Leon Frazer & Associates

VOLUME 24, ISSUE 2

STRATEGIES

The emotional impact of business transition decisions

A conversation with Gregg Becker, President, Predictable Futures Inc.

Handing over your business can be harder than you thought – but not for the reasons you thought it would be. Facts and figures are the easy part, but how do you ensure that your business, family members and business partners will thrive from a relational perspective once you're gone?

Gregg Becker, President of Predictable Futures Inc. has been leading best-in-class company transitions for private enterprise for over a decade, and holds an Advanced Certification in Family Business Advising.

At Predictable Futures Inc., you say that you ask, smart – sometimes difficult – questions. What's a difficult question that people need to ask themselves when preparing their family business transition plan?

The first thing people should ask themselves tends to also be the last thing they *want* to think about – handing off control. This is a complex and sensitive question – and it's crucial to answer it well. There are two categories that need to be covered when considering the transition of control: leadership and ownership.

First, you need to figure out the who, when and how of leadership transition. Basically, who will be the new you? It may be more than one person, and if so, you'll need to clearly define how the responsibilities will be spread. The more people you add, the more complex your plan will need to be. Business and relational success upon a healthy transition of control, and thoughtful timing.

Next, who's going to control ownership? How will transition in this sphere shift,

Editor's note

While financial considerations are typically at the forefront of people's minds when creating their family or business legacy plan, what tends to actually keep them up at night is concern for the emotional well being of their successors. We're here to help you clarify and address those issues and put effective solutions into place. In this Leaving A Legacy issue of *Strategies*, we hope to provide you with some thought-provoking insights to consider on this subject. And, as always, we're here to support you in that journey every step of the way.

Lucy Conte, Editor-in-chief

INSIDE

and when? Ownership control is typically represented by shareholders, directors, etc. This group makes decisions about shareholding, voting, dividends, and things of that nature. In many business transitions, this is where most of the focus is put, and it is often viewed largely as a transaction.

Handing over control isn't easy for a lot of business owners. Sometimes, it makes sense to do that incrementally, and other times a quick change is the better solution.

What's a problem that you solve for clients before it's even on their radar?

In the case of transitioning a family business, people often don't talk about the terms and conditions under which they're employed. This is an issue we bring to the forefront by having business families write out their rules of engagement. We get them to establish rules around hiring, dismissal, compensation, reporting and career development for example. How will the children be compensated in comparison to employees who are not family related – and to each other?

In the case where kids do different jobs and have different responsibilities, how will their performance be evaluated? Are owners also evaluated the same way? By creating a Family Employee Policy, we define the rules of engagement in the business for family members, which increases predictability, consistency and reduces the risk of conflict later.

For example, we had a client who was transitioning their landscaping business to two daughters. One daughter played a key role in the business and a vehicle was purchased for her day-to-day duties. The other daughter's responsibilities were significantly lighter and more administrative in nature, but she felt that it would be fair to provide her with a new vehicle as well. In this situation, the second daughter was blurring the lines between family and work.

How do you work with family members when they disagree with a decision that's been made in the plan?

People generally tend to be respectful when we come together with the family to discuss the transition plan. One way that we diffuse possible friction in advance is to meet individually with each family member before coming together. This helps us anticipate areas of contention that might come up, and have solutions in place to manage them.

Generally, families know each other well and there are no surprises about how people will respond or where they might be misaligned. They've just never had the opportunity to come together and discuss those issues in a safe place with the help of a neutral third party, and are usually grateful to be able to do so.

To help keep the family aligned in their transition planning, we begin by creating a family Code of Conduct. We also ask, "What are the Family Values?" These might include things like peace, harmony and loyalty. By using these tools as our guide, we can refer to them if discussions get heated. We can ask, is this behaviour or solution aligned to our value of harmony? And if it isn't, then we can figure out what a harmonious plan looks like.

In one case, a family member actually called the family out on one of the core values and said, "We don't do that!" Everyone laughed because they knew it was true. But that's okay, values can be aspirational too…they can be things the family would like to work on.

