

A THOUGHTFUL APPROACH TO PRENUPTIAL AGREEMENTS



TABLE OF CONTENTS

In this white paper:

Introduction	4
What is a Prenuptial Agreement?	4
Role in Financial and Estate Planning Process	5
Advantages and Disadvantages of a Prenuptial Agreement	6
Using a Trust as an Alternative	6
Creating a Valid Prenuptial Agreement	7
Strategies for Discussing Expectations	8
Keys to Creating a Successful Prenuptial Agreement	9
Additional Resources	10

A THOUGHTFUL APPROACH TO PRENUPTIAL AGREEMENTS

Few topics are fraught with as much confusion, anxiety, and emotion as prenuptial agreements. At Abbot Downing, we are often asked about the merits of prenuptial agreements, including effective ways for parents to bring up this topic with their children and how to begin the discussion with prospective spouses. Families with significant wealth often assume that requiring a prenuptial agreement should be expected, but frequently have questions about the impact the discussion will have on current and future family relationships. It's not unusual to hear comments such as, "It seems odd that we have to negotiate a contract like we're adversaries instead of two people in love" or "It feels like we are starting our relationship by assuming we'll divorce at some point."

Although prenuptial agreements don't fit into the category of musings that enhance a couple's romantic relationship, they can be very useful to enhance and clarify the couple's financial relationship and intentions prior to marriage. An agreement can also provide measures of safety and security for all parties concerned about the future of individual and shared assets throughout the marriage.

This white paper provides a practical introduction to prenuptial agreements, including:

- A brief history of prenuptial agreements
- Their role in a couple's overall financial and estate planning process
- Pros and cons of their use
- Discussion of alternatives (i.e., trusts)
- Summary of the process for creating a valid prenuptial agreement
- Typical content included in an agreement
- Practical strategies for discussing expectations

In our experience, both when and how you communicate about this topic are critical to creating a thoughtful agreement and help determine whether the agreement will be considered legally valid.¹

What is a Prenuptial Agreement?

A prenuptial agreement, also referred to as a *premarital* or *antenuptial* agreement and commonly abbreviated to "prenup," is simply a contract entered into by a couple prior to a marriage or civil union. The content of a prenuptial agreement can vary widely, but commonly includes provisions for the division of property—both physical property as well as financial assets and interests, treatment of future earnings, and spousal support in the event of divorce or dissolution of the marriage.

The law on prenuptial agreements in the United States is determined by individual states; therefore, the provisions required for an effective agreement differ depending on which state law governs the prenup process. One intended benefit of a prenuptial agreement is to avoid (or partially avoid) the cost and emotional stress of a long dispute over dividing up property in the event of a divorce, and, perhaps more importantly, to create an explicit plan that reflects the intentions of the couple rather than a reliance on the community or separate property laws of the state in which they reside. Postnuptial agreements are similar to prenuptial agreements, except that they are entered into after a couple is married.

Agreements between engaged couples are nothing new—couples have been using prenuptial agreements for thousands of years.² Scholars suggest the practice dates back to the ancient Egyptians. The Hebrew marriage contract called the *ketubah* is at least 2,000 years old and sets out a husband's financial obligation to his wife in case of divorce or widowhood. Dowries, often considered to be early prenuptial agreements, were mentioned in seventh century writings as a necessity.

In ninth century Europe, husbands were required to secure one-third of their property to their wives on their deaths as dower rights. Under English common law and in colonial America, “dower” was the share of a deceased husband's real estate to which his widow was entitled after his death. Wives, as well, sometimes brought dowries of money or land to the marriage, which were covered in an agreement drawn up before the marriage. Until the 19th century in the United States, married women could not own property and needed marriage contracts to guarantee them property in case of divorce or the husband's death. Although that is no longer the case, and many customs and practices have changed over time, marriage agreements are still common place today.

Role in Financial and Estate Planning Process

Contrary to popular opinion, prenuptial agreements are not just to protect the assets of a partner with significantly more assets. Couples of more modest means often use prenuptial agreements to clarify their financial rights and responsibilities during the marriage, or to protect the interests of children from a previous marriage in the case of a subsequent marriage.

It is often said that the better you know someone before marriage, the greater the likelihood of marital satisfaction.³ Some religions, for example, require premarital counseling to provide an opportunity to discuss differences and learn to more effectively understand and support each other during marriage. Typically, at least one of these sessions focuses on expectations regarding how financial matters will be handled during the marriage.

