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STRATEGIES

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7 tips for lending money

Lending money to a family member or friend is a kind gesture. And it appears to be a growing trend throughout North America. According to the Federal Reserve Board's Survey of Consumer Finances, loans from family and friends amount to US$89 billion a year in the United States. In Canada, a poll conducted by Abacus Data found that one-third (34%) of adults have borrowed money from family or friends at some point in their lives – whether to pay university tuition, make a down payment on a house, or cover an unexpected cost and bridge them to their next paycheque.

But is it ever a good idea to lend money to a family member or friend? While there's no question that it's nice to help someone in need, there is a significant amount of risk involved in doing business with a relative or friend. Once you enter into a financial transaction with someone close to you, it inevitably changes your relationship – and not always for the better. If loans are not repaid, it can cause tempers to flare and lead to fractures in friendships and disrupt family dynamics. Relationships can be permanently damaged.

Fortunately, there are a number of steps you can take to ensure that, if you do lend money to someone you know personally, the money gets repaid and there are no hurt feelings involved. Samuel Chinniah is Senior Vice President, Family Office Services, at T.E. Wealth. He regularly advises clients on the "dos" and "don'ts" of wealth management, estate planning and retirement preparation. Inevitably, he is asked about the best ways to lend money to family and friends. Here are some of his insights gleaned from years of experience.

Editor's note

Money and moods: it's a tricky combination. That's why this edition of *Strategies* is devoted to the psychology of spending. It explores some of the financial issues we struggle with when our emotions get in the way. Things like whether or not you should lend someone money, and how to be more mindful with your discretionary spending. So sit back, take a deep breath and prepare to have a financial habit or two called into question.

Lucy Conte, Editor-in-chief

INSIDE

1. Consider the person who is asking for money

The first thing you should do is give consideration to the person who is asking for a loan. How well do you know them? Have they asked you for money before? Is the person someone who consistently lives beyond their means? If you lend them money this time, will they ask you for money in the future? And, perhaps most importantly, is the person trustworthy? Scrutinizing the person who is asking for money is the first step in analyzing whether giving them a loan would be a good decision.

"Help rendered to someone in their hour of need is always a good thing to do," says Mr. Chinniah. "But the reality is that some people always live beyond their means. Ask yourself if this person has spendthrift issues. The last thing you want to do is become an enabler."

2. What is the purpose of the loan?

The next thing to consider is the purpose of the loan. Is it in alignment with your values? According to Mr. Chinniah, making this distinction will help you determine whether or not to move forward with the loan.

"If you think it is a worthwhile endeavour to support, then it probably is," says Mr. Chinniah. While some may consider education or starting a business to be meaningful pursuits, others may see value in helping a family member out with a loan for a car or money to buy equipment. The key is to be comfortable with the loan. If it doesn't feel right, it probably isn't in alignment with your own values.

3. Pay attention to red flags

When it comes to making a loan to family and friends, there are often red flags visible for people who choose to see them. Many people who turn to relatives or friends for a loan do so because they're unable to get a traditional loan from a bank. And many people who look for personal loans have done so in the past. Mr. Chinniah advises to watch for "habitual offenders," those people who have a history of borrowing money from loved ones and close personal friends. An obvious red flag is if the person seeking a loan has a history of failed investments, business ventures or other schemes. Another red flag is if the person has borrowed small sums of money in the past and is now looking to borrow larger amounts.

"Past behaviour is usually a good predictor of future conduct," says Mr. Chinniah. "Do a credit check on people and find out their current debt levels and credit score. Be vigilant."

4. Put the loan agreement in writing

Oral loan agreements between friends and family can be risky for a number of reasons. Expectations regarding a repayment plan may not be clearly communicated, and details of a oral agreement can be left open to interpretation. For these reasons, Mr. Chinniah says that it is always best to put a loan contract or agreement in writing, ensuring that it has clear terms of reference. You can also have a promissory note drawn-up, which is a signed legal document containing a written promise to pay a stated sum of money to a specified person at a specific date or on demand.

> **"If you can't do without the money, don't make the loan."**

"You should treat a loan as a business arrangement, even when dealing with a family member or close friend," says Mr. Chinniah. "Be careful about taking people at their word. Don't leave the details to chance. Put it in writing."

5. Charge interest on the loan

"If there's no cost, there's no commitment," says Mr. Chinniah. For this reason, it's a good idea to charge interest on any personal loan you make. If you don't charge interest, then the person receiving the loan may feel that you're not taking the financial arrangement seriously and they may also take the loan lightly. By charging interest, people borrowing money know that there's a cost to them if they fail to repay the loan.

