



Institutional framework for family offices

By James Williams

As family offices look for the best jurisdictions in which to establish trusts and wealth preservation vehicles, being able to benchmark the institutional quality of a specific jurisdiction and rely on high-quality outsourcing options, are increasingly important considerations. The following report provides an overview of how and why Bermuda is living up to these expectations.

It may only measure 21 square miles but Bermuda, with its close proximity to New York (less than a two-hour flight away), its well-established legal system, stable government and a lifestyle experience that is the envy of most other global jurisdictions, packs an awful lot of punch.

Boasting a sophisticated infrastructure, a

highly regarded and pragmatic regulator in the form of the Bermuda Monetary Authority, and an attractive, tax neutral regime, Bermuda is the ideal location for family offices that wish to attain an institutional standard.

“Since the 1950s, Bermuda has had a well-developed financial services industry to support wealthy individuals and families,” says Sean Moran, Business Development Manager at the Bermuda Development Agency, which aims to promote inward investment into Bermuda and enhance the island’s global reputation.

“The evolution of those services has developed into a more institutionalised offering for family offices. As family offices have grown and younger generations have

moved into positions of influence, expanding the geographic reach of the family, the depth and breadth of services that they require have expanded.”

Bermuda has long had a solid base of trust services and private wealth management services, and over the years it has worked hard been to build on that base to support the needs of today’s HNW individuals and family offices. Bermuda offers an excellent array of services and service providers ranging from trust companies, investment advisory firms and fund administrators to auditors, accountants and tax specialists: all the things that a family office needs to become an institutionalised entity.

“That is the value proposition we feel that Bermuda offers today,” adds Moran.

At a time when incidents such as the high-profile Panama Papers data leak make global headlines, being able to rely on a discreet, secure jurisdiction to protect one’s family interests cannot be underestimated. For many decades, Bermuda’s regulatory authorities have enforced robust anti-money laundering standards and maintained a private (not public) beneficial ownership register in relation to company formations. That is highly advantageous when family offices are hearing about data breaches in other jurisdictions where sensitive information is being disclosed.

“The rest of the world is, in effect, catching up to what Bermuda has been doing from a regulatory oversight perspective,” comments Ashley Fife, Senior Associate, Appleby (Bermuda) Limited, which provides legal and trust structuring services.

This is consistent with Bermuda long having had a good quality infrastructure in place, and over time, says Moran, this has led patriarchs and matriarchs of wealthy families to come to appreciate the value of Bermuda as a safe harbour.

“They understand the level of experience and professionalism of doing business here,” says Moran.

Benchmarking the quality of a jurisdiction

The above points allude to the quality of Bermuda as a sophisticated financial services centre with a stable regulatory and political infrastructure, but there are other considerations for family offices to take into consideration.



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From a tax perspective, Bermuda has been at the forefront of a global initiative to encourage worldwide international tax transparency. We were one of the early adopters of US FATCA and the Common Reporting Standards, and we are one of the only offshore jurisdictions to adopt Country by Country Reporting under BEPS,” confirms Bill Bailey, Partner, Financial Services Tax, EY Bermuda Ltd.

“From a family office or trust perspective, I would feel very safe knowing that Bermuda is doing everything necessary to stay off black lists.”

This is helping place Bermuda at the vanguard of regulatory transparency.

Moran adds that a large number of family offices today look for a tax beneficial jurisdiction. With its tax neutral regime, Bermuda has no income, corporate or capital gains taxes. “Those are important considerations for investment-minded individuals in family offices,” says Moran, adding that what also makes Bermuda so appealing is the safety, security and stability of the jurisdiction: “A lot of family offices are coming from areas of social and civil unrest, such as Latin America, where there are real threats of violence, kidnapping and political corruption. They want a safe jurisdiction where they can preserve their wealth and maybe even gain residence.”

The legal framework that a jurisdiction operates is also important and in that regard, Bermuda has no rivals. Its legal system, which uses English Common Law, is more than 400 years old.

“Bermuda has a commercial court that is dedicated to handling business to business cases,” explains Kevin Gunther, President, St George’s Group Limited, which provides trust and accounting services to family offices. “There is a separate court from the judiciary and that gives a certainty of confidence that

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Introducing the Bermuda LLC

By Sally Penrose

The Limited Liability Company Act 2016 (LLC Act) came into force on 1 October 2016 and introduced into Bermuda its first new corporate structure in 100 years. Appleby is pleased to have been able to work closely with the legislature to ensure that Bermuda's existing funds law is simultaneously amended so that LLCs are available immediately for use in investment fund structures. Appleby are ideally placed to advise with respect to LLCs.

What is an LLC?

