



The role of trusts, trustees and protectors in supporting family flourishing

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In September 1982, Forbes magazine first published its list of the 400 richest people in America.

23 years later, only 43 of the original Forbes 400 list members were still on the list – fewer than 11%. JP Morgan Private Bank conducted a study into 210 of the names that dropped off the original list (some 53% of the names) to understand what happened to their wealth. JP Morgan concluded that for these 210 names, they dropped off the Forbes list because either their wealth did not grow fast enough or their wealth eroded because of over concentration, overleveraging, overspending, taxation, family discord or liability suits. This research by JPMorgan highlights the quantitative risks to the preservation of wealth.

In contrast, a different study of over 3000 family wealth transitions in the US, based on interviews with the families, highlighted the qualitative risks to the preservation of wealth within a family as it passes from one generation to the next. This study started with the assumption that the chances of family wealth continuing from one generation to the next are only 30%, and then asked the question of “what went wrong” in the 70% of cases where family wealth failed to transition? The conclusion was that: 60% of the transition failures were caused by “a breakdown of communications and trust within the family unit”; 25% were due to a failure to prepare the heirs, (which the study describes as including “establishing family values” and “developing healthy individual attitudes towards wealth and responsibility”); and the last 15% were attributed to “all other causes” such as tax considerations, legal issues and lack of a mission¹.

Qualitative and quantitative issues

Therefore the successful preservation of family financial capital will require addressing both quantitative risks as well as qualitative risks. Family wealth advisors Lee Hausner

and Douglas K Freeman, in their book *The Legacy Family: The Definitive Guide to Creating a Successful Multigenerational Family*² place emphasis on the qualitative side of wealth in families. They write in the Introduction to their book:

“Some families have been able to perpetuate their success for many generations.... There’s a name for these special families. We call them Legacy Families. In these families, members recognise the importance of contributions to the financial, human, intellectual, and social capital of their family and community. They are connected to their heritage, maintain positive family relations, communicate effectively, and promote generational governance structures that assure the success of those to follow.”

The book “Family Wealth: Keeping it in the Family”³ by family wealth expert James (“Jay”) E. Hughes Jr. is a very well respected and often quoted US book dealing with the question of how to overcome the universal proverb of “shirt sleeves to shirt sleeves in three generations”. Hughes also emphasizes paying attention to both qualitative as well as quantitative issues:

“Families should employ multiple quantitative and, more importantly, qualitative techniques to enable them, over a long period of time, to make slightly more positive than negative decisions, regarding the employment of their human, intellectual, and financial capital.”

The Definition of Family Wealth

Both Hausner and Hughes advocate that “family wealth” should be looked at in terms of family human capital, intellectual capital, social capital and financial capital:

Family human capital refers to things like family dynamics, family communication, family relationships, and the overall well-being of each family member. It is a challenge growing up in the shadow of great financial wealth. Many great families fail because of a failure in the human capital. Hughes advocates that great families need advisers that can help the

inheritors find their own voice and that can help them to integrate the inherited financial wealth into their lives.

The intellectual capital of a family is another critical topic for a family that wish to continue its success across generations. It includes the knowledge level and understanding of individual family members, as well as the family as a whole, as to how to be effective owners of the family financial wealth.

The social capital of the family includes the charitable and philanthropic activities that the family are involved in. It also includes a reference to the good standing, reputation, or brand of the family within society.

Hughes raises the question of how can a family use its financial capital to invest in the family human and intellectual capital? After all, if a family have great financial capital, doesn’t it make sense to use it to make sure that the family members as individuals are flourishing and are educated to the highest education levels that they are individually capable of?

The new paradigm of planning for family flourishing

Family wealth experts like Hughes and Hausner are at the forefront of a new paradigm of planning for wealthy individuals and families aimed at, on the one hand, promoting individual and family flourishing, while on the other hand, avoiding or at least alleviating, negative family dynamics and the “dark side” of inherited wealth.⁴ This new paradigm calls for attention to both qualitative as well as quantitative issues; and more specifically it calls for attention to (i) qualitative issues concerning the individuals within a family of wealth; (ii) qualitative issues concerning the entire family emotional system; (iii) clarification of the roles and responsibilities of the ownership of family wealth, and how to develop effective owners of family wealth; and (iv) ensuring there is an effective system of family governance in place.

