WELL-BEING & INHERITANCE

Developing the intersection of well-being science and trust & estate planning

INHERITANCE PLANNING SUPPORTING FINANCIAL EFFICACY

What is the difference between estate planning supporting a beneficiary financially and estate planning supporting a beneficiary's financial well-being? The difference is not a minor detail when it comes to inheritance planning. Each interpretation will yield a different approach to when, how and how much to give to your children.

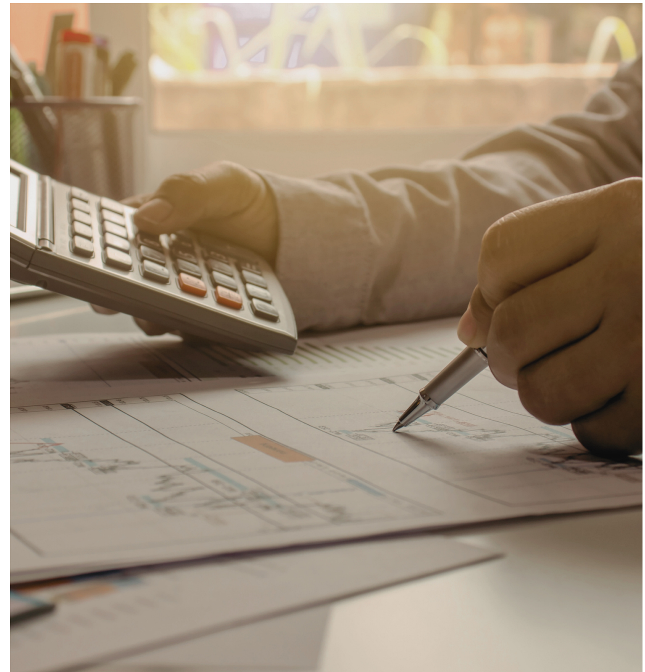
FINANCIAL WELL-BEING

Often, financial well-being is confused with wealth, an objective figure.[1] However, financial well-being is independent of wealth as it includes the individual's perception- "the perception of being able to sustain current and anticipated living standards and financial freedom."[2] People may experience high or low financial well-being regardless of their level of financial wealth based on their experience of these two components:

-**Living standards**: a combination of desired wealth and services considered essential to living.[3] Maintaining a desired standard of living is closely related to financial behaviors and goals.

-**Financial freedom**: not feeling forced or stressed about making choices regarding basic needs. Making decisions without worrying about financial constrains helps improve people's perception of their financial well-being.[4]

Based on the above, financial well-being is a multidimensional state of being both subjective and objective in nature.[5] It is relevant for mental health, life satisfaction, social relations, and overall well-being.[6]



DETERMINANTS OF FINANCIAL WELL-BEING[18]

PERSONAL AND PSYCHOLOGICAL FACTORS include financial behavior (past and present), financial knowledge and skills, personality traits of self-determination, self-efficacy, and life events (divorce, birth of child, etc.).

SOCIOECONOMIC FACTORS include age, income, gender, and education.

CONTEXTUAL FACTORS include economic landscape, consumer protection, legal and political stability, financial market development and accessibility among others.

CHALLENGES TO BUILDING FINANCIAL WELL-BEING

Not only the subjective nature of desired living standards and the sense of financial freedom, but also financial well-being poses a dichotomy for

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for individuals' behavior: enjoy the desired life today versus saving for the future. Learning to balance this equation is at the core of parents' concerns regarding their children and inheritance.

Income and education are two relevant socioeconomic factors in building financial well-being: [7]

> The higher the income, the lower the stress about the current financial situation and the higher the perception of meeting future goals.

> Higher education increases the stress about the current situation but also the perception of security about the future.

Two psychological factors that have an impact on financial well-being are:

Self-Control – "the ability to break bad habits, resist temptations and overcome first impulses-"[8] has a positive impact on financial behavior as well as financial well-being.

> People with good self-control are more likely to save money, have better financial behavior and feel less anxious about their financial situation.

They also pose challenges to being restricted in their freedom to act. Individuals with high self-control want to set their own goals and, if needed, impose their own restrictions.[9]

Future Time Perspective is the capacity to envision a desirable future and plan for it.[10] It is crucial for financial well-being and it can be learned and evolve over time.

> People with high future time perspective are better at preparing for the future by saving, investing, and procuring insurance.

SELF-EFFICACY, SELF-CONTROL AND EXECUTIVE FUNCTIONING

Financial self-efficacy refers to an individual's belief in their ability to achieve financial goals[11] and it has a direct impact on life satisfaction.[12] It is considered to be a better predictor of financial well-being than past financial behavior.[13] Moreover, self-efficacy is correlated to positive financial behavior.

FOUR SOURCES OF SELF-EFFICACY[19]

Expectations of self-efficacy are informed by four sources:

PERFORMANCE ACCOMPLISHMENTS: personal mastery experiences (successful as well as failures) influence individuals' confidence in their capacities.

VICARIOUS EXPERIENCES
Seeing others perform activities successfully or without adverse consequences can persuade people that they can do it too.

