

SYNOPSIS SERIES

Private Wealth Management & Family Offices

Introduction

With increasing wealth levels in Asia, it is no surprise that family offices are in recent years set up in the region, and we are set to see more. This has already been a global trend, part driven by private bankers and asset managers who have taken the option of departing financial institutions in recent years caught up in the demands of complex web of regulations. Some investment managers and hedge funds operators are choosing to return outside money to investors and join a family office, or restructure their operations in order to work on a bespoke basis with family offices. In a front-page article of The Wall Street Journal, family office was referred to as the new force on Wall Street (*"New Force on Wall Street: The "Family Office"*, 9 March 2017).

The stronger, more persistent Asia case for the emergence of family offices, is that over the last several decades, the growth of emerging markets around Asia, and in particular China, has brought about a growing number of "high" to "ultra-high" net-worth individuals. The rising need for wealth management, investments and asset allocation expertise is clear.

We are also at a juncture where the first-generation ranks of Asian founding individuals who have amassed fortune through various privately held businesses now come to a time of asking the inevitable questions of succession and wealth preservation for the next generation and beyond.

Given the growth of family offices, we seek to examine the key elements of the functions and services for family offices, and outline some key legal aspects as well as relevant regulatory considerations for establishing family offices or structures, or when family office professionals offer related services. The needs and functions of family offices would evolve subject to the increasing sophistication and complexity of the business, investment and personal circumstances of the family members.

Definition of a Family Office

The term 'family office' is actually a somewhat "fluid" concept which encompasses a variety of set-up and structures depending on the needs of the specific families. There is for instance an idea of a virtual family office (VFO), in which a private bank or other institution, such as a trust company or other service provider firm, which provides the services of a family office but through its institution so that the family office exists "virtually" within a larger organisation. The family can rely on a team of experienced professionals managing the functions of a family office, providing the necessary infrastructure and expertise on a whole range of legal, financial, tax and fiduciary issues while taking into account the private issues of the family.

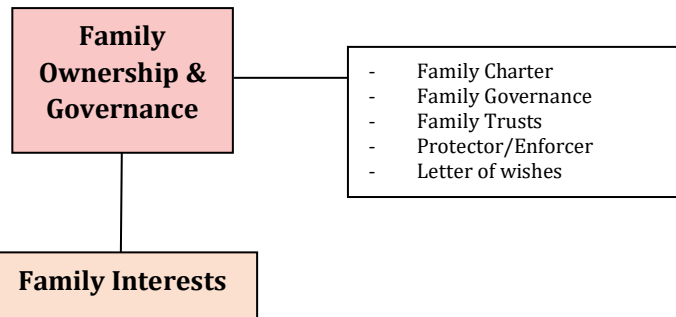
At its simplest, a family office carries out the administrative and management functions relating to the affairs of the family, their wealth and assets. From a professional perspective, a family office is a platform through which respective expertise in different relevant fields can be pulled together and coordinated in serving single or multiple families.

Broadly, family offices can be categorized as either ‘single’ or ‘multi’, where a “single family office” would serve one ultra-affluent family, while a multi-family office would more resemble traditional private wealth managers, whose business is established to serve several affluent families at once.

