ABA Section of International Law

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NEWSLETTER

INTERNATIONAL PRIVATE CLIENT COMMITTEE (IPCC)

JULY 2017

NOTE FROM THE CO-CHAIRS

Caroline Abela and Agnès Proton

Hello to our international colleagues and friends from the ABA-SIL, International Private Client Committee (IPCC). In this summer's newsletter, we bring you articles from the Spring Washington conference on the topic of Wealth Planning for PEPs and "High Risk" Clients: Risks and Challenges, which was a successful and well attended presentation of the IPCC.

The panel was co-sponsored by the following committees: ABA-SIL International Family Law, International Ethics, Latin America & Caribbean, and the International Anti-Corruption Committee.

Our panel chairs were Michael Parets (also moderator) of Withers LLP, Zurich Switzerland and Markus Zwicky of Zwicky Windlin & Partner, Zug, Switzerland.

The speakers were: Benjamin Borsodi, Schellenberg Wittmer, Geneva, Switzerland, Barbara R. Hauser, Barbara R. Hauser LLC, Minneapolis, MN, Michael Patrick, Farrer & Co., London, UK

The panel discussion focused on providing the tools to lawyers to identify high risk clients, ethical issues relating to politically exposed persons and providing effective advice while maintaining your professional ethics and integrity.

Thank you to all for all those who attended.

We encourage everyone to attend our monthly conference calls that are held the last Friday of every month at 9:00 a.m. ET.

Don't forget about our upcoming fall conference in beautiful Miami. The IPCC will be presenting on the topic of "Giving Across Borders: The Law and Practice of International Philanthropy".

We look forward to seeing you in Miami. Enjoy!

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ABA - SIL WEALTH PLANNING FOR PEPS AND “HIGH RISK” CLIENTS: RISKS AND CHALLENGES?

Duties connected to relationships with Politically Exposed Persons (“PEPs”)

Benjamin Borsodi, Partner / Attorney at Law, LL.M.

1. Executive summary

Lawyers acting as financial intermediaries have to comply with regulatory rules stated both in the Swiss Anti-Money Laundering Act of October 10, 1997 (“**AMLA**”) and the FINMA’s Anti-Money Laundering Ordinance of December 8, 2010 (“**AMLO-FINMA**”). Swiss legislation does not forbid a financial intermediary from having a business relationship with PEPs (Politically Exposed Persons, i.e. public officials) or from receiving assets from them. Such dealings are however considered as higher-risk business relationships and entail greater due diligence obligations.

2. Introduction

This memorandum gives an overview of the regulatory requirements for lawyers acting as financial intermediaries when dealing with PEPs.

3. Definition of financial intermediaries and PEPs

3.1 Definition of financial intermediaries

The notion of financial intermediaries is defined at Article 2 (2) AMLA and includes: banks as defined in the Banking Act of 8 November 1934 (let. a), fund managers, provided they manage share accounts or distribute shares in collective investment schemes (let. b), investment companies with variable capital, limited partnerships for collective investment, investment companies with fixed capital, and asset managers within the meaning of the Collective Investment Schemes Act of 23 June 2006, provided they distribute shares in collective investments schemes (let. bbis), insurance institutions as defined in the Insurance Supervision Act of 17 December 2004 that deal in direct life insurance or offer or distribute shares in collective investments schemes (let. c), securities dealers as defined in the Stock Exchange Act of 24 March 1995 (let. d), casinos as defined in the Gambling Act of 18 December 1998. Pursuant to Article 2 (3) AMLA, **financial intermediaries are also persons, notably lawyers, who on a professional basis accept or hold deposit assets belonging to others or who assist in the investment or transfer of such assets** (including in particular persons who carry out credit transactions, provide services related to payment transactions, trade for their own account or for the account of others in banknotes and coins, money market instruments, foreign exchange, precious metals, commodities and securities as well as their derivatives, manage assets, make investments as investment advisers and hold securities on deposit or manage securities).

3.2 Definition of PEPs

There is no single, universally agreed definition of PEP. National or international authorities and institutions have issued definitions which are often similar but may slightly differ.

For the Financial Action Task Force (“FATF”) in 2013 foreign PEPs are **individuals who are or have been entrusted with prominent public positions by a foreign country**, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials[1].The definition of PEPs is not intended to cover middle ranking or more junior individuals.

Swiss law defines PEPs at Article 2 (1) AMLO-FINMA which states that PEPs are:

a) **Persons holding prominent public positions abroad**, such as Heads of State or Government, senior politicians at the national level, senior government, judicial, military or party officials at the national level, senior executives of state-owned companies of national importance; and
b) Companies and people identified as having **close family ties or personal or business connections** to the aforementioned persons.

Legal scholars and case law have refined this definition. The following relevant points can be emphasized:

a) The mere status of public official or politician does not in itself suffice for that person to be a PEP[2].
b) A PEP qualifies as such even if he/she is active in a country which is not considered to be notoriously corrupt[3];
c) The definition of PEP only refers to the official position of the person at the time and for the duration of the relationship[4];

[1] See Recommendations 12 and 22 on Politically Exposed Persons dated June 2013;

[2] Decision of the Federal Court 6B_729/2010 of December 8, 2011, paragraph 3.5.7;

[3] Lombardini, Droit bancaire suisse, 2e éd., p. 1036, N. 110;

[4] SJ 2009 II p. 229;

d) There is no set deadline after which a PEP, who no longer holds the official position justifying his/her status of PEP, shall no longer be considered a PEP[5];

4. General requirements applicable to all business relationships

Financial intermediaries have to either be affiliated with a recognized self-regulatory organization or request or obtain a license from FINMA to carry on their business (Article 14 AMLA).

