Family Office Breakfast Seminar - Outlook for 2018: Considerations for Family Offices Event Summary

Thursday, February 8, 2018
8.30am – 11.00am

Fortnum & Mason, London, UK

Welcome and introduction

Vahe Vartanian, Founder & CEO, *Global Family Office Community*.
Email: vahe@globalfamilyofficecommunity.com

Panelists:

Yolande Escher, Senior Director, BNY Mellon Family Office Group
Email: yolande.escher@bnymellon.com

Camilla Wallace, Partner, Head of Private Client Group, Wedlake Bell
Email: cwallace@wedlakebell.com

Emma du Haney, Senior Fixed Income Investment Specialist, Insight Investment
Email: Emma.DuHaney@InsightInvestment.com

Mike Sergeant, Founder, Sergeant Leadership Communications
Email: mike@sergeantleaders.com

Panel Discussion:

Yolande Escher

While investing directly, especially into start-ups and new technologies which I see many Single Family Offices doing, it can lead to becoming a distraction for Family Office Executives and taking valuable time away from their main tasks such as wealth protection, risk and reputation management of the ultimate family. If an SFO decides to allocate a significant portion of their liquid assets to the PE/Direct Investment space it is best done with dedicated staff who do proper Due Diligence and Monitoring of those investments, even if small investments.

Family Offices have allocated a significant portion of their assets to index trackers / passive management in 2017, but the volatility experienced over the last two weeks and the significant outflows out of very large ETFs seen shows that passive needs to be always combined with an active strategy and that active money management just can't be ignored and that is ultimately the responsibility of the Family Office and their appointed Investment Managers.

Blockchain technology holds significant promise to positively affect the industries where BNY Mellon competes and we are actively participating on multiple fronts to bring blockchain solutions to market. BNY Mellon is working to address foundational questions about the interfaces between blockchain solutions and existing market and regulatory structures; key considerations include the effective representation of fiat currency in blockchain applications, management of participant identity and the adoption of effective and scalable technology platforms and standards.

Emma du Haney

A notable feature of all markets in the past few years has been low volatility. This year is already looking to be more fractured. Developed market government bond yields have moved sharply higher and this week equities have seen a wobble, with volatility spiking on Monday with its biggest daily climb ever.

The global background is one of strong growth, both in DM and EM countries (UK exception). Inflation is still surprisingly low and risks may be to the upside Central banks are seeking to normalise policy, by removing QE stimulus or raising rates.

But there are a huge number of more uncertain factors. Some of those we can envisage are:

- Impact of US fiscal stimulus against a background of limited global capacity?
- Global politics and protectionism?
- Brexit negotiations?

However, away from near term market moves, many family offices are also investing for the longer term and are focused on identifying new themes in markets. How you do that is key: the internet was an invention that changed the world, but investing in the dot.com bubble was an expensive mistake for many.

So what are some current themes to consider?

One trend of the past few years has been the move to disintermediation of the banks, with institutional investors providing private finance directly to companies, in return for collateral. For example, instead of a bank providing funds to a specialist mortgage lender to build up a pool of mortgages, which they will then securitise as ABS/MBS, investment management firms or institutional investors can provide the funding. This is being done across areas such as bridging loans, credit cards, as well as direct finance to companies.

Investors have security over the underlying assets, and as the deal is privately negotiated, the lender (us) can make sure the covenants and security pledged are firmly in our favour. Moreover, that the returns for investing in private non-tradeable debt are 100 – 150bps higher than through secured publicly traded debt. Taking advantage of the illiquidity premium in order to boost returns without sacrificing credit quality may be attractive for investors who don't need immediate access to their funds.

While emerging markets have rallied a lot this is still an evolving market that will continue to offer a structural investment opportunity. It is worth noting that the EM Corporate market is now over $2 trillion in size, larger than US high yield. Many European investors have very low allocations.

Also more markets are opening up, such as China's massive domestic bond market and Argentina's local bond market. Only 20 of the 55 African countries have issued debt so far. And the market for local currency corporate debt and the Panda market (onshore remimbi denominated bonds issued by foreign companies) are still in the early stages.

A third theme that is focusing the minds of fixed income investors is ESG. There is growing momentum on climate change. The French have already introduced mandatory reporting for companies on the integration of ESG criteria and climate change related risks. Other countries are considering following suit. And the EU setting up a group to align its financial system with its sustainability objectives.

ESG investing has moved beyond exclusion criteria, to encompass building portfolios invested in companies with, for example, lower carbon emissions than their peers, or with an active focus on sustainable projects, of which green bonds are just one example.

There is already data suggesting that ESG investing leads to better performance returns over the medium term. So as family offices seek to align their investment objectives with their non-financial aims, be they environmental, reputational or social, they may be able to do this without sacrificing returns.