"Interest ensures that a loan is treated with importance," says Mr. Chinniah. "Consider when you pay your monthly bills. Most people focus on paying the bills with the highest interest, or greatest penalty, first. You likely prioritize paying off your credit cards because they carry a high interest rate. That interest rate makes you take the credit card seriously."

Keep in mind that if you do charge interest on the loan, you'll need to include it as income on your tax return. The Government of Canada posts a prescribed interest rate on a quarterly basis, which can be used as a guide for the interest rate to charge.

Mr. Chinniah adds that you can return the interest amount that you've collected on a loan to the person who borrowed money from you. But he advises doing so once the principal amount of the loan has been repaid in full, and not before. You can return the accrued interest as a gesture of thanks once the loan is settled.

6. Ask yourself if you can afford to lose the money you're lending

One of the final things to weigh when considering making a loan is whether you can afford to lose the money you'd be giving to a family member or friend. If the loan were to never be repaid, would you still be alright financially? Loans that involve some form of collateral, such as a house or vehicle, are generally safer than loans made for less tangible things such as a tuition payment or vacation. Be sure to factor your own financial situation into the equation.

"If you can't do without the money, don't make the loan," says Mr. Chinniah.

7. Protect the personal relationship

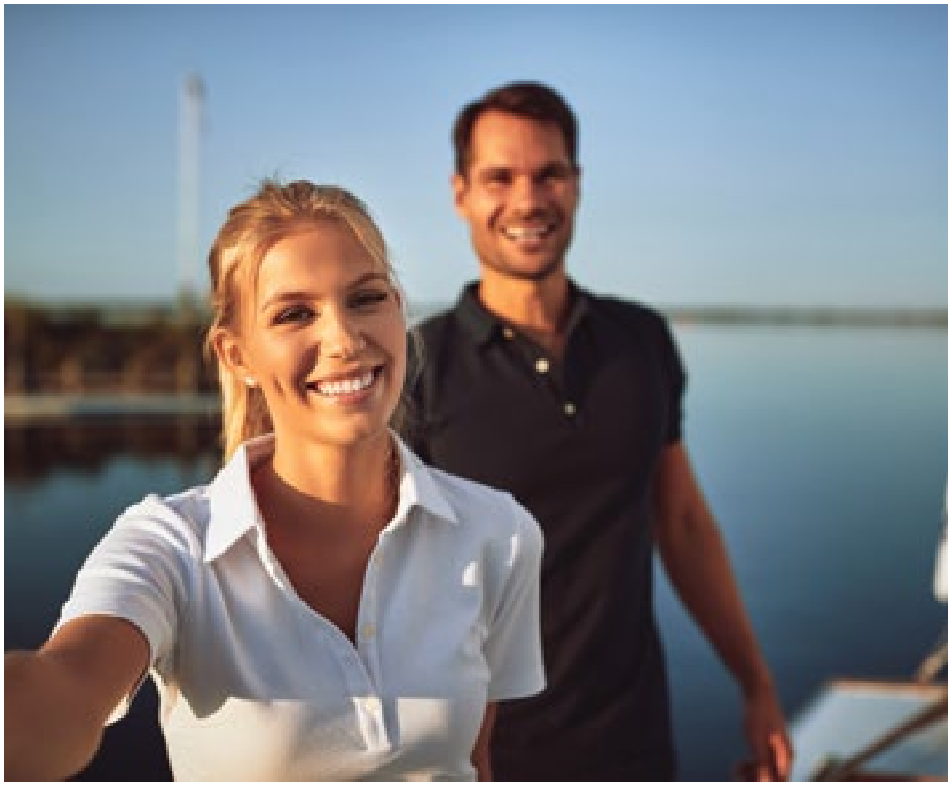
Lastly, take steps to protect the personal relationship you have with a loved one or friend. Don't let money cause irreparable harm to a valued relationship. By setting clear expectations, putting the terms of a loan in writing, charging interest, and giving full consideration to the person you are lending money to and what the money is to be used for, you can retain a strong and positive relationship with the person you have lent money to. Most importantly, have the courage to say "no" when asked to lend money – even if it is to a relative or friend.

"The biggest risk is the loss of a relationship," says Mr. Chinniah. "Money has a way of tainting relationships. A loan arrangement can strain a relationship and it is never the same again. Everyone should take steps to ensure this doesn't happen. It's not worth it."

Joel Baglole is an independent financial writer.