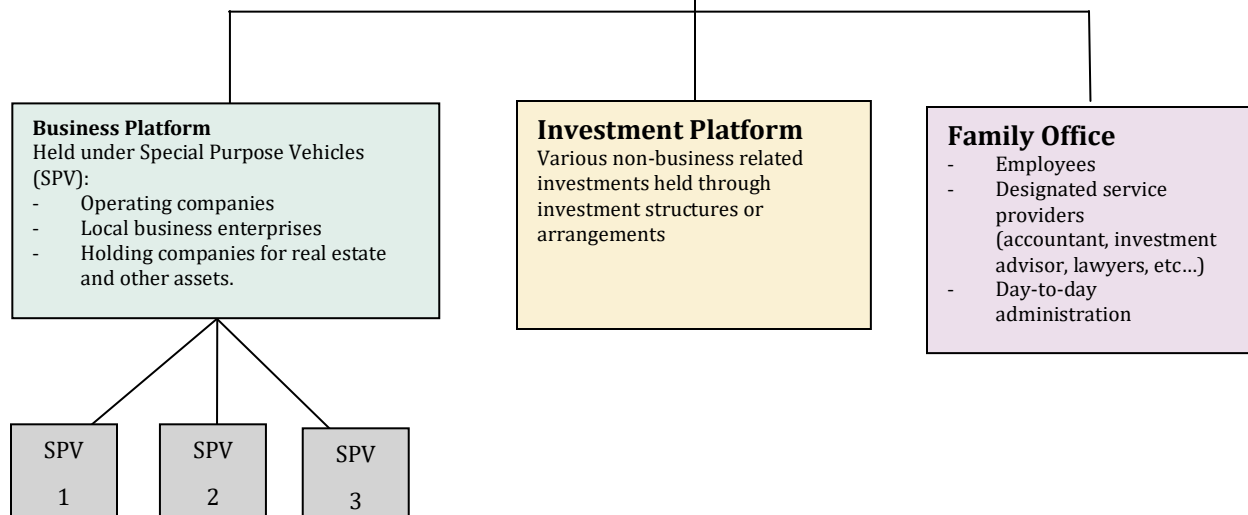
Besides, the functions performed by a family office may cover two distinct levels of management, although the two levels are often overlapping. The first level can be defined as relating to the family’s core management and overall interests in the family businesses and assets, which may be referred to as the “ownership/trust level”. The family office can be structured at this level driven by considerations around tax and succession planning as well as governance for the overall management and organization of the family’s ownerships and assets. On the other hand, the second level may be considered the “operational level”, being the administrative and operational aspects of the family assets, such as the day-to-day administration of the ownership and management of the family businesses or family trusts, and services on the investment management and asset allocation of the family’s wealth, which may or may not be held through family trusts.

Overview of Family Office Functions

Ownership/Trust Level



Operational Level



Accordingly, the activities and offering of services or expertise within family offices or their service providers are structured around the needs of these functions over the two levels. Family offices would seek to establish internal resources or engage external service providers to advise or assist on the key aspects of these functions, such as the following:

Family Charter & Governance

- Families may wish to establish family charter or principles of governance in order to reflect and instill the core values and legacy which shall drive the strategic direction and vision of the family businesses. Family offices could have an important role in developing a framework for family members and stakeholders to be properly engaged in determining and operating the family businesses and affairs in accordance with the family charter or governance principles. Family office professionals and advisers may provide appropriate recommendations and assist in putting in place necessary boards of management and governance structures that shall oversee the implementation of the family charter, and which could also involve the next generation family members in picking up the key principles and skills for continuing the family legacy.
- Within considerations of family legacy, family offices may often also engage in management and administration of the family charitable and philanthropic efforts. While the approach and extent may differ, certain recent market statistics suggest that increasingly high-net-worth and ultra-high net worth families are tending to establish formal principles and structures based upon or through which the family wealth is applied to selected good causes. This calls for administrative staff or professional service providers who are experienced in working with charities or philanthropy projects.

Tax, Succession Planning & Trusts

- As families grow in complexity both in family businesses and an extended family network of members, often across multiple jurisdictions, managing the ownership interests of family members can become complicated and cumbersome. Often, tax implications demand detailed administrative support and thoughtful tax planning, which require dedicated support by experienced family office professionals.
- Besides, careful planning is necessary to address questions and needs around inter-generational transfer of wealth, especially as families hope to strike a balance between having minimal disruption to the running of family businesses, preservation and investment of family assets, while providing for evolving situations and needs of future generations.
- Succession planning necessarily involves issues around transfer of ownership and controls. The potential tax incidents relating to transfers of ownership (such as gifts tax, inheritance tax, estate duties, stamp duties, for example or the likes, and also income tax or capital gains tax on holding or disposal) need to be considered. These can get quite complicated especially when family members, nature and location of assets in various jurisdictions attract myriad possible implications.
- Therefore, family offices are often involved in considering the detailed issues in succession planning relevant to the specific families. Where appropriate, as quite commonly used, trust structures are put in place for succession planning and transfer of wealth over time. The separation of legal and beneficial interests within a trust structure allows for a greater degree of flexibility as to how assets can be applied for the use and benefit of different family members across generations, and also as to

eventual transfers to specific beneficiaries. By using a discretionary trust structure, for example, beneficiaries can either be granted “fixed” interests in the trust assets or, alternatively, the trustee may be granted discretionary power of determining distribution of income and/or capital and to which beneficiaries or any relevant conditions. Others may consider structures such as foundations as well as certain corporate or non-corporate vehicles that may be included overall depending on the specific circumstances and requirements of the family and its objectives.