A limited liability company or "LLC" is a hybrid legal structure allowing the contractual and operational flexibility of a partnership to be housed within a corporate entity. Like a Bermuda exempted company, an LLC has separate legal personality and the liability of its members is limited. Whilst members of a Bermuda company receive shares, members of a Bermuda LLC will each have an interest in a capital account in a similar way to partners in a partnership.

Under the Bermuda LLC Act parties can create bespoke vehicles having the contractual freedom to set out in the LLC agreement the terms of operation and management of the LLC as well as expressly agreeing the allocation of profits and timing of distributions amongst its members. A Bermuda LLC may be managed by one or more members (a "managing member") or a manager may be appointed who may or may not be entitled to share in the profits of the LLC.

Key features of an LLC

- An LLC is a separate legal entity, the existence of which as a separate legal entity will continue until the LLC is dissolved.
- An LLC is governed by an operating agreement (LLC Agreement), which



Sally Penrose, Senior Associate Corporate, Appleby (Bermuda)

must be governed by Bermuda law but otherwise allows for maximum contractual flexibility amongst the members, particularly with respect to the allocation of profits, losses and distributions amongst its members. LLC interests can be denominated in any currency with the LLC chooses. The LLC Agreement can also provide for the voting and consent rights of different classes or groups of members.

- Subject to the LLC Agreement, an LLC has the capacity, rights, powers and privileges of a natural person.
- Any one or more persons may form an LLC for any lawful business, purpose or activity.

The process of forming an LLC is simple and requires the filing of a certificate of formation with the Registrar of Companies and payment of the appropriate fee. The Registrar will maintain a register of LLCs in Bermuda.

Structural flexibility of LLCs

A Bermuda LLC is an attractive structuring option for operators of investment funds and in particular closed ended private equity funds as the flexible corporate governance structure allows "managing members" to manage the fund (in a similar way to a general partner) but without unlimited liability for such members in respect of the fund's losses. LLCs are flexible when it comes to structuring the economics of the fund as well as capital call and default mechanisms.

The Bermuda LLC Act is modelled on the Delaware legislation and includes similar concepts to those found in the Delaware Act. Such similarities will allow for structural and administrative efficiencies when creating and managing onshore and offshore investment fund vehicles, allowing for principal legal documents of the onshore and offshore feeders to be harmonised. ■

- 4 ► your business dealings in Bermuda will be properly handled.”

One other consideration for family offices when choosing the best jurisdiction is the quality of the talent pool. That Bermuda has been supporting trusts and family offices for decades has helped it to attract top talent from around the world.

“For example, the CFA Society in Bermuda has a few hundred members and probably has a higher number of CFAs, per capita, than anywhere else in the world,” says Nathan Kowalski, Chief Financial Officer, Anchor Investment Management Ltd. “We have a highly educated workforce and Bermuda boasts a level of service that is second to none across the board, from asset management to fund administration, legal counsel, accounting and actuaries.”

Recently, the Bermuda Government also passed new work permit rules, offering more opportunities for local firms to bring in new talent from overseas.

Overall, from an outsourcing perspective, Bermuda is able to provide an effective end-to-end solution for family offices, from investment management, wealth preservation, administrative support (both legal support and estate planning) as well as philanthropic support.

Tax & structuring options for family offices

Bermuda offers a wide range of structuring options for family offices. These include unit trusts, limited partnerships, private trust companies ('PTCs'), captives for self-insurance purposes, as well as segregated account companies ('SACs').

Also, following its introduction last October, the Bermuda Limited Liability Company ('LLC') is a structure family offices can now avail themselves of. This can best be thought of as a hybrid between a traditional company and a partnership.

With a limited partnership there are restrictions in terms of how far LPs can get involved in the management of the partnership whilst still preserving limited liability, says Fife. With an LLC, however, members can participate in the management of the LLC and still avail of the benefit of limited liability.

There are also tax benefits. As Bailey



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explains: “From a US standpoint, capital gains, qualified dividends and things of that nature would be able to flow through directly to the investor.”

Commenting more broadly on tax considerations, Bailey observes that at EY Bermuda it will look at factors such as where the family is based, what types of businesses they have, which will determine how the family office should best be structured from a tax perspective.

“What we are seeing globally, generally speaking, is a lot of family offices employing a compliance specialist. I think the days of setting up family offices and not understanding what all the global tax issues are, are over. It is important to have the right controls in place for tax and compliance purposes and this can be a lot more economical if everything is handled by one individual,” says Bailey.

Private trust companies

A private trust company ('PTC'), is exempt from needing a license to carry out trust business in Bermuda and has the ability to act as the trustee of one or more family trusts.