High-net-worth financial health: do you know what you need to know?

They say money can't buy happiness, but the way you handle the money you've got can most certainly influence how happy you are. Good financial health doesn't just mean having ample wealth, it also means understanding how the financial decisions you make can impact your life. So what do you really need to know?



If you're in the high-net-worth category, chances are you're already working with a financial planner which means you don't need to worry about this stuff, right? Not so fast. While you may not need to know everything they know, you do need to know what kind of expertise they should have in order to be able to help you achieve optimal financial wellness. Here are a few things to consider when dealing with a planner.

- High-net-worth individuals tend to be more susceptible to changes in tax legislation, so you'll want your planner to have a lot of experience dealing with clients at this tax level. They'll likely be on top of those changes more so than someone who sporadically deals with clients who could be affected. They'll also know how to use those changes to your advantage.
- People with higher incomes often have more complex lifestyles. It's in your interest to work with someone who's used to collaborating with various professionals, such as your lawyer and accountant, to ensure you're provided with integrated solutions.
- Is your spouse involved? They should be. Typically, they're the ones who'll be impacted most by your financial decisions, so your planner should encourage their input and make it a priority to have a relationship with them. A good planner will also include your children in any legacy planning so that the whole family is clear about your vision and wishes.
- How do you want to use your wealth in meaningful ways? Clarifying what you want to accomplish is the cornerstone of any effective financial strategy. Your planner needs to understand this to be able to help you with your short and long-term life goals.
- If you're an entrepreneur, you'll have different retirement saving requirements than those who are eligible for a company-sponsored pension plan. Your financial planner should have experience with this type of scenario and be knowledgeable about setting up an individual or personal pension plan. There are various ways to do this, and an experienced planner can present you with different options and recommend the one that's best suited to you.

Knowing what you need is half the battle. Finding the right person to help you with those needs – and maybe even uncover a few new ones – will reduce financial worry and contribute to better financial health. Above all else, you should like and trust the planner you're working with. Do they understand your pain points? If you're not comfortable discussing such matters with them, maybe it's time to try someone else.

One of the best ways to source a planner is through referrals. Poll your family, colleagues and social network to see who's happy with their provider. That way, you'll also have confirmation of their competence and performance.

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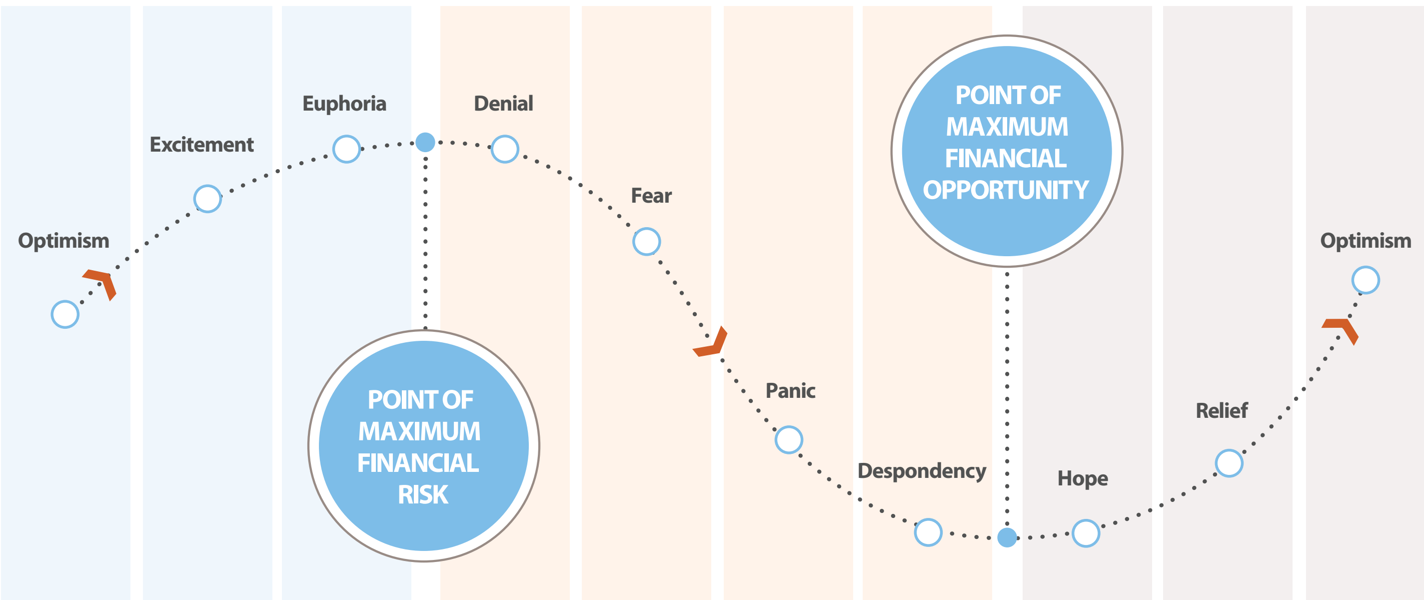
Emotional investing, the millennial way

