APPROACH TO INHERITANCE
Special Report
International Experience and China Practice of Wealth Planning

In Association with
Euromoney Institutional Investor PLC
The Importance of Wealth Management

Approach to inheritance

Special Report

An Overview of Private Wealth Distribution
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Most people want to pass something on to their children and grandchildren. They might want to hand down an heirloom, encourage a career choice that has spanned generations or simply maintain the family name. But the toughest choices come when a family has considerable wealth that it wants to pass on.

How should the transition of wealth be achieved? Exactly who should control the shared resources of a family that may have branched off, with each child growing up and having families of their own? How should the tax issues be managed? How can wealthy parents ensure their children add to the family wealth, rather than simply spend it?

These questions, however difficult, are all age-old. Wealthy, powerful and successful families have long struggled with how to bequeath their fortunes and influence to their descendants. History is littered with examples of their failure.

Over the centuries, ideas about inheritance have changed and evolved. Europe’s royal lineages, for example, are rarely pure bloodlines. They tend to reflect the outcomes of wars between European powers, and the unions and pacts made between the great powers of the day.

In ancient China, the eastern and western Jin dynasties and the southern dynasty placed great emphasis on genealogy, education and the continuation of family principles. Certain noble clans or families were highly regarded and wielded great influence, but their power faded or was wiped out in just a few generations.

More recently, China suffered great turmoil in a period that lasted nearly 200 years. During this time, the accumulation of wealth and its inheritance were impossible; most people simply inherited a surname and the deeds of their ancestors. But during 40 years of reform and opening up, considerable private wealth has accumulated in a stable, harmonious and prosperous society. Now, some of the people who have grown rich in China face the relatively new experience of planning how to pass this fortune on to the next generation.

In Europe and the US, wealthy families are already familiar with the ideas and means of passing on their wealth, whether to their descendants or to philanthropic causes. But for many Chinese families, this is something completely new. They are, however, familiar with the saying that “wealth creation is easier than wealth preservation” and the old adage that wealth created by one generation has usually been lost by the time it reaches the third generation.

This report will attempt to guide high net worth individuals through the complexities of protecting their wealth and making sure it grows so that it can be passed on to the next generation.

In the pages ahead, we identify instances where the family wealth was invested wisely, as well as a few glaring failures where fortunes were frittered away.

We will outline the tangible benefits of using a family office, trust or private foundation, and will demonstrate how, by making good decisions early on, the first generation has a better chance of transferring wealth successfully not just to the second generation, but to the third, fifth, and even the tenth.

Finally, we explain why there is more interest than ever in elite wealth management, and show that there is no ‘one size fits all’ model to follow. There are different requirements for every fortune and every family. That becomes evident from the case studies contained in this special report.
Making money is difficult; keeping it is even harder. Of the many rich, successful, and powerful families in history, only a few manage to keep their fortunes and pass them on to the following generations.

In this report, we will study some of these successful families - the Agnellis, the Rockefellers, and the Hearsts, as well as the creators of new wealth from the tech revolution such as the Gates family - to see what they did right and what lessons can be learned by others seeking to preserve their fortunes.
Introduction: Family fortunes

What is the difference between families that manage to keep their wealth for generations and those who watch it disappear? There are some clues from history.

Nothing is more important than seeking reliable professional advice, as shown by the example of William Randolph Hearst (see page 19), an American tycoon who rose from nothing to own the world’s first media empire.

Realizing that his children were not able to run Hearst Corporation, he put the business in the hands of professional managers and set up a family trust which, long after his death, still fills the pockets of his descendants. When the corporation does well — and 2017 marked the seventh year in a row of making a profit — so does the family.

Compare Hearst’s legacy with that of the Gould family. Railroad developer Jay Gould was – like Hearst – a product of America’s Gilded Age and was one of the richest men of his era. The bulk of his fortune was entrusted to his son George, who single-handedly frittered it away.

Once you have made your fortune, the hardest decisions you may face are how to protect it and manage it. Most people in this position start by forming a family trust, which cares for the wealth you created during your life and after your death. The trustee or trustees of your trust can be a family member, a close friend or a trusted financial institution with professional trustees. The creator or ‘grantor’ of the trust does not lose control of his or her assets, and can change the trustee and the list of beneficiaries whenever he or she wants.

The most important stage of a trust’s life is when it is first designed, says John Nicola, chairman and CEO of Vancouver-based Nicola Wealth Management. “You have to draw formulas into the trusts at the beginning about what happens after the grantor’s death,” he says.

This preparation, of course, needs to happen before the grantor’s death. Planning, Nicola points out, takes time and is ‘like having a bad tooth’, but is essential for ensuring the trust’s enduring success.

Choose the location of your trust carefully, says Christine Tan of Vistra, a global professional services firm based in Hong Kong and Singapore. Tan, who is managing director of trust services in Asia for corporate and private clients, points out that jurisdictions tend to be specialized. Most common-law trust jurisdictions offer discretionary trusts. However, certain jurisdictions such as the British Virgin Islands and Samoa have enacted special trust regimes, known as VISTA and SISTA respectively. These special-regime trusts are designed to hold the shares in family trading companies, while the trustees have no duty to intervene in the management of the company except under special circumstances.

Nor do all trusts have the same lifespan, ranging from 150 years in the Caymans and 360 years in the British Virgin Islands to perpetuity in Jersey and Hong Kong.

Trusts have been around since the 12th Century, when English knights put their assets ‘in trust’ before going to war. But they are now widespread and are growing in popularity in Asia.

Anu Sahai, a partner of McKinsey’s global wealth management practice in Singapore, says that the trust business will grow
by as much as 10% a year until at least 2025 in Hong Kong and Singapore, thanks to the combination of attractive location, infrastructure and regulatory environment. That’s a new development: until recently, many Asian families approached professionals for advice only when they encountered problems.

"It is always then difficult to identify suitable trustworthy family members that will continue to manage the family assets, particularly around the running of the family business," says Vistra’s Tan.

Trusts can also be subject to risk. One is data theft, when hackers target offshore trusts and reveal high-profile names. Another is the counterparty risk of firms that manage trusts. Clients "want to see risk controls, liability insurance and background checks on trustees," says Michael Addison, executive director of ultra high net worth wealth planning at UBS. But he adds that trust structures are "more robust [than] in the past", with greater focus on legal and tax issues.

Trusts are "invaluable for wealth and asset protection, and for passing on wealth to the next generation with a high degree of control over those assets", says Dillon Hale, who was the principal at a prominent Silicon Valley family office (see page 21) before he founded Peninsula Capital, an Asia-focused family-office consultancy.

But for wealthy investors eager to safeguard their riches, trusts are not the only concept they need to grasp.

"One of the big challenges that ultra high net worth families face is that in many cases the second generation is not interested in the business in the way that the first generation would want them to be," says Anurag Mahesh, head of the global family office group for Asia Pacific at UBS in Singapore. "What do they do about it? Some families are creating a family office so they can ease the next generation into managing family investment assets."

Family office

Family offices (or FOs) have been around since the 6th Century. Their modern-day revival began in 1882 when the Rockefeller family set up its family office; seven generations later, it is still running.

There are two basic types of family office – the single-fam-ily office (SFO), catering to the needs of one family, and the multi-family office (MFO), which serves several different families at once. But, like snowflakes, no two are the same, nor do they have the same ambitions or backstory.

Take the example of Man Capital (see page 10), a Lon-don-based SFO run by the Egyptian billionaire Mohamed Mansour, head of financial-industrial conglomerate Mansour Group.

For years, the family’s wealth was managed by Citi Private Bank. But in 2010, keen to boost returns and to exert greater control over his wealth, Mansour flew to New York to meet some of the top names in finance including David Rubenstein, co-founder of The Carlyle Group, and Goldman Sachs chief Lloyd Blankfein. He found that they had one thing in common. Once they had created their fortunes, they set up their own
family offices to help them care for future generations.

"I started thinking: why not get a team together to decide our own investments?" Mansour says. And he did.

Mansour set up Man Capital as a "private equity-style investment bank" and split it into three divisions. One focuses on startups; as a result, Man Capital was a pre-IPO investor in both Facebook and Spotify. The second stress-tests every big decision the group makes, while the third makes long-term investment decisions, spreading the family wealth over several industries and asset classes.

Family offices vary in size and scale, ranging from one-man outfits that do little more than arrange logistics, to powerful, standalone private investment banks. A good example of the latter is Palo Alto-based Iconiq Capital (see page 23) which manages $16.7 billion for some of Silicon Valley’s big names including Facebook co-founder Mark Zuckerberg.

Iconiq is one of America’s largest MFOs and targets higher returns — a key consideration in a low-yield world — by investing its clients’ capital in technology ‘unicorns’ including ride-hailing service Uber and Indian e-commerce firm Flipkart.

Experts agree that families need at least $200 million in liquid assets before setting up an SFO, and $20 million — or perhaps as little as $10 million — to be considered by the managers of an MFO. But it depends what you want your office to do. If, like Man Capital, the aim is to create your own investment bank, you are likely to need a lot more than that.

This is partly a reflection of the running costs. Man Capital has a 12-strong team of deal-makers including Manuel Perez, a family friend and former CIO at Citi’s global trust division. All are paid well and enjoy long-term, performance-based incentives.

But the additional costs arise because Man Capital has to leverage its own balance sheet. The office makes one or two big deals a year, each typically worth at least $100 million. Higher costs are inevitable; the aim is to mitigate them by generating outsized returns.

There are no guarantees, of course. A report in 2017 by the Williams Group wealth consultancy, which surveyed more than 3,200 high net worth families, found that 90% of inherited wealth has been lost by the time the third generation comes of age. A report in 2016 by Forbes found that just 20% of SFOs met or exceeded their own criteria for success, with an equal share doing badly. So, if success isn’t assured when you strike out on your own, why not simply entrust your assets to an experienced and qualified private wealth manager?

Clear benefits

There are two clear benefits that arise from setting up an SFO or joining an MFO. The first relates to wealth preservation and overall returns.

A private bank might set out to preserve and gently cultivate your wealth, while avoiding any risks. This may not be enough for rich families, whose members tend to grow in number as the years roll by (more offspring, more pockets to fill). A well-run family office will aim to generate higher returns at times of low interest rates. Man Capital aims to do so by putting its own balance sheet to work.

Other SFOs are clubbing together (see page 14) and using their collective financial clout to target and pursue high-return deals.

In some cases, SFOs join forces with private equity firms and corporates to buy assets that generate higher returns. This spreads risk and allows groups of like-minded family offices to invest in new assets, such as distressed debt or real estate or hedge funds. A few are even lending to funds, or other families and individuals.
The second benefit involves a blend of control and education. Again, take the example of Man Capital, which is overseen by chairman Mohamed Mansour; his son Loutfy is the CEO and should in time step up to the top job. A former Goldman Sachs banker, Loutfy is an impressive individual in his own right, but being fiscally responsible to all beneficial family members surely sharpens minds when a deal is on the table.

"A well-run family office, that adheres to strict compliance standards and boasts a trusted and reliable board of directors, helps the individual to future-proof what they have made for future generations," says Louise Bracken-Smith, who is co-founder of Fairway Group, an independent group that offers trust, fund and pension services in Jersey.

In any case, it is clear that as Asia gets richer, family offices are only going to become more widespread.

"The number of family offices grows in proportion to the wealth that is being created," says Dave Fox, who is president of the global family and private investment offices group at The Northern Trust Company in Chicago, as well as being a member of the firm’s operating group. "The more wealth that is created, the more family offices are created."

Family offices are fascinating subjects and, as mentioned before, no two are the same. However, there are some simple rules that are worth following, and these can make the difference between success and failure.

**Principles**

Good planning is paramount. Make sure the foundations of your trust or family office are strong before building on them. This is the lesson we learn from Randolph Hearst and Jay Gould, but it is one that is stressed again and again by those who are determined to pass on their wealth to future generations.

Diversification is crucial. Dillon Hale ran the Asia operations of Michael Dell’s $17 billion family office, and then went on to set up Peninsula Capital. Michael Dell’s family office was created to allow a more diverse range of investments outside the family business, Dell Technologies.

Finally, be flexible and learn from your mistakes. When Gianni Agnelli, grandson of Fiat founder Giovanni, chose John Elkann to run the family’s $23 billion fortune in 1997, it was a shock at many levels. But even though he was only 21, Elkann was a wise pick, and proof that family offices can be run well by dedicated and capable insiders as well as by professional outsiders.

He simplified the complex structure of the family office, which had been founded in 1927, and created a single investment firm called Exor which is majority owned by 80 family members. He moved its fiscal and legal headquarters to the Netherlands from Italy, thus reducing its tax bill. And he diversified its holdings away from auto-making and into technology, food distribution, energy and insurance. It worked. Exor’s pre-tax profit hit €7.76 billion in 2017, up 82% from the previous year, on net revenues of €143 billion, putting it in 20th place in the Fortune Global 500.

There is no single ‘right’ way to run a family office or trust, although there are plenty of ways that things can go wrong. As always, the trick lies in what you do from the outset: seek out good advice, tap people you trust and respect and remember that it’s easier to rectify bad decisions as soon as they are made, as the following case studies demonstrate.

This report aims to illustrate these key lessons. We will help to guide high net worth individuals who face some of the same dilemmas as those we profile. Are you worried about the ability of the next generation to safeguard your wealth? Are you unsure how trust structures will fit into your plans? Are you wondering whether a fully staffed family office is the right move for you — or whether you should join a multi-family office instead?

This report should help you find the answers. By learning from the lessons of the past, you can ensure prosperity and wealth for generations in the future.
1. 2  The benefit of a family office

[We] have set up this investment arm and family office to foster a sense of community and unity within the family. [We] want the Mansour name to be passed to generations and generations. Having a family office is a way to control what you are doing with your wealth. Mr Mansour is the decision-maker whereas if the wealth is managed for you, by someone else, there is less control. Mr Mansour set up a family office principally because after meeting other family offices he decided that he could do this himself with his own team. He set this up as he wanted to bring the generations together.

— The office of Mohamed Mansour

How can family offices help the next generation? Man Capital, founded by an Egyptian billionaire, offers a compelling answer to this question. The firm is proof that well-designed and well-run family offices can ensure that the wealth created today by successful captains of industry is passed on to successive generations, allowing them to prosper.

To understand Man Capital’s success, we need to re-wind to the year 2010. Mohamed Mansour, a 67-year-old, Cairo-born billionaire with offices and property in London, had just stepped down from his job as Egypt’s transport minister.

Mohamed Mansour’s father Loutfy started his cotton-trading business, Loutfy Mansour and Sons, in 1952, exporting to the US, the Soviet Union, China, Japan and Europe, then branching out into auto distribution in 1975. When Loutfy died in 1976, he left his business empire to his children. Mohamed Mansour took the business to the next level, setting up partnerships with top American companies and expanding their footprint globally.

By the time Mansour left the Egyptian government, Mansour Group was highly profitable and generated more than $6 billion in annual revenues.

But Mansour wanted a new financial challenge. His family’s wealth was overseen by Citi Private Bank, which manages the fortunes of many of the world’s richest people including the Saudi investor-philanthropist Prince Al-Waleed bin Talal. Mansour was happy with Citi’s service – it is important to seek professional and experienced advice, no matter how great your fortune – but he found himself wondering whether he could manage his money better.

Seeking an answer to this question, Mansour booked a flight to New York, determined to meet some of the world’s great financial minds: Goldman Sachs chief Lloyd Blankfein; JPMorgan...
Chase chairman and CEO Jamie Dimon; The Carlyle Group’s co-founder David Rubenstein; and Chuck Feeney, founder of The Atlantic Philanthropies, a liberal charitable institution.

It was a light-bulb moment for Mansour, who realized that all of these successful individuals had one thing in common: once they had created their own fortunes, they set up their own family offices or private trusts. That helped them to understand the difference between ‘good’ and ‘bad’ investing, and they were able to create their own financial legacies for future generations of their own families, by acting decisively and judiciously.

"I started thinking: why not get a team together to decide our own investments?” Mansour says.

So he did. Once he was back in London, he formed Man Capital, now based in Knightsbridge. Mansour set himself up as chairman, with his son Loutfy, a former Goldman Sachs banker, joining as chief executive. Manuel Perez, the first external hire, was well known to the family, having previously been chief investment officer at Citi’s global trust division.

The trio got to work, visiting family offices in London and New York to understand what worked and what did not. Mansour's ambition was to create, in his words, a highly active "private equity-style investment bank" that invested for the long term in assets in the developing world. That chimed with the nature of Mansour Group, which made its name operating in some of the developing world's riskiest markets.

Man Capital was split into three operating divisions. The first focuses on startups, and was an early investor in firms including Uber and music streaming service Spotify. Sometimes executives seek out opportunities; on other occasions, eager corporations and investors pitch to them. In 2012, Man Capital bought a stake in Facebook, then sold its shares and profited handsomely when Facebook went public in New York a year later.

The second division, referred to internally as its 'public markets' unit, is the beating heart of the entire operation. This is where Man Capital stress-tests every decision the Mansour Group takes. It’s not afraid to ask the hard questions. For example, if the heavy machinery division is doing well in one country but not another, the family office will demand to know why. If another division is looking to buy a rival, push into a new market, or monetize an asset by selling it or taking it public, Man Capital will act as an adviser.