Moreover, in all their business relationships, financial intermediaries have to comply with regulatory rules stated both in the AMLA and AMLO-FINMA. These rules can be summarized as follows:

4.1 Duty of due diligence

AMLA requires that the aforementioned intermediaries comply in particular with the duty of due diligence which includes: the verification of the identity of the customer (Article 3), the establishment of the identity of the beneficial owner (Article 4), the repetition of the verification of the identity of the customer and the **beneficial owner** (Article 5), the clarification of the nature and the purpose of the business relationship wanted by the customer (Article 6), the duty to keep records of transactions carried out and of clarifications required by AMLA (Article 7) and the duty to take the organizational measures required to prevent money laundering and terrorist financing in their field of business (Article 8).

AMLO-FINMA specifies the above mentioned provisions and provides that financial intermediaries have a general duty of diligence which includes the obligation to indicate the identity of the transfer order giver (Articles 10 and 11). It provides furthermore the enhanced duties of diligence in relation to higher-risk business relationships or transactions (Articles 12 to 19; see section 5.2), the duty to establish and maintain an **appropriate paper trail** (Article 20) and specifies which internal organization measures have to be taken (in particular implementation within the team of the qualified person in charge of money laundering prevention and the creation of internal guidelines; Articles 21 to 25). AMLO-FINMA defines the conditions of outsourcing (Articles 26 to 27) and provides rules on the termination of business relationships (Article 28 to 31).

4.2 Duties in the event of a suspicion of money laundering

In case of a suspicion of money laundering, AMLA institutes a duty to report ("**STR**") to the Money Laundering Reporting Office Switzerland ("**MROS**"; Article 9 AMLA).

The financial intermediary must freeze the assets entrusted to it that are connected with the STR as soon as the MROS informs it that it has forwarded the STR to the prosecution authority (Article 10(1) AMLA). The review conducted by the MROS should last no longer than 20 days (Article 23 AMLA).

The financial intermediary must continue to freeze the assets until it receives an order from the competent prosecution authority, but at the most for five working days from the time it was notified by the MROS of the transmission report to the prosecuting authority (Article 10(2) AMLA).

The financial intermediary is prohibited from informing the persons concerned or third parties that it has filed a STR (Article 10a AMLA).

4.3 Special requirements for Directly Supervised Financial Intermediaries ("DSFI")

AMLO-FINMA further contains specific provisions applicable to financial intermediaries who are not affiliated with a self-regulatory organization and therefore obtained from FINMA an authorization to pursue their activities as required by Article 14 AMLA (these intermediaries are labelled as DSFI). The first provisions are similar to the provisions on the identification of the contracting parties and the beneficial owner contained in the agreement on the Swiss bank's code of conduct with regard to the exercise of due diligence (CDB; Articles 39 to 59). Other provisions describe the obligations of the DSFI in connection with higher-risk business relationships (Articles 60 to 61) and give a list of documents which the DSFI shall maintain as a record of each business relationship and each transaction (Article 62).

5. Special requirements in relation with PEPs

5.1 International standards

The FATF recommended in 2012 that financial institutions, in addition to normal customer due diligence, should be required, as to foreign PEPs (whether as customers or beneficial owners) to:

a) Have an appropriate risk-management system to determine whether the customer or the beneficial owner is a politically exposed person;

[5] Explanatory report relating to the draft AML-FINMA of June 8, 2010, p. 13;

b) Obtain senior management approval for establishing (or continuing) such business relationships;
c) Take reasonable measures to establish the source of wealth of funds; and
d) Conduct enhanced ongoing monitoring of the business relationship[6].

5.2 Swiss law

Swiss legislation does not forbid a financial intermediary from having business relationships with PEPs or from receiving assets from them[7].

The AMLO-FINMA imposes stricter conditions on handling money from PEPs than international standards, since 2010. It obliges financial intermediaries to treat any business dealings with (to date, see section 5.3) foreign PEPs as a higher-risk business relationship (Article 12(2) AMLO- FINMA) and to label them as such for internal use.

As a result, these business dealings entail greater due diligence obligations, which are:

a) Pursuant to Article 14 AMLO-FINMA, the financial intermediary must perform additional clarifications and must determine: whether the co-contracting party is the beneficial owner of the deposited assets (a); the origin of the deposited assets (b); the use of the transferred assets (c); the background of larger incoming payments and their plausibility (d); the origin of a PEP's wealth (e); the co-contracting party's and the beneficial owner's professional activities (f); whether the co-contracting party and the beneficial owner are PEPs (g) and, for companies, by whom they are controlled (h).
b) The financial intermediary must ensure whether the clarifications' outcomes are plausible and document them (Article 15 (2) AMLO-FINMA).
c) The most senior executive body of the financial intermediary or one of its members must decide whether to conduct business with PEP (Articles 17 and 18 AMLO- FINMA). Furthermore, the most senior executive body must review such relationships annually and decide whether to maintain them (Article 18 (1) AMLO-FINMA).
d) The financial intermediary must establish an effective surveillance of these business relationships and transactions (Article 19 AMLO-FINMA).

Each institution shall establish a specific business policy with regard to PEPs. Such policy shall comply with Swiss law but institutions may adopt wider definitions of PEPs or decide to apply stricter due diligence obligations. Therefore, the treatment of PEPs may vary from one institution to another, depending on that institution's internal policy.

6. Recent developments regarding the status of politically exposed persons

6.1 Introduction

On 12 December 2014, the Swiss parliament adopted the Federal Act for Implementing the Revised Financial Action Task Force (**FATF**) Recommendations. The Federal Act provides new and revised provisions in the field of anti-money laundering, criminal and corporate law including several amendments to the AMLA[8]. The revision focuses on various issues including, but not limited to, the clarification and extension of the definition of PEPs.

