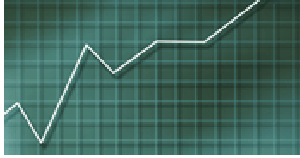

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Preventing Spoiled Children Through Incentive Trusts

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The recession has been a wake up call for wealthy individuals, many of whom have come to realize that with great wealth comes great responsibility.

More and more high-net-worth individuals, including Warren Buffett and Bill Gates, seem to be taking the Andrew Carnegie view of wealth: There is only so much money that one family needs and that passing on huge sums can be dangerous. In fact, PNC Wealth Management, a unit of The PNC Financial Services Group, released a survey this week that revealed that wealthy Americans have become significantly more concerned over the last two years that their children are becoming more spoiled.

The new survey found that 35% "believe that my children may be too spoiled by money and have too many material possessions," up from 22% in 2007. Fifty one percent believe the recession has changed the way their children will manage their finances and 47% are now discussing money management with their children.

"The recession did something that we hadn't really anticipated and that is it shocked affluent individuals into realizing that their affluence would not necessarily guarantee their financial security," Doug Freeman a senior managing director at First Foundation Advisors, said. "The recession has highlighted the need to encourage personal productivity and less reliance or dependence on inherited wealth."

Freeman said one way that high-net-worth individuals are reacting is by creating incentive trusts, which are trusts set up to reward or prevent certain behaviors or goals, a trend that he has seen grow over the last decade.

There are many varieties of these trusts, but the basic distinction is that some incentive trusts are goal-based and some are dollar-based. All are designed to encourage independence and self-sufficiency. Yet, "they are often designed counter-productively," Freeman explained. "By that I mean way too much emphasis is placed on how much money an individual earns as opposed to the quality of the work they do or what their talent or passion is."

If an incentive trust is set up by how much a person makes at their job, then a lawyer or doctor will earn more money and in turn receive more from the trust, whereas a schoolteacher who may need the money more will receive less. "An incentive trust should be designed to create opportunity and encourage and provide the resources to enable individuals to fulfill their own personal dreams, talents and passions," Freeman said.

The most important thing for those creating incentive trusts to remember is: What kind of message is being delivered to your children? What is the incentive intending to convey? Is the incentive to make a lot of money? To be self-sufficient? To follow your own dreams? “If you want to incent a behavior then you have to create a structure that is carefully designed otherwise you might incent the wrong behavior,” Freeman added.

Carol Kroch, Vice President and Managing Director Head of Wealth and Financial Planning at Wilmington Trust Corporation, said that throughout family estate planning she is seeing a values piece being added into the discussion, with wealthy individuals looking at questions of philanthropy, how much is too much for my children, and incentive trust planning.

While on the one hand families want to promote certain values in their children, they also want to promote family values directly by giving to charity. And they don’t want to spoil or hurt their children.

“When I think about the values conversation within families, the notion that money is a tool to driving values is what I hear a lot and a sense that money can cause harm if not appropriately handled,” Kroch said. “Keeping money in the family is one end of the values spectrum and giving to charity is another.”

There’s also the decision of at what age to give to the children; 21, 25, 30 or even 35. Kroch said she’s been seeing many of her very wealthy clients giving to their children as they get older. “The caution is between being too restrictive and not restrictive enough,” she said. As an advisor Kroch warns clients that the danger of drafting a trust too narrowly is that in 50 to 100 years family members may be struggling in a world very different then the one we are living in now. “The tension is between how restricted you want the statement of your values to be versus giving the trustee a flexibility in a future that may be hard for you to imagine.”