When thinking about the individual family members (the family human capital) the kind of qualitative issues to be taken into consideration include whether individual family members know themselves; what their personal dreams are; what work they are called to; whether they can successfully individuate and separate themselves from the shadow of the family wealth; whether they are mature or are maturing; whether they can successfully navigate the transitions in the adult life cycle; and whether they are free or whether they are suffering from an addiction.

When thinking about the family emotional system, the kind of qualitative issues to be taken into consideration include being aware of the multigenerational family culture and family dynamics that are present; being aware of the impact of anxiety on the family as a whole; and how family members react to stress and anxiety (times of change

in a family, e.g. a generational transition, are times of increased anxiety); what communication is like in the family; what trust is like; how the family deal with conflict; whether the family can accept diversity amongst its family members; how the family make joint decisions together; whether the family members can collaborate together, and leadership in the family.

At the family level, planning to avoid destructive family conflicts is an important goal. At an individual level, planning to avoid “doing harm” to family member beneficiaries is an important goal.

What does this have to do with trusts, trustees and protectors?

Trusts are a key part of the landscape for a wealthy family and a key purpose of establishing a trust structure is often to preserve and pass on family financial capital. Accordingly it makes sense to ask the question of what this new paradigm of planning means for trusts, trustees, protectors and the advisors who set them up and, how the flexibility of the trust concept can be taken advantage of.

One question that trustees protectors and advisors who work with trusts should ask themselves is whether trusts can be used to do more than just preserve family financial capital; are there ways that we could use trusts to help promote family human and intellectual capital?

If trusts are used to hold family financial capital, and if the wealth creator agrees with the proposition that family financial capital should be used to invest in the other three capitals, then this must at the least imply that the family trust or trusts need to be structured in such a way to authorise payments to support, or make investments in family human and intellectual capital.

Trusts can be very long-term vehicles and trusts also represent a governance mechanism. Therefore it is logical to think about how the trust could be used to institutionalize the structures policies and processes that can be used to help support the new paradigm of planning.

Planning principles from the new paradigm

Following are six principles and approaches drawn from the new paradigm as they might apply in the context of trust structuring or administration.

1. Be clear on the Mission of the Trust

Hughes says you can divide trusts up into essentially two different categories, and also the kind of person who creates the trust.

In the first scenario, you have trusts which are “mechanistic trusts” and where the settlor who creates the trust is a “mechanistic client”. This means that the intention in setting up the trust is to create a mechanism.

If the purpose of the trust is to avoid probate and to create a will substitute, then

the trust is a mechanism (and such a will substitute trust is not a bad thing).

If trust is set up primarily for some tax planning purposes that trust is also likely to be a mechanism.

However Hughes warns that some wealth creators will want to create long-term trusts that are essentially only intended to be a monument to the great success of the wealth creator. In this scenario, the money and preserving the money is the most important thing, more important than the impact on the beneficiaries. The wealth creator is setting up a trust so that everybody remembers what a great and successful man he was. Hughes calls this kind of long-term trust a mechanistic trust and he warns that there can be great dangers to the beneficiaries of such a monument to the wealth creator. He says that when such a long term mechanistic trust is set up, it involves a transfer of money into trust, and it is not a gift. Hughes says that there is a major difference between (1) transfers and (2) gifts.⁵

Therefore in the case of a transfer, and the creation of a trust which is a mechanism, there is no thought given to the impact of the structure on the beneficiaries, and there is great potential that it will do harm to the beneficiaries if it is a long term trust.