- However, a distinction should be drawn between family offices that are themselves the subject matter or operator of a trust set-up, and those who are actually providers of trust services. Professional service providers engaged in the provision of trust services and in particular acting as trustees are often regarded in law as fiduciaries and may be subject to certain specific licensing or regulatory requirements. On the other hand, family offices may use or operate private trust structures, but would need to consider specific issues with respect to the control and operation of such structures by family members.

When establishing a trust structure, it is common for the patriarch / matriarch to invariably feel uncertain about having to surrender control or ownership interest over the subject assets. Some instruments for safeguards are available to give a level of comfort that his/her wishes will be considered and observed in the long-term.

A number of jurisdictions offer trust structures which can be adopted for families. For example, customized trust regimes in the British Virgin Islands and Cayman Islands, namely the Virgin Islands Special Trust Act (VISTA) and the Special Trusts (Alternative Regime) Law (STAR), respectively, are designed to achieve family purposes of holding interests in underlying family businesses and assets.

Asset Allocation & Diversification

- Whether ownership remains directly with family members or becomes indirectly owned by the family through a trust structure, family offices are often engaged in certain asset management and allocation activities for investment of the family wealth and assets. The extent of set-up and breadth of expertise may vary depending on the investment appetite of the particular family. Principles of investment diversification typically see family offices of reasonable sophistication applying family wealth towards a range of different investment strategies and asset classes. Accordingly, family offices are often staffed with investment professionals with relevant expertise who assists or assumes investment management and decisions, and who may sometime be family members.
- Single family offices which are involved in investment management and asset allocation for the family’s own assets are again distinct from multi-family offices providing such services for a number of families. Multi-family offices are in effect investment managers or investment advisers who are usually subject to financial regulatory requirements. Operators of family offices should take into account any relevant regulatory requirements on providing investment services beyond a certain number or closed-group of investors. There may be certain registration or licensing requirements unless relevant exemptions apply.
- From a family perspective, investing through a family office may allow the family to maintain control over asset allocation decisions in line with core family principles or legacy. Family offices typically engage in some angel or venture capital investments in their chosen sectors, and are nowadays tending to consider environmental, social and governance factors in investments. Family offices may also seek to provide the younger generation an opportunity to gain direct experience by being involved with certain aspects of running certain investments or projects.

- Family offices may also consider structuring investments based on their own unique requirements and circumstances. A family office may choose to establish a dedicated investment fund structure for the family instead of having family assets pooled with other investors, while also retaining some control over the investment decisions. An external investment manager or adviser may be brought in if desired.
- Besides securities and financial assets, high-net-worth and ultra-high-net-worth families would often also invest in other asset classes such as art, antiques, precious metals, jewelry and gemstones, in respect of which the legal and practical matters around selection, valuation, authentication, ownership, safe custody, insurance, transfer, succession and other issues of management similarly require some dedicated attention and engagement of expertise through the family office.

The choice of location for establishing a family office would need to be taken considering the nature and range of activities to be carried out at the family office, the location and proximity of relevant family members, and the availability and depth of sufficient resource and well-qualified professionals to meet the required services and functions of the family office. This is distinct from, and will need to be compared and considered together with, however, the choice of jurisdiction for the family trust, or other key entities or vehicles through which wealth of the family is held or invested. Therefore, it is quite typical that a family office tends to be located in a well-established financial centre, whereas the family trusts and the structures through which investments or assets are held or operated are usually established and domiciled in offshore and/or tax efficient jurisdictions.

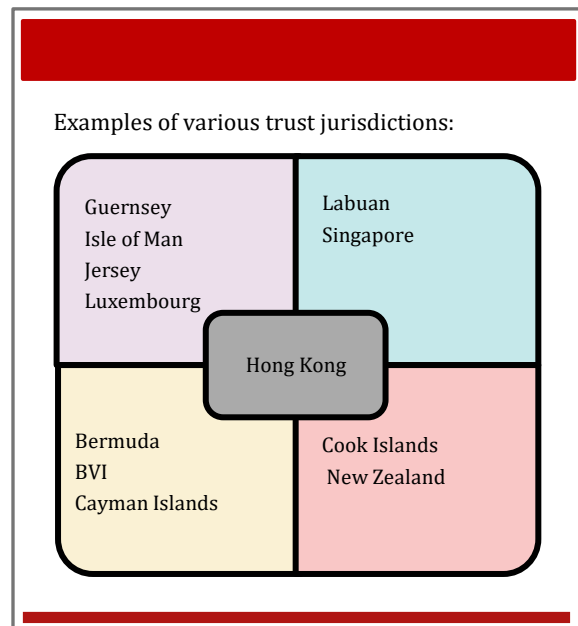
Structuring a trust

A number of jurisdictions offer trust structures which can be adopted for families. Professional trust companies have long been established in jurisdictions with a common law legal framework, to provide professional trustee services to family trusts of the very wealthy.