The following explanations aim to succinctly present the latest amendments which occurred with regard to the status of PEPs both on a Swiss and an EU level.

6.2 On a Swiss level – key points of the reform

6.2.1 Definition of PEPs

Prior to the FATF Recommendation, the term PEPs was defined under the AMLO-FINMA and its scope was limited to foreign PEPs[9]. However, following the FAFT Recommendations, the definition of PEPs was introduced directly into the AMLA, under the newly drafted Article 2a, which now includes national PEPs as well as PEPs of intergovernmental organizations.

The newly introduced Article 2a AMLA reads as follows:[10]

"[1] Politically exposed persons in terms of this Act are:

a. individuals who are or have been entrusted with prominent public positions by a foreign country, such as heads of state or of government, senior politicians at national level, senior government, judicial, military or political party officials at national level, and senior executives of state-owned corporations of national significance (foreign politically exposed persons);

[6] See The FATF Recommendations, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, February 2012;

[7] See FINMA report dated March 11, 2011 "Due diligence obligations of Swiss bank when handling assets of "politically exposed persons" – An investigation by FINMA", p. 3;

[8] Federal Act on Combating Money Laundering and Terrorist Financing, soit la Loi fédérale concernant la lutte contre le blanchiment d'argent et le financement du terrorisme (Loi sur le blanchiment d'argent, **LBA**).

[9] Ordinance on Combating Money Laundering and Terrorist Financing, soit l'Ordonnance sur la lutte contre le blanchiment d'argent et le financement du terrorisme (Ordonnance sur le blanchiment, **OBA**).

[10] https://www.admin.ch/opc/fr/classified-compilation/19970427/index.html#a2a

b. individuals who are or have been entrusted with prominent public positions at national level in Switzerland in politics, government, the armed forces or the judiciary, or who are or have been senior executives of state-owned corporations of national significance (domestic politically exposed persons);
c. individuals who are or have been entrusted with a prominent position by an intergovernmental organization or international sports federations, such as secretaries general, directors, deputy directors and members of the board or individuals who have been entrusted with equivalent positions, (politically exposed persons in international organizations)

2 The family members and close associates of politically exposed persons are individuals who are closely connected to persons under paragraph 1 either through their family or for social or professional reasons.
[…]

4 Domestic politically exposed persons are no longer regarded as being politically exposed in terms of this Act when 18 months have elapsed since they relinquished their position. The general duties of due diligence for financial intermediaries are reserved.

5 An international sports federation in terms of paragraph 1 letter c is the International Olympic Committee and the non-governmental organizations that it recognized that regulate one or more official sports at global level."

Regarding Swiss PEPs, the status of PEP ends 18 months after retirement from the relevant position. However, a domestic PEP may continue to be considered as such despite no longer holding his official position, when according to the intermediaries' general duties of due diligence, a higher risk still exists.[11] No such defined period is applicable for foreign PEPs and for PEPs from international organizations. For these persons, a rik-based approach must be used to determine whether PEP status must be maintained.

According to the Federal Council's message on the draft of the Federal Act for Implementing the FATF Recommendations[12], domestic PEPs include Swiss Federal Councillors, the Chancellor of the Confederation, Swiss National Councillors and State Councillors, directors and general secretaries of the Federal Administration, the Attorney General of the Confederation, Federal Prosecutors, Federal Judges, senior military staff officers, presidents and general secretaries of national political parties, as well as members of the boards of directors or the management of state-owned corporations of national significance. The following corporations are deemed state-owned corporations of national significance: the Swiss Post, Swisscom, CFF, SUVA, armasuisse, RUAG, Empa[13] and IFSN[14].

According to Art. 6 para. 3 AMLA, business relationships with foreign politically exposed persons and their family members or close associates in terms of Article 2a paragraph 2 are deemed in every case to be business relationships with a higher risk.

However, such presumption does not apply to domestic PEPs, whose participation does not automatically cause a business relationship to have a higher risk. For such individuals, further risk criteria must be considered.[15]

6.2.2 Duties in the event of a suspicion of money laundering

The provisions of the AMLA regarding the freezing of assets and the sharing of information have also been amended in significant ways.

Previously, a report to the MROS led to a duty of the financial intermediary to immediately freeze the assets entrusted to it that were connected with the report sent to the MROS.

Pursuant to the revised AMLA, the financial intermediary will, however, continue to execute client orders, despite having filed a report with the MROS, provided that a paper trail is maintained.[16]

The assets should only be frozen upon a notification by the MROS to the financial intermediary stating that the report has been forwarded to a criminal investigation authority.[17] An immediate freezing of assets is, however, still required with respect to assets of persons who were included in a list forwarded to the relevant financial intermediary by the Swiss Financial Market Supervisory Authority (**FINMA**), the Federal Gaming Board (**ESBK**) or the financial intermediary's Self-Regulation Organization (**SRO**).[18]

These lists are prepared by the Federal Department of Finance based on data received from other countries on persons under suspicion of being involved with or supporting terroristic activities.

Finally, the prohibition to inform third parties about a report to the MROS is decoupled from the freezing of assets. The

[11] Art. 6 para. 4 AMLA, second sentence.

[12] https://www.admin.ch/opc/fr/federal-gazette/2014/585.pdf

[13] Institution de recherche et de services interdisciplinaire du domaine des Ecoles polytechniques fédérales qui se consacre à la science des matériaux et aux développements technologiques.

[14] Inspection fédérale de la sécurité nucléaire.

[15] Art. 6 para. 4 AMLA.

[16] Art. 9a AMLA.

[17] Art. 10 para. 1 AMLA.

[18] Art. 10 para. 1bis AMLA.

prohibition to report will be applicable for an unlimited period of time with respect to any filing of a report to the MROS, including the filing of a suspicion report pursuant to art. 350ter para. 2 SCC.