The second scenario is where the trust created is intended to be “a gift of love”, and where the person creating the trust is a “patron”. In this second case the intention is for the trust to enhance the lives of the beneficiaries. The patron is one who sees themselves as a steward of the family wealth, who wants to see that wealth being used to make his or her children and heirs happy. The patron wants to help the members of the next-generation to fulfil their own dreams - and secondly to become steward /conservators of the family wealth. The patron first asks: “how can I help you with your dream?”

The starting point for the wealth creator/settlor when thinking about setting up a trust should be a careful and honest consideration of their purposes for setting up a trust. Is their intention to create a mechanism (and to make a mere transfer) or is their intention to create the second kind of trust, a gift of love, intended to enhance the lives of its beneficiaries?

If it is intended to be a gift of love, then as a minimum, the wealth creator will stop and ask, “Could this trust harm the beneficiary?” This is where getting advice on qualitative issues could be extremely important.

It should also be born in mind that a trust will always send a message to the beneficiaries. The beneficiaries will interpret the trust and the way it has been structured to form their own view on whether or not they see the settlor as having “trust” in them, and whether the settlor cared for them in setting up the trust. All the more reason why, if the settlor has a positive intention

towards the beneficiaries, to clearly articulate this.

For more information on the question of how to give well and how to make a gift of love rather than a mere transfer, see the book “The Cycle of the Gift”.⁶

2. Understand the family and its dynamics

Under the new paradigm of planning, when advising on the creation and design of a trust structure, the advisor should have an opportunity to spend some one on one time interviewing the wealth owners’ spouse and each of the adult children of the wealth owner. Alternatively the advisor should have an opportunity to observe the family interacting together e.g. at a family meeting. The advisor needs to have an understanding of what the family and its dynamics (i.e. the “family system”) are like.⁷ This includes having an understanding of what communication is like within the family. It includes thinking about the question of whether the family members have the ability to collaborate together, and whether they want to work together or not.⁸

The advisor should carefully consider whether the proposed trust structure can be integrated by the family, or whether, in light of the family and its dynamics, the structure may likely increase the chances of negative consequences arising such as family conflicts, or the family human capital suffering in some way. Once the advisor has a feel for the family system, the advisor should be reflecting on questions like the following:

- whether each beneficiary should have their own separate trust or whether a single family trust would be workable, or whether there should be a combination of separate trusts and joint trusts;
- whether any of the family members have the necessary relationship skills and maturity to take on representative roles such as being a member of the protectors committee or a member of the investment committee for the trust;
- whether the beneficiaries and the other parties to the trust can make the legal relationship work;
- whether locking the beneficiaries or other family members together into a particular structure is likely to lead to predictable family conflict or not.

The traditional advisory approach would be to deal only with the settlor and possibly the spouse of the settlor at the same time. However to get an accurate picture of what the family relationships are really like, it is important to talk to as many different adult family members as possible. The reason for this is because the settlor usually does not have an accurate picture of the dynamics and relationships within their own family, and because family dynamics will often change once the settlor dies.

3. Hold Regular Family Meetings

Under the new paradigm, while the settlor is alive, there should be regular family

meetings to talk about the trust and the family wealth. The meetings should be attended by the settlor and his or her spouse. They should be attended by the members of the protectors committee as well as the trustee and any investment trustees. The meeting should be attended by those beneficiaries who are mature enough to attend.⁹

The reasons for holding family meetings include so that the settlor can explain his or her wishes and vision to the beneficiaries and so that the beneficiaries can understand why the settlor has set up the trust. Family meetings should be held more than once. It should become an ongoing process or practice of the family. In general terms, consider one family meeting a year.

The trustee can coordinate and arrange the family meetings. Alternatively the meetings can be arranged by the settlor's advisor or the family office if there is one. The terms of the trust deed can provide that the costs of attending and arranging the family meetings are to be paid for out of the trust fund. This practice of holding family meetings, supported by the trust fund, can continue after the settlor has passed away.

When there is a family meeting to talk about a family trust the trustee should be involved as they are an interested stakeholder. However, as an interested party, the trustee should not play the facilitator role, unless the trustee is an institutional trustee that can provide a specialist in family dynamics. The facilitator needs to be a neutral party.