Camilla Wallace

Cyber security

This is an increasing concern for family offices and the wealthy; i.e. the fact that privacy is being eroded not only by the authorities and their different reporting regimes but also by the hackers in various parts the world. The latter argue that they are on a crusade to unveil organisations and ultra-high net worth families who are seeking to avoid the payment for tax or simply to money launder ill-gotten gains. It's worth noting that in the recent paradise papers I don't think there was a single case of illegality and in this instance yesterday's news has predictably become today's fish and chip paper. I understand Applebys has started legal action against the BBC on the grounds of breach of confidence and the BBC argue that they carry out responsible journalism on topics which are in the public interest. That is to say that Monaco resident Lewis Hamilton avoided tax on his earnings and a handful of UK TV personalities went into some tax schemes (no doubt on their accountants' advice) - is this really news I ask?

TOP 5 TIPS

- Use generic names for entities (companies, trusts, partnerships); consider name changes for existing ones if they use the family name
- Choose your counter parties wisely - were Applebys an easy target because of their size or are smaller organisations at risk because of lack of resources to invest in first rate cyber security

- Always take legal and tax advice when considering where to be "resident" to avoid the age old adage of "out of the frying pan into the fire" - consider jurisdictions carefully
- Use social media responsibly - Kim Kardashian's mugging in Paris was apparently triggered by her comments on social media prior to the attack
- Don't underestimate Jeremy Corbyn: possible exchange controls & very high rates of tax, reminiscent of Harold Wilson

Global Transparency & Other Trends

- Global trend for greater tax transparency
- Political pressure to make world elite to pay "fair share" of tax
- Anti-Money Laundering Legislation and Anti-Terror laws
- US FATCA paved way for multi-lateral information exchange

The main disclosure regimes already in place (or coming into force):

- **FATCA** – U.S. legislation (Foreign Account Tax Compliance Act)
- **CRS** – the OECD's "Common Reporting Standard"
- **PSC** - Register of Persons with "Significant Control" of UK/EU companies
- **Proposals for UK register of foreign companies owning UK property**
- **LEIs –** "Legal Entity Identifier code"
- **UK Trust & Beneficial Ownership Registers**
- **Data Protection changes**

FATCA (Foreign Account Tax Compliance Act)

- What is FATCA?
  - Bi-lateral U.S. Legislation – Requires "Foreign (non-US) financial institutions to report accounts of "US persons"
- Why? **-** Tax Revenue or Control?
- Who is in scope?
  - "Foreign Financial Institutions" e.g. banks, investment houses, fiduciary service providers
  - "Non-Financial Entities ("NFEs") e.g. trusts, foundations, family offices (if not FIs)
- What & Where?
  - All account details of US persons inc. name, address, TIN, Account No. and balance
  - Central registration with IRS (where necessary)
  - Reviewed annually, NFEs (e.g. trusts) to report to IRS when sums paid to US persons
- What if I don't comply? - risk of US withholding tax and penalties

GLOBAL FAMILY OFFICE community

CRS ("Common Reporting Standard")

- What is CRS?
    - Worldwide initiative requiring "financial institutions" to identify and report information on account holders and their controlling persons resident in CRS jurisdictions.
    - Much wider than FATCA
    - 50 jurisdictions already signed and 100+ jurisdictions by Dec 2018
    - Information exchange begins September 2017
- Why? - Tax transparency and global standard of automatic information exchange
- Who is in scope?
    - "Financial Institutions" – similar to FATCA but includes "Investment Entities" e.g. trusts, foundations, family offices *(if **managed** by an "FI")*
    - "Non-financial Entities" – still required to complete self-certification and disclosure of controlling persons
- What & Where?
    - Accounts and direct investments in CRS countries
    - account balances, names, addresses, dates of birth and tax residence of all account holders and their controlling persons (e.g. a family trust and its settlors/beneficiaries/protectors) resident in a CRS country
    - Self-certification on accounts/investments held by NFEs
    - FIs disclose to local tax author ity/government of FI's country of residence and individual family member's country of residence
- What if I don't comply?
    - Sanctions are developing under local laws (inc. penalties and criminal liability)
    - Opening or maintaining accounts and other financial relationships may be restricted

Legal Entity Identifier ("LEI") Numbers

- What is an LEI?
    - a unique 20-character alphanumeric reference code to identify trading entity
    - EU Legislation – to have effect in UK from January 2018
- Why? - to facilitate monitoring of financial stability for the purposes of reporting transactions
- Who is in Scope?
    - Any "legal entity" who wishes to trade on financial markets in the UK
    - Includes companies, trusts, non-natural persons, not individuals.
- What & Whose information?
    - Application to LSE must made and fee payable
    - Details of entity's name, address/contact details e.g. business address or adviser's
- What if I don't comply? – registration <u>not compulsory</u>, but investment services provided to these entities will be severely restricted

Persons with Significant Control ("PSC")

- What is PSC? **–**Requires all UK (and 2017 all EU) companies and LLPs to create and maintain a <u>public</u> register of all persons with "significant control
- Why? - Part of EU Money Laundering Regs. to identify "true owners" of legal entities; although it seeks "beneficial ownership", reporting skewed, PSC can be owner of independent trust company
- Who is in Scope? **–** All UK (or relevant EU) registered companies and LLPs only, but a PSC of a registered entity may be a trust or an offshore entity or individual
- What & Where?
  - Name, date of birth, nationality, address of any PSC namely:
    - Any individual holding>25% shares or voting rights
    - Any individual who "controls" the Board
    - Any other person who "controls" the company (e.g. trustees)
    - Public Register will be maintained at Companies House (or EU equivalent)
- What if I don't comply? – fines, criminal penalties for directors and shares can be restricted