The family office’s third main function is making solid, long-term investment decisions, which help to diversify the family's wealth, avoiding the dangers that lurk in focusing or concentrating on only one or a handful of investments. The legendary investor Warren Buffett once described diversification as "protection against ignorance" and Man Capital certainly heeds that lesson.

These long-term investments are where the real value shines through. Man Capital's 12-strong internal team of investment bankers and analysts target potential acquisitions, and determine what assets to buy. This is the closest Man Capital comes to its stated aim of being a private equity-style firm, able to put considerable amounts of its own capital to work — often with no clear exit date in mind.

Mansour says the family office completes one or two big-ticket deals each year, typically worth between $100 million and $125 million each. But the office does not work to a fixed budget or timeline, meaning it may complete a single $200 million investment one year and a scattering of deals worth between $20 million and $30 million each the next.

"We identify a viable business that we understand and which we want to build on, and then put the budget forward,” says an executive at Man Capital. When it ticks all the right boxes, the team meets, votes, and acts.

A good example of this occurred in 2012, when Man Capital, then just a few months old, bought OTS Logistics, a US-based firm with 3,000 staff in 100 countries, for $300 million. But the family office tends to focus on opportunities in emerging coun-
tries; in recent years, it has invested heavily in education in sub-Saharan Africa, a region Mansour knows well.

Its investment bankers spend a lot of their time trawling markets in Africa, southeast Asia, and central Asia, searching for undervalued assets that suit its portfolio. Man Capital's ability to hire seasoned banking and financial talent is helped by its long-term compensation and bonus structure — the longer you work there, the better you're paid — and the communal sense that when they buy an asset, corporation or fund, they are doing so not as strip-and-sell operators but as long-term investors.

Control your fate

Why choose a family office rather than settle with a private bank? The main reason is greater control, according to Louise Bracken-Smith, co-founder and managing director of Fairway Group, an independent group offering trust, fund and pension services in the UK Crown dependency of Jersey.

"Family offices allow wealthy clients to control the situation," she says. "They can set up an FO in a stable jurisdiction like Jersey, meeting all the right regulatory and compliance standards, setting up their own board of directors and trustees, and future-proofing their money for the next generation."

So should other high net worth investors follow Mansour's example and set up a family office? It is important to weigh up the costs and risks as well as the rewards. Whatever your wealth, putting your money to work with one of the world's largest banks reduces your personal responsibility for your investments. When a Man Capital investment goes south, Mansour and his team have no one to blame but themselves.

There are other risks when it comes to setting up a family office. They are expensive to run, and the learning curve is steep. Attracting and hiring the right people is also difficult — executives at Man Capital say the answer lies in identifying talented individuals who are not just intelligent and self-motivated but are also able to work in harmony with a small, close-knit team.

While these problems certainly need to be considered, it is clear that — when done right, and with the right amount of minimum capital — the benefits of setting up a family office should outweigh the costs.

For one thing, a family office allows you to shape your investment decisions to fit your own culture and belief system, investing in assets that you are committed to. This not only builds expertise among your team, but also helps to keep costs down because there is no need to employ a long list of external advisers from a variety of different banks. Well-run offices also ensure that your family stays connected and involved in the process of wealth generation and preservation, and also wealth succession. It's important for future generations to know their rights, and how their wealth is being managed.

Mansour himself talks about the "sense of destiny" that Man Capital instils in everything it does, and everything the group does. Running a family office is inherently risky — you need experience, a deep knowledge of global economic and financial affairs, a detailed and well-researched investment programme, access to quality investment opportunities, and good measures of nous, pluck and skill. But get it right and it can be immensely and permanently rewarding.

Mohamed Mansour and his team have built a family office capable of passing wealth down not just over one or two generations, but 10 or 20. It is an instructive example of the opportunities available for those wealthy individuals who decide to create a family office.
Bigger, bolder, stronger: From single-family to multi-family offices — and beyond

In the United States, the rise of multi-family offices has paved the way for a broader cooperation between the wealthiest families. Even among the richest people in the world, there is strength in numbers.

It sometimes feels as if Wall Street has been around forever, but its name and fame as a global financial centre really started in the 1870s, an era that included the formation of JP Morgan and the Dow Jones Industrial Average, and the launch of the Wall Street Journal. As the US economy grew, wealthy families from across the nation gravitated towards New York, home to the best lawyers, bankers, investment advisers and money managers.

The nation's wealthiest dynasties formed family trusts and offices, which were managed out of New York and incorporated in low-tax states such as Delaware and Nevada. The big New York banks in turn set up trust units that helped the rich put their capital to work at home and abroad, in places as far apart as Singapore and Switzerland.

In fact, one factor that has remained firmly in place is the family trust, a model that has stood the test of time, proving invaluable as a tool to preserve wealth, protect assets and pass family wealth to the next generation.

Family trusts offer wealthy individuals an incredibly powerful, flexible solution to many of their problems. Trusts allow families to elevate wealth management well beyond simple investment advice. By separating some or all of their assets into a trust, as well as hiring professionals to help set up and manage these trusts, rich families can ensure that their wealth is wisely passed on for future generations.

But as the provision of wealth management services to rich families grew, the industry also fractured. Some wealthy individuals decided to go their own way, setting up investment firms whose sole role was to manage the family fortune (see previous chapter). This gave them control and flexibility they could not achieve using external providers, allowing them to hire people that were a good fit with the family's culture and philosophy.

Others put their money to work with multi-family offices, or MFOs, capable of providing a full range of wealth-related services. These include: investment management and asset allocation; tax advice (for example, helping wealthy individuals to reduce their corporate and personal tax bills across a range of jurisdictions); estate planning, which helps to ease the passing on of wealth from one generation to the other; trusteeship, a crucial function which allows experts to best manage assets on behalf of a beneficiary; and foundation management, which helps clients make the most out of their charitable donations. Some firms go the extra mile, even arranging travel and household staff.

MFOs have grown in size and number. The most effective, experts say, revolve around one large, powerful family; families with smaller fortunes join as clients and leverage the power of

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1 South Dakota, which has no personal or corporate income taxes and no limit on ‘dynasty trusts’, as well as strong asset-protection laws, has since overtaken both to become America’s ‘trust capital’.
the large family. Annual fees charged by MFOs vary from about 0.6% for clients with over $300 million in assets, to 1% for families with $50 million.

"It would be wise for smaller families to consider the services of an MFO with a proven history and solid backing," says one investment expert. "The MFO pays overheads, hires staff and manages the business. As a small family, you get to leverage what they have built." Running a multi-family office is a cost-effective business model.

According to Family Wealth Alliance, a specialist publisher and event organizer based in Chicago, the largest US multi-family offices at the end of 2017 were Bessemer Trust, with $51.6 billion in assets under management, followed by Wells Fargo Family Wealth ($28.4 billion), Rockefeller & Co ($23.9 billion) and US Trust Family Office ($23.9 billion).

One interesting trend with MFOs is where one family drives the creation of an office before reducing its exposure as smaller investors join in. This ensures the hiring of top quality staff at the outset, committed to serving a well-known, high net worth family, but also leaves room for evolution. Some wealthy families, having subsequently moved a portion of their assets out of an MFO, now regard it as another of their business holdings.

**Join the club**

Although most MFOs tend to be dominated by one very large family, even the wealthiest families have proved willing to work together, pooling their resources to acquire assets that might prove too expensive for them individually.

This is particularly relevant for those families with more risk appetite. While some families are content to watch as their wealth slowly grows, others, seeking higher returns in a world of low interest rates, embrace risk. Frustrated with the weak performance and high fees of Wall Street's money managers, wealthy individuals and families have started to club together, using the power of their collective wallets to target and pursue high-return deals.

This strength-in-numbers approach has been around for more than a decade, proving effective when families lack enough capital to cut a solo deal, want to share risk with fellow travellers or simply want to build new relationships. But this model went to the next level in 2014, when Ross Perot Jr., the eldest son of Texan billionaire and former US presidential hopeful Ross Perot, hosted an elite gathering at his ranch in Texas. More than a dozen of America's richest people came, including the families of George Soros and Michael Bloomberg. Strangers bonded over the barbeque and skeet shooting, and trust was forged.

The group assembled that day has since expanded to include about 150 families, who have since participated in a number of deals, including several big-ticket acquisitions. The aim is to help families work together to strike private equity-style club deals that are riskier due to their sheer size, but which cost less (since there are either low or no fees to external investment advisers) and generate higher returns than a family might get from ordinary industry private equity funds.

Private equity firms – which are hobbled by bureaucracy, squeezed by pressure on fees, and struggling to generate historical returns – have taken note. On some occasions, they have been forced to compete for desirable assets with family networks. On others, buyout firms have joined forces with these families when extra capital or specialist knowledge of a sector was required, or to avoid a bidding war.

A case in point: when private equity firm BC Partners closed a deal in May 2017 to buy several dozen data centres from New York-listed CenturyLink, one of its
co-investors was Longview Asset Management, the family office of the Crowns, a Chicago-based family with an estimated fortune of $7 billion. The same month, the Pritzkers, one of America’s wealthiest dynasties, joined forces with Arkansas-based banker Warren Stephens, and with Jim Davis, the billionaire co-founder of Maryland-based staffing company Allegis Group, to buy Hargray Communications. Their three respective family offices combined to pay $700 million in cash for the cable operator.

And when family offices decide to sell assets, they may turn to hedge funds and private equity firms as potential buyers. These funds have raised enormous amounts of capital over the last few years and are desperate to deploy it. That means they do not always have the luxury of demanding the best possible price, experts say.

This kind of strength-in-numbers deal-making is happening elsewhere too. In May 2018, the family office of Anand Burman, one of Asia’s richest men with a fortune of $5.8 billion, joined forces with private equity firm TPG Capital Management to pay $267 million for Fortis Healthcare, a chain of specialist hospitals in India.

Risk-embracing FOs seeking higher returns are investing in a wider range of funds and sectors, including illiquid asset classes such as private credit, private equity and venture capital, as well as distressed debt, real estate and esoteric life-insurance products. They have begun acting as lending institutions, disbursing capital to individuals, funds and families keen to target their own big-ticket acquisitions, or joining forces with activist funds and shareholders to target undervalued and underperforming corporates and assets.

Others have even bought stakes in hedge funds, which are already under pressure from wealthy families to cut their fees. In this instance, the aim is to bolster their bottom line, boost earnings and glean vital knowledge from sophisticated alternative investment teams. That certainly was the logic at work when Hillspire, a family office that manages more than $5 billion for the family of Alphabet chairman Eric Schmidt, paid $500 million for a 20% share in DE Shaw.

As family offices grow in strength and power, they are demanding ever-greater respect from across America’s elite financial community. Wealthy families are pooling capital to cut bigger deals that generate higher returns. An added benefit is that they can operate quickly and decisively but also in secret, given that many deals involving the sale and purchase of privately held assets by US-based institutions and funds do not require approval by federal regulators.
Grandfathering inheritance: Learning from a giant

Is there a limit to how large a family office can be? Is a family office with multiple billions under management vastly different from smaller, more nimble offices? The case of the Agnelli family is instructive. The Agnelli family business is one of the largest corporations in the world — and provides clear examples of how to put family first.

John Elkann’s life changed forever in 1997 when he was named heir to the family fortune and empire by his grandfather, Gianni Agnelli. Some people thought the task would be beyond the baby-faced, 21-year-old man who had been born into a life of privilege and wealth, and raised and educated in London, Rio de Janeiro and Paris. But Elkann knew the family business well, and was widely regarded as hardworking, responsible and capable. When Gianni died in 2003, Elkann – only 27 years old – was thrust into the spotlight.

By then, Elkann was already in charge of three of Italy’s best-known brands: the car-makers Fiat and Ferrari, and Juventus football club. Yet Elkann took the accelerated responsibility in his stride, helping to revive Fiat, which was teetering on the edge of bankruptcy.

Could anything be more important than taking the helm of these famous businesses? Just one thing. In 2011, Elkann was put in charge of Exor, an investment business which has managed the Agnelli family fortune since it was established in 1927. That year, Fiat founder Giovanni Agnelli founded Istituto Finanziario Italiano (IFI), an investment fund that collected, managed and controlled his holdings in Fiat, subsidiaries and related companies, and his agricultural interests and real estate.

IFI continued to grow, investing and divesting assets. In 1957, it made its first investment in a financial firm that would grow to become Istituto Finanziario Italiano Laniero (IFIL), also controlled by the Agnelli and Nasi families, which would play a parallel role to IFI. Yet another investment firm, IFINT, was formed in 1964 to manage the families’ foreign holdings. Listings followed, with IFI completing its IPO in Italy in 1968, and IFINT selling shares in Luxembourg five years later. Further complicating matters, an umbrella organization called Giovanni Agnelli & Company was formed in 1987. Controlled by brothers Gianni (who owned 30% of the firm) and Umberto Agnelli, their cousin Giovanni Nasi, as well as Cesare Romiti, who was the chief of Fiat at the time, its underlying value was comprised of 70% of IFI ordinary shares. This new investment firm now controlled the family fortune.

This fiendishly complex arrangement, with family wealth spread across multiple funds and firms, was simplified in 2009 when IFIL and IFI were merged to create Exor, using the name of a French company bought by IFINT in 1991 that owned a majority stake in the water brand Perrier and the Bordeaux wine estate Château Margaux.

When Elkann was named the preeminent family leader and head of Exor, it was desperately in need of new blood and fresh thinking. Fiat remained its dominant investment and when the Turin-based auto giant struggled — as was the case in the late 1990s and early 2000s — the family’s fortune was directly impaired. An investigation by The New York Times in 2002 found that the Agnelli/Nasi dynasties consisted of about 150 descendants of the original patriarch Giovanni, including children and cousins, nieces and nephews, as well as grandchildren and great-grandchildren; of these descendants, 80 owned shares in the family-owned Agnelli & Company, which controlled the empire.

Elkann made two important decisions that forever changed the nature and focus of Exor, whose assets were used to pay dividends to hundreds of family dependants.
First, he moved its fiscal and legal headquarters from Italy to the Netherlands, limiting the firm's tax exposure while retaining its listing on the Borsa Italiana in Milan. That decision was approved by 85% of the shareholders, who include family members as well as a select group of external investors. Among the latter are US-based investment firms Harris Associates and Southeastern Asset Management, who also take the long view on wealth preservation and accumulation.

Elkann described the relocation as a "natural progression" for an increasingly global and diverse investment firm, adding that his objective was to create a "more simple company structure" that reflected its international profile.

Second, Elkann began to diversify Exor's investment base, moving it away from its historical roots in Italy and in industry. Once a defensive investor that passively sucked in revenues and spat out dividends, it has adopted a more active stance and outlook, introducing greater financial vigour by pairing investments with more disciplined benchmarking to ensure that each investment and asset pays its own way.

Exor bought positions in the German electricity producer RWE, and in Ocado, a British technology firm that specializes in food e-commerce. But the biggest Elkann-era investment took place in 2015, when it bought PartnerRe, a New York-listed reinsurer, for $6.9 billion.

The all-cash PartnerRe deal was a big spin of the wheel. An aggressive takeover, it remains the only large investment in which the firm owns a 100% stake. It also involved Exor taking on a substantial amount of debt, raising its loan-to-value ratio to more than 20%. PartnerRe made up 34% of the firm's gross asset value at the end of 2017, more than FiatChrysler, which accounted for 25% of its GAV. In April 2017, Exor doubled down on the sector when it bought Canadian life insurer Aurigen for $286 million.

So far, these investments have paid off. Exor's pre-tax profit rose 82% to €7.76 billion in 2017 on net revenues of €143 billion. Total income jumped from €23.7 billion in 2016 to €122 billion the following year, with earnings per share rising from €2.515 to €5.932 in the same period.

Exor's net asset value per share, or the total value of the firm's investments divided by its outstanding shares, was $56.9 in 2017, against $20.1 for the MSCI World Index. It placed 20th in the Fortune 500 list of the world's largest companies by revenues in 2017, squeezed between telecoms firm AT&T and automaker Ford. That is an impressive feat for what is, in effect, a very large family office.

These figures matter, not only because any investment firm tasked with managing a vast family fortune has to be growing rather than slowing down, but also because of the firm's unusual structure.

Holding company Gianni Agnelli e Cie, has a controlling 53% stake in Exor. Exor's board is made up of non-independent directors (including members of the Agnelli and Nasi families, the original co-founders of the investment firm), as well as independent directors (including Lloyds Banking Group CEO António Horta Osório and former M&S chief executive Marc Bolland).

A strong board is seen as both a blessing and a curse. On the
one hand, it keeps Elkann on his toes. Should it wish to do so, the board has the power to replace him as head of the family and as Exor chairman. On the other hand, it introduces a level of complexity unusual for family offices. The extended family — the precise number of members holding direct shares is unknown — is heavily involved in the behind-the-scenes discussions, ensuring that major investment decisions are made only after extensive vetting.

Anyone looking for guidance as to how to run a vast family investment firm with a seemingly limitless number of moving parts, should look no further.