When do you start and how old do the beneficiaries have to be? If the members of the protectors committee are also family members and they are adults, then the settlor and his or her spouse should have periodic family meetings which include the members of the protectors committee so that they understand the settlor's vision for the trust and the settlor's wishes etc.

How old do the beneficiaries have to be for them to be included in such family meetings? If the beneficiaries are mature adults it is critical that they should be included in the family meetings to talk about the terms of the trust. If the beneficiaries are young adults, they can still be included in family meetings which talk about the family trust(s) but which can be designed in such a way to avoid disclosing the actual amounts involved.

4. Trustee and beneficiary education

Under the new paradigm, "trustee beneficiary education" is an important practice where family financial capital is held in trusts.¹⁰ A trust is fundamentally a relationship between the trustee and the beneficiaries. How can you possibly have a good relationship if the parties involved do not know the roles the relationship is based on?¹¹ To avoid the scenario where the relationship between trustee and beneficiaries is a negative one, it is critical that

the parties to the trustee beneficiary relationship are properly educated as to the roles that the relationship involves.

A simple starting point in this area is to include discussion of the terms of the family trust structures as an agenda item at family meetings. This can be done in age appropriate ways. Topics to discuss can include the duties and responsibilities of a trustee and the requirement of a trustee (of a discretionary trust) to make independent decisions. Hughes advocates teaching that trustees are representatives of beneficiaries and that beneficiaries also have obligations if they are to play their beneficiary role well.

Authors Hartley Goldstone and Kathy Wiseman in their book *Trustworthy, New Angles on Trusts from Beneficiaries and Trustees*,¹² believe that one of the best ways to encourage a positive trustee and beneficiary relationship is to show families stories of times when these kinds of relationships have been at their best. *Trustworthy* is filled with stories of "mentoring trustees" and of successful trustee - beneficiary relationships.

If the trust structure owns the shares in a family business then the beneficiaries, or family members involved in the protector or investment committees should also be educated on the ownership role in the business (e.g. what decisions are reserved to the ownership level) and on the boundary between ownership and management of that business.

Education might take the form of a parent intentionally passing on a small portion of their wealth to child or children at a relatively young age. For example the parent might ask the child to set up their own trust. It is important that there is thoughtful communication between parent and child around the intended outcome of such a gift.¹³

If there are a number of family members who are all beneficiaries under a discretionary trust, the education curriculum should also be designed to ensure that those family members are developing the skills to be effective joint decision makers.¹⁴

5. Institutionalising the role of Family Elders

A common family governance system is based on forming a "family assembly" that comprises of the whole family and a "family council" which is a smaller group that can make decisions on behalf of the family. The family assembly is comparable to the legislative arm of government; the family council is the executive arm of the family government, and there should be a role for "Family Elders" who act as the judicial arm of the family government.¹⁵

A Family Elder is often a trusted uncle or aunt, or even a non family member who is "practically family". The archetypal family elder is someone who has reached the generative stage of life, and who is regarded as being wise. A Family Elder is also

someone who both the "Older Gen" and the Next Gen can both approach with confidence.

Family Elders are therefore often a critical component of the family governance system for long term family success. Family Elders bring wisdom to the Family. They tell the family stories. They play a role in mediating conflicts within the family. They have the ability to see both sides and to work towards achieving a balance. They are intermediate. They do things that often fathers' cannot do. They can help to bridge the communication gap between generations.¹⁶

Under the new planning paradigm, more thought needs to be given to the role that the protector or protectors can play in the governance system of a family trust. The protector role should be defined in more detail. There should be a charter or a job description created for the protector role.

The protector role on a family trust can be used to institutionalise the role of Family Elder for a family. Therefore the trust protectors committee becomes the committee of Family Elders. Furthermore, in a family where there is a large communication gap between the settlor of the trust and his children as beneficiaries, the best kind of person to play the role of protector on their family trust will be a Family Elder.