By discussing expectations and differences about money before marriage, partners can learn to more effectively understand and support each other during the marriage. As importantly, if a discussion regarding finances uncovers a red flag or a “hot topic,” there is value in the couple dealing with it before the marriage because more often than not, an issue that one person lets slide as “not that big of a deal” can snowball and become a bigger issue over time. Discussions about finances are important for any couple, but can be particularly valuable when each person is entering into a marriage from very different financial circumstances.

Much like premarital counseling can serve as a vehicle for facilitating discussion of key assumptions about how finances will be shared, the process for entering into a valid prenuptial agreement also facilitates a valuable discussion about financial assumptions. This includes discussing what will be considered shared marital assets—and liabilities—and the reasons why some assets or liabilities will be held separately by a spouse outside the marital relationship.⁴ The starting point for this conversation can be the full disclosure exhibits that each fiancée must prepare to ensure that the prenuptial agreement will be valid.

Ideally, a prenuptial agreement reflects a couple's roadmap for their financial future in addition to each partner's individual desires.

One of the most compelling reasons to consider a prenuptial agreement is the existence of a closely held family business or other legacy asset that has helped to define a family. This is arguably the easiest circumstance to explain to a future spouse. That is, the family has a practice of setting aside assets that hold particular significance among bloodline family members from consideration as shared marital assets. The prenuptial agreement safeguards these bloodline assets from leaving the family due to divorce or death. Examples range from shares in a family business to family heirlooms.

As a parent under these circumstances, it is your responsibility to make your children aware early-on of the family's expectations regarding this precaution and to help them communicate these expectations to prospective spouses. In simple terms, a family that begins discussing its expectations to protect family assets when the children are still young may have more success in not making either of the marrying people feel singled out when it is known that the expectation applies to all family members. This added family context may help the request for a prenuptial agreement to feel somewhat less personal to the future spouse who is marrying into the family.

Even starting at a young age, explaining the expectation of a prenuptial agreement requires thoughtful communication. We often see that the families that have chosen to be upfront about their intention to preserve so-called "legacy" assets (acquired and/or set up in trust for the benefit of multiple generations) before a future spouse enters the picture, has an easier time explaining why a prenuptial agreement is expected.

Advantages and Disadvantages of a Prenuptial Agreement

Advantages

- To protect the financial interests of older persons with substantial wealth who may be entering into a second or subsequent marriage.
- To protect the inheritance rights of children and grandchildren from a previous marriage.
- To protect an inheritance or special asset from going outside the bloodline.
- To protect a business or professional practice from division, which might require a sale upon divorce.
- To protect one spouse from taking on debts of another spouse, as when one spouse has significantly more debt than the other (e.g., college loans or excessive credit card debt).
- To protect one spouse in situations where that person will rely on the other spouse for income (e.g., when one spouse plans to give up a career after the marriage).

- To limit the total amount of spousal support in the event of a divorce, with the caveat that state law typically applies a "fairness lens" to the agreement.

Disadvantages

- The process of developing the prenuptial agreement may inadvertently raise concerns regarding trust in the relationship or comfort with the broader family.
- The agreement may require one spouse to give up the right to inherit from his or her spouse's estate when the spouse dies.
- A low- or non-wage-earning spouse may not be able to sustain the lifestyle to which he or she has become accustomed during the marriage if the agreement substantially limits the amount of spousal support to which the spouse is entitled after divorce. It's fairly typical that life circumstances change over time and they may not be adequately addressed by a prenuptial agreement.
- It can be difficult to project into the future how potential issues should be handled (e.g., what may seem like an inconsequential compromise between the couple during the romantic premarital period may seem more burdensome or have greater financial consequences over time).

Using a Trust as an Alternative

Families sometimes choose to try to protect their assets by creating trusts for their children as an alternative to prenuptial agreements. Like prenuptial agreements, there are pros and cons to trusts. One of the key risks associated with a trust occurs when there is a distribution—if the proceeds of a trust are co-mingled in a joint account with the child's spouse, then such assets could become marital property and be subject to the marital property laws of the couple's state of residence. In some states, even beneficial interests in a trust may be treated as marital property in divorce proceedings.

As a starting point, we recommend that you consider your goals in relationship to the various alternatives available to you and consult with your professional advisors. If you do choose to rely on a trust structure, be sure to communicate to the trust beneficiaries the implications of co-mingling distributions in marital accounts—this is an easy mistake to make, and the consequences can have a negative effect on the goal of preserving family wealth.