What's a common mistake people make in their business transition plan, and what should they do instead?

People tend to make a lot of untested assumptions about things, like timing and how things will go, because they don't have all the information at the beginning. This is where creating a clear Plan B scenario is invaluable. Figure out what you'll do if things *don't* go the way you hope or anticipate. For instance, if your kids say they're going to take over the business but then change their minds. Or maybe the wealth isn't what you thought it would be due to circumstances that were outside of your control.

This is where starting your transition plan early can make a real difference. People who start late are scrambling to get a plan in place at all, and don't have time to consider alternative scenarios and what they might do in those cases.

In an episode of CWB Wealth Management's *What They Don't Tell You* video/podcast, you mention that people often won't reveal the deep emotional issues that keep them up at night for fear of appearing vulnerable or incompetent. What is a common fear that people have, and how do you help them solve this?

Poor financial outcomes are rarely a concern. Successful business owners know how to set up the business for success after their departure. What keeps them up at night more is not knowing how their decisions will affect their family members or partners personally and emotionally. Will the family be happy with the decisions that have been made, and be able to handle things? Owners worry that they'll be blamed if things don't go well after the transition. Sometimes, it can cause marital discord if their spouse disagrees with their decisions, and this could have a lasting impact on that relationship.

We reassure people by working through various scenarios so that they can feel confident about their decisions. And by discussing issues with the involved family members and key players, we can get buy in, which alleviates some of the weight tied to transition-related decisions.

What did you learn in setting up your own business succession plan?

We had to have the same difficult conversations that we walk through with our clients. People's identities can get caught up in their roles, and this can make decisions challenging. In that regard, it was a great exercise to fully understand all the emotions our clients go through by going through it ourselves.

People are smart – they're running a business and making important decisions every day. They need to come to their own conclusions about what's best for them, their family and their business. What's sometimes overlooked is that the emotional and relational impacts of business transition decisions are just as important as the financial impact. Working through these issues, and giving yourself enough time to do that, removes a huge weight from business owners and sets them up for greater success.

Lucy Conte, Content Manager
CWB Wealth Management

It’s a seller’s market

It’s a great time to sell your house – as long as you don’t need to buy another one. The Canadian housing market is on fire and the statistics are staggering.

According to the Canadian Real Estate Association (CREA), March 2021 saw over 76,000 transactions occur via the Canadian MLS system. This is 40% more than the highest sales level for March on record. In fact, it beats the highest level of activity for *any* month in history by over 20%!

Of course, sky-high demand leads to price increases, and we saw an average of a 20% increase in prices across Canada for the year ending March 31, 2021. This level of activity is getting a lot of attention and deservedly so. In many markets, homes are going for an average of 5-15% above listing price, bidding wars are common and days on the market for new listings are low.

> **“It’s mostly a rational increase.”**

Housing prices surge

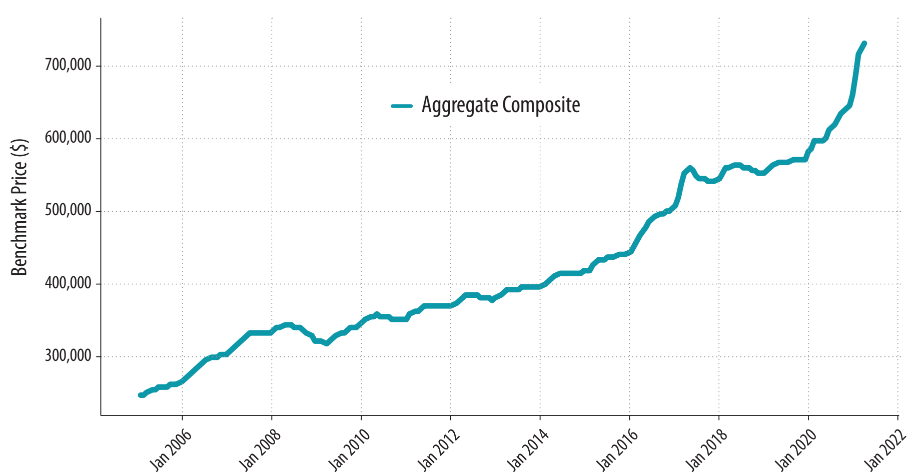
Typically, when prices for any asset rise dramatically in a short period of time it’s prudent to ask, what is driving the change? Is it fundamentals or speculation? In the case of the Canadian housing market, we think it’s mostly a rational increase based on some unique fundamentals due to the pandemic.

