Jersey Finance

Delivering Insight ▪ Driving Innovation

DRIVING FORCES BEHIND GCC HNW INVESTORS

2017

FOREWORD & OBJECTIVES

The importance of creating the right infrastructure and solutions for GCC families – especially as they invest and diversify overseas – cannot be over-stated.

Family business is the source of roughly 60% of GDP and an employer of over 80% of the workforce in Middle East economies, according to the Dubai International Financial Centre (DIFC). Further, it is estimated that USD1 trillion of assets will be transferred from second generation business families to the third generation over the coming decade.

And as this next generation looks more internationally, delivering a variety of succession planning options is becoming key to staying relevant to GCC families going forward.

Further fueling this is the fact the world is becoming more complex from a regulatory and transparency perspective.

This all bodes well for an International Finance Centre (IFC) such as Jersey. It has the scale, experience and depth of resources to understand and cater to the wealth management needs and requirements of clients from the GCC – and around the world.

Given the opportunities these trends also present for wealth managers and professional services firms targeting this client segment, we at Jersey Finance felt it important to provide further insights.

We therefore undertook some proprietary research in conjunction with Hubbis in March and April 2017 – conducted via an online survey, one-on-one interviews and a roundtable discussion. The objectives were to highlight key trends and client needs linked to the demand for advice and relevant solutions for HNW clients in the Middle East. For example:

- How can the wealth management and professional services industries address the challenges of families and family businesses in this region?
- How can the industry service the current and next generations of clients – especially in today's more complex world?
- To what extent do existing service offerings and product propositions need to evolve within the GCC?
- What's the likely impact of new international tax compliance measures – and what do clients need to alleviate their concerns?

We greatly appreciate the time and contribution of the participants in contributing to these insights.

GEOFF COOK
CHIEF EXECUTIVE OFFICER
JERSEY FINANCE

CONTENTS

Published by Hubbis in April 2017 in Hong Kong.

Michael Stanhope
Founder & Chief Executive Officer
Hubbis
T (852) 2563 8766
E michael.stanhope@hubbis.com
W www.hubbis.com

EXECUTIVE SUMMARY

"There is a need for offshore solutions amid a growing recognition in the region of the need for substance, sound corporate governance and robust legal jurisdiction."

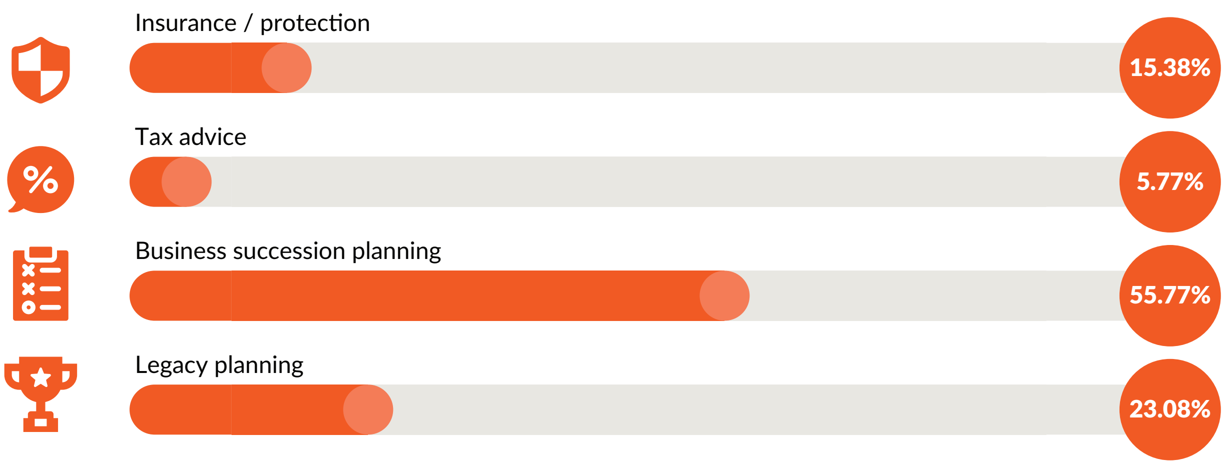
The importance of family businesses to economies across the Middle East demands that wealth managers and professional services firms find ways to service their needs when it comes to wealth planning and structuring.

This is essential as part of a smooth and orderly process of inter-generational wealth transfer – along with a proper business succession plan plus an estate plan.

Dealing with one without taking the other into consideration is doing only half of the job, believe industry specialists. And this needs to be implemented sooner rather than later.

