

CREATIVE

Wealth Maximization Strategies

TRIAD | WEALTH SYSTEMS
Russ McMillan, President
600 Emerson Road, Suite 110
St. Louis, MO 63141
Phone: 314-997-1388

AUGUST 2008

THE ROONEYS' DILEMMA



Born in 1901 in Pennsylvania, Art Rooney married and had five children, all boys. In 1933, using \$2,500 in winnings from betting on horses, Rooney bought a business franchise. Over the years, the business experienced some ups and downs, but stayed afloat. When Art died in 1988, his five sons inherited the business. Dan, the oldest boy, became the chairman of the company.

In the last two decades, the value of the Rooney family business increased exponentially. Suddenly, a second-generation mom-and-pop operation (the organization never incorporated) became worth hundreds of millions of dollars. Today, the business is conservatively estimated to be worth \$700 million (although one commentator puts the value at \$1.3 billion).

But the brothers are getting older. Except for Dan and his son Art II, none of the family is involved in the day-to-day operations of the business. For the past few years, the other four brothers have been discussing ways to sell their shares of the business. Dan, who wants to see the business remain under family control, is trying to find a way to buy out his brothers, but this presents a significant financial challenge. And the brothers are thought to be entertaining substantial offers from outside investors.

If you're a sports fan, you know the Rooney family business is the Pittsburgh Steelers, one of the most successful and storied franchises in the National Football League. But even if you don't know where the ESPN channel is on your cable service, it's worth a look at the challenges facing the Rooneys, because their issues are

quite similar to those of every successful family business in the United States.

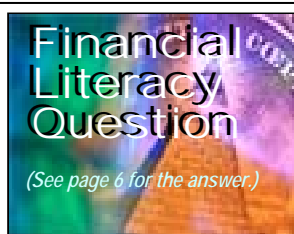
Jilian Mincer, writing in a March 17, 2008 *Wall Street Journal* article "Whose Business Will This Be?", reports that

"Only about 40% of family businesses make it to the second generation, 12% to the third and 3% to the fourth...Some are sold to pay taxes or because children who inherit them are unwilling to keep them going. Others stumble because they lack succession plans, which can be destabilizing if, say, siblings disagree about who should be running the company."

Other than the size of the numbers, the Rooneys' situation accurately reflects much of this assessment. Here are some of the issues the Rooneys face as their "family business" transitions to its third generation:

Equitable transfer of ownership.

When Art Rooney died, his ownership of the Steelers was spread among his five sons. The four sons not directly involved in the Steelers now own 64% of the company, or 16% each. Dan Rooney and his son, as active members of the business, own the other 36%. If the four brothers pass their respective ownership shares on to their children, the percentage of ownership for each individual heir will be even smaller – but there will be more shareholders. This dilution of ownership could



Here's a quick quiz on a basic financial concept. Do you know the answer?

If you experienced annual gains of 10% for three consecutive years, then lost 5% in the fourth year, what rate of return would be required in the fifth year to average 10% annually for the five-year period?

___ A. 15% ___ B. 21% ___ C. 27%

in the future make it harder to reach a consensus on business decisions. On the other hand, if the four Rooney brothers all sell to one buyer, Dan and Art could lose control of the business.

Just having owners who can't get along can sink a business, especially when minority shareholders aren't working in it. The discord may lead to dissatisfied shareholders asking to be bought out. In the words of Art Modell, formerly the majority owner of the Baltimore Ravens, "minority shareholders can sometimes force a sale. It becomes the only solution."

According to several sources, Dan Rooney has made a tentative offer to buy a portion of each brothers' ownership interest now, with the promise to buy the rest later. Based on Dan's offer, the Steelers have an estimated value of \$700 million. The four brothers, as part of "normal-course" estate planning, have hired Goldman-Sachs to make an independent appraisal of the franchise's value. A deep-pocket hedge-fund manager is supposedly interested in buying the brothers out at a higher valuation. Obviously, the four brothers would prefer to sell at the higher price, while Dan and his son would like to purchase at a lesser number.

With all these competing interests, what arrangement will result in an equitable solution for all parties?

Lack of funding for buyouts.