Depending on where the wealthy families and their assets are based, there are offshore jurisdictions all around the world which are well suited and carry a depth of expertise setting up and maintaining a trust.

While many other jurisdictions continue to provide the relevant legislation for trust law, historically the most frequently chosen offshore jurisdictions for setting up a trust would either be the BVI, Cayman Islands or Jersey. Saying this, families should nevertheless consider the following issues when deciding on the appropriate governing law:

- **Time-Zone:** Depending on where the relevant parties are located, the proximity of the offshore jurisdiction can drastically lower the turnaround time for communication, allowing for a more responsive management of the trust.



- **Legal History:** As the trust structure will ultimately hold legal ownership of the assets being held, families may (understandably) require a level of comfort in the legal system governing the said trust. Based on the relevant legislation, jurisdictions with longer history in dealing with trust law tend to provide a more comprehensive and sound administrative protection.
- **Court System:** Similar to the legal history mentioned above, a jurisdiction's court system could also be a relevant factor to consider where to set up a trust. Should the need arise for a party to rely on the local courts to enforce any responsibilities, it would be prudent to consider a court system which has experience in dealing with such matters.
- **Variety of Trust Structures:** Different families may set up trusts for different reasons. It is therefore important for families to consider the structural and legal difference of trusts not only provided by different jurisdictions, but also the different trust structures available within the same jurisdiction.

Certain jurisdictions have developed customized trust regimes. These trust regimes allow establishment of purpose trusts which can depart from traditional common law trust principles. Unlike traditional common law trust structures where the trustee has a fiduciary duty to oversee application and management of the trust assets, under such trust structures, the trustee's duty is to see to the purpose of the trust which is to hold certain assets. Where the asset is a company, the management of the said company can be left to the appointed director(s) of the company. The ownership is segregated from management of the company, and is able to provide the settlor with a certain level of control over the business during his/her lifetime.

Private Trust Companies

Aside from the trust structures mentioned above, another practice is using a private trust company ("PTC"), which has the sole purpose of acting as a corporate trustee for a trust. A PTC is essentially a private company with limited liability, usually incorporated in an offshore jurisdiction, and permitted under its constitutive document to act as a trustee for one or more trust structure. What differentiates a PTC from professional trust companies is its ownership and that it is often specifically dedicated to a particular family or trust. A PTC may be adopted together with a VISTA or STAR trust.¹

Whereas a professional trustee offers specific expertise of a fiduciary, longevity and independence of an institution, the following are the real and/or perceived advantages of adopting a PTC:

- **Privacy:** Adopting a PTC allows the Settlor to maintain a level of confidentiality and privacy with regard to the assets and business activities, rather than appointing a large and highly regulated institution as a bank trustee.

¹ Unlike a 'vanilla' trust (where the trustee may be subject to legal requirement to consider from time to time whether it is in the best interest of the beneficiaries that some of the investments be disposed of (and whether some or all of the directors of the underlying companies should be replaced)), when using VISTA trusts, shares in the underlying BVI company may be continually held, without the need for the trustee to consider whether or not to dispose of them. Directors may be removed only under specified conditions that could be tailor made under the trust's own "change of director rules". STAR trusts achieve the same objective via the careful drafting of the trust's purpose.

- **Reassurance of Assets:** Transfer of legal title occurs when appointing a PTC, however the board of directors of the PTC may be constituted with the Settlor's trusted adviser(s) or even family members, which would provide a level of comfort over management and control.
- **Flexibility of Assets:** Some financial institutions may have certain reservations or particular requirements with respect to holding non-conventional assets such as operating companies, majority shares of a publicly traded company, landed property (both within and outside Hong Kong) and precious artworks, in which case it may be more appropriate or necessary for a PTC to be established as trustee.
- **Efficient and Effective Decision Making:** Should an active business be among the assets controlled by the trust, there may be a need for a faster decision making process. Unlike professional trust companies which would most likely have no experience in running the business, the board of directors of a PTC would usually be made up of advisors and/or family members familiar with the business, this would allow for a speedy response to business decisions.
- **Cost:** Setting up a PTC may be quicker and at a much lower cost than setting up a trust company with a restricted trust license.
- **Fiduciary Duties:** A trustee is subject to fiduciary duties regardless of whether the trustee is an outside trust company or a PTC. If a PTC is used, usually held by a purpose trust created for the sole purpose of owning shares in the PTC, thus, the PTC is an "orphan entity" and shares in the PTC will not be subject to probate and estate duty issues. Consideration should also be given as to who should be the directors of the PTC. If the settlor is a director, there is potential risk he may be deemed not to have sufficiently divested the trust assets and those assets are at risk of being deemed part of his estate in determining the estate duty payable. Additionally, a director of the PTC owes a fiduciary duty to the PTC.