Investing in financial markets can be somewhat of an emotional roller coaster, which makes it difficult for investors to stay focused and make rational choices. We sometimes trick ourselves into thinking that we're infallible and can beat the market by tolerating higher levels of risk – or pull out too soon fearing a stock may plummet. It's challenging for investors to assess which stage of the roller coaster they've reached, and this may block them from seeing their level of exposure to financial risk.

Figure 1: The Market Cycle of Emotions



Source: Russell Investments – Sept 2017

The cycle of investment emotions (shown in Figure 1) can pose a substantial threat to an investor's financial well-being by causing them to ignore warning signs or statistical evidence. This is why committing to a diversified long-term investment plan is so important. The role of a financial advisor is critical here, as it's their job to steer investors away from reactive decision-making and towards rational investing. An experienced advisor understands the need for objective analysis in the face of market volatility, and can help create a portfolio designed to weather any condition over time.

When it comes to the stock market, investor emotions typically pendulate between two extremes: fear and greed. When things are great, we can have an irresistible urge to possess more (greed). When things go badly, we can resort to emotionally-charged, drastic decisions (fear). Experiencing FOMO (Fear of Missing Out) or FOIL (Fear of Investment Loss) can drive investors to get caught up in the speculative media hype that results in baseless investment opinions, only to yield an unpleasant outcome. Witness the Bitcoin bubble.

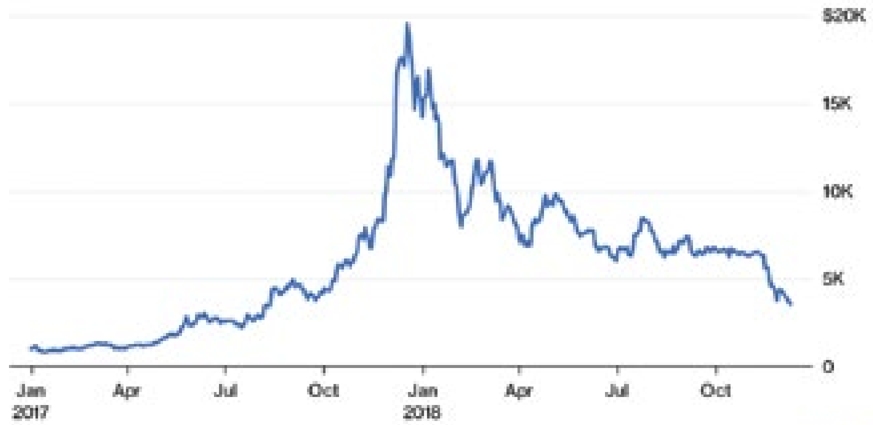
> "Be fearful when others are greedy and be greedy when others are fearful."
> ~ Warren Buffett

The cryptocurrency market spearheaded by Bitcoin in the last quarter of 2017 was riding a wave of euphoria. The price of Bitcoin went from $6,000 to $20,000 in the span of only a few weeks (see Figure 2), and was based on speculation that large institutions would be interested in buying crypto. Overly optimistic Bitcoin stories circulated and repeatedly claimed that it was going to replace the standard fiat money as the main global currency. This is the time when investors believe that nothing can go wrong, but in reality they're at a point of maximum financial risk. As the adage goes: when something is too good to be true, it usually is. And it was. In early 2018, Bitcoin took a nosedive and lost nearly 80% of its value. It's continued to decline steadily since.

Just as previous bubbles have served as a learning tool, so has Bitcoin. This classic financial bubble gave investing millennials a crash course on the importance of basing their investment strategy on a long-term outlook. Or did it?