The revised provisions of the AMLA, however, clarify that a notification of FINMA, ESBK or the financial intermediary's SRO by the financial intermediary is permitted.

The possibility that certain other financial intermediaries may have to be notified that a report to the MROS has been filed remains unchanged.

6.3 On a European level – key points of the EU Fourth Directive

On 25 June 2015 the EU Fourth Directive was enacted[19], replacing the previous Third Directive[20]. With a two-year window for implementation, all EU member states must be compliant with the new mandates by 26 June 2017.

Similar to the amendments made on a Swiss level, the EU Fourth Directive introduced an extended definition of PEPs which encompasses persons entrusted with a prominent public position domestically, as well as domestic PEPs who work for international organizations.[21] Domestic PEPs are persons entrusted with a prominent public position within the EU and include persons present in the EU who work for international organizations based outside of the EU, whereas foreign PEPs include prominent individuals from outside of the EU.

The EU Fourth Directive also now defines "family members"[22] and "persons known to be close associates"[23].

As under the EU Third Directive, PEPs continue to be considered as such for at least 12 months after leaving office (or longer, until the financial institution determines that the risk specific to such PEP has diminished).24 Despite discussions to extend this timeframe to 18 months (which was included in one of the drafts) it was finally decided to maintain the 12-months timeframe which applies independently to all categories of PEPs (unlike the Swiss system which makes a distinction between domestic and foreign PEPs).

The Fourth Directive also provides clarification on who can provide approval of PEP relationships. The Directive states that the approval does not have to be given by a member of the Board of Directors but can be given by "someone with sufficient knowledge of the Institution's money laundering and terrorist financing risk exposure and of sufficient seniority to take decisions affecting its risk exposure".[25]

Finally, it is worth noting that the EU Fourth Directive contains the following sentence chastising firms for refusing the business of a PEP: *"The requirements relating to politically exposed persons are of a preventive and not criminal nature, and should not be interpreted as stigmatizing politically exposed persons as being involved in criminal activity. Refusing a business relationship with a person simply on the basis of the determination that he or she is a politically exposed person is contrary to the letter and spirit of this Directive and of the revised FATF Recommendations."* [26]

[19] http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:JOL_2015_141_R_0003&from=EN

[20] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:309:0015:0036:EN:PDF

[21] Art. 3 para. 9 of the EU Fourth Directive.

[22] Art. 3 para. 10 of the EU Fourth Directive. Family members includes the following: (a) the spouse, or a person considered to be equivalent to a spouse of a PEP; (b) the children and their spouses, or persons considered to be equivalent to a spouse, of a PEP; (c) the parents of a PEP.

[23] Art. 3 para. 11 of the EU Fourth Directive. Persons known to be close associates means: (a) natural persons who are known to have a joint beneficial ownership of legal entities or legal arrangements, or any other close business relations, with a PEP; (b) natural persons who have sole beneficial ownership of a legal entity or legal arrangement which is known to have been set up for the de facto benefit of a PEP.

[24] Art. 12 of the EU Fourth Directive.

[25] See point 34 of the preamble of the EU Fourth Directive.

[26] See point 33 of the preamble of the EU Fourth Directive.

WEALTH PLANNING FOR PEPS AND "HIGH RISK" CLIENTS: RISKS AND CHALLENGES?

International Private Client Committee (IPCC) sponsored panel at the ABA-SIL Spring Meeting – April 2017

Michael Parets, Partner, Withers LLP
Markus Zwicky, Zwicky Windlin & Partner

As ambitious lawyers and advisors, most (if not all) of us want to work with and represent interesting, high-profile clients, the rich and the powerful, perhaps even the political connected. However, the recent trends require us to be more careful than ever in advising these types of clients.

Over the past several years, we have witnessed the piercing of the veil of bank secrecy and with that—perhaps with the help of technology and the right political climate—the erosion of financial privacy and the birth of a new age of transparency.

FATCA and the Common Reporting Standard, as well as well-timed tax amnesty programs, bring more effective tax enforcement and greater tax compliance. At the same time, information leaks like the Panama Papers, LuxLeaks and the

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Bahamas Leaks are exposing the use and abuse of offshore companies, trusts and foundations. While the use of these types of structures is not necessarily illegal or even inappropriate--and in fact often used as valuable and legitimate planning tools—few are surprised to find that, in many cases, they were in fact used for illegitimate purposes.

Of course, there are trade-offs to greater transparency. With greater transparency comes greater scrutiny and exposure for wealthy individuals and those of us who advise them. And greater exposure brings increased reputational risks, more regulatory and compliance risks, and even risk of criminal liability. All of which can sink financial institutions and ruin families or careers, and in fact have.

Those of us who provide clients with advice on how to hold, manage and transfer their assets, need to me more vigilant and careful than ever before. And we certainly cannot turn a blind eye to the previous or prospective misdeeds of our clients.

It is with this background that the International Private Client Committee (IPCC) sponsored the panel at the ABA-SIL Spring Meeting in Washington DC on April 26, 2017, entitled:

Wealth Planning for PEPs and "High Risk" Clients: Risks and Challenges?

In our panel discussion, we addressed the following question: How do you take a given stream of prospective clients and—

1. Identify those with a high risk profile;
2. Determine which of those high risk clients, including politically exposed persons (PEPs), you can and want to advise; and
3. Provide sound, effective advice to the "good" high risk clients without getting yourself or your clients into trouble.