We encourage couples to spend time discussing what they'd like to include in the agreement prior to meeting with an attorney.

Creating a Valid Prenuptial Agreement

It's not uncommon to hear a spouse who has married into a family with significant wealth make a comment such as, "Oh yes, that's the document I had to sign right before our wedding." More often than not, this is a reflection of the natural tendency to delay conversations that you anticipate to be challenging or difficult. Unfortunately, the delay not only rushes a critically important conversation, but may inadvertently undermine the validity of the agreement. A prenuptial agreement is the financial counterpart of wedding vows and should be thought through with enough time to reflect the spirit of partnership with which you approach your marital vows.

For any prenuptial agreement to be considered valid, regardless of some variability among state law, the following is required:⁵

- The agreement is fair (not one-sided).
- The agreement was entered into voluntarily by both parties without duress.
- The agreement reflects a full disclosure of all important financial matters.
- The agreement was made in writing and signed before a notary.

Sufficient time should be allowed for discussion and review so that neither party feels pressured into signing the agreement. Separate representation by independent attorneys is generally considered evidence that both parties understood what they were signing and did so voluntarily. Therefore, it's important that the family suggesting the agreement makes sure that the future spouse has the opportunity to select his or her own attorney (even if one party's family offers to pay for the legal services accessed by both fiancées).

Perhaps the most important factor to consider is your family's willingness to communicate about finances. This includes making full disclosure of everything each spouse owns—assets held in the spouse's individual name, assets where there is a future beneficial interest (such as trusts or limited partnerships), and all of the spouse's debts, including obligations from a prior marriage (such as child support or alimony). If you intend to sign a prenuptial agreement, good communication about finances is not just desirable, it's essential before you sign.

Every prenuptial agreement is unique to the circumstances of the couple that develops it, but there are some typical provisions. Most agreements begin with a brief description of each party's circumstances, such as age, occupation, any children, and perhaps intentions for future employment or education. Disclosure of each party's finances—assets, liabilities, and incomes—is required and is usually included as an appendix.

Common provisions include:

- A provision that each spouse's separately owned property will remain that spouse's sole and separate property during the marriage. Sometimes this refers to assets owned before the marriage but it can also include property acquired during the marriage through gifts and inheritances.
- A provision confirming how each person will deal with his or her own premarital debts.
- A waiver of the surviving spouse's legal right to claim a share of the other spouse's separate property at death.

- A provision for the ground rules for buying and owning property while the couple is married (particularly if the purchases will be made with the assistance of family assets from one spouse).
- An agreement about how taxes will be filed and paid based on each spouse's separate and commingled assets.
- A provision that the agreement will terminate (sunset) on a future date, or that the terms will adjust as time passes.

Additional provisions may include:

- An exchange of property for the waiver of property rights (for example, payment of a certain amount of money according to a specified timetable, life insurance coverage, or establishment of a trust for the spouse waiving their rights).
- A provision defining the rights of each spouse when one spouse contributes to the continuing success and growth of his or her spouse's business or professional practice. When these rights are not defined in an agreement, the contributing spouse may not be entitled to claim a share of the increase in value in the future which may, or may not, have been the intention.
- A provision spelling out how joint property will be divided in the event of divorce.
- A provision specifying how household expenses will be paid.

Choosing an attorney is an important decision. Suggestions to consider:

- The attorney's practice area (e.g., estate planning attorney or family law specialist)
- Your planning objective—planning for forever or for worst case scenario (divorce)
- Interview multiple attorneys
- Learn more about the attorney's perspective on the role of a prenuptial agreement and the process he or she uses to draft the document

Strategies for Discussing Expectations

"Early and often" are the words that apply to effective communication about most topics and they are particularly relevant to prenuptial agreements. We've already described the importance of full financial disclosure and understanding to the validity of the prenuptial agreements, but, as previously stated, effective communication about this topic should start well before the actual drafting of agreements.

Ideally, discussions of a prenuptial agreement will flow naturally from an understanding of your family's values and expectations regarding shared assets (such as a family business or family properties). It is certainly helpful when these discussions happen long before the first serious girlfriend or boyfriend enters the picture. Raising the topic of a prenuptial agreement is much more challenging when a relationship has become serious, because it may feel like a personal concern or mistrust regarding the person entering the family even when that is not the intent.