It is also increasingly pressing given that the GCC is experiencing rapid growth as an emerging market. In turn, there is a need for offshore solutions amid a growing recognition in the region of the need for substance, sound corporate governance and robust legal jurisdiction.

WHICH OF THESE IS MOST CRITICAL FOR MIDDLE EAST FAMILIES TODAY?



Gaining more momentum to get started

"Business succession planning is the most pressing need in the GCC today."

At the moment, business succession planning seems to be in greatest demand in the GCC today among HNW clients, according to 55% of respondents to our survey of 70-plus industry practitioners across the region who service these individuals.

This is followed by legacy planning (23%) and insurance / protection (15%).

At the same time, however, the biggest hurdle for GCC families when it comes to wealth transition relates to misconceptions about the issues and solutions.

Just over 34% of respondents to the survey raised this as the main factor holding back clients in the region.

Practitioners also said that 21% of clients don't know where to even start the discussion. Lack of good advice / options (17%) and the lack of relevant Shariah structures (15%) were two other relevant issues.

A dearth of practical solutions

But while a recent DIFC Wealth Management Working Group report identifies models of best practice to create the most conducive succession planning platform for GCC families – professional services practitioners acknowledge wealth structuring and succession planning in the GCC is generally difficult.

An important issue lies in the fact that countries within the GCC are relatively new to the tradition of inheritance.

While many wealthy Europeans are used to the concept of inheriting, over centuries sometimes, a significant part of the wealth in the GCC still remains in the hands of the first generation.

This leads to some important questions, for instance: how prepared is the next generation to take over? Also, what value do they place on the inheritance? And, how can the first-generation ensure the next one perpetuates traditions to ensure their viability?

These and other, similar, topics are vital to address and clarify, especially for family businesses.

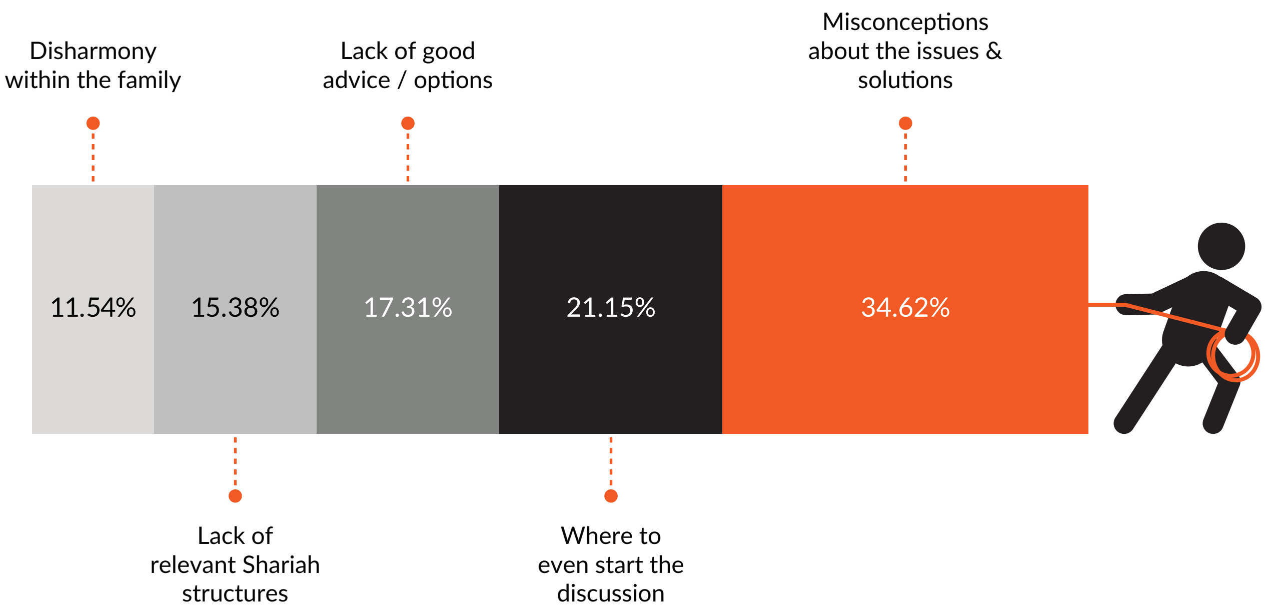
Adding to the challenge is the fact that many practitioners working in the GCC doubt whether the solutions that are available today will suffice to support families in transmitting the wealth to the next generation.

The efficiency and certainty which local laws and regulations provide to investors in some of these areas seem to be in question.