VERBAL PERSUASION
Individuals can be encouraged through suggestion into believing they can successfully accomplish tasks that might have overwhelmed them in the past or that they have not performed yet.

EMOTIONAL AROUSAL
Anxiety and vulnerability to stress can affect perceived self-efficacy in coping with certain situations.

> Research using the National Longitudinal Survey of Youth dataset[14] reveals that self-efficacy is indeed a predictor of wealth creation across time.

Executive functioning consists of a set of cognitive abilities or skills necessary for goal-directed behavior (attention, self-control and self-monitoring, and planning and initiative).[15] Good executive functioning decreases stress about the current financial situation and increases perception of future financial security.[16] Executive functions, such as self-control, are not only correlated to self-efficacy but also promote self-efficacy.[17]

ESTATE PLANNING AND FINANCIAL EFFICACY

This bulletin began by posing the question is the goal of estate planning to distribute wealth to inheritors or to improve their financial well-being? The first approach focuses on transferring assets to beneficiaries as well as establishing the structures needed to preserve the wealth. This approach is focused on the wealth itself and, many times, the planning includes "controlling" risk management practices and tools. The second approach, instead, focuses on increasing the beneficiary's sense of having enough resources to cover their needs and, therefore, better enables pursuing a meaningful and engaged life.

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In our January bulletin,[20] we touched on what motivates beneficiaries (Self-Determination Theory) to engage and lead a productive life. While intrinsic motivation is an essential starting point, individuals need to build on their self-efficacy to bring forward a successful life, including good financial efficacy.

The literature indicates that financial self-efficacy is based on personal qualities and capacities that can be developed from a young age and over the arc of a lifetime. Income does not harm motivation and efficacy but rather, it supports financial well-being.

The primary tool commonly used to improve financial self-efficacy is education aimed a improving financial literacy. However, research has found a weak effect of education on actual financial behavioral changes.[21] Focusing on building positive financial behaviors or executive functioning such as helping individuals create a budget and monitor their subsequent performance, can be more helpful in developing financial self-efficacy. Through case studies, individuals can also learn about pros and cons of financial behavior and develop efficacy through vicarious experiences. Coaching or counseling can also be very helpful in developing skills and capabilities for increasing self-control, resisting bad habits and changing behaviors in positive ways.

Our Well-Being Trust supports financial self-efficacy in many ways:

- The Trust offers the autonomy and freedom that allow the beneficiary to take ownership of their life (in all domains of life, including financial).
- The Trust's language plays a verbal persuasion role – a source of self-efficacy – by manifesting parents' belief in their children, their capacities and their potential.
- The Trust establishes an age (suggested 21) at which beneficiaries start receiving reports and relevant information about the investment strategy, performance and costs, including taxes. This starts an education journey for the beneficiary at an early age. At 25, the beneficiary can be a co-trustee and be more involved in managing investments and distributions. By sharing responsibility and decision making with an educated trustee, the beneficiary can practice, test their own skills, and learn from the experience. By 35, the beneficiary may be prepared to be the sole trustee with the skills and experience developed over the last 14 years and exercise their own self-efficacy in managing the trust funds and distributions. Based on research, the practical application of financial education is required to build good financial behavior and well-being.
- Paired with the above, the beneficiary can also be coached in good financial behavior and habits from an early age. The Trust provisions include the use of financial distributions to pay coaching services tailored to develop executive skills, self-efficacy, and other needed capabilities to improve financial and overall well-being.
- Parents can add their own lessons and experiences to the trust (such as what has been the money best spent for them, what has been the focus of their spending). The beneficiary can develop self-efficacy from their parents (vicarious experiences).
- Autonomy is another important feature of the Well-Being Trust. By granting freedom of choice, it supports individuals in setting their own goals and, if needed, imposing their own restrictions.
- The concept of Return on Well-Being introduced by the Trust invites the beneficiary to be thorough and intentional in spending money. Specifically, prioritizing the use of money that helps increase their well-being the most. In doing so, individuals are assessing their spending based on their own subjective well-being (vicarious experiences and emotional arousal) but also using empirical data (vicarious experiences) to inform the impact on well-being of different behaviors and choices. This analysis provides guidance for solving the equation spending today versus in the future.

Our lifetime approach to inheritance (or giving over the arc of the parent's lifetime) also supports self-efficacy since it is conceptually a structure that supports beneficiaries in their journey of becoming

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their best self. Having funds available beginning in their young adult life with the purpose of supporting their well-being entrusts the beneficiary with the use of their best judgement of in the deployment of those funds. Over time and with the support of an engaged trustee, the beneficiary can develop an understanding of money well spent or invested in their well-being. This is part of journey to master their financial well-being.

For more information on how to positively use family wealth and inheritance to foster family well-being - thriving in multiple domains of life, see our Family Wealth and Inheritance Services page or contact Richard Franklin, rfranklin@fkl-law.com, (202.495.2677), Claudia Tordini, ctordini@fkl-law.com or your FKL attorney.

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