The Steelers franchise might be worth a lot of money, but like many businesses, some of their best assets are illiquid (their stadium), or intangible (the brand-name association with the NFL). Keeping the business competitive requires reinvestment of profits, so it is unlikely that Dan Rooney could use cash flow to buy out his brothers. Yet taking on more debt to finance a buyout might make it harder for the Steelers to stay competitive. "When you don't have significant other assets to use as collateral to either buy out your siblings or pay the IRS the estate taxes, that's when you have an issue," says Marc Ganis of Sports Corp., Ltd in a July 11, 2008 *Pittsburgh Tribune-Review* article.

If Dan Rooney can't find a way to buy out his brothers' shares, entertaining offers from outside buyers may be the only way for the brothers to liquidate their interest.

Looming capital gains and estate taxes.

Besides advancing age, one of the factors pushing the four brothers to sell their interest is the prospect of higher capital gains and estate taxes in the near future. Commenting in his July 8, 2008 *SportBiz* blog on CNBC, Darren Rovell says "In the next three years, I believe that more high profile sports teams will be sold than ever before. Why? Because of the estate tax repeal in 2010 and even sooner than that, the potential of huge increases in capital gains taxes..."

Irrespective of who wins the 2008 presidential election, there is strong sentiment that the changing political climate will result in higher capital gains and a restoration, in some form, of the federal estate tax. In the Rooneys' situation, Rovell estimates that selling now could mean a capital gains tax savings of nearly \$80 million in comparison with higher future rates proposed by some lawmakers. That's a strong motivation to sell.

There's no way around it: Business owners must plan ahead - now

Sooner or later, every profitable closely-held business will eventually encounter these same scenarios as the Rooneys. One owner will depart, and two questions will have to be answered:

- 1. What will happen to the business when the owner leaves (by retiring, selling, or dying)?**
- 2. How will this transition take place?**

In a perfect world, those answers could come easily, and be executed flawlessly. But the real world isn't perfect. Partners don't always agree, heirs may fight over the inheritance, the government will come to collect taxes one last time.

And the details can be overwhelming. Commenting on the Rooneys' dilemma, attorney Chuck Greenberg, who heads a firm that specializes in franchise acquisition, said "You've got an extraordinarily valuable second-generation family business, and it's very complicated. The increased value is a wonderful thing for an owner but creates enormous additional complications from an estate-planning standpoint."

While prudent planning and foresight can't eliminate disagreements, won't make taxes disappear, or simplify the tax and estate issues, thoughtful preparation can greatly minimize the impact of some of these potential problems.

And the sooner you begin formulating and formalizing these plans, the better. When it comes to business and estate planning, procrastination often leads to liquidation. Quoted in the same *WSJ* article, Jere Doyle, an estate-planning specialist at BNY Mellon Wealth Management, says, "the longer you wait, the better the chances you'll have to liquidate to pay taxes."

Basic Instruments, Expert Advice

Crafting a solid succession plan usually results from a combination of basic financial instruments expertly applied to your unique situation. Among the basic "tools:"

A variety of legal constructions.

These legal arrangements may be trusts, corporations, other ownership or purchase agreements, gifting arrangements, or other contractual agreements. Which legal formats are chosen will depend on the particulars of your business – profitability, liquidity, number of successors or heirs, etc.

Life insurance.

Because many ownership agreements will be implemented on the death of one owner or shareholder, life insurance has long been used to provide the financial wherewithal to complete succession plans. Again, the type of insurance will vary depending on the circumstances, and should fit hand-in-glove with your legal arrangements.

Because of the contractual nature of most successor and estate agreements, the devil is often in the details. This is not a do-it-yourself project from a kit purchased on the Internet. You need experts that not only know the specifics, but will also make sure they get done.

It Starts with an Awareness of the Issue

In retrospect, it appears the Rooneys might have benefited from some advance business succession and estate planning. In the end, things may still work out, but most financial decisions made under duress aren't going to deliver the best results. (When Joe Robbie, the owner of the Miami Dolphins died, his surviving family members were unable to pay the estate taxes to keep the team.)

To be fair, this type of proactive planning seems to run counter to human nature, especially for successful business owners. Successful entrepreneurs are usually busy people, and unless there are health problems, they often find it difficult to retire. Being in charge for so long, “they don't want to give up control to the younger generation,” says Doyle. A survey from the Family Firm Institute found that fewer than half of business owners who expected to retire within five years had selected a successor, and nearly a third had done no estate planning beyond a will.