Today’s housing market is really being driven by unprecedented demand. Although we often hear about supply issues in the media, it really doesn’t appear to be true. As seen below, the last three quarters have seen extremely strong listing activity. Demand has simply been stronger which has led to the price increases.

In our view, there are four main factors driving the demand growth:

1. **Interest rates are at historical lows.** Falling rates have been the wind behind the housing market’s back for decades. The pandemic saw rates fall to new lows, which has increased affordability and financial flexibility.
2. **Significant increase in savings.** Personal disposable income has actually increased during the pandemic and a lot of the increase has gone to savings as expenses have come down in many cases. This recovery has disproportionately helped those who are better off. According to CMHC, workers making $36/hr or

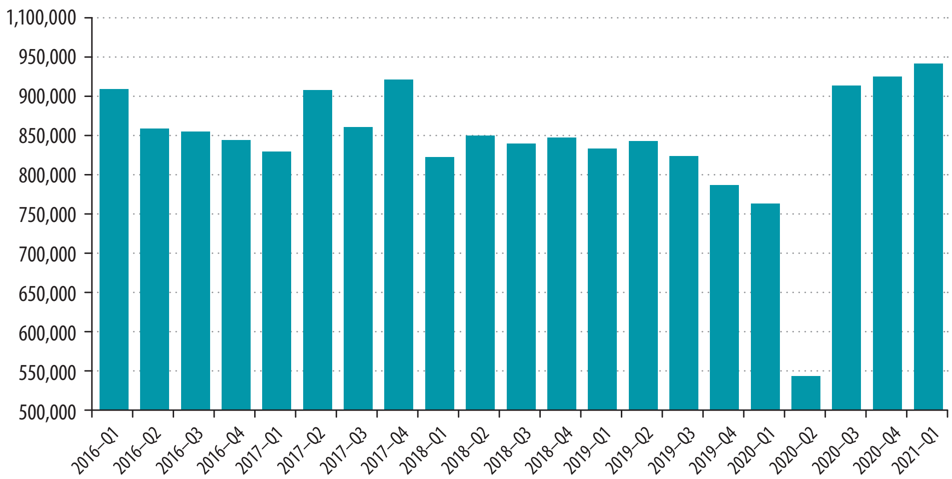
Home Price Index Performance Over Time



Note: Aggregate MLS® HPI time series include data for all participating boards/associations. The data is revised back to January 2005 as additional boards/associations join the MLS® HPI. Actual MLS® HPI data when they are statistically significant.

Source: The Canadian Real Estate Association (CREA)

Residential New Listings Canada



*Seasonally adjusted data at annualized rates

Source: The Canadian Real Estate Association (CREA)

more have seen employment rise by around 10% over the past year. These are the typical homebuyers. Those making $17.50/hr or less have seen employment rates fall by 20%.

3. **Non-mortgage debt is lower than pre-pandemic.** Higher savings and lower rates make a powerful combination for buyers to bid up prices for their dream home.
4. **Work from home.** The pandemic has seen a completely new trend of people leaving the city. If you can work from anywhere, why not buy a larger home for less money in an area with less congestion? The market in Ontario is a perfect example of this phenomenon. The 3-district chart here shows twelve-month price increases in Toronto compared to a city that has traditionally been a long commute option (Barrie), and one that has not previously been considered a commuter option (London). For the first time in a long time, the steepest increases in prices are happening in secondary markets and not in Toronto or Vancouver.