We began the discussion by, first, developing a working definition for PEPs and an understanding of why this designation is important and, second, identifying other types of clients with similar risk exposures. We then tackled distinct civil and criminal liability issues and we addressed reputational risk management for these clients. We then worked our way through succession planning issues and discussed how trusts, and similar structures, can be used to protect family wealth and provide a sound vehicle for wealth succession. We also addressed the potential value of family-controlled advisory and service companies such as single family offices and private trust companies.

Once we developed a good understanding of the issues, we applied our new-found knowledge to a case study:
Meet Chen…

- Chen was born with a silver spoon in his mouth. His father is a famous artist, and his mother comes from a very wealthy industrial family. Chen studied law and developed an interest in politics.
- Very recently, Chen served as campaign manager to the then newly-elected president of Suraysia and, as a reward for his good work and loyalty, was appointed Minister of Defense.
- From there, things do not go so well for Chen. A year into his tenure as Minister of Defense, political opponents of the newly-elected president accuse Chen and the president of accepting funds from a local drug cartel to finance the presidential campaign and for their own personal enrichment.
- The president and his administration are ousted from office, and the new government announces a formal investigation into the matter providing details of Chen's alleged involvement.
- In the meantime, with the help of some loyal friends in the military, Chen manages to escape Suraysia with his extended family on their private jet.
- Chen is married to a famous Bollywood actress and has 3 children.
- Chen and his family, claiming that the accusations against Chen are completely false and unfounded, come to you for help to protect their interests and family wealth.

The key take-aways from our discussion were as follows:

1. PEPs and high risk/profile clients potentially face distinct legal and reputational risks.
2. Their financial and wealth planning advisors potentially face parallel risks, and steps should be taken to mitigate those risks.
3. Wealth planning for PEPs and high risk/profile clients may require extraordinary measures to protect family wealth from extraordinary exposure.

"WHAT IS A FAMILY OFFICE—AND WHY ARE THEY SO POPULAR?"

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Definition of a Family Office

A popular saying in the family office industry is "If you've seen one family office...you've seen one family office." The point is, of course, how different the offices can be, as I stated in my now referred to as "classic" article, "The Family Office: Insights into Their Development in the U.S., a Proposed Prototype, and Advice for Adaptation in Other Countries,"[1] The definition of a family office is vague enough to cover everything from a one person part-time assistant to a full-service private trust company with a staff of dozens.[2] Indeed I know a family office in the United States that is one person, a family member, and his administrative assistant. He calls himself a family office. At the other end I also know a 60+ staff in Geneva for one couple and their two children—with a full-time art curator based in London.

Definitions do vary, including the following:

- "At its simplest, a family office is the structure used by a family to manage the business of the family."[3]
- "Although 'family office' is a fairly recent term, which first gained popularity primarily in the United States, where it was heavily marketed in the 1990's, the services provided by a family office have been provided without using that name for centuries all over the world."[4]
- "There is no template for family office structure, as by their nature they are tailored to the particular priorities and facts of each family."[5]
- "The family office is an important business that manages the personal financial and lifestyle affairs of its wealthy clients with confidence and discretion."[6]
- "Family offices come in many different shapes, sizes and locations, and each with its own unique and specific purpose. Given the significant variations between each, there is not typical family office…"[7]
- "While the term 'family office' can incorporate multiple forms of business and services, the core function of the great majority will be oversight and management of the financial assets of one or more families."[8]
- "One of the biggest issues facing a family that is considering creating a family office is defining what they mean by a 'family office'. The issue seems straightforward on its face, but it is not."[9]
- "'Single family office'-this is predominantly a family office that has been specifically created by the principal to manage his or her financial assets and those of his or her heirs."[10]
- "Different family offices will inevitably have a slightly different focus that will be driven by both the client's requirements and the technical background of the professionals at its core." [but there are common attributes][11]
- "Family offices are established to centralize wealth management services to the extended family group they serve."[12]
- "[A] single family office is a private company of dedicated professionals devoted exclusively to the investment, personal and legacy needs of one family."[13]
- "At its outset, the typical family office is usually shaped around the needs of the founder…the sole purpose is to serve the needs of the family."[14]
- "the single family office—independently serving the needs of the wealth-owner with at least one member of staff employed by the wealth-owner for that purpose."[15]
- "[I]n Canada, there is currently no commonly understood or accepted definition of a family office."[16]
- "A family office is a firm that takes care of the day-to-day administration and management of the funds of a super-wealthy family….In general a family office accumulates and focuses resources to facilitate a common interest in asset protection, cost control, financial education, family philanthropy and a host of other needs."[17]
- "Needless to say, the [single family office] structures are different from family to family, but usually include a person with financial or legal expertise who co-ordinates the family's financial activities…"[18]
- "In Russia, family office services are still regarded as something exotic, and there is no clear understanding of what a traditional family office is and how it works."[19]
- "The core activities of a family office arrangement involve the centralized management of wealth derived from one family, or a few, in an environment where family influence affects decision-making."[20]
- "The Rolls Royce of family offices [the single family office] is tailor-made to serve the needs of just one family."[21]

Now that we have reviewed what a "family office" is, we can gain some clarity by looking at the functions of a family office. Our focus will be on the single family office.

Functions of a family office

Although most family offices today do have a focus on investments, there are also those family offices that serve other non-investment needs of the family. For example, one clothing designer is still investing any extra capital in his business

[1] Journal of Wealth Management, Fall 2001.

[2] Id. P. 15.

[3] STEP handbook, Family Offices, Globe Law and Business, London 2015 ("STEP handbook"), Chapter One "What is a family office", Macdonald and McMullen, p. 7.

[4] STEP handbook, Chapter Two "Establishing the family office," Hauser, p. 21.

[5] STEP handbook, Chapter Three "Choice of Structures", Buchan-Smith and Crossley, p. 29.

[6] STEP handbook, Chapter Four "Recruitment and Talent Management Strategies", Rankin, p.52.

