's only to replace with a corporate trustee.

The beneficiary should be entitled to have as much knowledge about trustee decisions as possible. This might slow down the administration process, but if done in conjunction with much more clear precatory statements, it might lead to greater beneficiary understanding and acceptance of the trust, and therefore a greater feeling of control.

<u>The family conundrum</u>. As already discussed, a successful family life is very important to a person's happiness. Yet, as also noted, one of the primary reasons for creating a trust is to ensure that the assets stay out of the hands of former in-laws. And in many states, the fact that distributions can be made to help support a beneficiary's family can subject trust assets to division in a divorce action, because they become "marital" assets. This creates a tension that, at a minimum, should be discussed thoroughly with the grantor. How can you use a trust to simultaneously help nurture a family while at the same time delivering the message that a beneficiary's spouse is a second-class citizen? One possible approach might be to require that a beneficiary, before getting married, enter into a premarital agreement as a prerequisite to receiving trust distributions, but also ensure that the legal fees for that agreement on both sides are paid from trust assets, and that once the agreement is signed, both the beneficiary and the spouse are entitled to some form of distributions.

<u>Re-think the standards</u>. For too long we've blindly referred to "health, education, maintenance and support," for no good reason other than they're included in the Internal Revenue Code. Consider the following:

> First, why do we even use "maintenance" and "support" when the Regulations state clearly that they are identical terms? This is not a substantive issue, but rather evidence that we've tended to gloss over the issue.
>
> Second, paying for a beneficiary's support is often contrary to not only the grantor's objectives but also the factors that tend to create happiness. A person's work is one of the Big Seven happiness factors, and most grantors want their beneficiaries to be productive. Of course, there are many circumstances in which support is appropriate (when a beneficiary is attending college, for instance, or for a surviving spouse who has spent her life working in the home). But the number of times that the term is actually used, I suspect, vastly outweighs the number of times it's appropriately used.
>
> Third, broaden "education" to include things like personal enrichment classes and courses that lead to professional designations. Such courses may help with the beneficiary's personal growth (a happiness factor) and are unlikely to sap a beneficiary's incentive.
>
> Fourth, distributions for "health" should almost always be added, and might be expanded to be clear that the trustee can pay insurance premiums and perhaps also reimburse employee co-pays for such insurance. While we're on the subject of

insurance, by the way, "health" might also include payment of insurance premiums for disability, AD&D and perhaps even long-term care or life insurance designed to replace the income of the working spouse in the event of her death (being mindful, of course, not to create any "incidence of ownership" problems).

More isn't better. The happiness studies seem to indicate that, once a person has achieved a certain income level, increases in income don't make her much happier. Therefore, if an amount is being automatically distributed, whether as a W-2 match, a unitrust amount or an "income" distribution, consider an inflation-adjusted cap on that amount.

Can trusts foster personal values? This seems an especially difficult objective, and a drafter could drive herself nuts trying to contemplate all contingencies while still not achieving the desired result. There may be some small steps, however, that are effective. For the grantor who wants to foster community involvement, the trust could make a dollar-matching distribution for a beneficiary's charitable contributions. This perhaps should be limited in amount for smaller trusts. Personal growth classes, discussed above, might also be helpful.

Draft in an age appropriate manner. If people don't change much after 40, then trusts that go much longer than that probably can't be expected to work any miracles in a beneficiary's personal development. Therefore, most of the "behavior modification" provisions should end by that age (except in the case of self-destructive behaviors like substance abuse, of course). Instead, trusts that extend beyond age 40 should focus on giving control to the primary beneficiary: making her the trustee or at least an advisor.

Avoid pot trusts Since studies seem to indicate that we gauge our happiness largely in comparison with others, even to the point of preferring a higher status in the pecking order to earning more money, a strong argument can be made that pot trusts are, as a general principle, to be avoided, since the possibility that one beneficiary "gets" more than another can be a significant point of friction. Further, if some of the more "esoteric" suggestions above are followed, this friction could be increased even more (nothing would hack off a real estate developer beneficiary more, for instance, than watching pot trust funds go toward personal growth classes for her clay-pot-throwing sibling).

Finally, are we sure they're necessary? I realize that better estate planning minds than mine, cited in these materials, have concluded that all significant gifts to individuals should be in trust, not outright. And in most cases I'm sure there's truth to the idea. But in the long run, will it really make a difference? If the beneficiary has little input or control, then there is evidence to suggest that he or she will actually be less happy. On the other hand, if the beneficiary has greater input and control, he or she runs the risk that the asset protection benefits, the ability to protect beneficiaries from others, derived from trusts may be compromised.

