Link to Article
Link to Partner Profile

China HNW's craving wealth protection

Lack of succession planning and asset protection strategies now surfacing as rich seek to ensure future is safe

THE NEW CROP OF AMBITIOUS BUSINESS PEOPLE and entrepreneurs entering China's millionaire club has created unprecedented demands for wealth management services. It has however highlighted the lack of preparedness among Chinese HNWs and their wealth managers in areas such as succession planning and asset protection.

The failure to grasp succession planning as part of a holistic wealth management strategy is evident from the numerous cases of rags-to-riches and vice-versa in China in recent years.

LEFAN GONG
Zhong Lun Law Firm

"We have many examples where after several years of enjoying their riches, the wealthy have nothing left due to lack of planning," according to Lefan Gong, a partner with Zhong Lun Law Firm, which is headquartered in Beijing. "There are also cases where succession planning went well for a few years and then the wealth vanished."

The HNW ranks in China - those with investible assets of USD 1.5 million and more - has increased from approximately 180,000 in 2006 to nearly 1.6 million in 2016, according to a Bain and Co. report. Among these, the numbers of the richest of the rich - those with USD 5 million and beyond - have grown at an even faster rate, the report adds.

However, most of these individuals are new to the HNW situation and are unaware of planning solutions to consider and pitfalls to avoid on the path to wealth creation.

Growing need Gong said that typically in China, individuals do not segregate their wealth, mixing company assets, personal assets and family assets together for convenience and tax avoidance reasons. This asset mixing proves detrimental when cash flows dry up and creditors beckon. If personal assets need to be forfeited to satisfy any creditor claims, families may be left with no assets whatsoever.

However, new HNWs are learning quickly and are seeking effective strategies to safeguard themselves against the vagaries of future events, hence the increase in demand for wealth management advice.

Across the board, a transformation is under way with China's affluent taking a different approach to how they view wealth. In 2009, 37 per cent of HNWs ranked "wealth creation" as their top priority from a list of seven objectives, according to an ongoing Bain and CMB survey. Today, 44 per cent cite "wealth preservation" or "wealth inheritance" as their top priorities, compared with just 13 per cent who pick "wealth creation", the report added.

OFFERING A RANGE OF SERVICES UNDER ONE ROOF HELPS THE WEALTH MANGER'S ABILITY TO LOOK AT THE CLIENT'S NEEDS IN A MORE HOLISTIC WAY

What they want The complexities in devising effective trust structures for Chinese clients that will stand the test of time are the same as that for affluent families elsewhere in the world, as most of the needs stem from the desire for asset protection and/or succession planning, branching out into more niche areas such as tax planning or the sale of family businesses.

With more and more Chinese families residing outside of China, structures that minimise their tax liabilities are a growing area of interest.

However, since non-residents cannot move their local assets abroad, they are restructuring their wealth by setting up onshore PRC trusts in addition to multiple overseas trusts for asset protection, succession planning or other needs such as marriage or student education. In serving these clients, wealth managers who can offer multiple services - tax planning, onshore trust, offshore trust, restructuring of businesses - have an advantage over those who focus solely on a single aspect of wealth management.

"Offering a range of services under one roof helps the wealth manger's ability to look at the client's needs in a more holistic way," Gong said. "The clients, however, may need to use multiple lawyers because their businesses may be in different jurisdictions."

Gong added that a client contemplating the sale of the family business creates requirements not just for succession and estate planning, but also for tax planning, in addition to helping the family negotiate the terms of the transaction.

Emerging area Yet wealth managers and other service providers in China still have a long way to go before they can be ready to meet the requirements of these emerging wealthy families.

Conventionally, Chinese have only known of commercial trusts. Family trusts are still a relatively new concept and, therefore, the level of expertise in the area is still developing, Gong said.

There is a dearth of experienced trust lawyers in China who can reliably guide HNWs with the mechanics of setting up family trust structures.

"Some domestic trust agreements are being adapted from commercial real estate trusts," Gong said. "There are flaws and loopholes that could create problems going forward, setting the families up for lawsuits once the settlor dies."

In this scenario, the success of wealth managers in China going forward would depend on how quickly they are able to shake off the old and reorient themselves to cater to the demand for new types of services being sought by HNW families, some of whom have already tasted the flavour of offshore trusts and are therefore increasingly sceptical of such local versions of pseudo "family trusts".

"Commercial trust and family trusts are two are entirely different animals," Gong said. ■