Investment Management & Structures

One feature commonly incorporated within a family office is the function of a bespoke asset manager specifically to serve the investment needs of the family. In this instance, investment professionals or portfolio managers may be engaged by the family to run private fund(s) or investment portfolios. Through this platform, a range of investment strategies may be managed to fit the needs of the family's overall investment objectives.

In Hong Kong, multi-family offices may be required to hold a license from the Hong Kong Securities & Futures Commission ("SFC") to engage in relevant regulated activities, possibly type 4 – advising on securities, type 5 – advising on futures contracts (if relevant) and/or type 9 – asset management. It is also not unusual for a set-up that first started as a single-family office to subsequently develop into a multi-family office, as the original team grows in expertise and track record then sees the value and opportunity of providing investment services to other high net worth families. Family offices should be aware of the related regulatory implications and when a need for license may be triggered.

Family offices may establish or invest through dedicated fund structures specifically set-up depending on the types of target assets. For multi-family offices, more often than not, private fund structures are useful for pooling assets of different families, enabling sharing of costs and risk diversification.

The following are some examples of possible structures both single and multi-family offices can consider, and the appropriate fund vehicle or structure may be established in a jurisdiction or domicile of choice suited to the family, subject to relevant tax considerations:

- **Unit trusts:** As a common fund structure, a unit trust allows investment assets to be held by a trustee for and on behalf of holders of units who shall be interested in the investment returns of the underlying assets, as each unit represents a share in the underlying assets. The unitization of interest may facilitate ease of administering ownership and transfers, as well as exits and distributions, subject to realization or liquidity of the capital and income from the underlying assets.
- **Segregated Portfolio Company (SPC) or Protected Cell Company (PCC):** This is an alternative structure which single and multi-family offices may tend to adopt. For single family offices, an SPC or PCC can segregate assets as well as liabilities into separate independent portfolios or “cells” which could be differentiated by asset classes, distinct geographic focus, different ownerships or other reasons to separate one from the others. For larger single family offices with liquid assets, there may be a wish to appoint different investment managers to manage different cells for diversification purposes. Apart from the ease of adding segregated portfolios or cells to raise cash and invest in different time periods, an SPC or PCC may be a more cost effective approach than setting up multiple fund structures to achieve different investment strategies. Establishment costs and operating costs are lower, as these are spread and administration are shared across different segregated portfolios or cells.
- **Limited partnership:** Usually established as a closed ended structure, family offices may choose this structure to hold investments in private equity and real estate investments, or other illiquid assets to be held over a certain term. A limited partnership structure may be particularly appropriate for pooling together investments by a number of families. A lead family office or the multi-family office family may own shares in the General Partner that manages and exercises overall control of the structure.

Under new legislation introduced on the Hong Kong open-end fund company (OFC) structure, it would also be possible to establish sub-funds where the assets and liabilities of one sub-fund will be ring-fenced from those of other sub-funds.

The availability of the OFC structure is pending detailed implementing rules to be issued by the Hong Kong SFC. As the OFC will be subject to the SFC regulatory oversight and is required to appoint a SFC licensed investment manager as well as a custodian who meets SFC's required eligibility, the use of the OFC for private clients and high-net-worth families may be more likely adopted by multi-family offices rather than single family offices, if family offices wish to consider this new Hong Kong vehicle.

In considering the choice of structures as well as jurisdictions for establishment, appropriate legal as well as tax advice should be taken. Depending on the intended purposes, certain families may also consider establishing charitable entities or foundations through which the family wealth may be invested and applied. Family offices should familiarize themselves with the broad range of structures that may be adopted and possible jurisdictions, in order to suit the investment needs, management and operational arrangements, legal and tax considerations for the families and the assets in question.