Despite clear evidence, millennials seem to have a crypto crush and their romance is based on trust. A recent survey conducted by eToro claims that nearly half of millennials trust the US stock market less than crypto assets. The fall of Lehman Brothers, followed by the worst recession

Figure 2: Bitcoin intraday highs



Source: Bloomberg

since the Great Depression, eroded the last bit of trust and resulted in a breakup with monolithic institutions such as traditional exchanges and large investment banks. According to the Millennial Disruption Index (MDI), banking is at the highest risk of disruption due to the fact that 70% of millennials would consider financial services from Google, Amazon, Apple and Paypal rather than their own nationwide bank. Having grown up in the technology era, it's easier for millennials to associate with FinTech companies than banking moguls such as J.P. Morgan and Wells Fargo, which are still operating on older platforms that have become far less appealing. On the verge of life-changing life events such as marriage, the birth of a child and the purchase of a new home, this tech-savvy, forward-thinking generation needs more than what banks are currently offering.

Millennials are increasingly seen as the generation that wants to invest according to its beliefs and, oftentimes, the money takes a backseat to social or environmental causes. In this way, they're seeking to use emotions constructively to drive change in the markets, rather than react to it as in the case with roller coaster investing. This means they won't play out the emotional investing model to its conclusion.

The extent to which they'll succeed in disrupting the markets remains to be seen, but one thing is clear. Their suspicion of institutions, the stock market, regulators and corporations is bound to have an impact one way or another.

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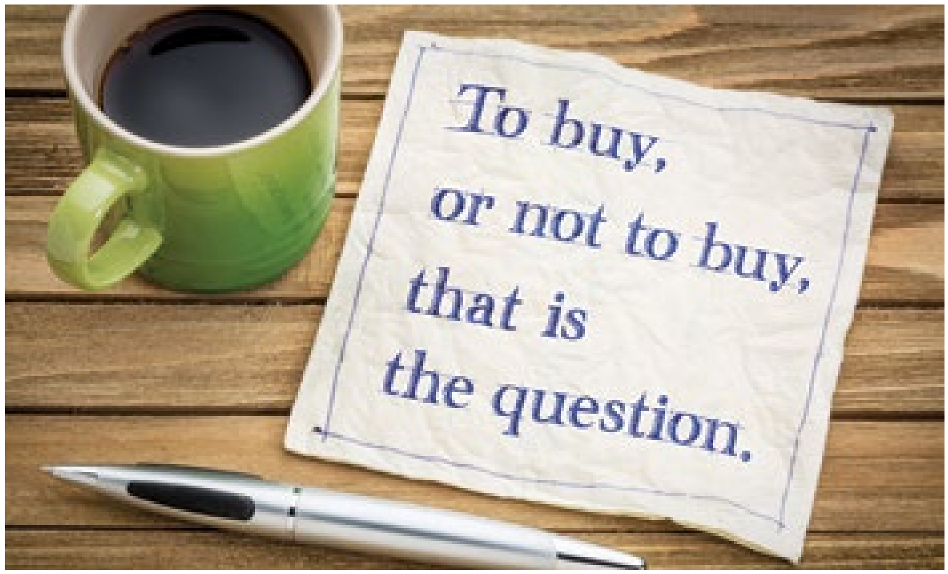
You are what you buy: what your spending says about you

If asked what you value spending your disposable income on most, what would you say? Would your bank account summary and credit card statements tell a different story?

Apart from the essentials (food, housing, transportation), we all keep a mental checklist of what we "can" and "can't" afford. Essentially, this comes down to what we value. But what we *don't* spend our money on can say just as much about us as the things we *do* spend it on.



Why we buy

In an article published in *Psychology Today*, financial psychologist Dr. Brad Klontz says that our financial values are largely shaped by our life experiences, most of which are formed in childhood. He calls these "flashpoint experiences" and believes they can either be helpful or non-helpful. For instance, if your parents valued education and intellectual pursuits, chances are you'll also see this as a worthwhile investment. If they tended to be fearful of spending money and held back, you might adopt that financial behaviour too.

Birds of a feather

Our financial values aren't necessarily locked into the patterns formed in our upbringing. Sometimes, they can shift depending on the social and environmental influences in our lives. Let's say you join a social circle that regularly goes to art exhibits and galleries. This might inspire you to invest in building your own personal art collection, even if this isn't something your family particularly valued.

Of course, the reverse can be true. You might find that, despite having certain interests or values, the influences in your life dissuade you from putting money towards those things. I have heard people say that fresh cut flowers are a waste of money because they die shortly after you buy them. But who doesn't walk into a room and feel instantly uplifted by their sight and scent? Would you think twice about making such a purchase if, say, your partner finds it frivolous and makes comments to that effect when you buy them? This is a minor example, but could also apply to more significant spending decisions, like whether or not to pursue a passion project or take a dream vacation.