Beneficial Ownership Register of Overseas Companies Owning UK Property

- What are the Proposals? – similar to PSC but to apply to non-EU entities owning UK Property (e.g. BVI companies) proposals set out in April 2017 – awaiting draft legislation, summer 2018 and scheduled "live date" 2021
- Why? - widen scope of PSC to foreign company ownership
- Who is in scope?
  - All <u>overseas</u> legal entities owning UK property or purchasing UK property
  - Property = residential <u>and</u> commercial freehold (and long leasehold) property
- What?
  - Broadly aligned with the PSC register regime in relation to "beneficial owner"
  - Public register maintained by Companies House – details to be confirmed

Trust and Beneficial Ownership Registers

- What is Trust Register? – register and reporting of details (inc, values) of trusts and their "beneficial owners" to HMRC and other relevant organisations. June 2017 (UK and other EU member states). 31 January 2018 deadline has been pushed back to 5 March 2018 (or 5 October following the relevant tax year)
- Why? - to encourage greater transparency and establish a central database of trusts and their beneficial owners
- Who is in scope?
  - UK Trusts or
  - Non-UK trusts but <u>**only**</u> if they receive UK source income or have <u>direct</u> UK assets and are liable to pay one or more UK taxes
- What?
  - Name of trust, creation date and accounts with values of each asset category
  - Addresses, passport/ID card, dates of birth, trust relationship of all "**Beneficial Owners**" (inc. settlors, trustees, protectors and beneficiaries)

NB. Potential beneficiaries - letters of wishes

- Where does it go?
  - Banks and other relevant persons (if requested)
  - "law enforcement authorities" e.g. Government bodies/police (if requested)
  - Compulsory report to HMRC – held on its central "beneficial ownership" register of taxable trusts (only if a UK tax charge has arisen)
  - Not publically available
- What if I don't comply? - risk of civil law and criminal law penalties

Data Protection

- What and When? The General Data Protection Regulation (GDPR) will replace the Data Protection Act 1998 (DPA) with effect from 25th May 2018, despite Brexit.
- How? In the UK, the GDPR will be supplemented by the Data Protection Act 2017, the provisions of which are currently being finalised.
- Why? The GDPR is an evolution rather than a revolution and incorporates very similar principles to the DPA, and uses very similar concepts.
- What if I don't comply? The GDPR also introduces a number of new requirements, is significantly more prescriptive, and carries heavy penalties of up to €20,000,000 or 4% worldwide annual turnover.
- SFO/MFO – If an SFO classifies as a data controller or inputer it is likely that they will be exempt from the regime as it will be processing data for "domestic" purposes; unlikely for an MFO.
- Organisations, including family offices, must be compliant from day one, i.e. May 2018 – there will be no further grace period.

What do I need to do? To comply with the GDPR, organisations must take the following steps:

- Ensure they are able to identify all of the personal data they hold;
- Ensure their use of personal data is in accordance with the principles of the GDPR;
- Implement policies, procedures and training to demonstrate that they are compliant with the GDPR; and
- Possibly appoint a Data Protection Officer (internally or externally).

Privacy Planning

- Different jurisdictions have different classification requirements (e.g. under CRS) – may give some (limited) opportunities to reduce disclosure **–** but for how long?
- Consider keeping letters of wishes more generic and not naming individuals as far as possible
- Choose names of entities carefully – avoid using family names, sequential numbers etc. "The Vladimir Putin Family Discretionary Trust No.8" invites enquiry
- Being misinformed is not a defence – penalty regime likely to still apply
- Failure to comply will limit scope for investment and access to many jurisdictions

Thank you to our Event Partner, BNY Mellon:

- BNY Mellon is the world's largest custodian. It is like a safety deposit box for a family's investment assets. The role of the custodian is to be the CCTV camera over the assets and monitor any activities on the accounts. Examples are daily checks to make sure there are no failed trades, no overdrafts and no pending actions in relation to the investments (corporate action).

- The role of any suppliers/third parties is to understand the evolution of the family (office) and provide risk mitigation tools at each stage. A global custodian for example can help in the area of risk analytics across the family's total wealth.

- By appointing a master custodian you create operational efficiencies in a safe environment. The less banking relationships the family maintains the better the Family Office Executive can keep control and oversight over cash movements, asset performance and others. Every extra account bears risks and costs.

- A Family Office that keeps in place a well-documented and tight decision making process (over investments, but also other decisions) together with the family members are usually better able to protect the family wealth from external, negative forces.

- The custodian acts as COO to the Family Office. All the administrative burden is taken over by the custody team. This helps tremendously as the family's wealth grows and expands into multiple asset classes.