Foundations: an alternative structure

Foundations have been broadly accepted within civil law jurisdictions, and appear to be adopted by a growing number of common-law jurisdictions as well. Similar to other legal entities, foundations are structures through which legal ownership of property or assets are held and/or transferred.

Possessing the key legal attributes of corporations, while at the same time operating through a purpose or benefit similar to a trust, foundations can be a platform for charitable activities, but also for asset management and tax planning purposes.

Hong Kong trustee services

Perhaps in recognition of the increasing demand for trust services, Hong Kong trust law was recently modernized to strengthen the attractiveness of Hong Kong trust services industry among a competitive international market. The Trust Law (Amendment) Ordinance 2013 was brought into effect on 1 December 2013, with changes to the Hong Kong Trustee Ordinance (Cap.29) (the “**Trustee Ordinance**”) with respect to the powers, duties, responsibilities and remuneration of trustees. While this has made the Hong Kong trust law regime more updated and into closer alignment with other jurisdictions, trustees should still be aware of differences from other jurisdictions and the legal implications, especially while operating internationally.

Professional trust companies seeking to operate and provide trust services in Hong Kong should also consider the requirements for establishing a trust company under Part 8 of the Trustee Ordinance. Save for private companies², any company incorporated in Hong Kong can apply in writing to the Hong Kong Companies Registrar to be registered as a trust company, subject to the following requirements:

1. the objects of the company in its articles of association are restricted to some or all of the objects set out in Section 81 of the Trustee Ordinance;
2. the issued share capital of the company is not less than HK\$3,000,000;
3. HK\$3,000,000 (or at least that amount) of the issued share capital is bona fide fully paid up for a cash consideration;
4. the board of directors has been duly appointed;
5. the company has complied with the deposit requirements under the Trustee Ordinance (for a sum not less than HK\$1,500,000);
6. the company is able to meet its obligations, apart from its liability to its shareholders, without taking into account the sum deposited with the DAS mentioned in point 5 above.

Section 81(1)(d) of the Trustee Ordinance sets out a prescribed list of objects for trust companies, which cannot be exceeded. Among the permitted objects, a trust company can:

² As defined under Section 11 of the Companies Ordinance (Cap. 622), a company is a private company if

(a) its article:

(i) restricts a members’ rights to transfer shares;
(ii) limit the number of members to 50; and
(ii) prohibit any invitation to the public to subscribe for any shares or debentures of the company; and

(b) it is not a company limited by guarantee.

| Comparing features of foundations with other legal entities: | | | |
|--|---------------------|---------------|--------------------|
| <i>Fundamental Features</i> | <i>Corporations</i> | <i>Trusts</i> | <i>Foundations</i> |
| <i>Shareholder's Interest</i> | ✓ | ✗ | ✗ |
| <i>Beneficiary's Interest</i> | ✗ | ✓ | ✓ |
| <i>Separate Legal Entity</i> | ✓ | ✗ | ✓ |
| <i>Operating for a defined Purpose or Benefit</i> | ✗ | ✓ | ✓ |

“ act as investing and financial agent for and on behalf of executors, administrators, and trustees or any other persons whatsoever and to receive money in trust for investment and to allow interest thereon until invested.... ”

While any company carrying on a business in the regulated activities of investment management or advising in securities is subject to be licensed by the SFC, trust companies registered under the Trustee Ordinance engaged in such activities “wholly incidental to the discharge of its duty as such (i.e. as trustee)” fall within an exemption from licensing requirement. The exemption would cease to apply if the portfolio management service provided becomes a separate or distinct business of the trust company, although a trustee company may typically appoint an appropriate investment professional to manage the portfolio or, in practice, acts on professional advice in carrying out its duties as trustee.

Besides the specific applicable exemption from license as an advantage, registered trust companies of bank groups may qualify to be trustee or custodian of SFC regulated investment funds. Otherwise, under current Hong Kong law, companies or institutions acting as trustee and providing trust services are going forward subject to a licensing regime and a “fit and proper” test, and come under certain regulatory oversight and requirements for complying with specific anti-money laundering law.

As a further remark in closing, there has been heightened regulatory oversight across financial and investment businesses, along with the international standards of increased transparency pursuant to anti-money laundering global initiatives and the inter-governmental cooperation in automatic exchange of information framework under the Common Reporting Standard.

While the trend for the growth of family offices shall continue, when balancing and planning personal and private financial and wealth needs, operators of family offices and the families themselves would need to ensure sufficient attention and consideration are placed on the applicable and evolving legal, regulatory and compliance issues relevant to their wealth management and wealth preservation.

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