Successful succession

Elkann's rise to the apex of Italian financial and cultural life highlights a curious aspect of inheritance. He was a reluctant beneficiary of others' troubles and struggles, most notably the death of Edoardo, Gianni's only son, in mysterious circumstances in 2000. But his success was no accident. From a young age, Elkann was fastidious and conscientious — and keen to learn. He worked at Fiat factories around the world, learning how goods were made and how money worked.

By choosing his grandson as the family's power broker and titan, Gianni was showing faith in so-called 'grandparenting inheritance', the theory that the third generation can be better at managing wealth than the second. Dillon Hale, who ran the Asia operations of Michael Dell's family office and who is a strategic advisor to Credit Ease Wealth Management, points to the example of the Smorgons, one of Australia's richest families, as evidence of this theory.

When Victor Smorgon, a steel-to-paper titan, was considering his ideal successor, he looked beyond his own children to Peter Edwards, a grandson who was just out of high school. Edwards worked on the family's steel factory shop-floor, absorbing real-world practical experience and getting to know the family business better than anyone. Under his command, the family office, called Victor Smorgon, has grown and diversified, owning the second-largest tuna fishery business in the South Pacific, as well as commercial interests in industries ranging from plastics and clothing to food and fuel.

In much the same way Elkann, now 42, has transformed Exor. It is no longer the stodgy outfit whose fortunes were tied to the financial performance of the Fiat group but an increasingly global investment firm with dividend-generating assets scattered across the world. It has made big bets in sectors such as retail and finance that have little or no connection either to Italy or to the firm's industrial heritage, a fact that has been criticized in some corners of the Italian media. It raised eyebrows in 2015, when it bought a 43% stake in The Economist Group, the London-based publisher of the Economist newspaper.

Exor's financials have undoubtedly benefited from the extraordinary revival of Fiat, which merged with Chrysler in 2014 to create Fiat Chrysler Automobiles (FCA). Both FCA and CNH Industrial, a capital goods firm controlled by Exor, are legally incorporated in the Netherlands and fiscally resident in the United Kingdom. Ferrari is also legally incorporated in the Netherlands, highlighting the importance of jurisdiction when it comes to taxation, wealth preservation and long-term corporate sustainability.

Exor is not perfect. It is overly dependent on revenue streams generated in North America, and it is still in the early stages of diversification. Investment experts believe the chairman's ultimate ambition is to diversify entirely away from car and vehicle production, a capital-consuming process, and potentially to dilute the family's shareholding.

Elkann's big bets, notably on PartnerRe, have so far proved successful. Perhaps more impressively, he has managed to keep the sprawling Agnelli family happy — no small feat. His success, and his position at the head of Exor, is dependent on his ability to keep the family fortune growing. Few would bet against him doing so.
Financial wealth can feel real and lasting. It can also prove illusory and is easily squandered. According to an Italian proverb, the first generation makes money, the second maintains it, and the third fritters it away. Some fortunes do not last even that long. A Forbes survey found that one in three businesses passed to the next generation, while just 10% of family firms were still extant when the third generation came of age. In short, if your grandparents were rich, you probably are not.

Of course, there are powerful and wealthy exceptions to the rule: people who passed their fortunes down the ancestral line to the willing, the able, or the plain lucky.

America’s so-called Gilded Age was a period that lasted from the 1870s to about 1900. It witnessed the rise of industrialists such as John D. Rockefeller and Thomas Mellon, who amassed vast personal fortunes during their lifetimes, before passing on their wealth and wisdom to their children. The Rockefellers and Mellons are still among America’s richest and most influential families.

Then there’s William Randolph Hearst, perhaps the most extraordinary figure of that extraordinary era. The son of a miner, Hearst became proprietor of a San Francisco newspaper in 1887 at the age of 24, before going on a buying spree and acquiring publishing groups across the country. Twice elected to Congress, his life was immortalized in Orson Welles’ film *Citizen Kane*. When he died, he left behind 15 profitable daily newspapers, and a handful of radio and TV stations.

Yet Hearst’s enduring legacy is less his creation of the world’s first media empire, and more his ability to ensure that his fortune lasted long after he died in 1951. In the years before his death, Hearst realized that none of his children was competent to run the firm he had founded. His will placed Hearst Corporation in the hands of professional managers, and granted Hearst family members five of the 13 votes on a self-perpetuating board of trustees. That ensured they would never have enough seats to control the business outright.

The will was carefully drawn up by Hearst and his lawyers, and was explicit and enduring in its statement and meaning. When Hearst Corporation did well, dividends would flow into the Hearst
Family Trust, and from there, into the pockets of his descendants. Anyone who challenged the will would immediately be disinherited. The trust will, in theory, be dissolved when any family member who was alive at the time of Hearst's death passes away, an event expected to happen around the year 2035.

It is hard to argue with Hearst's clarity and foresight. Cold-hearted as an individual, he was also clear in his thinking, and concerns about his progeny were probably well founded. (Like their father, none of Hearst's five sons graduated from college). Hearst Corporation has not only survived, but thrived. It reported a seventh straight year of record profits in 2017, according to president and CEO Steven R. Swartz, on revenues of $10.8 billion.

Hearst Corporation has changed with the times, judiciously acquiring and shedding assets over the years like any good active investor. It remains heavily invested in print journalism, in a conscious nod to the founder's first love. Its business media division accounted for 28% of total profit in 2017, according to Swartz, and it owns stakes in digital magazines including BuzzFeed and Vice. But it has also diversified, investing in transport, health services and aviation safety. In April 2018, it bought an additional 20% of Fitch Ratings for $1.965 billion, raising its stake in the ratings agency to 100%.

The Hearst family is as heavily involved with the corporation and the trust as ever – and just as well remunerated. The corporation is chaired by William Randolph Hearst III, a philanthropist who has built his own investment legacy; he has founded firms including, in the middle of the 1990s, @Home Network, an early Internet service provider.

Its experienced board is comprised of family members, including another of the founder's great-grandsons, George Randolph Hearst III, and non-family members, including its chief financial officer Mitchell Scherzer, a former investment banker with 20 years' experience at Goldman Sachs.

Finally, consider this for a moment. At the end of 2017, the Hearst family was America's ninth-richest family, according to data from Forbes, on a par with the Walton, Mars and Koch dynasties. Hearst's 67 remaining descendants are collectively worth $28 billion. Then compare that with the agonizing experience of the Gould family, another star of the Gilded Age.

When Jay Gould, a ruthless railroad tycoon, died in 1892, he left behind one of history’s great fortunes. His son George inherited the lot, but when he died in 1933, the family wealth had dwindled from a peak of $77 million during Jay’s lifetime (not adjusted for inflation) to just $5 million. Needless to say, the Goulds do not make it into the modern rich-lists. If you need a warning from history, this should be it.
Dillon Hale has spent the past 22 years running and advising some of the world’s largest family offices, in markets including the US, China and Australia. Every successful family office, he says, starts "with the primary aim of wealth preservation".

Anyone aiming to invest their wealth more successfully, and to learn to recognize the risks and rewards of setting up a family trust or office, should meet Dillon Hale.

Born in South Africa, Hale studied law and economics before joining a merchant bank in Johannesburg. After moving to Australia, he ended up as national director of Australia’s fourth-largest private bank before setting up First Capital, an investment consultancy that provided advice specifically to family offices.

A meeting in New York led him to join Capricorn, an investment firm that was founded by Jeffrey Skoll, eBay’s co-founder and first president. This family office manages $5.5 billion on behalf of Jeff and the Skoll Foundation. Hale spent five years there, rising to the position of principal, and is currently a strategic adviser to the firm.

Notable investments made by Capricorn during this period include Tesla, Vitaminwater, SpaceX and Planet Labs.

The chance to work for the $17 billion family office of technology billionaire Michael Dell proved irresistible.

"It was a family office that everyone looked up to in our industry," Hale says. "They didn't have much exposure to Asia at all, and they wanted me to help build an office and presence for them to cover all Asia."

After joining as head of Asia and opening offices in Melbourne and Hong Kong, he got to work on a plan to create relationships with large regional family offices with a similar philosophical outlook; the aim was to share information and views, learning about the local investment environment and potentially sharing in hard-to-access investment opportunities as a partner.

It wasn’t always easy. The innately conservative approach to investing among some elite Asian families meant that time was spent "working out who was 'real' and who was not", in Hale's words.

"There is a strong educational component to building a family office," he says.

"Diversification through asset allocation is also critical."

Some business owners want to plough everything back into their firm. Dell did that, before his firm hit turbulence. Then he told his family office to diversify as far away as possible from Dell Technologies. This is important in markets where the rules might change overnight. As Warren Buffett often says, don’t put all your eggs in one basket.

Two years ago, Hale embarked on another adventure, setting up a new Asia-focused consultancy whose clients include FOs based in China, Silicon Valley, New York, the UK and South Africa. After 20 years at the top of the industry, he has some cogent advice for anyone setting up a family office.
A question Hale often fields is whether wealthy individuals need a family office.

"My answer is that it's an expensive exercise that's not right for everyone - you need to be of a certain size" he says. But for anyone who decides to forge ahead, there are simple rules to follow. "Having created significant wealth, you want to protect it. All successful FOs in my experience start with the primary aim of wealth preservation."

After that, you need to diversify. A customized asset allocation model allows family office managers to manage risk while protecting the asset base.

"It encourages investment along a spectrum of asset classes", from the conservative (cash, treasuries, investment-grade bonds) to the risky (venture capital funds, startups). "The amount allocated across this spectrum depends on a family's circumstances and its view of the macro environment. The common point will be diversification of risk."

How important is location to a family office? That depends. If all your capital is tied up in mainland China, Hale recommends that you consider locating your office in Beijing or Shanghai, so you can hire local experienced investment talent that is often harder to find in other cities. If your wealth is offshore, go for the likes of London or New York, because even though they are expensive (tax rates and staffing and overhead costs are high), they are filled with seasoned investment talent.

Hong Kong and Singapore are two other obvious choices. Both share a time zone with Beijing, are easy and quick to travel to, and boast transparent and reliable legal and financial systems.

Hale urges those with a fortune that falls short of the super-wealthy bracket to consider forming a trust rather than a family office and to outsource investment management to a best-in-class wealth manager. Trusts are multi-functional and used for a number of reasons – to protect and manage wealth, to house a private family foundation or to pass on wealth. They have "truly stood the test of time" over many centuries, Hale says, proving "invaluable for wealth and asset protection, and for passing on wealth to the next generation with a high degree of control over those assets. I doubt there is a single-family office in the US that does not also run its own family trust or trusts."

Hong Kong is a "good, accessible and close" place to form a trust. Other viable jurisdictions include Jersey, the British Virgin Islands and Bermuda, while the Cayman Islands' STAR Trusts specialize in structured finance and commercial transactions. "Choosing a jurisdiction that suits your needs is important," Hale notes.

Trusts are also central to the key aim of passing on wealth successfully to the next generation.

"There are steps first-generation wealth creators can take," he says. "From a structuring point of view, there are strings attached to ensuring that wealth is passed on successfully, particularly when it comes to trusts."

Carefully enshrining long-term operational rules in a trust's deed is paramount, as it regulates how wealth is invested and paid out when a family member passes away, comes of age, or accomplishes a stated career or life goal.

Over the course of his long career, Hale has come to the conclusion that no two families or sets of needs are the same. They might be in the early stages of building their fortune or focused on preserving what they already have. Some families are still in transition, somewhere between the two.

As successful family offices and trusts grow, they might put down roots in new markets and asset classes, becoming as sophisticated as any global investment firm. Capricorn Investment Group and Michael Dell's office are useful examples here. In Europe, multi-generational families "tend to have very mature structures", Hale adds.

"As you hit the fourth or fifth generation, many family members are pursuing their own interests, with little or any interest in the original family business," he says.

But remember a key lesson: future generations only benefit from the good decisions you make now.
Every technology billionaire has his or her own approach to personal wealth management while sharing one thing in common: a clear belief that a dedicated and careful approach to money management is the best way to make a fortune last — and make a difference.

To find some of the best and most active examples of high-end wealth management these days, you need to head not to London, New York or Singapore, but to America’s west coast.

This is where the headquarters of five of the 10 largest global firms by market capitalization are found, including the list’s top four: Apple, Alphabet, Microsoft and Amazon. Each of those digitally driven firms has created vast wealth for its founders. *Forbes* named Amazon’s Jeff Bezos the world’s richest person in 2018, with a fortune of $112 billion, followed by Bill Gates, with a net worth of $90 billion. They were followed closely by Mark Zuckerberg and Oracle founder Larry Ellison.

But it is what these pioneers of technology and industry have done — and continue to do — with their wealth that is the real story here. And no two tales are the same.

Take the 62-year-old Gates. His story has focused in recent years on the Bill & Melinda Gates Foundation. And rightly so: since its formation in 2000, the $38 billion private foundation has worked to improve global healthcare and tackle poverty. But the family’s fortune is managed elsewhere, by a private firm called Cascade Investment.

Based in Seattle, not far from Microsoft’s global headquarters, Cascade has been run since 1995 by Michael Larson, once a money manager at Boston-based Putnam Investments. Cascade’s latest filing to the US securities regulator flags up Larson’s “broad understanding of the capital markets, business cycles, and capital investment and allocation, and an appreciation of the interests of long-term shareholders”. That filing from May 2018 adds that Cascade invests in “public equity, fixed income, and alternative assets”, while also dabbling in venture capital.

On Larson’s watch, the investment firm has diversified its holdings. When he started, Gates’ net worth was $5 billion, and Cascade was dominated by and dependent on the performance of Microsoft stock. Since then, it has invested in a wide array of publicly and privately held firms, including waste removal firm Republic Services, drinks group Femsa, and Four Seasons Hotels and Resorts, whose other major shareholder is Saudi businessman Prince Al-Waleed bin Talal.

Over that period, Larson has delivered compound annual returns of a little over 10%, by investing in stocks operating in super-reliable industries that do well in all seasons, from consumer goods to timber to home furnishings. Cascade’s data shows it has outperformed index funds in years both good and bad, maximizing its returns in 2017 and minimizing its losses in 2008.

It has also expanded its focus to include other developed markets, buying stakes in UK firms including Carpetright, JJB Sports, and spirits maker Diageo. But otherwise, the investment firm has barely changed. While the Gates Foundation continues to tackle health and other problems, whether finding a cure for malaria or fixing broken schools, Cascade Invest-
ments has stuck firmly to what it knows: investing well and wisely, and serving the personal financial needs of the one family that matters. By any measure, it has succeeded.

Laurene Powell Jobs, the widow of Apple co-founder Steve Jobs, is the founder and president of Emerson Collective, a Palo Alto-based non-profit organization. She has taken on the mantle of her husband, a great activist and innovator, leveraging the family’s $20 billion fortune in order to tackle social issues, donate to political campaigns, and invest in startups.

Over the past decade, Emerson Collective has put its money to work in a dozen early-stage enterprises. In July 2017, it invested $40 million in a Series B funding round for Los Angeles-based virtual reality developer Within, whose backers include Singaporean sovereign wealth fund Temasek. A month later, it became the majority owner of The Atlantic, one of America’s oldest weeklies, marking the latest foray into old-fashioned print media by a super-wealthy US family. Emerson, which sees itself as a social-impact enterprise, has also backed journalism non-profit institutions including ProPublica and the Marshall Project, and runs an anti-gun-violence project in Chicago.

Vulcan Capital, an investment firm founded in 2003 by Microsoft co-founder Paul Allen, also focuses on generating outsized revenues by investing in startups or early-stage firms. The Seattle-based outfit typically injects between $10 million and $100 million into each target; over the years, it has invested in China’s Alibaba Group, film producer DreamWorks Pictures, online property broker Redfin and music streaming service Spotify. Reflecting Allen’s values, Vulcan Capital says its aims are to generate high returns while taking “an entrepreneur-friendly, long-term approach to investing” and “supporting ventures that have a positive impact on lives and communities”.

But perhaps the most influential high-end outfit on America’s west coast is Palo Alto-based Iconiq Capital. A private investment bank that sources, structures and packages investment deals before offering them to clients and sometimes outside investors, it combines traditional wealth management services with a sensitivity to the financial and personal needs of the super-wealthy.

Iconiq manages $16.7 billion in assets, overseeing the fortunes of many of Silicon Valley’s richest people, including Facebook co-founder Mark Zuckerberg and LinkedIn co-founder Reid Hoffman. Iconiq, founded in 2011, has evolved quickly, opening offices in nearby San Francisco as well as in Singapore and New York. It has put its clients’ wealth to work wisely, investing in a dozen technology ‘unicorns’ including ride-hailing service Uber, software developer Apttus and Indian e-commerce firm Flipkart, which in May 2018 sold a 77% controlling stake to US retailer Walmart for $16 billion. It recently shifted gears again, by ramping up its private equity division and pursuing more buyouts of larger, mature technology firms. Its aim is to generate higher margins for both itself and its clients, mostly family offices with personal assets in excess of $100 million.
Silicon Valley’s super-rich creators, innovators and disruptors are pioneers in what has come to be seen as sustainable philanthropy or ‘Philanthropy 2.0’: using business thinking and solutions to make a real difference and to drive change. This includes impact investing — putting capital to work in projects that provide a return while addressing a particular social problem — and ensuring that charities and the causes in which they invest are transparent and can explain their business decisions.