If the beneficiaries of a trust are a group of siblings, giving the protector role to one or more Family Elders may also help to build into the trust a mechanism to smooth over differences, or resolve conflicts that arise amongst the siblings.

6. The Trust Mentoring Committee

As has been discussed, under this new paradigm, family flourishing requires families to have access to both quantitative advice as well as qualitative advice. The next logical question that follows from this is what would be the best way to institutionalise the use of qualitative advisors by a family?

If a family has a single family office, the SFO can retain an advisor with expertise in qualitative issues, e.g. an expert on family dynamics. If the family have a Private Trust Company, the board of the PTC can include a director with qualitative expertise or a "family committee" or "mentoring committee" can be created under the PTC. Access to qualitative advice can also be institutionalized through the family governance system by creating a family advisory board or a family "Brains Trust"¹⁷ of different kinds of family advisors.

However, not every family will have its own SFO or a PTC. But at least in Asia, many of the high net worth families will have a family trust structure. Therefore the question is, can the access to qualitative advice be built into the terms of the family trust? One approach might be to do so by constituting a "Mentoring Committee" under the terms of the trust. Under this proposal:

Firstly, the Mission of the Trust is stated to be to help enhance the life of the beneficiaries. But what does this mean? This concept of how to enhance the life of a beneficiary needs to be articulated, perhaps in the letter of wishes for the trust. This includes a variety of concepts including that the beneficiaries are able to develop as mature adults and that they can manage to incorporate the family wealth into their lives.

Secondly, it is stated that the members of the Mentoring Committee are responsible for ensuring that the Mission of the Trust is being advanced.

Thirdly, once a year, the members of the Mentoring Committee are to invite each beneficiary who is a young adult (e.g. 18 years and above) to meet with them. If the members of the Mentoring Committee are not qualified to conduct these meetings themselves, they should have the authority to bring in professionals who do have the necessary qualitative skills.

The purpose of the meeting is to ask the beneficiary how they are going in terms of the defined "Mission of the Trust" and to ask them what mentors they need; and to encourage the beneficiary to go and find their own mentors and teachers. The beneficiaries would also be encouraged to prepare their own personal development plan as part of this process. The proposal is to have a process in place to ensure the beneficiaries are encouraged to go and look for the mentors that they need. It advocates an "open mentoring system" rather than a "top down model".¹⁸ This means the members of the Mentoring Committee do not have to play the mentoring role themselves (thought this can be an option) but rather they are responsible for bringing the process to life.

In an Asian context it would be typical that distribution decisions are made by the corporate trustee who will be guided by a non-binding letter of wishes and who might be asked to consult with the protectors committee before deciding on a distribution. If there is a Mentoring Committee operating, then the normal model could be modified slightly to require the corporate trustee to consult with the Mentoring Committee before deciding on the distribution.

The intended goal of this approach is to ensure that the beneficiary's life is enhanced, not burdened, by the Mentoring Committee. However, care has to be taken to avoid creating a situation in which the beneficiary feels burdened by the trust, but in a different way than in the past. It would be wise to acknowledge that it will be the beneficiary's own actions that will have the greatest impact on his/her success and fulfillment in life, and that the trust is intended to support the beneficiary in being able to take the steps that will lead to the rewards the settlor, as Patron, believe he/ she deserves. It will be important to have the beneficiary feel he/she "owns" the experience.¹⁹

The objections

Expect that these new approaches will meet with resistance. It is not going to be surprising if a settlor is reluctant to hold family meetings or does not like the concept of educating the beneficiaries about the trust. The first objection the settlor will raise is that the terms of the trust are for him or her to decide on, and they are quite correct. The second objection the settlor will raise is that they want to preserve the flexibility to change their mind about the terms of the trust in the future, therefore its terms have to be kept hidden. The logical response to these kinds of objections are that there will be a big difference between the settlor forming a trust in a vacuum without having had the benefit of any feedback or reaction from his or her adult children as opposed to having the benefit of that feedback which the settlor can then take into account when he or she makes his or her decision. Having a conversation with your children does not mean that you are giving them any decision making authority.

