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FAMILY OFFICES AND THE BERMUDA PROPOSITION

by Ashley Fife

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John Grisham's character, Troy Phelan, in "The Testament" has a dramatic approach to estate planning.

Mr Phelan, an elderly businessman with an estate worth billions had three failed marriages together producing eight children. Most of the children resent each other and are not involved in the family business.

Mr Phelan commits suicide and leaves a will revealing to his family that he has left his entire estate to his illegitimate child, a missionary, in Brazil. The result is hostile litigation and a business left in tatters.

There are numerous real-life examples reminiscent of the Phelan family. The growth of substantial Chinese family-owned companies, when followed by the death of the wealth creator and CEO, has exposed a cultural apprehension of many Chinese business owners to communicate with family members about the family business and wealth.

Professor Joseph Fan's study (at the Chinese University of Hong Kong) revealed an average decline of share value by 60 per cent of significant Chinese-owned family businesses in the eight years following the death of the wealth creator. Professor Fan's study included, among others, Sun Hung Kai Properties and Hung Fok's gambling and property conglomerate. Professor Fan considers family governance key to ensure a successful continuation of the family business following the wealth creator's death.

A family's involvement in a family office may facilitate discussion among family members to agree values for application towards the management of the family's wealth. This increases the possibility that an environment of trust and respect will be in place between family members well before the wealth creator's death. However, a family office's role is often not limited to succession issues.

There are varying opinions regarding what a "family office" is, but it can be broadly described as an organisation that provides services to one or more families to coordinate and implement one or more longer term objectives of the family in respect of investment and insurance; family businesses; tax and succession planning; accounting and reporting; education, philanthropy and lifestyle.

The role of each family office is determined by the particular needs, objectives and resources of the family. A family that has sold its business interests may have different objectives to a family that wishes to continue to grow the business after the death of the wealth creator. The size, age, beliefs, personalities and other unique family circumstances influence a family's objectives.

The employment of experts in-house to provide advice and to coordinate, manage and provide administration services in respect of a family's affairs comes at a significant cost. The costs of technology to organise and protect information and facilitate reporting also cannot be underestimated.

A family office may need to consider which services it retains in-house and which it outsources and whether to leverage resources by participating in a multi-family office. A family may also consider maintaining a small administrative office (or allocating staff of its existing business) to coordinate specific experts from various external professionals. The aim of this arrangement (often described as a "virtual family office") is for those professionals to regularly discuss the family's affairs to facilitate a holistic approach to the management of the family wealth.

The growth of family offices has also been motivated by families' desire to centralise information regarding family investments; eliminate hidden, duplicative and otherwise unacceptable fees charged by (often conflicted) investment advisers; and focus upon implementing the family's specific long term investment objectives.

In the United States, the removal of the "private investment adviser exemption" in the Investment Advisers Act 1940 has prompted a number of investment advisers to restructure their operations so that they are owned and controlled by "family clients"; only act for family clients; and do not market their services to the public. A family office in the United States that satisfies the "family office exclusion" avoids regulatory burdens including reporting to, and undergoing periodic examinations from, the Securities Exchange Commission.

The Alternative Investment Fund Managers Directive also provides an exemption to single family investment vehicles from registering as alternative investment fund managers when managing or promoting alternative investment funds in the European Union for persons with whom the family has "close familial relationships".

The choice of location for a family office is influenced by the family's objectives and the location of family members, business operations and key business and investment contacts. Family offices seeking direct and co-investment opportunities may wish to situate their core family offices in locations where trusted investment personnel and family members can network with other wealthy families and advisers. The availability of a range of banks, custodians and expert service providers is also a determinant. For these reasons New York, Miami, Singapore, London and Switzerland are popular locations for family offices.

The location of the family office, motivated by convenience, may differ from the location of ownership structures that may be motivated more by tax and regulatory considerations. Many offshore financial centres offer tax neutrality, an efficient regulatory environment and have experience administering and managing private wealth. Technological developments may enable single and multi-family offices to operate effectively, or engage service providers, in offshore jurisdictions.

Bermuda is an attractive jurisdiction to establish single or multi-family offices and holding and investment structures. Bermuda has: a strong insurance and investment sector with a physical presence on the island (Bermuda has more captive insurance companies than anywhere else); an efficient regime for private funds;

considerable experience establishing segregated account companies; a flexible private trust company regime; and continues to develop flexible and innovative trust legislation.

Bermuda recently created a streamlined jurisdiction for the court to consider applications to extend perpetuity periods for trusts established prior to August 1 2009 (being the date when settlors could establish new Bermuda trusts without any prescribed maximum perpetuity period, except for trusts over Bermuda land). Bermuda's residency requirements now permit persons over the age of 18 years to obtain a residency certificate enabling them to reside (but not work) in Bermuda indefinitely provided the criteria is satisfied.

Other recent reforms: facilitate office formation and the granting of work permits to specialist employees; create further safe harbours for limited partners who advise general partners; and permit companies to convert to limited partnerships with legal personality and vice versa.

Bermuda's Model 2 FATCA intergovernmental agreements, pending privacy legislation and its resistance to public registers detailing beneficial ownership also reflect Bermuda's recognition of the importance of privacy, a key factor for family office clients.

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