This progressive form of investment is favoured by America’s technological elite for several reasons, says Dillon Hale, the founder of Peninsula Capital, an Asia-focused family office consultancy. It allows them to build a lasting legacy, to include their children in decision-making, and to use their colossal wealth in ways that are socially, culturally and environmentally positive, often tax-efficient, and which largely evoke admiration among their peers.

Philanthropy 2.0 represents a novel approach to philanthropy, blurring the lines between charity and investing. It underscores an important point that all investors should bear in mind: profit and philanthropy do not need to be mutually exclusive.

The direct approach

Do the family offices of tech titans invest directly, or choose to put most of their money in funds? The general rule: the larger the office, the more direct and streamlined its structure.

Michael Dell’s office, with $16 billion under management, is a case in point. Hale, who once led Dell’s Asian family office, says the family office almost never used funds, preferring to use “direct investment strategies”. Another example is eBay founder Jeff Skoll, whose family office Capricorn invests its assets evenly between underlying funds and directly in illiquid or semi-liquid investments.

“They ask if their team are qualified to undertake a certain type of direct investing,” adds Hale. “If the answer’s yes, they invest directly. If it’s no, they outsource to the best fund or funds they can find.”

Smaller family offices will invest more capital in underlying funds, largely because they lack the resources to hire the best-qualified and most-experienced talent, and the capacity to source direct investments of the highest quality. Most therefore use pooled investment vehicles.

“I have very often seen disastrous mistakes made by smaller family offices with inexperienced staff, trying to invest directly,” says Hale.
Raymond Wong: Creating an inheritance philosophy

Raymond Wong King Kwok is a man of many talents. He is a doctor of psychology, a student of history and a connoisseur of antiques. He is also one of Hong Kong’s most senior insurance professionals. Each of these facets of his life is reflected in his approach to wealth management and family inheritance.

Raymond Wong King Kwok, AIA’s Hong Kong executive district director, has worked in the insurance business for 40 years. He now manages 18 business areas with more than 2,000 staff. But despite this obvious success, he did not have the most auspicious start in life.

He grew up in difficult circumstances, developing a stammer when he was young; his father was addicted to gambling; he lived through the riots in late 1960s Hong Kong. But he overcame these hurdles.

His stammer went away eventually and, as a result, he became more confident about tackling life’s obstacles. He majored in economics, taking a night course at junior college, and broadened his mind by studying philosophy and religion. He took a keen interest in psychology, which became an important part of his life, and eventually earned a doctorate in this subject.

After all this, he found what he wanted to do career-wise. When he was 30, Raymond Wong got a part-time job in the insurance sector. Thanks to a buoyant economy, a rising stock market and an influx of foreign firms, Hong Kong had quickly become one of the most important financial hubs in the Asia Pacific region. Wong’s talent soon became obvious and in his first 12 months, he won Agent of the Year at his company.

“I just wanted to give it a try,” says Wong. “I had no idea that all these years later I would still be in the industry.”

Drawing on his studies and his experience, Wong began to think about how best to train people to make the most of their potential, and set up a training company called Hi-Me Transformation. He also thought deeply about how to make the most of the time he had with his family.

Wong and his family enjoy two or three holidays every year, each lasting for at least 10 days. It is a time when everyone in the family "sits together to enjoy a meal and lives in one place", he says. Even though he puts great emphasis on spending time with his family, he has also spent plenty of time thinking about how best to prepare them for the future.
Philosophy of family inheritance

Wong’s professional background and long study of economics has clearly influenced his pragmatic approach to managing his family’s money, and he sums up his guiding philosophy as follows: investment diversification and the flexible use of tools.

This diversification not only applies to typical asset classes such as stocks, funds and properties, but also to antiques, marrying Wong’s investments and his hobbies. His approach is influenced by his background in business and economics as well as his fascination with psychology.

Wong also talks about “mental accounts”, referring to a mix of investments that is segregated psychologically as well as financially.

The most important mental account? The foundation of the family. If a man’s home is his castle, it should come as little surprise that the asset that best sums up this concept is the house where Wong’s family lives, in Hong Kong’s Repulse Bay. He set up a single trust for the house, because the house is not just an appreciating asset but a testament to unity.

“It is a symbol of the family and it must be preserved and cannot be sold,” says Wong.

This commitment does not extend to other property investments, which are filed under the mental account of “long-term investment”. These are either managed by professional institutions or handed directly to his children and the intention is gradually to increase his children’s ownership of these assets in future.

The mental accounts do not end there. In the mental account of “health”, he arranged medical and life insurance for his own future care. In the category of “charity”, he plans donations, primarily related to education. In “financial investment”, he shifted stocks, funds, and other financial assets to private banks. He will regularly review these investments, so that he is always ready to hand down the best assets to the next generation.

The network of connections and business resources that he has built up over more than 40 years belong to the mental account of “career”, to be handed over to his son gradually. Another special mental account is that of “heirloom”, which covers the antiques that Wong has collected over the years. From his perspective, it serves as the “last and ultimate asset” in the family’s wealth.

Wong’s antiques collection is not only an element of wealth management, but an embodiment of his thinking and research of history, culture and life. In his view, every antique tells a story. But these antiques are not going to take precedence over a careful management of his family’s finances – he prefers appreciation and research to collection.

It is perhaps fitting that after spending so much time worrying about how to take care of future generations, Wong can now enjoy studying the past as part of a Master’s in Arts Business Management offered by Tsinghua University and Sotheby’s.
Family spirit: The importance of values

Decades of opening up and reform have created bountiful new opportunities for a generation of Chinese. But for those who have achieved success, the next steps are not always obvious. Hao Hongjuan, an experienced financial industry professional, has taken an enlightened approach to managing her family wealth.

Hao has first-hand experience of the seismic shift in China's financial sector. She has spent more than two decades working for China's state-owned banks, in a variety of positions including president of a bank branch, general manager of a business division and executive director of a subsidiary. Her focus has been on some of the fastest growing and most important areas, including consumer credit, wealth management, digital insurance and risk management.

This experience has clearly given Hao a keen understanding of the opportunities and risks in China's financial markets. But her success means these are not merely questions for her clients. She now faces the dilemma of how to manage her own family's wealth — forcing her to consider not just tax and investment issues, but also broader questions about the values she wants to pass on to future generations.

Finding finance

Hao was born to an educated family. Her grandfather was an intellectual and her father was an artist, interested in Chinese traditional arts such as calligraphy and jade carving. Many of her aunts and uncles are teachers. "Our entire family values education," she says.

A love of learning was instilled in Hao from a young age. She was passionate about the sciences and humanities, and did well in literature, mathematics and physiology. But when she went to university, she chose to specialize in finance, majoring in this subject at the Beijing-based Central University of Finance and Economics.

Hao says the choice married those early passions for soft and hard sciences. "Finance is a balanced discipline which has the nature of liberal arts and the logic of science," she says. Her timing was impeccable: she earned her Master's degree in finance just as China's economy was beginning to open up.

When she took a job at a bank, she stood out. She advanced quickly in her career and, like her husband, who works in the technology sector, she was successful. As their careers flourished, the couple directed their obsessive focus on research outside their jobs, considering the best way to manage their family finances. They settled on an approach that lays a solid foundation for the transfer of their wealth not just to the next generation, but to many generations to come.

Working in the financial sector meant that Hao had thought about the questions of management and transfer of family fortunes long before it became an
issue for her own family. She came up with a guiding philosophy that has helped steer her own decisions.

In her view, family prosperity should be judged according to four different criteria. First is what might be called "the family spirit", the core values of a family which are passed on from one generation to another. Second, the specific experience of family members, including their level of education, their work experience, even their emotional experience. Third, the contribution that family members are making to society, whether through specific programmes or day-to-day charity.

It is only after these factors are considered that Hao thinks about the fourth point, a factor that for many families would be front and centre: the family assets, including cash, properties, financial assets and other markers of wealth that can be handed to the next generation.

Good family wealth management and inheritance planning requires a careful balance of all four parts, according to Hao. She points to family spirit as the most important, in part because it determines the other three.

"I don't want to leave my descendants a fortune that can be measured only in currency," she says. As a result, when Hao began planning her family's wealth inheritance, the first thing she worked on was formulating a clear idea of what sort of "family spirit" she expected her descendants to observe.

She began by thinking about this rather philosophical question from two angles. Hao reasoned that any institution — a bank, for example, or a corporation — can only survive in the long term if it makes some contribution to the greater good. On a macro level, this means benefitting the development of the country and the society. On a micro level, it should facilitate the pursuit of a quality life.

Hao believes that the same thing is just as true of a family, and even of an individual. She wants her children, and their children in turn, to contribute to society, to their own families, and to others outside the immediate family. But she also wants them to do this from a position of knowledge, with an emphasis on quality education and the importance of experience.

After wrestling with these concepts, and discussing them with her family as well as members of a professional inheritance-planning team, Hao came up with four words to sum up her family spirit: self-improvement, integrity, excellence and contribution. Once this philosophy was put in place, Hao and her husband had the foundations to start planning their family finances.
Cornerstone investor

Coming up with the key tenets of a family spirit is one thing, but how can you ensure that future generations do their best to follow these broad guidelines? Hao decided the way forward was to write a family constitution, a detailed document that covers everything from the organizational structure of a family council, the specific responsibilities of the members and the procedure for handling family affairs.

The council is the family’s “organ of power”, composed not just of family members but also external advisers who can offer impartial input. The chairman of the council is an elected position, although this is mainly a representative function.

Another important part of the family constitution was the founding of a fund, named Cornerstone, which was designed to capture long-term, stable returns for family members. The family council decides on the specific investment bias, but they do not necessarily reap the benefits of growth in the principal: this, instead, is seen as a cornerstone for future generations.

What about the interest and other income generation by the Cornerstone fund? That itself goes into two separate funds, the Self-improvement fund and the Le Shan fund. They are both designed to further the influence of current generations of Hao’s family on those who will follow them.

The Self-improvement fund aims to encourage offspring and family descendants to actively create and start businesses in their own area of expertise, offering financial support for projects – as long as they are in line with the family’s core values. This investment could come in the form of equity or credit. Any income earned by the investments of the Self-improvement fund will be fed back into the Cornerstone fund.

The Le Shan fund is a channel for the family to participate in programmes for public good, encouraging family members to make the most of their wealth and contribute to society. The fund avoids blind donations, instead encouraging family members to make an active, personal contribution to charities or projects they are involved with.

On paper, Hao’s solution to managing her family wealth may look complex, with overlapping funds and a family constitution that sets clear terms for governance. But in essence, her approach is simple, driven by those early considerations of what exactly it was she stood for – or what her family should stand for in the future.
The Confucius family refers to the sprawling clan whose members are descended from the Chinese philosopher Confucius.

The clan has survived for more than 2,500 years, despite cataclysmic dynastic and political changes. Its pedigree or genealogy documents 82 generations; the entire history of the clan is packed into 80 volumes and weighs in at a hefty 125 kilograms. It is the oldest, most complete and detailed family pedigree and even earned a mention in Guinness World Records in 2005 for being the longest family pedigree in the world, as each and every descendant is traced back to Confucius. The 2009 version of the Pedigree of Confucius Family took 10 years to update, at a cost of Rmb13 million ($1.9 million), and includes about 2 million descendants of Confucius.

The genealogy is supposed to be updated every 30 years, according to clan custom. But record-keeping lapsed during the Cultural Revolution when Mao Zedong denounced Confucius as a symbol of feudalism, and it was not until 1999 that the family tree was updated for the first time since the founding of the People's Republic of China.

The Confucius family disciplines are described in biographies, genealogical records and other historical literature. The most important are The Analects of Confucius, which are a collection of the words of Confucius and his disciples. Confucius Family Disciplines from Ancestors was compiled by Kong Shengxian, a member of the 64th generation of the Confucius clan, who was also known as the Wise Man Yan. By studying the instructions of the ancestors and reflecting on his personal experience, the Wise Man Yan advised clan members to "respect Confucianism and Taoism, follow rituals, stay moral, read literature and be reasonable". The core philosophy is "never to disregard moral principles in pursuit of profit or bring insult to the Confucius Family".

Confucius told his son Kong Li, "One does not speak properly without learning the Book of Poems; one does not behave properly without learning the Book of Rituals". By encouraging learning from the Book of Poems, Confucius encouraged the acquisition of knowledge and cultivation of moral character. Likewise, learning the Book of Rituals was meant to encourage good manners and compliance with codes of conduct.

What is the relevance today? Many Chinese aspire to live by the philosophical ideas of Confucius, ideas which emphasize the importance of a virtuous life, filial piety and ancestor worship; this, in turn, informs how Chinese may think about questions of family and inheritance.

The importance of manners, morals, learning, rituals, and discipline

The Confucius clan
How is the stock of global wealth distributed around the world? How quickly are Chinese high net worth investors catching up with their peers in Europe and North America? What are the biggest differences between the approaches wealthy families in these three regions take towards inheritance planning? This chapter will tackle all of these questions — and many more.
The rapid growth worldwide in the number of high net worth individuals (HNWIs), as well as in their overall wealth, is expected to continue over the coming years. Asia Pacific, North America and Europe boast the largest numbers of HNWIs, but Asia Pacific is showing the fastest growth in both numbers and wealth.

Capgemini’s World Wealth Report 2018 reveals that the number of HNWIs worldwide rose 9.5% in 2017, accelerating from an increase of 7.5% in the previous year; total financial wealth grew 10.6%, also up from 8.2% in the previous year.

But zoom in to focus on Asia Pacific and it is clear that this region not only has the largest number of HNWIs and the biggest share of the wealth, but is also the most important driver of overall growth, as shown in Figure 2-1-1 and Figure 2-1-2. That explains why the wealth management industry in Asia Pacific is booming.

High net worth individuals in Asia Pacific, North America and Europe account for more than 90% of the total number worldwide and more than 80% of the total wealth, overshadowing the Middle East, Latin America and African regions.

Zoom in still further, and it’s possible to see the potential for the wealth management industry in China.

The Global Wealth Report 2017 by Credit Suisse shows that in China, the number of HNWIs with investable assets of more than $1 million is now close to 2 million, representing roughly 5% of the global total. China ranks fifth in terms of the absolute increase in the number of HNWIs in 2017, after the US, Germany, Australia and France. The number of millionaires in China is expected to rise 41% to more than 2.7 million in 2022, putting it in third place after the US and Japan.

These trends illustrate the exciting opportunities for the wealth management industry in Asia Pacific and China in particular.
Whether in China, the United States or Europe, HNWIs tend to be gathered in the big metropolises. In China, there are five provinces or municipalities directly under the central government where the number of HNWIs – those with individual investable assets of more than Rmb10 million ($1.4 million) – exceeds 100,000 persons, as measured up to the end of 2016. These five – Guangdong, Shanghai, Beijing, Jiangsu and Zhejiang – are all located in the south or east of China, with the exception of the capital Beijing. In addition, the number of HNWIs in Shandong, Sichuan, Hubei and Fujian provinces exceeds 50,000 persons.

A similar phenomenon is clear in the United States when it comes to the geographical distribution of HNWIs, as illustrated in Figure 2-2-1.

The wealth of most HNWIs in the US is found in 12 metropolises, including New York, Washington DC, Chicago, Boston, San Francisco, Houston, Los Angeles and Detroit. These cities account for two thirds of the country’s HNWIs and three quarters of their wealth. In 2014, the investable wealth of HNWIs in these 12 cities increased by 10.1%, which was more than the average for the whole country. Since 2008, nine out of these 12 cities have seen an annual growth in wealth that was equal to or higher than the average value of 8.6% for the US.

For ease of comparison, Europe can be considered as a single economic entity or region, where the UK, Germany, France and other European sovereign states are roughly equivalent to provinces in China.

The total number of HNWIs is not the only consideration, of course. What about the concentration by geography, occupation or industry? It is only by examining the data further that we can get a clear idea of the HNWI universe today.

### 2.2 Compare and contrast: Chinese and Western HNWIs
**Figure 2-2-1: Geographical distribution of American HNWIs in 2009-2014**

**U.S CAGR 2009-2014: 8.9%**

<table>
<thead>
<tr>
<th>Year</th>
<th>U.S Total</th>
<th>Top 12 MSA Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>US$7.2T</td>
<td>US$349</td>
</tr>
<tr>
<td>2010</td>
<td>US$7.9T</td>
<td>US$360</td>
</tr>
<tr>
<td>2011</td>
<td>US$8.8T</td>
<td>US$350</td>
</tr>
<tr>
<td>2012</td>
<td>US$10.4T</td>
<td>US$368</td>
</tr>
<tr>
<td>2013</td>
<td>US$10.8T</td>
<td>US$373</td>
</tr>
<tr>
<td>2014</td>
<td>US$11.4T</td>
<td>US$382</td>
</tr>
</tbody>
</table>

**% Change 2013-14**

- **U.S:** 9.4%
- **Top 12 MSA:** 10.1%

- **Seattle:** 13.3%
- **Detroit:** 8.5%
- **San Jose:** 12.5%
- **Dallas:** 12.4%
- **Houston:** 15.2%
- **Philadelphia:** 9.0%
- **Boston:** 10.8%
- **San Francisco:** 12.3%
- **Washington D.C.:** 8.1%
- **Chicago:** 7.8%
- **Los Angeles:** 11.5%
- **New York:** 8.8%

The European countries with the largest number of millionaires in 2017 were the UK (2.2 million), Germany (nearly 2 million), France (nearly 2 million) and Italy (1.3 million), according to Credit Suisse’s *Global Wealth Report 2017*.