[7] STEP handbook, Chapter Five "Management of the Family Office", Loder, p. 57.

[8] STEP handbook, Chapter Six "Investment", Peacock and Scott, p. 81.

[9] STEP handbook, Chapter Seven "Families working (well) with outside lawyers", Field, p. 95.

[10] STEP handbook Chapter Eight "An adviser's view—private banker", Dwek and Knox, p. 99.

[11] STEP handbook, Chapter Nine "An adviser's view-accountant", Sutton, p. 103.

[12] STEP handbook Chapter 11 "Family office risk management and insurance", Bourn, p. 117.

[13] STEP handbook, Chapter 15, "Family office governance", Hillerstrom, McCracken and Renkert-Thomas, p. 167

[14] STEP handbook, Chapter 20, "The life cycle of the family office," Voth, p. 237.

[15] STEP handbook, Australia chapter, Drewery, p. 249.

[16] STEP handbook, Canada chapter, Bueschkens and Main, p. 261.

[17] STEP handbook, India chapter, Gadge, p. 307.

[18] STEP handbook, Israel chapter, Ephraim, Eyal and Kaplan, pp 321-2.

[19] STEP handbook, Russia chapter, Alekseyev and Egorova, p. 350.

[20] STEP handbook, U.K. chapter, BaiKafena, Springett and von Schmidt, p. 372.

[21] STEP handbook, U.S. chapter, Duke, p. 387.

but has accumulated homes in several countries along the way. His family office oversees the property management and staff, including nannies. The principal benefit to a family is always to have trustworthy staff taking care of whatever their needs might be from time to time. Many of the common services have been mentioned above.

A list of those services could include any or all of the following:

- Investment management or oversight
- Cash flow management and projections
- Consolidated financial reports
- Budget preparation, for all family members
- Bank financing
- Property management
- Yacht and aircraft management
- Art collection management
- Risk management procedures and policies
- Personal security, including K & R coverage
- Reputational risk, and social media policies
- Bill-paying
- Hiring, overseeing and firing household staff
- Coordination of estate planning and life insurance
- Record-keeping
- Tax returns and projections
- Trust oversight
- Philanthropy
- Family travel arrangements
- Family education
- Family meetings
- Family events
- Concierge services

Advantages and Disadvantages

The advantage of having a family office is the total dedication to the needs of one family. The disadvantages are cost and possible complexity. The costs can be controlled, based on the services the family uses. In many cases the family office will elect to outsource more expensive functions, such as investment management. Many families ask how much they should have in net worth in order to consider a family office. There is no general answer, though, because the cost will depend entirely on the services.[22]

Growth of Hybrids

With the growth of family offices, other contenders are eager to share the perceived profits of providing family office services to wealthy families. Unfortunately, they often fail to realize that "profits" are not a sure thing when time-consuming personalized services are provided. The more familiar model is the traditional profit from the investment function.

Over time, especially when a next generation is in charge, the single family office can begin to seem like too much of a luxury. At this stage many family offices, in particular in the United States, have decided to seek other families to share the costs of the office. These "multi-family offices" (MFOs) often have the same difficult time in producing profits. Their solution is often to offer investment products, a retreat to a more familiar business model.

Five Predictions

Kirby Rosplock, author of The Complete Family Office Handbook, and I wrote an article for the Journal of Wealth Management, on "The Family Office Landscape: Today's Trends & Five Predictions for the Family Office of Tomorrow," published in Winter 2014. In that article our five predictions were as follows.

Prediction One: A Continuing Increase in the Number of Single Family Offices (SFOs) and Multi-Family Offices (MFOs)

Based on the global growth in the number of ultra-high-net-worth families, we predict that once again there will be a surge of interest in the creation of family offices. These may take the form of a traditional, fully staffed single family office, or the small staff that manages outsourcing (the Prototype in the Hauser 2001 article) or a larger multi-family

[22] Estimates usually range from $50 million to $200 million.

office. This interest will be multiplied by the predicted enormous generational wealth transfers.

Prediction Two: Talent will migrate to the family office realm from multiple sectors; professional designations and training will ramp up in the family office sector as advisors try to distinguish themselves with specified family office credentials.

We predict a continuing increase in the number of educational events targeted to the family office market sector. Advisors will continue to enter the family market space from a number of sectors. Families themselves will continue to come together to share their experiences. Eventually there will be some solid, accredited "certification" programs.

Prediction Three: Non-Investment Services will be a Differentiator

Rather than the focus on purely investments, families are returning to the priority of having help with their non-investment services. An example is the head of a single family office in Pennsylvania. He has been in the family office for 33 years, and has a strong investment background. He has decided that his focus must be educating the 4th generation. He plans to spend 80% of his time on that, explaining that "investment management has become a commodity."

Prediction Four: More SFOs will have a Contingency Plan for Succession and/or Exit of the FO

Our prediction is that family offices will embrace contingency planning and succession as a normal course of business more readily than in the past. Family offices with a clearly articulated mission or purpose statement, with regular family meetings with family office executives to discuss the vision and the strategic planning process tend to appreciate the importance of having a contingency plan in place. Based on the above changes, from the generational wealth transfers to the increases in the number of households as clients of the family office, family offices will increasingly be focusing on the future state of the family office. The concerns range from the over-arching issue of whether their vision is to remain as a family office or to join a multi-family office, or simply to disband, to management issues of retaining skilled talent in the office. These multi-faceted issues are affected by each sub-family's goals and objectives, making it very challenging to prioritize. Nonetheless, the changes are inevitable, so we are confident in predicting that more and more offices will be developing succession (and exit) plans—for the family office, its staff and for family members.