Drawing another example from among NFL team owners, Lamar Hunt, the long-time owner of the Kansas City Chiefs, transferred 80 percent of his franchise ownership to his four children in 1997, paying a hefty gift tax since the team was then valued at \$188 million. Three years later, Hunt told reporters “if I was real far-sighted, I would have done it when the franchise was worth \$10 million. But for some people, it's hard to think in terms of dying. They don't want to admit it could happen to them at any time.”

One of the ways to make planning easier is planning to talk about it regularly – even if you're not ready to formalize anything. Carmen Bianchi, president of the

Family Firm Institute, advises family-owned companies to establish “family councils” at which business-related issues can be discussed – without lawyers or bankers in the room. Bianchi says this often diffuses conflicts before they erupt, and helps prospective heirs and non-involved partners feel like they are part of the company's future.

When it comes to the actual plan, many financial service companies have programs to help business owners systematically process the succession and estate issues they face, as well as in-house experts to coordinate the legal and financial aspects of implementing their wishes.

If you're a business owner, return to the two questions below:

1. **What will happen to your business when you leave (by retiring, selling, or dying)?**
2. **How do you want this transition to take place?**

After 75 years in business, the Rooneys find themselves in a dilemma. But it doesn't have to be that way. If you know the challenges, you can take action. But if you procrastinate, the only action may be to liquidate.

Managing Your EFC for College Expenses

Prepare to be overwhelmed: Here are a few statistics provided by David Juliano from a May 2008 *College Funding* article:



- According to the College Board, average total charges (including room, board, tuition, and fees) for an in-state student at a public four-year institution for the 2007-2008 academic year were \$13,589.
- For out-of-state students, the number jumped to \$24,044 a year.
- Average total charges at private four-year institutions were \$32,307.

These numbers reflect an increase of almost 6 percent over the previous year. As Scooby-Doo would say, “Too scary!” But how's this for even scarier?

- For a child born today, given the same rate of annual increase over the next 18 years, the cost of attending a private school would be **\$92,000 a year!**
- For a family with two children who both attend private four-year institutions, this future scenario adds up to education costs of more than **\$750,000!**
- Assuming an 8 percent annual rate of return, this family would need to save **\$1,300 a month** from the time their first child is born until the second graduates.

Talk about sticker shock. How can you realistically expect to save for college *and* retirement?

Numbers like these emphasize why everyone should investigate all possible sources of educational financial assistance. In fact, Juliano reports that “the majority of college students do not pay the full sticker price at the school they attend.” Many college students are able to offset their education costs through need-based grants, loans and scholarships, and work-study programs.

In order to maximize your child’s chances for financial help, you must be familiar with the two acronyms: FAFSA and EFC

FAFSA and EFC

The FAFSA (Free Application for Federal Student Aid) is the primary document for determining eligibility for needs-based assistance from the federal government and many colleges. FAFSA asks parents and students to collectively document their current income and assets, beginning with the year prior to the student entering college. (A new FAFSA must be completed each year.) This financial information is processed through a formula to derive a number called the expected family contribution (EFC) – the amount of educational expenses that the student and his/her family are expected to pay in the upcoming year. The EFC number is inversely connected to one’s eligibility for financial assistance; the higher the EFC, the lower the amount of aid available, and vice versa.

Managing Your EFC

The FAFSA formula for calculating your EFC allows certain assets to be deducted or excluded from consideration. Thus, it is possible through the use of “asset positioning” to lower your EFC score, and increase your student’s eligibility for financial assistance.

Some of this asset positioning is simple. Using cash on hand to pay down consumer debt will lower your EFC (along with your monthly debt service). Likewise, purchasing a laptop computer for your child with cash

on hand will lower EFC. If possible, pension payouts or bonuses deferred into the next calendar year will lower this year’s EFC.

For the purpose of the FAFSA, some assets are considered “non-assessable,” i.e., they are not counted in calculating one’s EFC. Among the non-assessable assets in the federal eligibility calculation:

- Annuities;
- Life insurance cash values;
- Retirement accounts;
- Home equity in a primary residence; and
- Personal items such as automobiles, furniture and other household items.