The third objection the settlor may raise is that by talking about the terms of the trust, this will take away the beneficiaries incentive to work and to make it on their own. One response to this kind of objection is that it is possible to have family meetings and to provide training and education on the trustee beneficiary relationship and on the skills needed to be collaborative owners of family wealth, in a manner that is age appropriate. These things can all be done without having to show either the financial statements for the trust or the terms of the distribution plan. Another response is to point out that the fact that a family is wealthy is often very transparent to children and young adults. They already know there is money, but they can also tell that it is a taboo topic in their family.

Hughes warns that keeping secrets about family wealth creates a very destructive dynamic in the family. There is a difference between maintaining age appropriate confidentiality, and secrets.²⁰ Secrets tend to create great anxiety within the family.

Conclusions

One basic tenant of the new paradigm of planning for family flourishing is to first make sure that you "do no harm" with the structures that you are creating. Another basic tenant is that it is no longer acceptable planning to turn a blind eye to the qualitative issues concerning both the individual and the family system. This means that care must be taken when setting up structures that they will not be harmful to the individual and that there must be a chance that the structures can be integrated into the family system. In other words, that the family have the capacity to make the legal structures work.

Under this new paradigm, the technical issues, including tax legal regulatory and investment management issues all remain to

be dealt with. But it is no longer sufficient to solely focus on these technical and quantitative issues.

Trustees, protectors, investment managers and advisers who are used to dealing with the technical and quantitative issues must either find ways to at least be aware of the qualitative issues, or alternatively they need to develop ways to collaborate with other advisers who can contribute the necessary qualitative skills.

END NOTES

- 1 Roy Williams and Vic Preisser, *Preparing Heirs*.
- 2 Palgrave
- 3 Bloomberg Press. Also see the second book by Hughes Family: *The Compact Among Generations*, Bloomberg Press.
- 4 That there is a "dark side" to inherited wealth is explored in books such as *Navigating the dark side of wealth, a life guide for inheritors* by Thayer Cheatham Willis, and also *Beyond Gold; True Wealth for Inheritors*, by the same author; *The Golden Ghetto, the Psychology of Affluence*, by Jessie H., O'Neill.
- 5 An interview with James E. Hughes Jr published in the *Worth Magazine* Article "Growing a Great Family", 2 February 2004.
- 6 *The Cycle of the Gift, Family Wealth and Wisdom* by James E. Hughes Jr., Susan Massenzio and Keith Whitaker, Bloomberg Press.
- 7 Hughes states that "form should always follow function".
- 8 Would they be interested in forming a "voluntary social compact"?
- 9 Should the spouses of the beneficiaries attend? Many Asian families would be reluctant to include spouses.
- 10 *Family Wealth; Keeping it in the Family*, chapter 10 and chapter 11.
- 11 Hughes.
- 12 Available from Amazon.com. Also see the collection of positive stories on the trustee beneficiary relationship available from the website of *Navigating The Trustscape* at www.NavigatingTheTrustscape.com
- 13 For a process on how to make such a gift see *The Cycle of the Gift*.
- 14 See *Family, The Compact Among Generations*, by James E. Hughes Jr., Bloomberg Press, for more information on ownership education.
- 15 *Family Wealth; Keeping it in the Family*, chapter 18.
- 16 For more on the role of the Family Elder see *The Cycle of the Gift*, Chapter 8.
- 17 See the *Legacy Family*, chapter 13.
- 18 For more on "open mentoring" see the paper *Mentoring: A Different Perspective*, By Richard E. Caruso, Ph.D.
- 19 These comments were made by Patricia Angus, the founder and CEO of Angus Advisory Group LLC.
- 20 An interview with James E. Hughes Jr published in the *Worth Magazine* Article "Growing a Great Family", 2 February 2004.

The concluding part of Christian Stewart's series on family business and wealth preservation will appear in next month's *Offshore Investment* magazine.