Prices will likely continue to increase in Q2 before they start to moderate. Once the economy is fully opened up, people will again have other things to spend their money on. It's likely that prices in secondary markets (like London and Barrie) will moderate or even correct if the return to office is more pervasive than expected, or if some buyers move back to the city, or the tide of those leaving levels off. Mortgage rates should rise somewhat (and already are modestly) putting downward pressure on prices – or least on price increases.

We do acknowledge that increases in price and activity that are this rapid need to be monitored, and that there is always a risk that what appears logical can turn into rampant speculation. If we were to see three or four plus years of double-digit price increases, we would be much more concerned. By then, pandemic factors will have subsided and it would be much more likely that speculation was driving the market rather than fundamentals. For now, we are not worried that housing activity will spill over into the economy in a negative way.

Scott Blair, CFA
Chief Investment Officer
CWB Wealth Management

"Prices will likely increase before they start to moderate."

% Difference From 12 Months Ago (March 2020 to March 2021)

Note: Aggregate MLS® HPI time series include data for all participating boards/associations. The data is revised back to January 2005 as additional boards/associations join the MLS® HPI. Actual MLS® HPI data when they are statistically significant.

Source: The Canadian Real Estate Association (CREA)

The 3 Ps for leaving a legacy

"Legacy is not what I did for myself.
It's what I'm doing for the next generation."
–Vitor Belfort

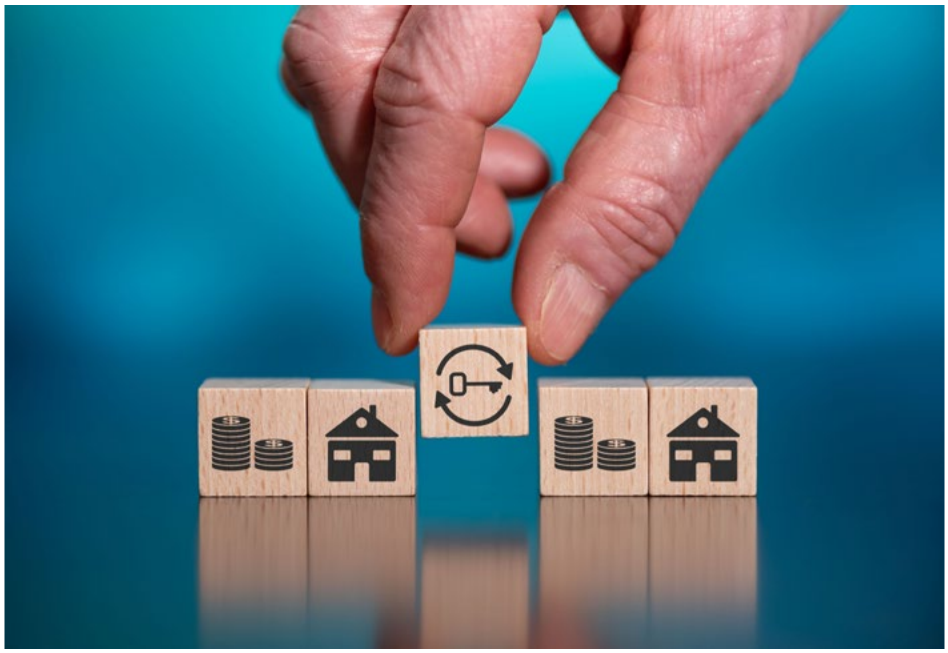
Your business, your net worth and your family name. As a business owner, these are just some of the legacies you'll eventually want to pass onto your children. Transferring these legacies, though, is not without the risk. Businesses can falter, net worth can be spent and a family name can be forgotten gradually over time. But with thoughtful planning and ongoing assistance, you can minimize these risks to preserve, protect and promote your legacy well into the future.