Different strokes for different folks

A report by the Office of Consumer Affairs (OCA) on the changing age structure of Canada's consumers notes that as consumer needs change over their lifetime, so does their spending. For instance, young adults spend more on education-related expenses, whereas seniors spend more on travel.

A related OCA report on consumer spending shows that various social, economic and marketplace trends at the household level affect consumer behaviour. For example, the increasing number of senior couples who spend on recreation and entertainment indicates that they have better health and financial security than their predecessors did. The increase in average household spending on communications at all ages suggests that most Canadians value connectedness.

The report further notes that what we *don't* spend money on can also reveal something about what we value. While harder to document, consumer boycotting is becoming a popular way for people to express their political views. "Boycotting has brought about a number of changes in companies' social and business behaviour, such as the development of certain voluntary codes. In fact, any consumer decision to stop buying a product can ultimately and substantially influence corporate strategies. New trends in the fast food industry's offerings are one example of the marketplace's responsiveness to consumers' willingness to walk away."

Our preferences can be complex and changing, and sometimes we even spend in ways that are out of character for us. But it's important to check our spending habits now and then to make sure they really do align with our values. Dr. Klontz says that in doing so, "…we don't just become materially richer – we become emotionally wealthier as well."

Lucy Conte,
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Editor-in-chief, Strategies Newsletter

Sources:
https://bit.ly/2WZrd8n
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Financial mistakes to avoid during a divorce

With more than 50% of marriages ending in divorce, I'm sure everyone knows at least one person who's gone through the process and, likely, had more negative experiences than positive ones. Divorce can be one of the most stressful and emotional times someone can go through, so it's crucial to make sure you don't let your feelings impact important financial decisions that you can't turn back from. Here are five of the most common mistakes that I've seen.

It's very important for both individuals to go through all the emotional stages before making any final decisions. If an agreement is signed before both parties are emotionally ready, there may be regrets later on that can lead to unnecessary future litigation.

> "Be aware of the tax implications on accounts and investments."

Make sure financial information is up-to-date

Accurate information ensures the process is as smooth as possible and avoids you having to re-hash numbers. Make sure all statements are recent and that all assets are honestly disclosed, including debt balances. An older statement "found" by one spouse may falsely show money that is no longer there. Not necessarily because the other spouse is being dishonest about it, but more likely because it was money spent by both on cars, vacations, children, etc.

Don't forget about taxes

When agreeing to the division of assets and who gets what, be aware of the tax implications on the different accounts and investments. A $100,000 bank account is not the equivalent of a $100,000 stock portfolio or RSP account after taking into account future tax liabilities. When equalization is done, it should take into account both immediate and contingent tax liabilities for both parties.

Don't underestimate the importance of an accurate budget

Why does BUDGET sound like a six-letter curse word? Because nobody likes to put one together! But this is a vital component to ensuring both parties walk away with an agreement that is manageable and meets their needs. Budgets need to realistically reflect your lifestyle and include future expenses. A budget is equally as important for the spouse paying support, otherwise they might find they can't actually afford the settlement that was agreed upon.

> "Budgets need to realistically reflect your lifestyle and include future expenses."

And the most common financial mistake made during a divorce …

Thinking short-term instead of securing your financial future

Let's face it, even under normal circumstances people tend to satisfy their current wants or needs and put very little thought into planning and saving for the future. So when going through a divorce, it's very easy to concentrate on your current needs and forget about the big picture. Sometimes, it just may not be possible to maintain your current lifestyle. You may need to make and accept a few adjustments today to ensure you are financially secure in the present, and future.

There are different ways to settle a divorce and, most of the time, it doesn't have to mean a battle in the courts. You can instead choose to work through things peacefully together. Lawyers are there to provide legal advice but it can also be invaluable to seek other professionals for emotional support and financial advice, such as a Certified Financial Planner. Having an unbiased perspective can help you avoid some of these common mistakes, so you can hang onto your finances – and peace of mind.

Marie Machado
Vice President & Financial Consultant
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Still living different

Financial Consultant Valerie Pippy returned from her third Live Different build trip in the Dominican Republic this past March. We couldn't be more proud of her warmth, generosity and fighting spirit. Joining her on the trip were clients Roger Kenrick and Sybil Veenman. Staffers Mary Marsillo, Megan Saxton, Paul Robinson and Lucy Conte also made the trek to lend a helping hand. Valerie will be returning to the Dominican for a fourth build trip in 2020.

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