Such issues – regardless of whether they are more perception than reality – create a challenge for wealth structuring and for the GCC to promote itself as a strategic hub to secure private wealth in the region.

As a result, practitioners have observed growth in the use of wealth management structures from IFCs such as Jersey for activities such as co-investment, joint venture deals and also private funds.

WHAT'S HOLDING SOME GCC CLIENTS BACK WITH WEALTH TRANSITION?



Creating a new landscape

The region's private banks and wealth managers also need to play a key role in all of this.

This is specifically in relation to them encouraging and facilitating the growth and sophistication of family offices. The birth of the 'Family Business Private Bank' and the 'Family Business Private Banker' is long overdue.

A growing level of sophistication in this area would also help encourage the growth in structuring.

Indeed, faced with all the disruptive elements and challenges stemming from demographic trends, high costs of doing business, low profit margins and regulatory burdens – private banks need to make the shift quickly to stay relevant.

Carving the path in this way is crucial since there is a new generation of clients coming through which faces new challenges.

And they need solutions, amid the impact of the Common Reporting Standard (CRS) and initiatives such as the Automatic Exchange of Information (AEOI) in forcing greater transparency and clients to seek advice on the best way forward – and the right structures to help them get there.

"A growing level of sophistication [within private banking] in this area would also help encourage the growth in structuring."

RESEARCH SCOPE & CONTEXT

Recognising some of these developments and trends among wealthy families in the GCC, this White Paper is the culmination of the views of over 90 practitioners working in this market. These included individuals at private banks, trust and fiduciary services providers, consultants, law firms and other professional services firms – who participated in at least one element of the research. The goal was to get their perspectives on some of the following themes:

- Transparency in the GCC – and what this might means in the global context
- Privacy Vs transparency
- CRS and it impact in the GCC (especially the UAE)

These were gathered by focusing on the following discussion points and questions:

- How can the wealth management industry meet the needs of families and family businesses in the Middle East?
- What are the challenges these clients have?
- How are client expectations changing in relation to what they want from their wealth managers?
- To what extent do existing service offerings and product propositions need to evolve? What can really be done within the GCC?
- Succession planning – how can the wealth management industry help clients transition between generations?
- How can the industry service the new generation of clients?
- What's the likely impact of new international tax compliance measures for anyone holding money in the UAE as of January 2017?
- Offshore versus local structures – what are the options, and for whom?
- Reputational risk – how important is this to client when choosing a jurisdiction?

One-on-one discussions were complemented by further research in two ways:

First, we conducted an online survey, which was completed by 73 wealth management and professional services practitioners across the GCC. Respondents included a mix of private banks, law firms, trust companies, consultants and other providers of fiduciary services. Results were gathered on an anonymous basis.

Secondly, we held a thought-leadership roundtable in Dubai in late March 2017, to discuss the key talking points in relation to the themes of this White Paper.

"This White Paper is the culmination of the views of over 90 practitioners working in this market."

THE NEXT-GENERATION GCC FAMILY BUSINESS

The next-generation of young people in the GCC are generally considered to be smart, dynamic, educated and aware of the challenges of globalisation.

The majority of them are also keen to take over the family business and maintain the family business' legacy.

More specifically, according to a global survey carried out by Deloitte on next-generation family businesses in May 2016, they are applying their own set of ideas. They seem convinced that they will take on a different approach to that of the previous generation.

For example, the survey found that they would like to:

- Introduce further professionalism into the firm
- Take more risks
- Invest in technology and innovation
- Diversify their business
- Introduce proper governance systems
- Employ non-family members

Yet based on the observations of specialists in this field, the next-generation in the GCC is today still appear to be 'sandwiched' between local traditions and the requirements of globalisation.

Their risk appetite is also still limited, so they need to take action in a more robust way in order to meet their own vision and expectations.

Again, education and transparency are key.

"The majority of [the next-generation in the GCC] are also keen to take over the family business and maintain the family business' legacy."

"Nearly 56% of respondents to our survey said that loss of control is the biggest misconception that GCC families have when it comes to wealth structuring."

Challenges and misconceptions rife for GCC families

GCC families inevitably face a host of challenges that impact which solutions and what type of advice is required.