Metropolises act as a magnet for businesses and hence generate wealth because of the mix of policies, services and infrastructure that they provide; for example, they may attract technology talent, or financial specialists, or the small industries that supply bigger manufacturers.

**Industry structure: manufacturing makes money**

The manufacturing industry still plays an important role in wealth creation.

Up to 80% of first-generation entrepreneurs (or FGE) are still engaged in traditional industries, as shown in Figure 2-2-2. As for the second generation of family businesses, the three main sectors that they engage in are manufacturing, finance and construction. When it comes to gold-collar workers (GCWs, also known as highly skilled knowledge workers), they are found mainly in manufacturing, information and finance.11

Hurun Chinese Luxury Consumer Survey 2017 by Hurun Research Institute also reached a similar conclusion, finding that financial wealth is still concentrated in traditional industries. However, the survey also pointed out a shift towards emerging industries, with 35.4% of HNWIs engaged in emerging industries such as cultural education and media, medical treatment and health as well as TMT.12

**Factors contributing to wealth: self-employment**

A significant proportion – just over half – of high net worth individuals are entrepreneurs or business owners who are self-employed, whether in China, the US or Europe. Let’s first take a look at China. As shown in Figure 2-2-3, business owners represent up to 51% of high net worth individuals (HNWIs).

In America, a research report by U.S. Trust (*U.S. Trust Insights On Wealth And Worth 2017*) shows that for high net worth individuals under 51 and with assets worth more than $3 million, nearly 50% are entrepreneurs or business owners.13

Among “millennials”, or those aged between 23 and 34 years old (in other words, the generation born between 1984 and 1995), 49% are entrepreneurs or business owners. For Generation X, or those aged between 35 and 51 years old (in other words, who were born between 1967 and 1983), 44% are entrepreneurs or business owners; whereas for the older generation, who are at least 71 years old, 10% are active entrepreneurs or business owners.

In Europe, family business is an important factor in the creation and inheritance of wealth and covers a wide variety of enterprises ranging from conventional "mom-and-pop" stores and SMEs to international giants such as Swatch, L’Oreal and BMW. Even though many world-renowned family enterprises experienced a dilution in ownership in the second half of the 20th century, the founding families still tend to dominate and influence their core businesses, and these are an important driver of family wealth in Europe.

Among the top 500 family businesses worldwide, European families represent the majority, accounting for up to 44.8% of the total, followed by North American families with 27.8%.14

To sum up: from corner shops to transnational corporations with a global reach, business has turned out to be the main source of wealth creation, and entrepreneurs and business owners account for a significant proportion of high net worth individuals.

**Wealth creation, protection and inheritance**

In contemporary China, the creation and accumulation of so-
The Importance of Wealth Management

Special Report

An Overview of Private Wealth Distribution

Figure 2-2-2: Profile comparison of first-generation entrepreneurs (FGE), second-generation family business owners and gold-collar workers (GCW)

FIRST-GENERATION ENTREPRENEURS

More than 80% is still in traditional industries

SECOND-GENERATION FAMILY BUSINESS OWNERS

Mainly in manufacturing/finance/construction industries

GOLD COLLAR WORKERS

Mainly in manufacturing/information technology/finance industry

Figure 2-2-3: 2017 HNWIs in China (by Occupation and Asset Scale)

FIRST-GENERATION ENTREPRENEURS

41% 10% 29% 5% 14%

SECOND-GENERATION FAMILY BUSINESS OWNERS

50 to 100 million

GOLD-COLLAR WORKERS

above 100 million

Professional investors

41% 10% 29% 5% 14%

Others

Note: * Gold-collar workers (GCW) include senior executives, professional managers, professionals.

** Other high net worth individuals (HNWIs) include housewives and socialites (i.e. athletes, entertainers and painters).

Source: CMB and Bain & Company, China Private Wealth Report 2017
### Figure 2-2-4: HNWIs in America (by Occupation)

<table>
<thead>
<tr>
<th>MILLENNIALS</th>
<th>GENERATION X</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Family Background growing up:</strong></td>
<td><strong>Family Background growing up:</strong></td>
</tr>
<tr>
<td>Wealthy/Upper middle class</td>
<td>Wealthy/Upper middle class</td>
</tr>
<tr>
<td>Middle class</td>
<td>Middle class</td>
</tr>
<tr>
<td>Poor</td>
<td>Poor</td>
</tr>
<tr>
<td>Mother worked</td>
<td>Mother worked</td>
</tr>
<tr>
<td><strong>Current Household/family:</strong></td>
<td><strong>Current Household/family:</strong></td>
</tr>
<tr>
<td>Married</td>
<td>Married</td>
</tr>
<tr>
<td>Divorced</td>
<td>Divorced</td>
</tr>
<tr>
<td>Have children</td>
<td>Have children</td>
</tr>
<tr>
<td>Blended family(stepchildren)</td>
<td>Blended family(stepchildren)</td>
</tr>
<tr>
<td>Live with parent or grandparent</td>
<td>Live with parent or grandparent</td>
</tr>
<tr>
<td><strong>Work and income:</strong></td>
<td><strong>Work and income:</strong></td>
</tr>
<tr>
<td>Entreprenur/business owner</td>
<td>Entreprenur/business owner</td>
</tr>
<tr>
<td>Two-incomehousehold</td>
<td>Two-incomehousehold</td>
</tr>
<tr>
<td>Inherited family money</td>
<td>Inherited family money</td>
</tr>
<tr>
<td>HH income more than $1M</td>
<td>HH income more than $1M</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>BOOMERS</th>
<th>SILENT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Family Background growing up:</strong></td>
<td><strong>Family Background growing up:</strong></td>
</tr>
<tr>
<td>Wealthy/Upper middle class</td>
<td>Wealthy/Upper middle class</td>
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<tr>
<td>Middle class</td>
<td>Middle class</td>
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<tr>
<td>Poor</td>
<td>Poor</td>
</tr>
<tr>
<td>Mother worked</td>
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</tr>
<tr>
<td><strong>Current Household/family:</strong></td>
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<tr>
<td>Married</td>
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<td>Divorced</td>
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<tr>
<td>Have children</td>
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<td>Blended family(stepchildren)</td>
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<tr>
<td>Live with parent or grandparent</td>
<td>Live with parent or grandparent</td>
</tr>
<tr>
<td><strong>Work and income:</strong></td>
<td><strong>Work and income:</strong></td>
</tr>
<tr>
<td>Entreprenur/business owner</td>
<td>Retired</td>
</tr>
<tr>
<td>Two-incomehousehold</td>
<td>Two-incomehousehold</td>
</tr>
<tr>
<td>Inherited family money</td>
<td>Inherited family money</td>
</tr>
<tr>
<td>HH income more than $1M</td>
<td>HH income more than $1M</td>
</tr>
</tbody>
</table>

Source: US Trust, *2017 Insights on Wealth and Worth*
cial wealth can be traced back to the reform and opening-up of the economy in 1978. As first-generation entrepreneurs grow older and affluent second generations prepare to take over, the understanding of wealth inheritance has become more urgent and important, particularly given the lack of guidance or examples from the pre-reform era. But analysing the available data can provide useful insights.

Figure 2-2-6 shows that the proportion of high net worth individuals who were born in impoverished families declines as age group declines, while the proportion of people from wealthy families rises. This result is unsurprising – but the sheer scale of the difference might come as a shock.

Among the younger generation (the group aged 23-34), 68% of high net worth individuals are from wealthy families, 29% from middle-class families and only 3% from impoverished families. For the elder generation (the group aged 71 or more), the proportion from wealthy families is only 25%, while 25% are from impoverished families and 50% from middle-class families. In other words, three quarters of the older generation of wealthy individuals were able to create wealth through their own efforts. By contrast, looking at the younger generation of wealthy individuals, 68% of them came from wealthy families and represent the affluent second generation.

This shows how wealth has gone through three different stages: wealth creation, wealth protection and wealth inheritance. During this process, professional wealth management and inheritance institutions can play an important role as careful succession planning provides more opportunities for the next generation to achieve success.

China has gone from being an emerging market to developing much as the US market did 70 years ago; in other words, people from low- and medium-income levels still have the opportunity to grow rich and become high net worth individuals. This means there are both opportunities and challenges for a wealth management industry that is still in its infancy.
Demand for family wealth inheritance advice is strong, both among Chinese and Western HNWIs. Some 53% of high net worth individuals worldwide have initiated the planning of family wealth inheritance, although there are regional differences (in North America, the figure is 62%, in Europe, 58%, and in Asia 49%).

But although they are driven by the same needs, Chinese HNWIs and their Western peers differ in a number of ways, including in inheritance ideas, opportunities, actual structures and content of inheritance plans.

Western countries attach greater significance to social capital, China cherishes family capital.

Chinese HNWIs attach the greatest significance to the inheritance of family capital and financial capital. Family capital generally covers areas such as innovation, courage, resistance to pressure, values and other deep-rooted ideas of thinking and lifestyle which have contributed to the prosperity and continuation of family businesses; financial capital lays a solid foundation for the carefree life of the next generations.

In addition, political and commercial relations (social capital) and key assets (or industry capital on which the profits of enterprises are achieved) are the last two in the ranking of inheritance demands.

Western HNWIs also pay attention to the inheritance of financial capital, but put greater emphasis on social capital than their Chinese peers. According to the U.S. Trust Insights On Wealth And Worth 2017, 64% of interviewees treat the delivery of financial assets to the next generation as a very significant inheritance target; regarding the distribution of wealth inheritance, the financial assets left within the family represent about 79% of the aggregate on average, while up to 16% is earmarked for philanthropy. The report further indicates that, "high net worth individuals (in America) hope to change the world in a proactive manner, which has been handed down from generation to generation", and thus they attach greater significance to impact investment. They not only set up and give money...
to philanthropy funds, but also ensure that their descendants can take office at such funds, with some even holding decisive posts.

**Western HNWIs plan early, Chinese ones wait**

Most Chinese HNWIs are entrepreneurs and gold-collar workers, and are the first affluent generation to give priority to "wealth creation" in their lifetime. However, this is a new situation in modern China, so they have no examples to follow and cannot refer to how others have handled such matters in the past. They also tend to regard this as something that can wait because it is not urgent.

In comparison, Western HNWIs typically possess experience of family wealth inheritance. Even for the older generation (aged 73 or above), over 50% have inherited family wealth with that proportion increasing to 78% for the generation of "millennials". As a result, Western HNWIs understand the significance of family wealth inheritance at an earlier stage, and enjoy the experience of arranging these matters. According to the data collected, 82% of the millennials (or those aged between 23 and 34) who were interviewed have begun to consider the inheritance of family wealth.

**Chinese HNWIs prefer dedicated teams, Westerners resort to professional institutions**

There are a variety of ways of arranging wealth inheritance, including statutory succession, wills, grants, jumbo insurance policies, family trust and family foundation.

As statutory succession may involve risks and disputes, and suffers from greater uncertainty, it is rarely adopted by high net worth individuals. For those HNWIs with relatively diversified assets classes, succession as set out in a will and grant is simple and effective because possessions such as stock rights, real estate, antiques, scripts and paintings can be inherited in this way. However, testamentary succession and grant can also involve cumbersome procedures and may not be suitable for high net worth families with huge property portfolios and numerous family members.

Jumbo insurance policies are used to help with tax avoidance and property isolation, and can assign beneficiaries; however, due to the restriction of one-off inheritance and absence of mobility, jumbo insurance policies do not cover all properties.

Family trusts offer greater flexibility, more functions and better privacy. The trust structure can be used to assign beneficiaries and income distribution rules, and to allow overall planning for taxes and debts; it can be implemented before and after death without interruption, and thus is favoured by an increasing number of HNWIs.
number of high net worth individuals. Family foundation is suitable for ultra high net worth individuals, and places emphasis on the investment and application of family wealth.

Thanks to the development and internationalisation of the financial industry, high net worth individuals can tap the experience of international trust companies, family offices, banks and law firms when planning inheritance.

But in many cases Chinese families prefer to establish their own teams of trusted personnel to ensure privacy, flexibility and independence, rather than leave such planning to institutions.

Because death is a taboo subject in traditional Chinese culture, Chinese high net worth individuals seldom use wills or jumbo insurance policies, but prefer to grant before death. In recent years, Chinese high net worth individuals have become more aware of family trusts, and have begun to use these to ensure flexibility, privacy and other functions.

Western HNWIs tend to be more familiar with the different options available given that these have been used over several generations to pass on wealth. As a result, Western HNWIs voluntarily select professional institutions to plan and realize their family wealth inheritance. Family trust and family foundation have been widely used in Western countries, and are regarded by HNWIs as standard practice when it comes to wealth inheritance.

Anu Sahai, a partner of McKinsey’s global wealth management business in Singapore, points out that the wealth management market in the US and Europe is highly advanced. “In recent decades, families in Europe and America prefer to employ private banks and family offices to manage their wealth, while the majority wealth in Asia is managed beyond those channels,” she says.

**Chinese HNWIs focus more on the business handover**

When it comes to inheritance planning, Western HNWIs generally take a holistic approach to wealth preservation, inheritance and tax planning. Families with experience of wealth inheritance may already have templates for pre-nuptial agreements or trust beneficiary plans, which provide a useful reference for the next generation when doing their inheritance planning.

By contrast, Chinese HNWIs highlight the cultivation of the next generation and the handover of the business in their inheritance planning, and generally carry out their whole planning with a focus on these two themes. They pay less attention to technical issues such as wealth preservation and tax planning.

It is worth noting that both Chinese and Western HNWIs attach great significance to the inheritance of family spirit, a family charter and family management systems, making sure to incorporate these into the inheritance planning. With the de-
development and evolution of society, an increasing number of Chinese HNWIs have realised the importance of comprehensive and systematic inheritance planning. They are getting ready to move closer to their Western counterparts.

**Chinese and Western HNWIs may converge in their choices in future**

The differences in institutional environment, including law and taxation, have led to the different concepts of family wealth inheritance between China and the West.

Despite considerable progress in the legislation of the civil and commercial sectors, China still lags developed countries in some aspects of the law, making it difficult to satisfy demand for secure and indemnificatory arrangements for family wealth inheritance proposed by high net worth individuals.

Since China has no inheritance tax, high net worth individuals feel less pressure to arrange the inheritance of their wealth through legal structures. By contrast, in Western developed countries, families place greater emphasis on legal solutions when planning inheritance. Most Western countries impose hefty inheritance taxes of close to 50% – or even more. That means that, in the absence of proper arrangements and tax planning, family wealth can be eaten up by taxes by the time it reaches the third or fourth generation.

For this reason, professional-based and innovative family wealth management and inheritance structures such as family trusts and family offices have been developed, and have gradually gained market recognition and acceptance. They are now an acceptable and popular way for high net worth individuals to manage family wealth.

China is pushing ahead with a reform of the tax system, including measures to increase transparency with regard to overseas assets and income. The legal profession is lobbying for improvements in trust law and the development of civil trusts, which will help with the overall planning of professional institutions and wealth inheritance services in terms of taxation, legal affairs and wealth management.
FAMILY TRUSTS AND FAMILY OFFICES

What is the role of family trusts in helping manage inter-generational wealth transfer? How much extra flexibility do family offices offer? Are we on the cusp of a Big Bang for family offices in China? This section will investigate.
Family offices bring together a team of experienced professionals who can provide the services of a banker, trust services provider, attorney, certified accountant, investment manager, stock broker, insurance broker and financial consultant. The family office has become the top choice among some of the wealthiest families in the world.

Family offices carry out the comprehensive management and governance of the entire balance sheet for ultra high net worth families; their services cover daily financial and enterprise management as well as long-term requirements such as legacy planning and asset management. Ultra high net worth families use their family offices as a vehicle to plan investments, insurance, law, tax and philanthropy as a whole.

How does the adoption of family offices compare to the use of private banking services? The usual story is simple: as wealth rises, families are more likely to reduce their holdings in private banks and set up family offices. In that sense, the omens are good.

The 2018 edition of Global Family Office Report, researched by UBS and Campden Wealth, found that of the 311 family offices surveyed worldwide, more than half reported growth in assets under management during 2017. One third of those surveyed had two or more branches worldwide, and for the group as a whole, the average portfolio return was 15.5% in 2017. 
3.2 Family offices in China: Still developing

China’s economic boom has ushered in the first generation of ultra-wealthy entrepreneurs, the majority of whom are now in their fifties and sixties. These entrepreneurs understand the importance of preserving the wealth they created over the past 30 or so years. They want to manage this wealth and pass it on to the next generation.