These suggestions are not meant to be definitive, only illustrative. In the end, it is the conversation with the client that these suggestions engender that will prove the most valuable to the planning process. Showing the client that you understand and want to deal with these issues will help to create a deeper and more satisfying professional relationship.

**E. Reexamining Family Philanthropy**

Charles Collier, as part of his work at Harvard, listed the best practices of successful families. They tend to:

Focus on the human, intellectual and social capital of their family;

Stress the priority of *each* family member's individual pursuit of happiness;

Work on enhancing intrafamily communication;

Adopt a long-term time frame for determining success;

Tell and retell the family's most important stories;

Create mentor-like relationships when establishing family trusts;

Collaboratively define a family vision statement (what Collier calls "the Shared Dream");

Teach children and grandchildren the competencies and responsibilities that come with financial wealth;

Give younger family members as much responsibility as soon as possible.[84]

One of the key ways families achieve these best practices, according to Collier, is through family philanthropy.

Claude Rosenberg, Jr., in his classic text on charitable giving, notes some of the benefits to family philanthropy; it can be: a great teacher of sound values; a cohesive element – a fine common interest – for a ladder of generations within a family, as it should be among those within each distinct generation; a practical tool that helps young people learn about business; and a psychological boost for people of all ages and of all income levels, including those of inherited wealth, who often suffer from low self-esteem and even guilt stemming from their receipt of money they haven't earned.[85]

Note that tax savings is not listed among the benefits of family philanthropy. The client who is interested in both social good and tax savings can accomplish those goals without having an overarching "vision" to his or her giving. By comparison, family philanthropy should be introduced for those clients who are concerned about family

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[84] Collier, *Wealth in Families* (Harvard Univ. 2002).

[85] Claude Rosenberg, Jr., *Wealthy and Wise: How You and America Can Get the Most Out of Your Giving* (1st Ed. 1994).

values and financial education, as well as charitable giving. It can be thought of as the organized charitable giving by several members of a family to achieve a unified goal.

Family philanthropy can, but doesn't have to, involve family foundations. Generally, clients appreciate hearing about the simplest solutions first, moving to more complex only when needed. From simplest to most complex, then, it can involve:

Meeting as a family to talk about a common charitable goal, followed by each family member separately giving to that cause according to his or her ability;
Meeting as a family, followed by gifts from the wealthier generation to help the less wealthy family members participate (or perhaps a family "challenge grant," where parents match whatever children contribute);
Establishing a family donor-advised fund, giving the family a reason to meet and plan their gifts, but with no administrative responsibilities; or
Establishing a family foundation.

James E. Hughes Jr. discusses the roadblocks associated with long-term generational transfers of wealth. He reasons that families generally focus on financial capital but rarely address two critical forms of capital - human and intellectual. Success is often measured by the accumulation of financial assets, but long-term success (defined as greater than one-hundred years) is extremely unlikely unless the family can positively answer certain qualitative questions including:

> Is each individual family member thriving?
>
> Are family members willing to listen to those issues of those they lead?
>
> Is the family's collective capital (human, intellectual and financial) being managed to help family members achieve their individual pursuits of happiness?[86]

In other words, perhaps the most important issue to deal with when creating a family foundation is establishing the purpose of the foundation, with input from all the family. This input should be obtained before the foundation documents are drafted, to ensure that the drafting takes into account all the family goals and objectives.

For our purposes, family philanthropy can also add to each family member's feelings of control and happiness. Ideally, by getting the family together to talk about charitable and financial issues in a neutral context, the family meeting provides a setting for families to begin discussing more "hot button" issues (like estate planning, education, careers and business succession planning). It is a place for younger family members to learn about money management, without giving them large sums of money. It allows children and grandchildren a sense of control, not only through gaining knowledge of markets, but also because it allows them to have a voice in how the family gives. And, as the studies have shown, giving money away makes people happy!

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[86] James E. Hughes Jr., *Family Wealth – Keeping It in the Family – How Family Members and Their Advisers Preserve Human, Intellectual, and Financial Assets for Generations* (2004).

## F. Conclusion

Our professional lives, never easy, seem to have gotten a lot more troublesome lately, leaving us with three alternatives: just deal with it, quit practice or find a new way to go about our work. The latter course, if taken with the client's personal, rather than tax planning, needs as a signpost, has the potential to be the most satisfying. By helping the client with the hard question of how to leave a family or philanthropic legacy, the complexities described above, as well as others, become more manageable, because they no longer are the primary focus of the advisor – client relationship. And, paradoxically, we may find that the tax planning is more effective, because it is now tied to goals that are important to the client.