Prediction Five: Multi-jurisdictional Multi-Family Offices will become the Norm Not the Exception

As seen above, it seems inevitable that family offices everywhere will become increasingly multi-jurisdictional. We see this happening in the following ways:

- Families become increasingly multi-jurisdictional and require tax and investment advice from each jurisdiction where they live
- Access to global information, especially about "best practices" for continuing the family wealth , will become more and more in demand
- Pairing with peer families in other jurisdiction will increase
- The creation of "one global stop" multi-family offices (an ideal market for the global private banks).

Future of Family Offices

Just as there has always been a need for personal services to wealthy families, I predict that there will always be a need for "family offices" however they are defined. The number of family offices has continued to increase globally.

(U)HNW INDIVIDUALS - MANAGING REPUTATION IN A GLOBAL WORLD

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High net worth individuals and their families enjoy considerable wealth and influence with reputations to match. There are, however, genuine risks in such privilege. Proper consideration and planning is required in order to prepare wealthy families for the inevitable crisis or issue, rather than leaving it until it's too late.

Crises can come in all shapes and sizes and from many directions. Misconduct by Family members; alleged financial impropriety; espionage, whether by staff, a rival or a state; and the modern scourge of cyber breaches are all facts of life. They do happen to other people, but that is not to say they will not happen to you or your clients.

Wealthy families and their advisers need to be aware of and plan for risks that can cause serious, if not necessarily catastrophic, harm to the reputation of the family as well as its associated business and other interests. The better prepared, the more resilient you will be when the crisis or issue hits.

Lessons to be learned from the corporate sector

The last decade has seen huge corporate failures, no more so than in the global banking sector. Those running such organizations have forgotten the fundamentals: good governance, proper risk management and business leaders who actually understand what is being done on their watch. It is no surprise therefore that this period has also seen corporations' owners and officers, of both public and private entities, starting to recognize that their reputations go straight to the bottom line. It hits their share price, their credit lines and the willingness of others to work for or with them. What comes with that understanding is a belief that more can and needs to be done to prepare for crises in order to improve resilience. As always 'prevention' is better than the 'cure'.

Many of the world's leading corporations are owned a few shareholders. At the head of many of these global businesses sits an individual or family – whether operating on an individual basis or within a family office. They have great personal, commercial and political influence wherever they operate. Alongside these rewards, however, there are considerable risks. Such risks can often be traced back to three key issues, all of which stem from globalization – dispersed families, the global nature of business and wealth and the international reach of the internet.

Dispersed families

The tendency of family members to be educated and work away from their country of birth has increased significantly in recent years, with the result that families are often dispersed around the world. International cities such as London, New York and Hong Kong have all benefited considerably. Wealth and prestige have flowed into them. For the individuals concerned, the excitement of living and working in such cities, coupled with the fact that they can afford to live an international, rather than simply domestic, lifestyle results in a global profile for them and their families.

However, what can accompany such choices are new challenges. Younger family members see how others live. They therefore become less inclined to maintain the ways (religious or cultural) of their parents and earlier generations, adopting behaviours more in keeping with their new location.

Such behaviour can create an obvious conflict between the new cultures they immerse themselves in, and those in which they were raised and where they will no doubt still have connections. What might be acceptable behaviour in Western Europe or the US does not necessarily apply in parts of the Middle East for example, or vice versa for that matter.

In choosing to live away from the usual family network, the younger generation members will not necessarily have immediate back up to support them in their new locations. Risks such as kidnapping, blackmail and media exposure become real concerns, the first two more so if the family is from certain parts of the world. The propensity for an individual to be at risk of wrong-doing – civil, criminal or moral – can increase.

All of these create a potential risk to reputation, as well as a physical threat. The conduct of a wealthy individual and his family makes news, not least because wealth makes an individual a modern-day celebrity. Certainly since the 2008 crash, for some at least, wealth is not something to aspire to but to criticize. When someone makes themselves an easy target the media will not need a second invitation.

Global businesses

Historically, successful families typically built their wealth operating in only one or two jurisdictions. Few were multi-national. Again, recent times have seen a huge change on that front. Individuals and businesses, having already saturated their domestic market have looked further afield, whether exporting their business abroad or starting new operations in other parts of the world.

Such developments have brought fabulous wealth and success for many. However, what comes with such expansion is a need to understand local business norms, rules and culture as well as domestic politics, regulation and law. What may be acceptable business practice in some countries can be a serious criminal offence in other jurisdictions, in some cases irrespective of where the offence may have taken place. Investment decisions which may, in the past, have been entirely private and/or uncontroversial now run the risk of scrutiny and/or being seen to be unacceptable in the court of public opinion. There is no better example than in the context of tax planning.

For example, the decision as to where to hold funds, traditionally at least, would have been driven almost exclusively by investment and financial considerations. Now, alongside those factors sits the potential reputational impact of such an investment. As such, the fiscal benefits of holding funds offshore may be outweighed by the reputational harm caused or risked by such an arrangement. Potential reputational harm can be as much a relevant factor for individuals who operate with a high degree of privacy and discretion as it may be for a business whose public reputation is at the core of its success. Like it or not, families and their associated businesses and advisers need to be alert to the new paradigm of public opinion and how it affects their investment and tax-planning choices.

Local reporting, global readership

Twenty years ago a story published in one country was unlikely to spread across national boundaries, never mind continents. A story could disappear as quickly as it arose. It often led to those who found themselves in the media spotlight adopting the mantra "*never complain, never explain*". That may have been entirely appropriate in the pre-internet world where a story today was tomorrow's fish and chip paper.

In the digital age, however, stories are permanent and accessible all around the world. Furthermore a story published on one website can be picked up by media operators across the globe in a matter of minutes and be re-published, often without any credibility checks. In turn, such stories can be collated by databases such as Worldcheck with the potential to cause significant harm to an individual's banking or other financial arrangements.