To illustrate these three legacy-enhancing strategies in practice, let's meet Mic and Stevie Flatwood, a fictional business family. For the past 30 years, Mic and Stevie raised their three children and grew their small music store in their hometown of Vancouver into the largest chain in British Columbia. Now that their children are ready to take over the family business, Mic and Stevie would like to spend more time travelling, seeing their favourite bands, and less time counting inventory. They also want to ensure the financial legacy they've created will allow their family business to continue, provide their children and grandchildren with financial security and give back to the communities they work in.

Preserve

Mic and Stevie will eventually need to pay about $3M in estate taxes and administration costs, even after all the tax-efficiency planning they've done with their advisors. These expenses will be paid by their estate and reduce the value of the inheritance left to their children. Their options for paying these expenses include:

1. Liquidating some of their estate assets (e.g., investment portfolio, real estate, rare record collection)
2. Creating a dedicated fund in advance
3. Purchasing a permanent life insurance policy



The costs/benefits for each of these options is summarized below:

TABLE 1 – PRESERVE

OPTION	COSTS	BENEFITS
Liquidate estate assets	• Projected pre-tax funds required to fund estate expenses: $4.0M (assumes 50% capital gains inclusion rate and 50% tax rate) • Future changes in rates of return and income taxes may reduce net proceeds below the amount required	• Funds not required until after death
Dedicated fund	• Projected pre-tax funds required to fund estate expenses: $2.9M (assumes 4% rate of return) • Taxes payable annually on investment income • Future required amount not guaranteed	• Investment funds under your control
Permanent insurance*	• Projected pre-tax funds required to fund estate expenses: $1.6M (assumes 10 payments of $185,093 at 1.50%) • Premiums must be paid in advance	• Funds grow tax-exempt inside of policy • Premium flexibility • Guaranteed amount payable on death

*estimates provided by CWB Insurance Solutions

Protect

After being in the music industry for over 30 years, Mic and Stevie have seen their fair share of lawsuits and messy divorces. While they've been relatively lucky and are still going strong commercially and personally, they're concerned about the negative impact of a future legal dispute on the financial legacy they want to leave to their children.

One option they're considering for protecting their financial legacy is transferring their family assets to several trusts. For example, when Mic and Stevie turn 65, they can transfer their personally-owned assets (e.g., home, investment portfolio, rare record collection) to a joint partner trust. Since their trust is now the legal owner of these assets, they will no longer be subject to legal claims that may be levied against Mic and Stevie personally (subject to certain conditions). These assets will also no longer be subject to probate fees (depending on the province you live in, probate savings could be material) and their estate can be wound up faster than if they continued to own these assets personally.

As for their three children, Mic and Stevie can set up a family trust for each of them to hold their shares in the family music business, and their respective personal assets. Each family trust will also provide their children with a degree of security in case they were to get divorced in the future, since these trust assets would not be considered family property (e.g., shares in the family music business would not end up being owned by a non-family member).

While these trusts can provide legal protection and probate savings, Mic and Stevie understand there will be costs involved in setting up each of them, and in preparing the ongoing annual trust returns and time spent with their advisors to oversee these trusts.

> **"While trusts can offer legal protection and probate savings, there are costs involved with setting up and maintaining them"**

Promote

Mic and Stevie are first-generation entrepreneurs who are very proud of the longevity of their business, and the benefits it's provided their family, employees and customers. While they participate in and give to various charities in their community, they'd like to create a lasting legacy using the wealth they've accumulated through their business. They'd also like to teach their children and grandchildren financial responsibility and the value of philanthropy. After speaking with several fellow business owners, they've decided to set up the Flatwood Family Foundation to oversee the family's charitable activities.

The costs/benefits of their family foundation are summarized in Table 2.