These can be broken down into several broad areas:

- Family challenges – dynamics between individual family members, conflicts, etc
- Succession challenges – knowing when the right time might be, who the right person is to take over, etc
- Business challenges – changing landscapes, geopolitical uncertainty, currency fluctuations, shifting economic cycles, etc
- Tax challenges – VAT, CRS, etc
- Emotional challenges – death, dynamics change, etc

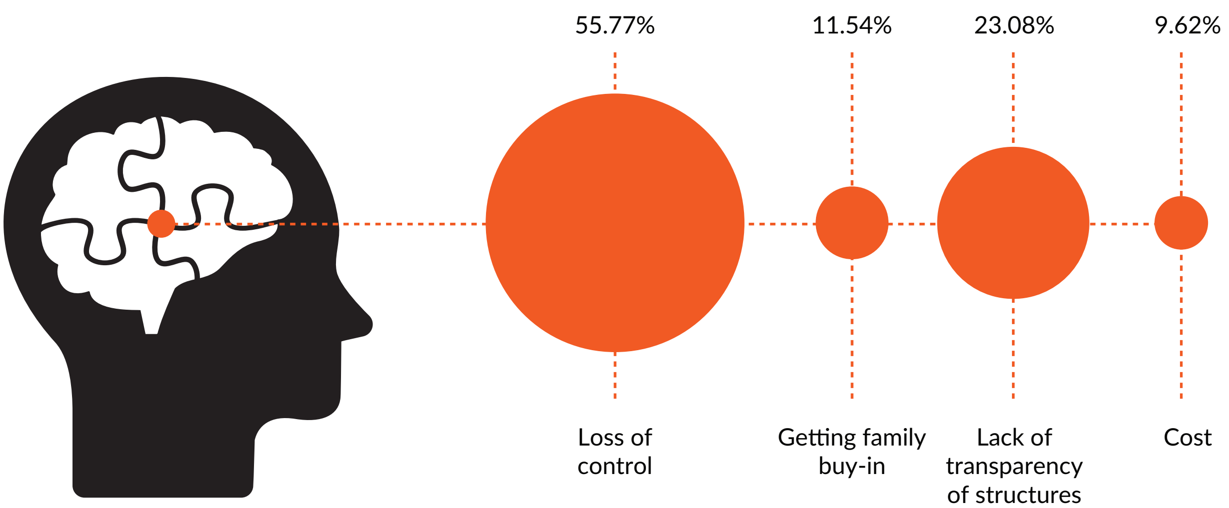
Added to these, patriarchs are not always willing to plan ahead, consider own mortality and share details of the business.

Further, mis-information about tax and tax obligations is rife within the GCC.

There are also various misconceptions that GCC families have when it comes to wealth structuring.

Nearly 56% of respondents to our survey said that loss of control is the biggest. The others are lack of transparency of structures themselves (23%), getting family buy-in (11%) and cost (9%).

WHAT IS THE BIGGEST MISCONCEPTION GCC FAMILIES HAVE WITH WEALTH STRUCTURING?



No one-size-fits-all solution

It is clear to see, therefore, that succession planning, to help these clients transition from one generation to the next, requires a different approach for each family.

Listening, encouraging engagement, education and sharing experiences are all key components of finding a solution.

Families also need to be encouraged themselves to ask whether they are making the most of their wealth opportunity.

For example, are they seeking advice to ensure that their wealth is preserved and passed on? Or, do they clearly understand the impact of VAT?

Some professional services practitioners say that the right approach to winning business from the next generation is to adapt to the families.

For instance, some of them in the second or third generations might need support in taking the idea of succession planning to the patriarch. Others potentially need support with their desire to spread their wings.

"Listening, encouraging engagement, education and sharing experiences are all key components of finding a solution."

The do's and don't's of legacy planning for Middle East families

Do's

- Talk, discuss, reach agreement
- Listen, take opinions on board
- Take tax advice
- Obtain updated advice if matters change
- Ask questions
- Fact-find – assets per jurisdiction

Don'ts

- Plan to circumvent Shariah principles
- Assume
- Exclude family members from airing their views
- Over-complicate
- Ignore tax
- Mix up family and personal ownership of assets

DELIVERING THE RIGHT STRUCTURES & SOLUTIONS

The barriers to smooth wealth structuring and succession planning in the GCC can probably be broadly broken down into two main areas: legal and cultural.

From a legal perspective, various restrictions, such as those on foreign ownership of land and LLCs outside Free Zones, mean that solutions need to be more tailored.

Adding to the challenge is the fact that this makes it costlier to implement. The region is also characterised by a very varied client base in terms of GCC nationals and different expatriates.

Perhaps most troubling for wealth management and professional services practitioners advising HNW GCC families, is the fact that many domestic solutions are largely untested.

As a result, there is a great deal of uncertainty, which acts as a major barrier to implementation when considered in conjunction with the costs.

People often turn to offshore solutions, therefore, implemented in jurisdictions that present themselves as offering more expertise, experience and more robust – and tested – solutions in terms of wealth structuring.