Parent-to-Child Communication

Parents who are reluctant to discuss the extent of the assets their children will likely inherit may find it particularly difficult to navigate the disclosure requirements of a prenuptial agreement. Ideally, you will explain to your children over time that an important aspect of your family's overall financial and legacy planning is the expectation that all family members enter into prenuptial agreements. But if the relationship does happen first, our recommendation is the same: Begin with the context of values, principles, and intentions regarding inherited assets and how a prenuptial agreement addresses the family's expectations for transferring property to future generations.

Go beyond the simple statement that prenuptial agreements are just "what you do." Instead, have an in-depth conversation regarding the reason why it is important to carve out assets such as an interest in a family business. Additionally, explain that a prenuptial agreement doesn't automatically require a child to keep all of his or her assets separate. The couple can create joint accounts. In fact, to help the marrying couple learn to build a financial future together, the couple should be given the opportunity to create their

own financial roadmap and have some portion of “their” assets actually be “theirs” so that they can learn to make financial decisions together instead of each spouse only handling his or her own finances.

Communication with a Future Spouse

It is one thing for a young adult to understand and accept his or her family’s reasons for expecting a prenuptial agreement, and it is quite another to feel prepared to bring up the topic with a future spouse. Identify trusted resources who can serve as sounding boards and practice bringing up the topic. This person may be a parent, a family attorney, or other trusted advisor who is willing to give you time to gain clarity about what you wish to say and to practice the first conversation. Your goal is to enter into thoughtful discussions and make wise decisions based on love and understanding, but it is natural to feel reluctant about the first conversation.

Communication Starters for Future Spouses

Remember that good communication is key to a good marriage. Accordingly, the discussion of a prenuptial agreement is most effectively done within the context of how a couple plans to manage their finances during their marriage, recognizing that their practices may certainly evolve over time and circumstances.

A few questions for an engaged couple to consider to help facilitate listening and learning from each other include:

- What are your goals?
- What values, including values about money, did you inherit from your family or other important influencers in your life?
- What role does money play in your life?
- What are your most important principles related to money and marriage?
- What are your thoughts on keeping finances separate or co-mingling them together?
As noted above, some couples decide to have accounts that are designated as yours, mine, and ours (household). There’s no right answer, but this question is fundamental to how you will set up and manage your finances after you marry.
- How will you deal with a significant debt that one spouse is bringing to the marriage (e.g., student loans, child support, or alimony)?
- What are your respective views regarding taking on debt as a couple?
- What are the plans when one spouse moves into a home owned by the other spouse?
- What should happen if one of us stops working outside the home?

Keys to Developing a Successful Prenuptial Agreement

- **Know yourself.** Understand your financial goals, your general attitude toward money, your spending and saving habits, and your approach to communicating about these matters.
- **Accept your differences.** The goal is not to have the same views, but to come to a place of understanding, empathy, and agreement regarding how differences will be addressed.
- **Communicate effectively:**
 - a. Think through your concerns.
 - b. Set the stage by choosing a reasonable place and timeframe for discussions to occur.
 - c. Prepare to listen and understand—don’t interrupt.
 - d. Be open to new ideas.
 - e. Ask for what you want.
 - f. Look for options that work for both of you.
 - g. Consider using a trusted advisor as a facilitator.
- **Negotiate lovingly.** Mutual love and respect are the foundation from which to negotiate with each other’s best interests at heart.
- **Accentuate the positive.** Focus on the value of agreeing in advance to financial guidelines that will serve you for many years to come.

Additional Resources

- Dubin, Arlene G. *Prenups for Lovers: A Romantic Guide to Prenuptial Agreements*. Villard, 2001.
- Kent, Richard G. *Prenup Postnup: How They Work and Why You Might Need One*. Booksurge.com, 2009.
- Stoner, Katherine E. and Irving, Shae. *Prenuptial Agreements: How to Write a Fair & Lasting Contract, 4th Edition*. Nolo Press, 2012.

Endnotes

¹ Stoner, Katherine E. and Irving, Shae. *Prenuptial Agreements: How to Write a Fair & Lasting Contract, 4th Edition*. Nolo Press, 2012.

² Kaplan, Marion A. *The Marriage Bargain: Women and Dowries in European History*. The Hawthorne Press, Inc., 1985.

³ Wright, H. Norman. *101 Questions to Ask Before You Get Engaged*. Harvest House Publishers, 2004.

⁴ Stoner, Katherine E. and Irving, Shae. *Prenuptial Agreements: How to Write a Fair & Lasting Contract, 4th Edition*.

⁵ Ibid.

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