TABLE 2—PROMOTE

COSTS	BENEFITS
• Professional fees to set up family foundation	• Flatwood family name positively associated with community donations in perperity or until the family foundation is wound up
• Ongoing annual CRA return preparation fees	• Tax receipt issused for donations to the family foundation
• Time required by family members	• Family gets to decide which third-party charities the family foundation donates to • Opportunity for younger family members to learn about financial responsibility and philanthropy

Whatever your legacy goals may be, they're far too important to be left to chance. Preserve, protect and promote the things you hold dear. We can assist you with your family business succession plan, giving you greater peace of mind in knowing that all possible options have been considered to secure your family's legacy. Our roster of experts includes trust and estate practitioners with specified knowledge in tax optimization strategies. We also offer coordinated insurance strategies through licensed advisors of CWB Insurance Solutions.

Jason Kinnear, CPA, CA, CBV
Family Office Manager, T.E. Wealth

Insurance products are offered through CWB Insurance Solutions, a wholly-owned subsidiary of CWB Wealth Management. All insurance products are subject to the limitations and conditions in the applicable policy or certificate of insurance in force at the time of purchase or enrollment and applicable legislation.

The corporate executor—who, what, where, why, and how much?

When deciding who to appoint as your executor, you'll likely want a detail-oriented person with a good blend of strong financial and emotional acumen. Maybe the choice is obvious – but maybe such a person just doesn't exist in your life. Or maybe you need someone with a unique or specialized skillset. What then? Enter the corporate executor.

The idea of using a corporate executor remains a mystery to a lot of people: when or why should you use one and what are the costs? In this article, we'll explore these questions and hopefully leave you with a better understanding of this often-misunderstood resource.

Why use a corporate executor?

There are several situations where using a corporate executor might make sense:

1. The person you'd like to appoint as executor doesn't live in the same jurisdiction as you.
2. You operate a business that will need to be managed or sold after your death.
3. Family tensions make it difficult to maintain impartiality, making a third-party executor a more effective option.
4. Your family may include individuals with unique dependency needs.
5. If trusts are established that will be administered by a corporate trustee, the executorship and the trusteeship services will often be provided by the same firm.
6. While some find an executorship appointment to be a great honour, others may find it burdensome. You may not want to put executorship duties on a loved one who would struggle to manage them.

While this is by no means an exhaustive list, you can see there are many valid reasons for considering a corporate executor. Why, then, do so few people choose to use one? The number one reason – and you likely guessed it – is cost.

While it's true that there are sizeable fees, it still may be worthwhile if your situation involves some of the above-mentioned situations. My main critique of the cost argument is that many people who cite cost as an impediment don't actually know what the cost is. They don't know what's reasonable in the marketplace, how it would be structured, when it would be paid and who would pay it. Let's explore this further.

Process & fees

The appointment of a corporate executor would occur within your will in the same way you'd appoint an individual. So, instead of naming Jane or John Smith, you'd name a trust company. Outside the will, you would then sign an agreement with the trust company which would outline your agreed upon compensation arrangements for the executorship, and any other services they would provide upon your death. Your will would state that the trust company is entitled to receive renumeration based on the agreement that you've previously made with them.

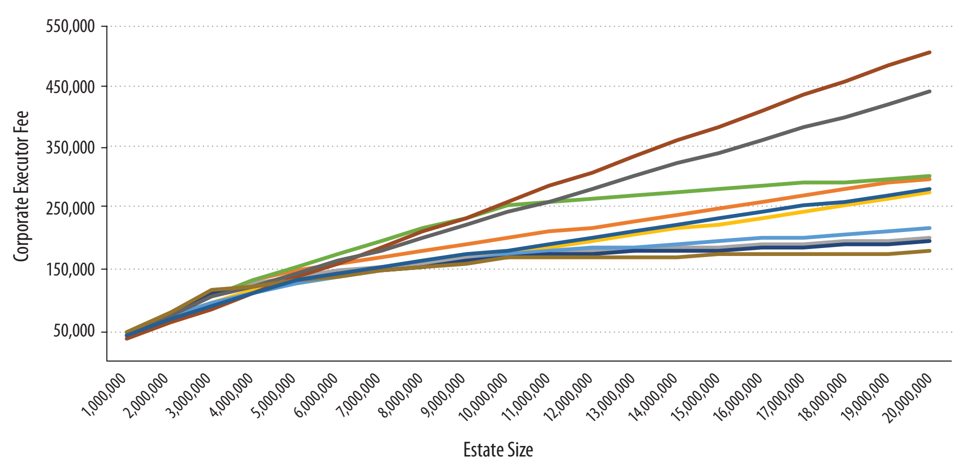
Over the past few years, I've reviewed the agreements for most of the major players in this space and I've designed a tool to help estimate the costs for my clients. Without naming firms (sorry!), here's a summary of the findings which are current as of June 2020. Each line represents one of 10 different trust companies, and shows what their fee would be for any given estate size.