For many of these wealthy Chinese entrepreneurs and their families, the family office remains a component of the family business and is rarely separated completely from that business; in China, people are inclined to mix family interests with business interests. This can lead to disagreements over how best to invest any gains from the family business – for example, whether to reinvest them in the business itself or whether to take the opportunity to diversify in unrelated areas to spread risk.

With the rising popularity of trusts, people are now more aware of how a trust can be used as a tool for wealth preservation, wealth management and inheritance of intergenerational wealth. In China, people recite the proverb that wealth only lasts for three generations, but now they know that outcome can be thwarted with the use of a trust structure.

Another complication arises when one male head of the family has several children by different wives; in such cases, the decision-maker is typically the male head of each family.

In China, even if family members are dissatisfied with decisions concluded by the master of their family, they have to respect and comply with such decisions in most cases.

As a general rule, there is very little transparency in China when it comes to family wealth, mainly for reasons of privacy; security concerns are understandable as wealthy families are vulnerable to kidnap, fraud and other criminal activity. In many cases, the master of a family may prefer to spread the family assets among different institutions and investment groups so that no single institution or family member knows the full scale and scope of the family wealth.

In China, the administration of the family office is usually dominated by family members – unlike in the US or Europe. One of the difficulties in China is finding suitable employees – in terms of the experience, skills and qualifications – to work in the family office, which is why some family enterprises have little choice but to set up their family office in Hong Kong or Singapore, where the talent pool is bigger, albeit more expensive.

China’s business-owning families are adapting with regard to the management of their family wealth, investing assets more widely, improving corporate governance and applying best practices – although some still favour short-term, high return investments rather than taking a long-term view.
Where are things heading?

The growth in HNWIs in China has been extremely fast, and there are now nearly 2 million Chinese with wealth exceeding $1 million, according to the Global Wealth Report published by Credit Suisse; in addition, China has more than 18,000 ultra high net worth individuals (those whose net worth exceeds $50 million) who are the natural candidates for establishing a family office.

Most HNWIs are aged between 41 and 60, and therefore at a stage in life when they value the preservation of family wealth and inheritance planning. Most are also still in control of the family business, either as managers or shareholders, and therefore need to plan for the inheritance of the family firm.

The majority (55%) of HNWIs are entrepreneurs, while 20% are senior executives with shares in large enterprises and transnational corporations. Among HNWIs with assets in the hundreds of millions of dollars, the proportion of entrepreneurs is even higher, at 75%. Research shows that 86.2% of entrepreneurs have considered or set out to prepare family inheritance. Chinese entrepreneurs attach great significance to the cultural inheritance (75.7%) and wealth inheritance (75.1%), creating substantial opportunities for the development of family offices in China.

HNWIs are inclined to favour investment areas that require professional knowledge.

They gravitate towards bank financial products and trust products as well as domestic real estate, deposits, cash, private equity and stocks. Because most of these assets require specialist knowledge, HNWIs are more likely to accept the services of family offices for such investment purposes.

China’s regulatory environment for wealth inheritance in regard to foreign exchange, tax affairs, individual assets and income has undergone tremendous change, setting stricter compliance requirements for the wealth planning and inheritance of HNWIs. This has led to the rapid development of family offices in China.
Family offices generally use a family trust to hold family assets such as property or shares.

The consignee or co-consignee of the family trust mainly refers to family members and consultants; the beneficiary of the family trust generally includes family members of different generations.

Family offices are of great importance when it comes to managing the family trust, applying measures to protect the consignee and the beneficiary. In this regard, family offices generally enable family members to perform the obligations attributed to the consignee by virtue of coordination with the various family members, legal, tax and financial consultants. Among the 200 or more listed family firms in Hong Kong, about one third are held via family trust, including those of Li Ka-shing, Lee Shau-kee, Kwok Tak-seng, Joseph Lau Luen-hung, Albert Yeung Sau Shing and Run Run Shaw. For example, Li Ka-shing has set up at least four trust funds for the holding of subsidiaries’ shares, and designated the beneficiary of each trust fund respectively.

The investment portfolios of family offices include bonds, equities, private investment funds, hedge funds, exchange traded funds, venture investments, joint investments or direct investment in real estate, real estate investment trusts, futures and cash.

**Concept and functions of family trust**

When wealth becomes the "new normal", families turn to instruments such as life insurance policies and family trusts to assist with the inheritance of their wealth.

Because these instruments are more complex in nature, families then turn to professional advisers or institutions (for example an insurance company, trust company or financial consultant) to help with the planning.

'Family trust' is not a legal term under Chinese law, but is a term related to financial and consulting businesses. This means it is not defined in legislation. The common functions of a family trust include effective inheritance (to prevent the children and spouse from spending money improperly or squandering the family wealth); wealth management (to carry out family wealth management through the specialised investment of a trust company); replacement of testament or agreement; property isolation; equity inheritance; asset holding on behalf of the holder; family funds (for example, to pay school fees for younger family members); trust of upbringing fees; policy trust; charity, and so on.

Internationally, the family trust is the core instrument the family office uses to carry out family wealth management. For example, the Run Run Shaw Family Office uses Run Run Shaw Charity Trust Fund as the wealth management instrument. As the trustee, Shaw Trustee (Private) Limited carries out the management of trust property entrusted by Run Run Shaw, holds all the equity of various entities of Shaw’s family, and distributes trust property income to Shaw’s family.
members.

Family trusts can be understood from two perspectives. For ultra high net worth individuals, family trusts are a wealth management instrument constituting one of the functions of family office; while for customers who have no plan to establish family offices for the time being, family trusts are a wealth inheritance tool that is easily realized — and an important step towards the specialised planning of wealth inheritance.

It is worth noting that insurance, particularly life insurance, faces significant restrictions in spite of its significant leverage effect and probability of exemption from inheritance tax. First, there are restrictions on individuals applicable to insurance: that is, senior citizens are not suitable buyers of life insurance, and people with serious diseases are restricted in the purchase of life insurance.

Second, there are restrictions on the functions of life insurance: that is, insurance indemnity is paid once, which is not beneficial to the beneficiary in money management terms. There is no way of avoiding the situation that the beneficiary squanders property.

Third, there are restrictions on the time for acceptance of wealth inheritance through insurance: that is, acceptance is only available after the insurer passes away, so customers need to wait for a long time. In our opinion, compared to insurance, family trusts are more suitable for inter-generational long-term inheritance and for high net worth individuals to carry out long-term planning. Of course, the combination of insurance and trusts may provide the best of the both worlds, and achieve better results.

Effective inheritance

When high net worth individuals or families have created wealth, first generation entrepreneurs usually cannot spend all the wealth they have accumulated and so most of it is passed on to the second generation and the third generation; some wealthy entrepreneurs choose to make charitable donations, in addition to passing on wealth to their descendants.

However, it is not unusual to see the children and spouse in affluent families spend money improperly or squander the family wealth; they may even be defrauded by the people around them or make unsuccessful investments. Therefore, one of the objectives of a wealthy person is to make sure the wealth continues to be passed on to the third, fourth and successive generations effectively and safely, and to avoid a situation where the property falls into the hands of others.

This is why first-generation entrepreneurs use a family trust to ensure that wealth is passed on to their children effectively.

Planning for a lack of succession

Many entrepreneurs realise that their children will not carry on the family business themselves, either be-
cause they lack the necessary management skills or the inclination.

There are also many entrepreneurs who know how tiring it is to engage in industry and who therefore prefer that their children do not have to take over as second generation family business owners.

In such cases, how should the inheritance be handled? Sometimes, entrepreneurs decide to sell the business before they retire, and transform the family’s assets from company shares into monetary financial assets.

One option is to entrust specialized investors of the trust company to carry out the management of family financial assets through the establishment of a family trust, to try to realize a steady gain in the family wealth.

Avoiding disputes

In recent years, disputes over inheritance have led to litigation, pitting family members against each other and exposing their financial affairs to public scrutiny. The greater the fortune, the more likely it is that successors are involved in litigation.

For example, many Chinese are familiar with the dispute that followed the death of Xu Linlu; he was the disciple of Qi Baishi, the first generation great master of traditional Chinese painting. Xu’s children contested the fact Xu’s widow inherited most of his estate and later disputed the will which she produced. The dispute brought unwelcome publicity to the family and consumed a lot of time and money.

Another well-publicised case was that of the coking magnate Yan Jiying in Shanxi: when he passed away, his ex-wife, long-term companion and children from both unions sparred over his assets.

One of the problems is that in China, it is taboo to write a will or discuss death. As a result, very few people engage a specialist to prepare a will. What’s more, even if a will is written, if any of the family members refuses to approve what is written in the will, they must lodge a lawsuit in court.

Family trusts can replace a will in inheritance planning. Under normal circumstances, life insurance is only suitable for middle-aged and young customers, while there is no restriction on age to a family trust. Therefore, when high net worth individuals consider property arrangements after death, family trusts provide a decent and proper alternative.

A family trust is set up in order to avoid a scramble for property among family members after the owner of the wealth suffers accidental or natural death. Unlike a will, family trusts do not require the intervention of an executor and probate proceedings, and it avoids both the deadlock in dividing the inheritance and the risk of unwelcome publicity due to an inheritance dispute.
**Avoid accidental outflow of wealth**

In recent years, China has seen a rise in divorce and the ensuing scramble for custody of the children and property. Young people who seek an easy divorce may have inherited or received property from their parents instead of earning it themselves.

Although there are specific provisions on the gift of property before and after marriage in Chinese legislation on marriage, and especially in judicial interpretation of the supreme people’s court, such provisions often cannot resolve the parents’ demand that “benefits should always be kept for their family.”

While parents often want the wealth that they have accumulated to help provide a relaxed living environment and a relatively high starting point for their children once they are married, they also worry that if their children divorce, the family wealth can be lost. This is especially so because they have no way of forcing their children to sign a prenuptial agreement.

For such clients, a family trust can be set up with the children as beneficiary; this arrangement can replace a prenuptial agreement and avoid the accidental “loss” of wealth if the child’s marriage fails.

**Prevent enterprise risks**

In Chinese history, many magnates experienced ups and downs in wealth and some even went bankrupt. In early 2018, a 55-year-old entrepreneur with the surname of Zhou from Shangyu, Shaoxing committed suicide by jumping off a building. It was said that he left behind a debt of nearly Rmb10 billion after death.

In another example, when the founder of Galloping Horse passed away, he left his family a huge amount of debt due to valuation adjustments.

Risks exist in the market. In addition to poor management, there are other factors such as "black swan" and "grey rhino" events which can impact business activities. Some private entrepreneurs want to strip out part of their wealth to avoid a situation where their family ends up in financial difficulty in the event of the failure of the family enterprise and joint liability for the debts.

Family trusts can be used to isolate property from enterprise liabilities, provided the trust meets certain conditions. First, according to the regulations in Article 15 of the *Trust Law*, it must be a pure trust for the benefit of others; second, according to the regulations in Article 12 of the *Trust Law*, the establishment of the trust shall do no harm to the interests of creditors.
Encourage family development

There are specific customer groups for the previously mentioned five core functions; these customer groups have specific demands based on factors such as age, family background and occupation, and these demands can be basically met through customised family trusts. Trusts originate from the common law system in which properties and interests are separately arranged. The most distinctive characteristic of such a system is the flexibility which can meet the different demands of different customers at different stages.

In addition to the five core functions, some customers also wish to meet their demands in other aspects through individualised family trust. For example:

**Family charity.** Through the establishment of a family trust, two kinds of beneficiaries are defined. The first kind is family members, who obtain major trust properties; the second type relates to philanthropy, and usually involves a fixed profit distribution. The typical arrangement goes like this: a 20% return on investment (or the fixed amount of Rmb300,000) is donated by the trust company to the charity organization or public benefit activity designated by the client in the form of a fiduciary payment every year.

**Family fund.** Scholarship, fellowship, living allowance and venture capital are provided to their children or the children of other big families in the form of a family trust. The family fund is often used to make some family members obtain equity in inheritance, and some family members obtain "compensation" through the beneficiary right of a family fund.

Whether in mainland China or developed Western countries, the purpose of the establishment of a trust is nothing more than asset preservation, inheritance, tax planning and so on. There are more detailed categories: from the perspective of reversibility, trusts are divided into revocable trusts and irrevocable trusts; proceeding from the discretionary power of the trustee, trusts can be divided into discretionary trusts, reserved powers discretionary trusts, fixed interest trusts, VISTA trusts, private trust companies, purpose trusts and Samoan limited partnership trusts etc.

Such categorized trusts reflect the needs of customers. There are two big differences between China and much of the West when it comes to the purpose of trusts: first, the categorisation of trust purposes has not been constant; second, Chinese customers are not accustomed to establishing multiple trusts to meet different trust purposes — instead they want an all-inclusive trust. However, it is possible to set up multiple trusts, and in different legal jurisdictions, for example in the place where assets will be deposited in future, and where the descendant will live in future.

**Trust property:** A special purpose vehicle or SPV can be set up overseas in a low-tax environment and used to hold the ownership of property, equities, aircraft, yachts, antiques, artworks, listed company stock, private company shares, as well as bank deposits and safes. In China, putting equities and property in a trust can involve a heavy tax burden, and because of regulations and a lack of familiarity with trusts, the implementation may not be available in some regions.

**Tax burden on beneficiary:** The issue of a tax burden on the beneficiary is relatively complicated, reflecting different individual income tax systems. In mainland China at present, there is no definite legislation regarding collection of income tax for the profit distribution of trust beneficiary, and tax is not withheld and remitted.
3.4 Family trust development in China

China’s economy has taken off in the past 40 years, spurred by a series of reforms and a greater openness to the world. With the rise in prosperity and accumulation of wealth, high net worth individuals can expect to encounter stricter supervision of foreign exchange, tax and transparency of assets and income. This is where the use of family trusts can be particularly advantageous for planning the inheritance of wealth.

Legal basis of family trust in China

Family trusts in China are represented as a trust contract in its legal form. Family trusts are not only subject to the rules and regulations of the Trust Law, but are also governed by general articles in the Contract Law of the People’s Republic of China related to validity of contract, capacity to conclude treaties, liabilities for breach of contract and so on. Many people complain that there is no special legislation covering family trusts in China, but that is potentially misleading. There are regulations concerning trusts that can offer clear guidelines, but it is true that there is no specific regulation on the establishment of family trusts in the current Trust Law in China.

Transferring trust ownership

Many critics think that there is no regulation covering the transfer of ownership to the trustee in the Trust Law of China, in other words that family trust in China is a kind of "unreliable trust". In fact, this is a common misunderstanding of the Trust Law.

Article 2 of the Trust Law states:

"Trust in this law refers to the behaviour in which the client consigns the property right to the trustee based on trust to the trustee, and the trustee manages or handles property in his own name according to the client’s intention for the interest and specific purpose of the beneficiary”.

Article 14 of the Trust Law states:

"Property acquired by the trustee with the commitment to trust is trust property."

Although a representation like "the ownership is transferred to the trustee", which is common in overseas trust law, is not used explicitly, the term used in Article 14 - "acquire" - indicates the transfer of ownership of trust property. If such property is still the property of the client, it will be a part of heritage. It is clear the trustee has acquired the ownership of trust property due to the legal trust behaviour of the client.

There is no specific regulation on the mode of transfer of property in the Trust Law itself, but this is not an omission or deficiency in legislation. In the current legal system, there is separate regulation on the change of the ownership of property. For example, in Article 9 and Article 23 of the Property Law of the People’s Republic of China, it is stipulated that delivery of movable property and registration of immovable property are taken as the mode of transfer of ownership respectively; in Article 33 and Article 140 of the Company Law of the People’s Republic of China (which we will refer to subsequently as the Company Law), the mode of transfer of equity of a limited liability company and share of a joint stock company is stipulated.

Therefore, the trustee shall confirm whether ownership has been transferred according to the form of trust property. Common fund trusts shall be subject to the billing statement issued by the bank or similar documents. Non-capital trusts shall be subject to the delivery mode according to legal regulations. For example, artwork shall be subject to delivery and occupancy, while equity will be subject to industrial and commercial registration or registration with China Securities Depository and Clearing Co., Ltd.
Is trust property within the scope of heritage?

Many customers are concerned about the issue of whether trust property is still within the scope of the client's heritage after the establishment of a trust. In fact, this issue has been confirmed by judicial decision in China. We directly quote the contents of the decision.

"Upon verification, our court holds that the focus issue in this case is whether 53049 yuan of the deceased Zhang Dekui should be taken as heritage to divide, and the key to solve the problem is how to identify the nature of such 53049 yuan. On October 26, 2004, Zhang Dekui as the client signed the Contract of Fund Trust with Teng Airong as the trustee. On June 30, 2008, they signed the supplementary agreement of the Contract of Fund Trust. As far as the contents agreed in such two contracts, the contracts were signed according to the Trust Law of the People's Republic of China and the Contract Law of the People's Republic of China. Since the entrusted fund 53049 yuan of the client Zhang Dekui as trust fund is within the adjustment scope of the Trust Law of the People's Republic of China, such 53049 yuan shall be identified as trust property. According to 3.2 of Article 3 in the Contract of Fund Trust, the client designates the client himself as the only beneficiary of the trust contract. According to 3.4 of Article 3 in the contract, within the validity period of trust under the contract, the client may change the beneficiary upon approval of the beneficiary. According to Article 15 of the Trust Law of the People's Republic of China, "Trust property shall be distinguished from other property for which trust is not established. After trust is established, when the client is deceased, dissolved according to law, revoked according to law, declared bankrupt, the beneficial right of trust shall be taken as heritage or property to be liquidated."