The FAFSA also differentiates between assets held by the student and the parents. A greater percentage of assets held in the student’s name will count toward the EFC, so there may be benefits to keeping assets in the parents’ names.

Appropriate asset positioning is a legitimate financial strategy. From even this cursory overview, it should be obvious that judicious planning can help your child maximize opportunities for financial assistance.

However, any decisions must be made within the context of your overall financial program. Recommendations to buy new financial products for their supposed “EFC advantage” have to be weighed against the costs incurred. These costs could include income and capital gains taxes, surrender charges, management fees, as well as the opportunity costs for liquidating a profitable but “assessable” asset.

As an example, some financial commentators might recommend making extra mortgage payments as a way to build additional home equity that can be tapped when your child goes to college. It’s true that the equity will not count toward your EFC, but in order to use the additional equity to help with educational costs, you will incur interest charges. Also, the amount of equity available will primarily depend on the home’s current market value, not on how much “extra” you’ve added.

Still, if you have children who are likely to pursue higher education, it may be beneficial to consider how your financial decisions are affecting your EFC. And the next time you meet with your financial professionals to consider new strategies or products, be sure they educate you on the “EFC impact” of any changes.

A Stable Financial Shelter for Tough Times

A small article on an inside page of the February 26, 2008 *Wall Street Journal* read “FDIC Readies for a Rise in Bank Failures.” Hmm. Looks like the FDIC knew what was coming. Here’s the lead from a Sunday, July 13, 2008 *NPR* report (www.npr.org):

Federal regulators seized IndyMac Bank Friday, one of the nation's largest lenders, because of questions about its viability.

The bank is now being run by the Federal Deposit Insurance Corporation (FDIC). The bank is the largest mortgage lender to fail during the housing crisis and is one of the biggest banks to collapse in U.S. history.

John Reich, director of the Federal Office of Thrift Supervision, said Friday that IndyMac "failed due to a liquidity crisis," that is, it ran out of money. The OTS said it transferred IndyMac's operations to the Federal Deposit Insurance Corp. because it did not think IndyMac could meet its depositors' demands.



The purpose of the FDIC is to insure the savings of depositors, and the agency's actions were typical for such an intervention: The government stepped in on Friday, and by Monday, the bank's customers were being served, ATMs were working, and debit cards and checks were honored. But

regulators also acknowledge that more banks are likely to fail.

As the housing crisis unwinds, it's unnerving to think that even your savings might not be safe. But despite the trouble plaguing many financial institutions, guess which sector appears to be holding steady? Well-managed, mutual life insurance companies.

A report on the "Townsend 100" (one hundred life insurance companies, comprising 85% of the industry) published in the July 7/14, 2008 *National Underwriter*, showed that even in the tough economic environment of the past several years, the companies showed a record \$30.4 billion in operating earnings in 2007, and a surplus gain of 6.4% over the previous year, the highest percentage increase since 2004.

As a specific example of financial strength in the midst of widespread downgrades for financial institutions, on July 18, 2008 Standard & Poor's announced it had raised credit and financial strength ratings of the Guardian Life Insurance Company of America from AA to AA+. S&P cited a "very strong capital adequacy and liquidity, a stable earnings profile" as reason for the upgrade, and added there was "limited

speculative-grade credit risk and no exposure to subprime mortgages."

It's no surprise that life insurance companies remain solid. No financial institution – bank, brokerage house, mortgage lender, insurance company – is free from the possibility of failure. But there are several characteristics of life insurance companies that tend to make them more capable of surviving financial distress. Among the most prominent:

- Life insurance companies cannot practice fractional banking, i.e., they cannot lend more than they have in deposits. In addition, they must keep sufficient reserves to meet claims. These constraints promote conservative and prudent use of the premiums they collect.
- Their primary business purpose – providing monetary benefits on the death of an insured individual – is supported by extensive mathematical research. Unlike other types of insurance where coverage and costs may be manipulated through definitions of what is covered or deductibles and waiting periods, life insurance is based solely on whether one is alive or dead. This makes for stable pricing, and a very low incidence of insurance fraud.
- The mutual company model is cost-efficient. Mutual insurance companies are owned by the policyholders and rely on premiums for capital to support the company, with any excess money returned as dividends to the policyholders. John Bogle, the pioneer of the Vanguard mutual funds, acknowledged that he built his company on the concept of a mutual life insurance company because it was a "structure designed to put the client in the driver's seat. And that structure must lead to a strategy that is founded on delivering services at the lowest reasonable cost."