Other than the basic requirement under Bermuda law to have the Memorandum of Association to identify the trust company, there are no other prescriptive requirements for setting up a PTC, as is the case in other jurisdictions.

“For example, in other jurisdictions there is a requirement that a service provider performs certain functions for the trust company i.e. provides directors or fund administration services. This is not required in Bermuda. The family has the flexibility of involving licensed service providers only where they feel it is appropriate to do so.

“As a consequence of not having the same business risk considerations as

9 ► licensed trustees, PTCs are generally prepared to take on riskier, illiquid investments and make quicker investment decisions than licensed trustees. A PTC can also use a mix of directors – there is no requirement that the directors be resident in Bermuda – and that can also benefit the investment making process,” explains Fife.

The decision as to how the shares of the Bermuda PTC are held is usually dictated by the family office’s estate planning needs and desire for confidentiality.

Segregated account company

A segregated account company (‘SAC’), can be used for a variety of insurance purposes, such as renting a captive (as opposed to operating a pure captive), life and annuity companies, transformer vehicles, as well as securitisation and derivatives structures.

Similar in concept to the Segregated Portfolio Company one finds in Cayman and the BVI, the SAC is a multi-cell structure where the assets and liabilities of each account (or cell) are legally ring fenced from all other cells in the structure.

The advantage to this, says Gunther, is that a family office can launch multiple investment strategies, all within one structure, as opposed to launching numerous standalone funds.

Another advantage of SACs is potentially for different generations of the family office to have different cells within the structure, such that the first generation might be in Cell 1, the second generation in Cell 2 and so on.

Kowalski says that because a family office might have different liquidity needs, an SAC could be a useful way to tailor its investment preferences.

“What makes the Bermuda SAC unique is that each cell has the opportunity to invest in other cells within the SAC. A Cayman SPC does not offer that flexibility,” explains Moran. “One could segregate different portfolios, different generations of the family, as well as within each of those generations segregate different asset classes and investment strategies.”

Both the PTC and SAC are part of the same structuring consideration for a family office. In that sense, one should view them as complementary, not mutually exclusive, structures.



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Bill Bailey, EY Bermuda

Tax benefits of using an SAC

One unique feature of the SAC structure is that each account can have its own ‘redemption account’ to collect the proceeds of share redemptions from an investment without having to repatriate the proceeds back to a home jurisdiction, which could lead to the family office member incurring a taxable event.

“Today, family offices have multiple generations located in different geographic areas. Having a flexible structure where you could put all US investors in one cell for tax purposes, all UK investors in another cell, and so on, could help bifurcate different tax risks and reporting,” explains Bailey.

The fact that family members who choose to use an SAC can freely decide when to exit an investment strategy and redeem the shares means that they are able to enjoy a greater degree of flexibility than were they to use a trust structure.

The Bermuda captive

The use of captives in Bermuda is principally for self-insurance purposes. The United States is the biggest, single source of captive business for Bermuda, accounting for over 60% of the Island’s insurance formations, according to Bermuda Insurance.

Even though the Cayman Islands is catching up in terms of the number of captives, Bermuda still dominates from an AUM perspective: USD161 billion compared to USD61 billion in captive AUM relative to Cayman. Often a family office or a company will incorporate a captive where they might have difficulty getting commercial insurance, or the costs of insuring against particular risks are prohibitively expensive.

As mentioned earlier in this report, Latin American family offices might want to use a ► 19

13 ► captive to insure their family's wealth against kidnapping and related risks. "Not only can these family offices use PTCs to establish their assets in a safe, secure jurisdiction, they can also use captives to insure those assets against a wide range of risks," says Fife.

Family offices can choose to establish their own captive or rent a captive and when it comes to deciding between the two, Fife suggests: "Clients might consider it's cost effective to form a pure captive if they were confident it would write annual premiums in excess of USD1 million, whereas a using a separate account in an SAC that is used as a sponsored captive, might be justified if the account could write annual premiums of USD350,000 or more. Many clients start by insuring with a rent-a-captive before later forming a pure captive when it becomes cost effective to do so."

A family business may arrange for the trustee of a family trust to own the captive. If structured effectively, says Fife, this may:

- insulate the captive's assets from creditors of the insured parent company or family members;
- facilitate estate planning and minimisation of estate and other taxes;
- mitigate the impact of civil law, forced heirship and community property regimes; and
- facilitate families' philanthropic objectives.

At St George's Group Limited, Gunther confirms that the way in which captives are utilised depends on the needs and the expertise of each individual family office.

