Contributors:
Beth Tractenberg
Hubert Tse
Stacy Choong
Katie Graves

Some have called it 'affluenza' - that lack of motivation that can affect the second and third generations in wealthy families when they realise they simply need not work hard or be productive in order to live a comfortable life.

Motivating children of means

Motivating children of means is a challenge for families around the globe when they come to transferring wealth to the next generation, and is an issue that cuts across cultures and geographies. Many attempt to tackle it by planning for transfers to take place over the long term, using trusts that may or may not come with strict conditions.

Beth Tractenberg is a partner at Steptoe & Johnson, an international law firm, in New York. She says many high net worth clients begin the process of planning trusts with detailed instructions setting out the terms on which money might be passed on, often trying to insist children and grandchildren achieve a certain level of education, and/or become productive members of society, before they can see any benefit. A frequent request is that beneficiaries should only receive trust distributions that match the amount they are already earning in a job, though of course the outcome for the child that is a social worker versus the other who is a hedge fund manager belies the sentiment.

Tractenberg says: **"Frequently clients come up with ideas for trusts that at first blush make sense, but as soon as we start to explore the restrictions on distributions they might not really work."** She gives an example of the stipulation that children must finish four years at university before becoming eligible for money, which can be inappropriate if a beneficiary is developmentally challenged, or if they choose to pursue a vocational course instead.

Another client insisted that his son should only receive money from his estate for essentials, but never for luxuries: **"I said, 'What about if the trust ends up with $100 million in it, and he finishes college and wants to spend some time travelling around Europe. Would you consider that a luxury?' He said yes, his son would have to pay for that himself. But most clients realise that it's more sensible to have a trust that is more flexible and open in terms of the discretion available to adapt to any and all circumstances."**

She advises older generations to set up flexible trusts and draft a 'Letter of Wishes' to trustees, setting out guidelines on all sorts of issues, including the family philosophy on work ethic, standard of living, and circumstances in which trustees should be more strict or liberal about distributions.

Katie Graves is a registered foreign lawyer with law firm Withers in Hong Kong, advising on wealth protection and estate planning. She says some parents are tempted to use their powers as a parent, including their economic powers, to influence the next generation, but this can backfire if children go along with their parents' wishes for the wrong reasons, only to renege later.

Graves says the best way to successfully motivate children in wealthy families is either through bequests of capital that encourage entrepreneurship, or with seniors who are willing to be active and effective mentors.

/"Frequently clients come up with ideas for trusts that at first blush make sense, but as soon as we start to explore the restrictions on distributions they might not really work."/ Beth Tractenberg, Steptoe & Johnson

A closer commitment

Stacy Choong, a partner in the Singapore office of Withers, adds: **"During the last few financial crises in Asia, we observed that where children were old enough to participate in the family business, and had to confront challenges and rebuild that business together with their senior mentors, they ended up feeling much closer and more committed to their family business."**

She says that in the most successful transitions, patriarchs provide consistent and effective mentorship, rather than just throwing their children in at the deep end and expecting them to sink or swim.

Choong advises clients against hiding their wealth from their children – a strategy some use to try and bring their family members up unhindered by the demotivation of inherited riches. Instead, one education technique she has seen work effectively involves teaching children how to use their allowance from a young age, with one third to go on nice things, or the benefits of wealth, one third to be saved and invested, and the remainder to be given away, to encourage philanthropy.

Hubert Tse is a partner with Chinese law firm Boss & Young in Shanghai, advising Chinese and global hedge funds, HNWIs, family offices, sovereign wealth funds and financial institutions. He says the issues facing Chinese parents are almost the opposite when it comes to motivating children. He points out that there is a lot of new wealth in China, and says that this means younger generations are still very motivated to succeed, because the Chinese culture has always been that people are ambitious and driven, and work hard to get ahead in life and in their career. Most want to exceed themselves, to be the best and to outperform parents' achievements. Lots of young men and women aspire to build companies like Alibaba, Tencent and Baidu, and become the future Jack Ma (Alibaba) or Robin Li (Baidu).

Risk averse

However, he says: **"Parents face a challenge when they are passing on businesses that their children may not be as adventurous or entrepreneurial any more, and may be more cautious because they are operating in a very different world, and business climate, to their parents 15 or 20 years ago. China has changed a lot since opening up over 30 years ago, and Chinese society and business environment have evolved tremendously. Today the second generation operates in a much more complex and crowded market place, in an increasingly globalised world, so they have the daunting task of managing unprecedented business and legal risks and challenges in their businesses in China today."**

He adds, **"Furthermore, given that the parents have built up the wealth, brands and business in the last 20 years or so, the younger generation will be looking to preserve those and, in doing so, they may be more conservative with their investments and in the running of their businesses."**

Every family, whatever their nationality or cultural roots, will have its own concerns about making sure that children continue to work hard and be productive, however that may be defined. Many parents worry that children will marry partners who do not have the same lifestyles, or that they will take poor advice and fritter money away, or even fall off the rails and lose wealth to drink, drugs and gambling habits.

"If the money is in trust it is not going to be available to a divorce settlement," says Tractenberg. **"If it is just kept there for random discretionary distributions, it's quite protected."**

Discretionary trusts can be the best way ahead, providing the necessary motivations while still allowing the flexibility to adapt as the next generation comes of age. Good family relationships are also critical. ■

Contributors:

Beth Tractenberg
Partner, Private Client
Steptoe & Johnson
New York

Hubert Tse
Partner, Finance & Corporate
Boss & Young
Shanghai

Stacy Choong
Partner, Estate Planning
Wealth Protection, Withers
Singapore

Katie Graves
Registered Foreign Lawyer
Wealth Planning, Withers
Hong Kong

WEALTH STRUCTURING 20:20 is an Appleby feature publication that aims to tap into the issues facing high net worth individuals around the globe, and investigate the themes and challenges affecting this elite group.

Offshore Legal, Fiduciary & Administration Services

applebyglobal.com