Communications advisers used to speak of having a golden hour to respond to a media crisis – now it is often a question of having a golden minute or two.

It is also a reality for many of the world's wealthiest that they do not crave publicity and prefer a discreet profile. However, this means that their internet profile is often weak. One of the consequences is that an adverse story, especially if published on a popular site, can acquire additional prominence and feature highly in the results of any Google search of them, thus creating a disproportionate impact.

As much as the internet creates huge issues of managing reputations as regards mainstream media, the web also provides each and every disaffected individual with a platform to air his or her grievances and views, irrespective of whether there is any merit in his or her opinions. Facebook campaigns, Twitter attacks, Instagram messaging, revenge porn, the hacking of images and bank accounts and denial of service attacks all pose genuine risks for high profile individuals often caused by those with little, if anything, to lose.

The web is frequently the first step for the anti-voice, emboldened by the perceived, if not actual, cloak of anonymity it provides to detractors. While the mainstream press w in many jurisdictions will typically be conscious of the need to provide a fair and balanced report, including offering the subjects a right to reply to the story, social media offers no such assurance, is far less predictable and moves much faster. What is more, even if the perpetrator can be identified, there is little guarantee that taking action would be the right option or even successful. Action can merely provide the oxygen that fans the flames.

However, it is not always external forces that create the risk. Social media can also lead to challenges, particularly where younger family members are involved. For example, both private information and location can be easily and unwittingly compromised by such seemingly innocent acts such as posting holiday photos which give away location or the personal assistant's innocent chatter about his or her work for his or her employer on an unsecured social media site.

Cyber security

Today a threat to high net worth individuals and their families arises from cyber security. We all store and communicate highly confidential information in electronic form. In the case of wealthy families and their advisers this means that an array of highly sensitive material, personal and professional, is available to anyone who breaches the system. This risk is not about if it happens, but when. As has recently been seen with David Beckham, the reputational impact of a cyber-attack can be just as damaging as the financial consequences.

Common scams involve gaining access to passwords and monitoring private email accounts to understand the way business is transacted, before sending emails purporting to come from the family or its advisers, often authorizing fraudulent financial transactions. Alternatively, ransomware operates by inserting a malware infected link that, when clicked on, will quickly spread throughout any other devices linked to the network. A message will then be displayed, advising the user that the system has been locked / encrypted and that to access their files they will need to pay a fine before a specified deadline. Wealthy families can be a target for phishing emails, messages which when opened allow criminals to access private information or install ransomware onto the system.

It is not possible to over-emphasize this issue. While the risk cannot be eradicated, a considerable amount can be done to reduce the risk and to be prepared to respond well to any breach.

The means by which a family should protect itself are both organizational and technical. As well as ensuring that technical systems are as robust as possible, it is also wise to invest in proper vetting of prospective employees, strong internal compliance measures, robust contractual obligations on staff and an ongoing education programme about best practice. They are all basic requirements that aid IT security.

As much as it pays to build strong organizational and technical systems, they also require regular stress testing. Wealthy families should also ask whether those with whom they regularly conduct business had sufficiently robust systems in place. Advisers such as accountants, bankers and lawyers will hold a considerable amount of sensitive information regarding their clients. Those looking to exploit the system have an unnerving ability to find the weak link in any chain. The leak of the 'Panama Papers' from the law firm Mossack Fonseca is a perfect example of this.

Managing crises

A crisis can come in many guises, whether it is a high-profile scandal which has already reached the international news, or a threat of harm which can be contained or prevented. Once a crisis event takes place things can move rapidly, making it imperative to maximize those 'golden hours or minutes', the actions taken in the first moments of a crisis can help to determine the success or failure of the response.

There are four key stages to managing a crisis or issue: planning, prevention, protection and evaluation.

Taking each of those in turn:

1. Planning. You can never plan for every eventuality. However, the mere exercise of establishing a crisis communication plan will produce benefits in identifying points of weakness and improvements to governance. A plan will need to include the following: (i) the identity of the crisis team, including internal and external advisers, and the likely leader (including a back-up option); (ii) identification of the keys risks and a response for each while recognizing the need to be flexible; (iii) a communication plan; and (iv) identification of those stakeholders who must or may need to be consulted such as family members, insurers and shareholders. Having produced a plan, it should be regularly revised so as to ensure that it is kept up to date. It should also be practiced.
2. Prevention. Even before a crisis, there will be many practical steps that can be taken to reduce the risk of a problem arising and to make the individual and his business more resilient in a crisis. Such steps can include tightening physical and cyber security and ensuring that good employment and service agreements are in place with staff members including suitably worded terms around confidentiality, privacy and copyright.
3. Protection. When confronted with a crisis or issue, there is an overwhelming need to take steps to protect the individual or business at stake as much as possible. Failure to address an issue is likely to compound the problem – be proactive! Always, without fail, respond honestly to an issue. Attempting to lie or mislead runs the serious risk of only compounding the problem. Also empathizing or expressing sorrow does not necessarily have to amount to an admission of guilt.
4. Evaluation. After going through a crisis or dealing with an issue, it is also vital to evaluate how the matter was handled. What lessons can be learned so that mistakes are not repeated?

Conclusion

Today protecting the interests and reputations of high net worth individuals and their families is not to be viewed as a luxury. The issue requires proper planning and consideration. There is also an increasing need to consider reputation issues from a global perspective. It therefore requires a much greater degree of sophistication by way of a response within the crisis team, including the professional advisers working in a much more integrated way to achieve the best outcome for the client. Proactive management, starting with good crisis management planning, has the ability to reduce the chance of the risk arising, as well as ensuring the individual is better able to weather a storm.