Since both the client and the beneficiary in the contract are Zhang Dekui, he changed the beneficiary to be Zhang Moubing under the contract in the form of will on March 28, 2010. On December 9, 2010, the trustee Teng Airong issued "the Letter of Confirmation for the Change of Beneficiary", and the beneficiary was changed to be Zhang Moubing. Therefore, Zhang Dekui is no longer the only beneficiary in the aforesaid trust contract, and trust shall go on, while the trust property shall not be taken as the heritage of Zhang Dekui to divide. The request presented by Zhang Moujia and Shen Mou shall not be supported.

In Decision (2013)YMSZ No.235, the court has made it clear that trust property is not within the scope of heritage. In this case, although the trustee is not a trust company but a trustee as natural person, it still deserves attention: first of all, Chinese legislation doesn't distinguish a trustee as legal person or natural person, the case is generally applicable; secondly, in the case, the client changed beneficiary, which was confirmed by law. This is a constant state in family trust; finally, the court decision has confirmed the applicability of Article 15 in the Trust Law: trust property is not within the scope of heritage.

Asset isolation and the right of revocation of creditor

One question that arises – and which is very important to some clients, as well as to their creditors – is whether trust property can be isolated from a client's debts through the establishment of a family trust.

The independence of trust property is based on the regulations in Article 15 of the Trust Law, which states;

"Trust property shall be distinguished from other property of the client for which trust is not established. After trust is established, when the client is deceased, dissolved according to law, revoked according to law, de-
clared bankrupt, if the client is the only beneficiary, trust shall be terminated, and trust property shall be taken as heritage or property to be liquidated; if the client is not the only beneficiary, trust shall go on, and trust property shall not be taken as heritage or property to be liquidated; however, when the client as joint beneficiary is deceased, dissolved according to law, revoked according to law, declared bankrupt, the beneficial right of trust shall be taken as heritage or property to be liquidated".

So there are two issues: first, trust property is no longer the client's property; second, as long as it is a pure trust with a third person as beneficiary (and the client is not one of the beneficiaries), then at least during the normal operation period of trust the possibility that the property will be returned to the client has been nullified.

In the case of a real pure trust with a third person as beneficiary, in order to ensure that there is no possibility that property may be returned to the client, it shall be explicitly agreed in the design of the contract framework that under the circumstances that it is terminated ahead of time, property shall be distributed to the beneficiary in advance instead of returning trust property to the client's account.

In order to prevent the party concerned from infringing the interests of the creditor through malicious establishment of a trust, the right of revocation of the creditor is also stipulated in the Trust Law. In addition, in order to balance creditor benefits and the liberty to establish trust through entrustment, specific conditions are set to exercise the right of revocation. It is specifically reflected in Article 12 of the Trust Law:

"If the client establishes trust to do damage to interests of the creditor, the creditor has the right to file an application with people's court to revoke the trust. If the people's court revokes trust according to the regulations in the preceding clause, no influence will be exerted on the trust benefits which have been acquired by bona fide beneficiary."

In order to guarantee the stability of a trust, it is not absolute for the creditor to exercise the right of revocation unless certain conditions are met. According to the regulations in current legislation, several necessary conditions are required for the creditor to revoke trust.

First, before the client establishes the trust, the creditor has been entitled to 'legal creditor's right of the client'. This right is subject to legal enforceability. The precondition that the creditor of the client may claim for the revocation of trust is that the creditor is entitled to legal creditor's right of the client, and such creditor's right shall be generated before the client establishes trust. If the creditor's right is generated after the establishment of trust, when other creditors are newly added due to financial crisis caused by operation and other problems, no influence will be exerted on the existence of family trust and the realization of the initially set goal.

Secondly, the client does harm to the creditor's benefits with the establishment of trust for property. To be specific, the client separates his own property to establish a trust, so that he has no way of paying off all his debts. Therefore, a core criterion to make decision on the right of revocation: after trust is established, whether the client's assets are not enough to pay off debts at that time. Therefore, if the funds subject to family trust are just one part of individual total assets of the client, the creditor has no right to claim for the revocation of trust.

Thirdly, the creditor files an application for the revocation of trust with the court according to law. This also means that the creditor's right of revocation shall be subject to litigation. According to the rule in civil and commercial litigation "whoever claims shall be the one who produces evidence".

In other words, the creditor thought to be the victim of trust shall produce evidence about the fact that the client does harm to the creditor's right through the establishment of trust. As a matter of fact, it is very hard to produce such evidence.

Put simply, as long as assets used for the establishment of trusts are less than net assets, the debt isolation effect of trusts is definite. As a country with the continental law system, without the need to confirm judicial decision, according to the regulations in Article 12 and Article 15 of the Trust Law, the conclusion can be drawn.
We need to point out, since the natural person generally neither carries out bookkeeping, nor has a way of making a subsequent audit of the condition of assets, the trustee shall judge whether "assets used for the establishment of trust are less than net assets" with caution — for fear that some people with ulterior motive make use of trust as the mode to evade debts.

**Family trusts have entered a new stage of development**

Entrusted services (i.e. from trust companies) and consultation services (i.e. from private banks, third-party wealth management companies, etc.) in the domestic family trust have grown in the past five years or so, and each institution has developed its own advantages and characteristics. As the market for advising high net worth individuals hot up, institutions will probably compete more intensely based on their level of expertise in legal, taxation and wealth management matters.

Typically, customers are not used to paying for high quality services. But as the tax laws evolve, the tax planning function of family trusts will become an important aspect of wealth inheritance planning, and require the involvement of more professional tax experts, particularly as there are few reference publications or works examining China's current legislation regarding family trusts as well as the *Trust Law*, the *Company Law*, the *Securities Law of the People’s Republic of China* and other related content.

Finally, providing objective and neutral service is an important means of improving customer stickiness. In the future, wealth management institutions will try to offer a comprehensive wealth inheritance planning capacity both at home and abroad, and to provide neutral and objective services for customers.

**What needs to change?**

Family trusts in China are expanding, but to develop further, certain conditions should be met.

**Tax reform**

The 2018 NPC & CPPCC Sessions released news about the upcoming reform in personal income tax. Compared with developed nations in the world, China is not at all strict or critical about legislation and collection of personal taxes. When it comes to personal income tax, China has not yet completely established the regulations about the deduction of personal income tax and small-sum exemption of personal income tax, nor does China have a death tax or gift tax. That means Chinese people do not have to take tax liabilities into account when passing on their assets to their children or grandchildren.

If China starts to levy a death tax and gift tax, it would be very positive for the family trust business because it would encourage people to plan from a tax perspective. Outside China, family trusts have proved a flexible and effective instrument of planning with respect to personal income tax if one wants to pass on wealth to future generations.

**The accumulation of experience**

In 2013, private banking was the first business area to start offering family trust services. Since then, many institutions have got into the business, such as trust companies and service providers such as private banks, third-party wealth management companies, insurance companies, law offices and accounting firms, leading to greater familiarity with this particular wealth management product.

The future development of family trusts does not rely on external force, but on the accumulation of practical experience. The trust industry is gradually shaking off its association with shadow banking and promoting its image in the role of genuine trustee, thus definitely benefiting the long-term development of family trusts.
This chapter gives examples of how family trusts may be used in a variety of different circumstances facing Chinese high net worth individuals. These include: ensuring that the fortune is inherited by the next generation; avoiding a loss of the family wealth as a result of divorce; the segregation of property; providing for both inheritance of wealth by the next generation and charitable donations; and providing inheritance for family members with different tax residence situations.

Thanks to globalisation, many Chinese families work, study or live overseas. Likewise, their wealth – whether real estate or financial assets – may be in China or abroad, and this presents complications when it comes to managing wealth and inheritance planning. High net worth settlors need one-stop, integrated and global inheritance planning services.
We can design a family trust to meet settlors' requirements. Every family has its own particular characteristics and demands, but there are also some general points of similarity. We provide summaries of several typical schemes below.

**Need: guarantee of inheritance for a young child**

(1) Basic information and requirement of settlor

Mr. and Ms. Li have a five-year-old son who is too young to take over the ownership or running of their company. Their elder daughter, who studies abroad, said she definitely would not return to take over the company.

By focusing on the manufacturing and export of electronic products for nearly 20 years, Mr. and Ms. Li have established a complete upstream and downstream supply chain and formed valuable relationships with overseas customers. But they both feel they no longer have the energy to travel around the world, participating in exhibitions to win orders, and so they plan to gradually reduce their involvement in the management of the company and then retire.

The major wishes of this client are two fold. One, they want a steady source of capital, even if it is not huge. Two, they want to ensure that their underage son has steady and sufficient living and education expenses before he becomes economically independent, regardless of the state of his health or career development.

(2) Trust scheme and expanded application

Overall planning: Establish an incentive scheme at the top level of the company and sell a portion of the company's shares to the management at a fair price, in the hope of improving the loyalty of the professional managers through share ownership; sell non-core business assets so as to withdraw funds and establish a family trust.

Trust scheme: The beneficiaries are Mr. and Ms. Li and their underage child. The trust is designed with a supervisor, Ms. Li.

Expanded application: The core function of this kind of trust is to avoid influence on underage children of incidental factors in their career and health, and arrange long-term funds, extra expenditure and future costs for marriage, house purchase and entrepreneurship in advance.

**Need: protection of family wealth if a child's marriage fails**

(1) Basic information and requirement of settlor

Mr. Zhou's parents, who run a very successful local enterprise, support Mr. Zhou's life in Beijing financially. Mr. Zhou has set up a new business with his friends, and he plans to marry Miss Zhang, whom he met at work, in two years' time.

Mr. Zhou's mother is worried about her son's financial security because of the significant difference in wealth between her son's family and that of her future daughter-in-law. She suggests that her son and daughter-in-law sign a prenuptial agreement, but Miss Zhang objects and Mr. Zhou faces a dilemma.

The main requirement of Mr. Zhou's mother is to avoid financial loss in the event of a crisis in her son's marriage. The problem cannot be solved fully even if Mr. Zhou's properties (cash and equity) are transferred to his mother's name before marriage, for these properties will be returned to Mr. Zhou (the only child) after the death of his mother. So the problem still exists.
(2) Trust scheme and expanded application

Trust scheme: Establish a pre-marriage trust and include cash in the trust. First, Mr. Zhou should return the cash to his mother, who will act as trust settlor. The primary beneficiary of the trust is Mr. Zhou, followed by his mother. Mr. Zhou's children (if any in future) will be listed as primary beneficiary.

Expanded application: The settlor of this kind of trust is mainly the person preventing his or her children from suffering financial loss if their marriage falls apart. Establishing a pre-marriage trust for the children is a better solution than a prenuptial agreement, for two reasons: (1) It does not require the signature or knowledge of the future spouse and therefore does not hurt the feelings of the spouse; (2) the financial privacy of the party is protected, as there is no need to list properties – unlike a prenuptial agreement.

Need: property segregation

(1) Basic information and requirement of settlor

Mr. and Ms. Wang set up a chemicals business 10 years ago after resigning from a state-owned enterprise. Their company has reached a certain scale after years of development. Their parents are alive and Mr. Wang pays their maintenance and medical expenses. Mr. and Ms. Wang have a 16-year-old daughter in senior high school in the US. Ms. Wang often travels between China and the US, and spends most of her time in the US looking after their daughter. Annual expenditure in the US is about $120,000. Ms. Wang has pretty much left the business, and does not directly participate in its daily operations or management any more.

Mr. Wang hopes to expand their company so that it can be listed in the next three to five years. A capital markets adviser suggested that Mr. Wang should bring in an outside investor, improve the organizational structure of the company and import a new production line from overseas, financed with the help of bank loans. The total investment is about Rmb700 million, which includes a planned loan of Rmb400 million. As requested by the bank providing the financing, the main shareholder Mr. Wang and minority shareholder Ms. Wang will undertake unlimited joint and several liability for the financing.

Mr. Wang hopes to be able to list their company, but Ms. Wang prefers the current steady life so that the older generation can enjoy their old age in peace. Their daughter is unlikely to return to China for her college entrance examination, so the cost of their daughter's 10-year stay in the US must be ensured. Mr. and Ms. Wang risk losing the wealth they have accumulated – as well as the financial security of their parents and daughter – if their efforts to find an outside investor and list the company do not come to fruition.

Therefore, the basic requirement of the settlor is to segregate parts of their property to safeguard the life of the whole family, especially their daughter's studies in the US.

If the property is segregated, they can always start their business from the scratch if it dwindles, but is not heavily in debt.

(2) Trust scheme and expanded application

Trust scheme: Carry out due diligence covering the condition of their assets and establish a family trust for some of the cash assets which are distributed to family members (including cash obtained from selling real estate that they do not use). The beneficiary is Mr. Wang's daughter (primary beneficiary) and both of the couple's parents (secondary beneficiaries). After finishing the trust, Ms. Wang should coordinate with Mr. Wang to sign all relevant documents, so that the company can develop further and be listed with the help of venture capital. Trust property is mainly allocated to their daughter's studies and life, as well as the basic needs of the parents of the couple (settlor).

Expanded application: This kind of trust is mainly aimed at segregating parts of the property owned by a family or individual to safeguard the life and needs of family members. Besides, the settlor can start from scratch again if he or she suffers a loss or setback in their career. The trust is usually oriented to the following: (1) Plan to segregate parts of assets to prevent career risk due to forecast economic downturn; (2) Segregate parts of wealth from matrimonial property to avoid enterprise operation risk of breaking up the family; (3) Segregate parts of the
property when planning to provide guarantee for enterprise or other individuals due to the worries of involvement. Always see to it that the segregation should be completed before external liability or guarantee.

The trust has the following structural feature: The couple (settlor) cannot be the beneficiary of trust, so as to avoid the segregation effect of the trust.

**Need: Mixing inheritance and public welfare**

*(1) Basic information and requirement of settlor*

Ms. Liang, a successful entrepreneur, is in her sixties and is single. Several years ago, she received a large sum of money when she sold her business to management and retired. She lives off the income from her wealth. Her son and daughter live abroad and she visits her children and grandchildren often. Ms. Liang believes in Buddhism, and her important social activity in her retirement is participating in various Buddhism activities.

Settlor’s appeal: Ms. Liang paid a considerable sum for the education abroad of her two children and for their marriage. Now, they can support themselves and live a comfortable life abroad, and no longer need her support. She wants to withdraw from frontline organization work but still wants to provide steady financial support to continue the Buddhist activities which she participates in now. As for family, she hopes to leave part of her assets to the third generation of children after she dies.

In summary, Ms. Liang’s needs cover both inheritance and charitable donation, where the amount of money used is flexible to some degree, and is long term rather than a one-off donation.

*(2) Trust scheme and expanded application*

Trust scheme: The trust is a kind of mixed trust of charitable donation (including charity and non-profit matters) and private benefit (inheritance). It does not particularly focus on exemption from individual income tax from the settlor’s perspective because to take advantage of a tax credit, the donation would have to be implemented by a specific non-profit foundation, which is less flexible than if the individual makes a direct donation.

Ms. Liang’s trust structure has no essential difference in other aspects compared with an ordinary family trust. The main difference is trust benefit distribution. Beneficiary of the trust includes two types: (1) five children in the third generation; (2) Public welfare recognized by settlor Ms. Liang.

Expanded application: Charitable trust came into existence formally when *Charity Law of the People’s Republic of China* came into effect on September 1, 2016. Supervised by civil administration department and China Banking Regulatory Commission (or CBRC), it has to follow multiple requirements. As a result, not all charitable donors or families choose charitable trust mode as determined in *Charity Law of the People’s Republic of China*.

Inheritance and public welfare mixed trust mode may be the best choice of a high net worth settlor (family). The choice, though unable to bring about tax deduction directly, is relatively flexible and personalized. Common distribution modes of mixed trust include:

Principal inheritance (income public welfare mode): It is the mode described above, which is usually implemented when the settlor is alive.

Quota inheritance (balanced donation): In a typical case, the trust beneficiary can obtain a fixed amount of income from the trust as funding of settlor. When all natural beneficiaries are 35 years old or more and need not be looked after (except in the event of disability), the undistributed trust property will be donated to public welfare at one time.

Parallel mode: It means allocating a fixed proportion of the amount to public welfare every year and storing or distributing the rest to other family beneficiaries.
Case 1: Two offshore family trusts hold equity and other family assets separately

Mr. and Ms. Wang and their daughter Wang Yi are Chinese nationals and tax residents, who live in Shanghai all the time. Their son Wang Er and his wife are tax residents and nationals of Hong Kong, China, where they live and work. Mr. Wang is the main owner of the family assets.

Mr. Wang set up a company that specializes in software development 8 years ago. With 60% of the shares, Mr. Wang is the company’s CEO and plans to list it on NASDAQ within one year. Mr. Wang has a private Hong Kong bank account for his investments and financial assets, and plans to purchase a universal life insurance policy and a house for Wang Er and his wife to live in.