"If the family is part of a manufacturing conglomerate, for example, with a significant number of shareholders, they will have a different kind of requirement to a family office with a lot of liquidity and a wide portfolio of investments. An example of a family that might have a need for a captive is one with an art collection valued at USD300 million or higher, who decides it makes sense to access premiums in the market through a reinsurer as opposed to buying insurance from a primary retail insurer.

"All the people and services needed to run an efficient, transparent and responsible family office are based here in Bermuda and situated within 10 blocks of one another. There is so much expertise here that family



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Kevin Gunther, St Georges Group

offices can find the right solutions to their specific needs, which, in this case, might be deciding on whether or not to set up their own captive," explains Gunther.

Bermuda: A one-stop shop for outsourcing

Bermuda has a full complement of legal expertise, investment talent, trust services, administrators, tax advisors: basically everything needed to run an institutional quality family office.

This is not to suggest that families will necessarily outsource every aspect. After all, they will typically have long-standing existing relationships with asset managers in a variety of locations and as Gunther emphasises, "we would not look to interfere in that.

"However, we will monitor the performance of those relationships and be quite frank if expectations are being met or not. We work with managers from all over the world. Our clients' investment mandates range from European property markets to Asian commercial and tourist developments to resource exploration. Bermuda's administrators can support a full range of global investment styles and strategies."

It is important to note, however, that Bermuda has a growing community of local investment advisors. According to the BMA, there are currently some 60 licensed investment managers on the island, in addition to 25 companies who manage highly specialised insurance-linked securities (ILS) funds. This offers a good mixture of qualified, regulated investment talent for family offices to develop investment goals with.

"We have a full suite of fund managers and investment strategies ranging from traditional long-only funds to private equity and ILS funds," explains Kowalski. "There is also a full suite of private banking services, ► 24

19 ► a large number of trust companies, and of course insurance companies.”

He further adds that with respect to reporting obligations, and keeping track of investment gains and taxes obligations, it is important for family offices to select a back-office that has the right people in place: “One that has a combination of accountants and lawyers and trust officers who understand the various functions of a family office,” says Kowalski.



“There is a strong level of collaboration between the Bermuda Government, the BMA and the island’s service providers.”

Nathan Kowalski, Anchor Investment Management Ltd

A regulatory compliance hub

To show just how seriously Bermuda takes compliance, the island is currently positioning itself to be a hub for regulatory compliance expertise.

“We have a partnership with the Regulatory Compliance Association. They hold an annual Symposium here, and we are the only jurisdiction, outside of the US, that is making the RCA’s curriculum available to industry participants,” confirms BDA’s Moran.

Bermuda’s commitment to compliance with international best practices will continue to set it apart from many other international financial centres. Back in August, at an event hosted by Oyster Consulting (Bermuda) Ltd, Henry Komansky, a consultant at Oyster, was quoted as saying: “Over the past year, Bermuda has been updating its legislation to address gaps in the AML/ATF framework and bring Bermuda in line with 2012 FATF 40 recommendations, interpretive notes and updates. It appears that legislative change will continue as the Island prepares for its 2018 AML/ATF country evaluation.”

Outsourcing the audit function

As family offices broaden their investment horizons they are becoming more complex in terms of trading activity. Consequently, another important outsourcing consideration is for the production of high-quality audit reports.

“Bermuda has multiple players in the audit space that can provide that function very effectively. In addition to increased trade complexity, family offices appreciate having a second set of eyes to make sure the asset value on paper is what it claims to be when making investments in private equity and other illiquid assets,” says Bailey.

Another reason that is driving demand for greater transparency and accountability

is that these are often multi-generational families. A member of a family’s younger generation who, in their mid twenties, might feel they ought to have access to a million+ USD but the grandparent(s) who amassed considerably more, may not have wanted that to happen.

“They might then hire lawyers to try and break up this dynastic wealth structure,” observes Gunther. “Preparation of audited financial statements may provide a degree of protection that gives the professional trustee or private trust company greater assurance. It’s important that a family’s wealth is managed prudently. We find ourselves going through an education process with our clients because some of them, particularly the younger generation, grew up never having to worry about money.”

Conclusion

A global reputation; expert talent; robust legal system, and enviable location and lifestyle opportunities: these are all key strengths that Bermuda is able to leverage to support the growing institutional ambitions of global family offices.

“It is also important to stress that there is a strong level of collaboration between the Bermuda Government, the BMA and the island’s service providers,” says Kowalski. “It is highly unlikely that any legislation will be introduced without having had widespread input from the professional community beforehand.”

For those that have worked hard, accumulated wealth and want to protect it for the future, Bermuda ticks all the boxes.

And with the America’s Cup sure to draw large crowds of affluent, international sailing enthusiasts to the island this summer, there is a collective hope that the next wave of multi-generational family offices will choose to call Bermuda their home. ■



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