Here are a few of my observations:

- A minimum estate size of $1,000,000 will often apply.
- The average[1] fees at $1M, $3M, $5M, $10M and $20M are 4.2%, 3.4%, 2.7%, 2.0% and 1.4% respectively.
- While there is a $10,000 spread between the most cost-effective and least cost-effective fee on a $1M estate, this divergence becomes much more significant as estate sizes get larger.
- The most cost-effective alternative for a $1,000,000 estate is also the least cost-effective solution for any estate over $9,000,000.

[1]Averages omit the highest and lowest figures from the sample set. This helps increase accuracy by avoiding the outlier effect.

Executor Compensation by Estate Size - Comparison Of 10 Fee Grids



Source: Doherty & Bryant Financial Strategists.

There are zero upfront costs associated with this appointment. The executor fees would be collected from your estate after you die, and your beneficiaries would receive the net amount after the executor fees have been collected. What *does* occur up front is the agreement and, potentially, the negotiation of what that future fee structure will be when you do die.

If you already have a corporate executor named in your will, that word 'negotiation' may come as a surprise to you. When a corporate executor is required, it's common practice for estate lawyers to recommend a specific trust company for you and coordinate the paperwork. However, my experience has been that this process would typically result in an off-the-shelf agreement being signed. This would eliminate the opportunity for you to explain why you should perhaps qualify for a lower-than-advertised rate.

Consider this

The costs associated with corporate executors is as high as it is because the trust company has no way of knowing what they're getting into, and administering a disorganized and mysterious estate can be very time consuming. They need to price the unknown into their fee models. If you can illustrate to the potential trust company that your affairs are orderly, kept up to date, well documented and, dare I say, "simple", then there's a good chance you'll be able to sign a reduced rate. It doesn't hurt to shop around a bit.

Other considerations

It's also important to note that, like naming an individual as an executor, the appointment of a corporate executor is a revocable position. As such, you're free to change your mind in the future if your situation evolves and you no longer need a corporate executor. Or, if your situation has become less complicated you may be able to negotiate a more competitive arrangement.

I typically recommend to my clients that they have a robust review of their estate documents at least every five years and, if applicable, their corporate executor and trustee appointments would be included in this review process.

While this article has focused on corporate executors, if your estate includes trusts that will need ongoing management then those trustee costs would be in *addition to* the executor arrangements that have been the focus of this article. While the executor duty is a one-time event, the beneficiaries to your trusts will have an ongoing relationship with any corporate trustee that you may appoint. So, it's important that you have a solid understanding of the agreements that you have in place for the care and management of your trusts.

In the long term

I hope this has brought you some clarity on when it might be beneficial to use a corporate executor, and that you now feel more equipped to have these conversations with your estate lawyer or financial planner. If your situation could benefit from this expertise, you shouldn't let the fees persuade you from doing what's best for you and your loved ones. As with many things, doing a job poorly can be much more expensive and painful in the long term than paying someone to do it correctly the first time.

Aaron Hector, B.Comm., CFP, R.F.P., TEP
Vice President & Financial Consultant
Doherty & Bryant Financial Strategists

Leon Frazer & Associates
INVESTMENT COUNSEL

Vancouver · Calgary · Toronto

1-800-418-7518 www.leonfrazer.com info@leonfrazer.com