In his 2006 book *Money, Bank Credit, & Economic Cycles*, Spanish economist Jesús Huerta de Soto provides the following assessment of life insurance companies relative to banks:

The institution of life insurance has gradually and spontaneously taken shape in the market over the last two hundred years. It is based on a series of technical, actuarial, financial and juridical principles of business behavior which have enabled it to perform its mission perfectly and survive economic crises and recessions which other institutions, especially banking, have been unable to overcome. Therefore the high "financial death rate" of banks, which systematically suspend

payments and fail without the support of the central bank, has historically contrasted with the health and technical solvency of life insurance companies. (In the last two hundred years, a negligible number of life insurance companies have disappeared due to financial difficulties.)

David Lewis, in a March 10, 2008 entry for Twin Tier Financial (www.twintierfinancial.com) comments on the health of life insurance companies during tough economic times:

...during one of the most turbulent financial times in our nation's history - the Great Depression - it was the insurance contract which provided the most stable financial shelter, not the demand deposit accounts (checking and savings accounts) offered by banks. While many banks failed and never reopened their doors, while the stock market crumbled, and many people lost their entire life's savings, the insurance company was one of the only institutions to survive intact and almost virtually unscathed. This scenario continues to repeat itself during every period of recession or depression in this country.

Occasionally, some financial commentator will criticize life insurance as a "poor investment," comparing it to the historical return performance of some stock, index or other financial instrument. But this criticism overlooks some of the other, less tangible aspects of owning cash value life insurance. One of the intangibles is the designed financial stability that has

allowed life insurance companies to remain solid in times of economic turmoil.

ANSWER TO THE FINANCIAL LITERACY QUESTION ON PAGE #1

Answer: c

Here are the numbers:

A \$10,000 account earning 10 percent annually for five years would grow to \$16,105.10 (Fig. 1). A loss of 5 percent in the fourth year would leave a balance of \$12,644.50 going into year 5. (Fig. 2) In order to reach \$16,105.10 by the end of the fifth year, the account must increase by 27.3684 percent!

FIG. 1

BEGINNING YEAR BALANCE	GAIN/LOSS	ENDING BALANCE
1 \$10,000.00	\$1,000.00	\$11,000.00
2 \$11,000.00	\$1,100.00	\$12,100.00
3 \$12,100.00	\$1,210.00	\$13,310.00
4 \$13,310.00	\$1,331.00	\$14,641.00
5 \$14,641.00	\$1,464.10	\$16,105.10

FIG. 2

BEGINNING YEAR BALANCE	GAIN/LOSS	ENDING BALANCE
1 \$10,000.00	\$1,000.00	\$11,000.00
2 \$11,000.00	\$1,100.00	\$12,100.00
3 \$12,100.00	\$1,210.00	\$13,310.00
4 \$13,310.00	-\$665.50	\$12,644.50
5 \$12,644.50	\$3,460.60	\$16,105.10

This simple exercise illustrates the disproportional impact of losses in your financial accumulation plans. Sometimes the best way to consistently make money is by not losing it.

Material discussed is meant for general illustration and/or informational purposes only and it is not to be construed as tax, legal or investment advice. Although the information has been gathered from sources believed reliable, please note that individual situations can vary, therefore the information should be relied upon when coordinated with individual professional advice.

CREATIVE

Wealth Maximization Strategies



600 Emerson Road, Suite 110
 St. Louis, MO 63141-6762
 Phone: 314-997-1388
 Fax: 314-787-5600
www.triadwealth.com

Registered Representative of Park Avenue Securities LLC (PAS). Securities products and services are offered by PAS, 7 Hanover Square, New York, NY 10004, 1-888-600-4667. TRIAD | Wealth Systems is not an affiliate or subsidiary of PAS. PAS is a member FINRA, SIPC.