Knowing the risks of the business, Mr. and Ms. Wang want to establish an offshore family trust to protect the family assets for the use of their children and descendants. If possible, they hope their family wealth can be passed on to multiple generations. Mr. Wang understands financial investments and often makes investment decisions based on his own analysis.

In general, two trusts should be established:

- Trust A holds Mr. Wang’s 60% stake in his company.

- Trust B holds the financial assets and investment portfolio of Mr. Wang in his private Hong Kong account, for example, his universal life insurance policy and the house that he plans to buy in Hong Kong;

Since Mr. Wang is the owner of the assets, he is the settlor of Trust A and Trust B.

The beneficiary of Trust A is Trust B and the beneficiary of Trust B is Mr. Wang, as well as any family members he designates.

Mr. Wang and his family members are Chinese, and live in Asia mostly, so an Asian trust company with a Chinese language service ability should be selected. In general, trustee and trust establishment place (jurisdiction where trust is applicable) should be kept consistent as much as possible, so as to avoid the complex situation where multiple laws are applicable.

Mr. Wang hopes the family wealth can be passed on to several generations, so the trusts are established in Hong Kong, China, where they can exist sustainably.

Both trusts can be set up as Hong Kong reserved powers discretionary trust, and thus Mr. Wang, the trust settlor, can reserve investment management powers for trust assets in the two trusts and act as investment manager of the two trusts.

Both trusts can be set up as revocable or irrevocable trusts. To be specific, a revocable trust is flexible, whereby trust assets can be revoked to the name of the trust settlor, but it has weak powers when it comes to the segregation of assets. In the case of an irrevocable trust, trust assets cannot be revoked to the name of the trust settlor, but the assets segregation ability is strong. A revocable trust can change into an irrevocable trust at any time. After the settlor of a revocable trust passes away, the trust will change into an irrevocable trust automatically. An irrevocable trust cannot change into a revocable trust. Trust relationship can be terminated, regardless of the reversibility of trust. The most common thing is that the trustee will have no fiduciary duty, the trust relationship will be cancelled and thus the trust will be terminated when all trust assets are distributed to the beneficiary and there are no new assets in the trust.
Mr. Wang, the trust settlor, can double as trust protector before he passes away. Meanwhile, Mr. Wang can appoint Ms. Wang as trust successor protector after obtaining her approval. Where the protector is unable to fulfill his duty, the successor protector shall have the right to act as formal protector.

Mr. Wang can also directly designate Ms. Wang as current protector, but he must consider if there is any other person suitable to act as successor protector, who will replace Ms. Wang’s position in the event that Ms. Wang is unable to fulfill the duty of a protector. The protector plays a significant role in family trust but it is not a necessary role. The protector may not be appointed if there is no proper person, and in such cases, all protector clauses in trust agreement will cease to apply.

Protector selection principle: a person that the founder trusts enough; knows the trust demand of the founder; knows the duties and responsibilities of the protector; and no conflict of interest with the trust beneficiary as much as possible.

The trust protector protects the rights and interests of the beneficiary in trust by restraining the trustee’s rights. The protector has the following rights (according to relevant clauses of trust agreement): replace trustee and replace investment manager. Besides this, the trustee shall not exercise the following limited rights until obtaining approval or notifying the trust protector in advance (taking Hong Kong reserved powers discretionary trust for example): distribute trust assets or income during the term of the trust; apply for effecting the designated payment with trust assets or income; distribute trust assets or income upon the expiration of trust; announce date of acceleration of maturity of the trust; transfer trust assets to another trust; increase/remove beneficiary; expand exclusion category; change trust clause.

With regard to rights of the main roles in offshore family trust, such as settlor, trustee, beneficiary, protector and investment manager, the settlor can employ a professional lawyer for property planning of the offshore trust before the trust is established to formulate and modify the trust agreement and empower various roles with different rights, so that all parts to the trust can be restrained mutually and the trust structure reaches a relatively steady state.

As the main shareholder in the enterprise, Mr. Wang is the one who faces the risk of involvement in a lawsuit stemming from the operational side of the business and therefore two offshore family trusts should be established in general for the case above, in order to separate family enterprise assets from other family assets and to ensure that corporate dividends that Trust A (which holds enterprise equity) obtains can be distributed to the beneficiary of Trust B. As a result, money that the enterprise earns for Mr. Wang has been distributed to Trust B holding other family assets through Trust B when the trust holding enterprise equity is involved in a lawsuit or debt. The assets of Trust B are not affected, and this means risks to the family assets are avoided.

Mr. Wang may establish a third trust (employees stock option plan trust) if he plans to turn a portion of his shares into stock options to reward core employees who have worked for him for many years, so that they continue to work for him after the enterprise is listed. For this trust, assets are employees’ stock options and the beneficiaries are Mr. Wang’s employees. This trust should be independent from Mr. Wang’s other two family trusts.

**Case 2: Different trusts are established for beneficiaries with different tax resident status**

Mr. and Ms. Li and their son Li Yi are tax residents and nationals of Hong Kong, China. Ms. Li and her son plan to emigrate to the US. Mr. and Ms. Li’s daughter Zhang Er, who is unmarried, has settled in Canada and is a Canadian tax resident and national.

Mr. Li, who has no emigration plans, is the main owner of the family assets. The main assets include owner-occupied real estate in Hong Kong and financial assets. Mr. Li hopes to establish a family trust to protect his family assets and provide a reasonable wealth inheritance plan for his children. Meanwhile, Mr. Li plans to reserve investment management power for trust assets.

Mr. Li, as trust settlor, needs to divide his financial assets into two parts, which are attached with trust respectively:

- Trust A is a non-US foreign grantor trust, which takes Ms. Li and their son Li Yi – who will become US tax residents –
as beneficiaries. Trust A is usually set as a revocable trust according to the tax compliance requirement of the US.

- Trust B takes their daughter Zhang Er (a Canadian tax resident) as the beneficiary. Trust B can be a revocable or irrevocable trust according to the demand of settlor Mr. Li; Mr. Li can also serve as beneficiary of Trust A and Trust B.

Since Mr. Li hopes to reserve investment management power for trust assets, Trust A and Trust B must be established in jurisdictions supporting reserved powers discretionary trusts.

The US and Canada are countries specifying complicated tax duties, and in general, different trusts should be established for beneficiaries with different tax resident status, so as to avoid tax duties in a trust structure that are too complicated. In general, the settlor needs to employ a professional tax lawyer to complete the necessary compliance modification of the trust agreement and letter of intent, issue formal tax opinions for trust and determine tax duties of trust before establishing this kind of trust with complicated tax duties.

Case 3: Different trusts are established for beneficiaries who may be in conflict

Mr. Li and his ex-wife Ms. Liu have a son called Li Yi. Li Yi and his wife have a daughter Li Xiaoyi. Mr. Li and his current wife Ms. Li have a son called Li Er (married) and a daughter Li San (unmarried). All of these people are tax residents and nationals of Hong Kong, China.

Mr. Li is the main owner of the family assets, which include a Hong Kong trading company wholly owned by Mr. Li and owner-occupied real estate and financial assets in Hong Kong. Mr. Li hopes to retire by selling his trading company in Hong Kong to the management layer for cash, and meanwhile, establish a family trust to protect his family financial assets and formulate a reasonable wealth inheritance plan for his son Li Yi and Li Yi’s daughter Li Xiaoyi, as well as his son Li Er and daughter Li San. Mr. Li plans to reserve investment management power for trust assets.

In light of the complex family member relationships, Mr. Li, as trust settlor, should divide his financial assets into two parts (including the Hong Kong trading company which is going to be cashed in) to establish family trust respectively:

- Trust A: The beneficiary is his son Li Yi, the wife of Li Yi and Li Xiaoyi; the protector or successor protector is ex-wife Ms. Liu.

- Trust B: The beneficiary is Mr. Li, his son Li Er and daughter Li San; the protector or successor protector is Mr. Li or Ms. Li.

Where these beneficiaries have conflicts of interest, the beneficiaries will be distributed in different family trust structures, so as to avoid dispute and even lawsuits among the beneficiaries in the same trust structure.

Those are three common cases where more than one trust should be established, but in fact there are many other cases. For example, since different trust jurisdictions support different trust types, the settlor can choose to divide his or her assets into two parts if he or she wants to own direct control rights for trust assets and protect trust assets fully according to his or her family condition, assets and demand. Trust assets which the settlor hopes to control directly should be injected into VISTA Trust and trust assets which the settlor hopes to protect fully need to be injected into a discretionary trust or reserved powers discretionary trust.

With a change of tax resident status of the trust settlor or beneficiary and alteration of trust appeal, assets and laws and regulations, some clauses of family trusts may need to be changed from time to time. Perhaps the trust structure needs to be adjusted, and the trust type may be transformed or recombined and even the jurisdiction which the trust applies to may need to be changed.

Offshore family trust have been designed with complex laws after hundreds of years of development. A reasonable trust structure is based on cooperation of such professionals as trustee, legal counsel, tax adviser and investment adviser and full communication with the family settlor. This may seem complicated — but the successful establishment of a trust structure is the start of family wealth management.
4.3 Cross-border family trusts

There are many successful examples of cross-border enterprise equity family trusts due to the international demand of Chinese enterprises, such as Infinova-Liu Family Trust, Liaoning Zhongwang-Liu Family Trust and Baoxin Auto-Yang Family Trust. Below is a summary of public information of these three projects.

Infinova-Liu Family Trust

Infinova's case is described below based on public information.

Mr. Liu Zhaohuai, the actual controller of Shenzhen Infinova Limited (hereinafter referred to as "Infinova"), a company listed on the Shenzhen Stock Exchange, injects equity he holds in Infinova into an overseas family trust successfully through a structural family trust design. Mr. Liu holds about 30% of Infinova indirectly through a family trust group composed of four family trusts (hereinafter referred to as "Liu Family Trust").

As of January 19, 2017, the Liu Family had established four family trusts through "JZ LIU Family Trust", which holds in total 100% of JHL, a limited liability company established in Delaware, the US. Holding Infinova's 30% stake directly, JHL is the largest shareholder of Infinova. The specific structure is shown in the diagram below:

Figure 4-3-1 Infinova-Lou Family Trust Structure
Liaoning Zhongwang-Liu Family Trust

The holding shareholder of Liaoning Zhongwang Group Co., Ltd. (hereinafter referred to as "Liaoning Zhongwang") is Liaoning Zhongwang Jingzhi Investment Co., Ltd., which is a wholly owned subsidiary of Zhongwang China Investment (HK) Limited. Zhongwang China Investment (HK) Limited is a wholly-owned subsidiary of Zhongwang China Investment Limited, which is a wholly-owned subsidiary of China Zhongwang Holdings Ltd. listed on Hong Kong Exchanges and Clearing Limited (hereinafter referred to as "China Zhongwang"). Holding shareholder of China Zhongwang is Zhongwang International Group Limited. The actual controller of Liaoning Zhongwang is Mr. Liu Zhongtian (hereinafter referred to as "Mr. Zhou").

Mr. Zhou holds 74.16% of the ordinary shares and 99.99% of the preferred shares of China Zhongwang through Liu family trust which he controls.

Mr. Zhou, as the only settlor, established Liu family trust on September 26, 2013, with trustee of TMF (Cayman) Ltd. Liu family trust holds 100% equity of Prime Famous Management Limited, which held 100% Radiant Day Holdings Limited. On September 27, 2013, Mr. Zhou transferred the 100% equity of Zhongwang International Group Limited he held directly to Prime Famous Management Limited; on July 18, 2014, Prime Famous Management Limited transferred the 100% equity of Zhongwang International Group Limited that it held to Radiant Day Holdings Limited. Therefore, Mr. Zhou has held 100% equity of Liaoning Zhongwang directly through Liu family trust since July 18, 2014. The structural design is shown in the following diagram:
Baoxin Auto-Yang Family Trust

Established in Cayman Islands and listed on The Stock Exchange of Hong Kong (SEHK), Baoxin Auto Group Limited (hereinafter referred to as "Baoxin Auto") was acquired by China Grand Automotive Services Co., Ltd. (hereinafter referred to as "China Grand Auto") on June 27, 2016. Prior to acquisition, the relevant equity and actual controller information of Baoxin Auto were as follows:

Major shareholders holding more than 5% shares of Baoxin Auto are Baoxin Investment Management Ltd. (hereinafter referred to as "Baoxin Investment") and Auspicious Splendid Global Investments Limited (hereinafter referred to as "Auspicious Splendid"); to be specific, Baoxin Investment holds around 48.6% equity of Baoxin Auto and Auspicious Splendid holds about 5% equity of Baoxin Auto. The actual controller of Baoxin Auto is Mr. Yang Aihua, who holds over 50% equity of Baoxin Auto through Yang Family Trust *(including Sunny Sky Trust Yang's Trust) before Baoxin Auto was acquired by China Grand Auto. The specific structural design includes two parts:

1. Holding 48.6% equity of Baoxin Auto. Sunny Sky Trust is a discretionary trust, with beneficiary of Mr. Yang Aihua, his children and later generations, where Mr. Yang Aihua serves as protector and Credit Suisse Trust Limited as the trustee which holds all Baoxin's investments. According to trust document, the trustee shall not have any assets investment or management right as long as the protector Mr. Yang Aihua is on duty, so Mr. Yang still controls Baoxin's investment indeed. The specific structural design is shown in the following diagram:

2. Holding 5% equity of Baoxin Auto by Yang's Trust. Yang's Trust is a trust which takes Mr. Yang Aihua and Mr. Yang Zehua (the brother of Mr. Yang Aihua) and their children and later generations as the beneficiaries. Mr. Yang Aihua serves as trust protector and his daugh-
ter Yang Chuyu as the trustee of this discretionary trust, who owns Auspicious Splendid wholly. According to the trust document, the trustee shall not have any assets investment or management right as long as the protector Mr. Yang Aihua is on duty, so Mr. Yang Aihua still controls Auspicious Splendid. The specific structural design is shown in the following diagram:

The details of the three cases above are based on the information disclosure requirements of the capital markets. It is not required to disclose the person who holds shares through a trust if that stake does not exceed 5% and the person does not serve as the actual controller, which contributes to the high level of privacy of a trust. In addition, even though shareholding through a trust is disclosed, some details for the trust, particularly for specific information of the beneficiary, are not disclosed. For that reason, the privacy of trust can be ensured.

Moreover, cross-border asset holding is possible, in spite of China’s foreign exchange system. Particularly for equity investment, a large number of foreign-funded enterprises have been settled in China, and it is common that the overseas entity holds domestic assets through a structure consisting of several layers. Therefore, there are many cases where domestic companies are held through foreign trust. Of course, in cases of cross-border arrangements of assets, it is necessary to apply to contact authorities (e.g. National Development and Reform Commission, Ministry of Commerce and State Administration of Foreign Exchange) for filing and approval.
How assets are allocated in a family trust

There are many ways that families can apportion control over their assets in a family trust. But there are clear advantages of opting for an independent investment adviser.

The diagram below shows the operation mode of a typical family trust.

Under this mode, the application of trust property involves three main modes:

**Mode 1:** Settlor reserves investment decision right. According to Article 2, Trust Law of the People’s Republic of China, the settlor may instruct the trustee to manage trust property still during the term of the trust. But in practice, it is not a good "habit" that the settlor decides or participates in the decision in the whole process. The reasons are described in the text below.

**Mode 2:** Application of trust property is under full management of settlor, i.e. settlor plays roles not only of settlor in the trust relationship but also property administrator in the trust management relationship. Overlapping of the two roles has no conflict of interest, but there will be a definite conflict of interest and related transaction once the settlor purchases (allocates) other financial products it issues. Of course, the conflict of interest and related transactions are not completely forbidden under the framework of Chinese laws, as long as they are fully disclosed and confirmed by the settlor. Under this mode, the settlor, since it is familiar with the product it issues, can fulfill the settlor’s duty of care better.

**Mode 3:** The independent investment adviser mode, i.e. employing an independent third party to act as investment adviser, who shall manage the complicated trust property. The utmost advantage of this mode lies in independence, which, however, means trust property may be managed from the view of the beneficiary. Investment managers should ensure value appreciation and preservation of trust property, which is the basis for sustainability and the long-term distribution ability of the trust.

Mode 1 is not recommended in terms of management. It can be used for a short-term trust but should be avoided for a long-term one. The reasons are as follows.

First, it deviates from the basic appeal of trusts. As specified in Trust Law of the People’s Republic of China, trust property should be independent from the settlor’s other properties. The settlor should agree to separate “this sum of money” from its own direct management once a trust is established. It is an inevitable choice to entrust others to manage property, for the settlor’s life and energy are limited.

Second, under this mode, the settlor will have one more reason if claiming for the trust property in future: the settlor continues controlling the trust property. Therefore, having the settlor managing trust property directly will hinder the realisation of "debt segregation", although it is not the goal that every trust pursues.

Third, since the family trust is a kind of long-term management mode, to deliver the assets to a professional institution must be better that delivering them to yourself or any other individual. Many of China’s richest people made their money by being experts in their own fields. They are now increasingly leaving their investments to the experts, too.