Culturally, meanwhile, the common concerns across more developing markets for wealth solutions are just as real for families in the GCC, including:

- Loss of control
- Sensitivity around Shariah and privacy/confidentiality
- Long lead-in times, etc

"There is a great deal of uncertainty, which acts as a major barrier to implementation when considered in conjunction with the costs."

Against this backdrop, among what is likely to go wrong with estate and succession planning in the GCC, 30% of respondents to our survey pointed to the wrong advice about what clients need.

Although this didn't rank as highly as family disputes (50%) as the most likely cause of setback for structures and solutions, the wrong advice appears more likely to be an issue compared with clients using the wrong structures – or at least unnecessary ones (17%).

Inheritance tax implications seems to be of minimal concern, at least according to survey respondents, with just 2% of them choosing this option.

WHAT IS MOST LIKELY TO GO WRONG WITH ESTATE / SUCCESSION PLANNING IN THE GCC?

Assessing the use of trusts

> "Although trusts remain a valuable tool for offshore assets, there is still a limited use for them when it comes to onshore assets."

The difficulty of shoe-horning common law-style structures such as trusts into a civil law jurisdictions – and, instead, finding a local solution – sums up the dilemma industry professionals advising HNW GCC families.

The UAE and other GCC countries have increased legislative efforts to build a platform for wealth management and structuring. Such initiatives include the DIFC Trust Law, the DIFC Wills & Probate Registry, DMCC Single Family Office structure, and the Abu Dhabi Global Market.

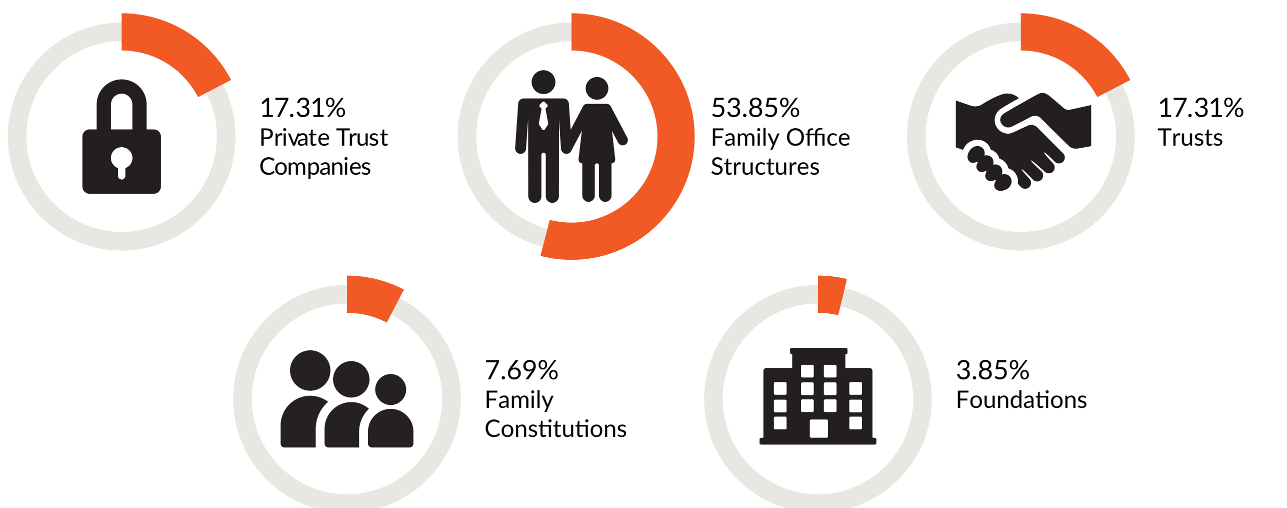
As with many other jurisdictions, the development of onshore wealth management platforms complements offshore solutions, where internationalisation of wealth is required.

Leading IFCs offer legal certainty, stability and substantial wealth management experience.

As a result, although trusts remain a valuable tool for offshore assets, there is still a limited use for them when it comes to onshore assets. This is because there is a need to deal with local interests as well as the laws and regulations.

This hasn't held back fiduciary services providers and others from trying to widely promote trusts in the Middle East as a wealth structuring solution.

WHICH OF THESE STRUCTURES IS MOST POPULAR AMONG GCC FAMILIES TODAY?



Saying this, DIFC structures, for example, are being used in a limited number of cases – and practitioners believe that this is likely to increase slowly.

Some practitioners say that a test case confirming the robustness of a DIFC structure, for example, would be incredibly valuable.

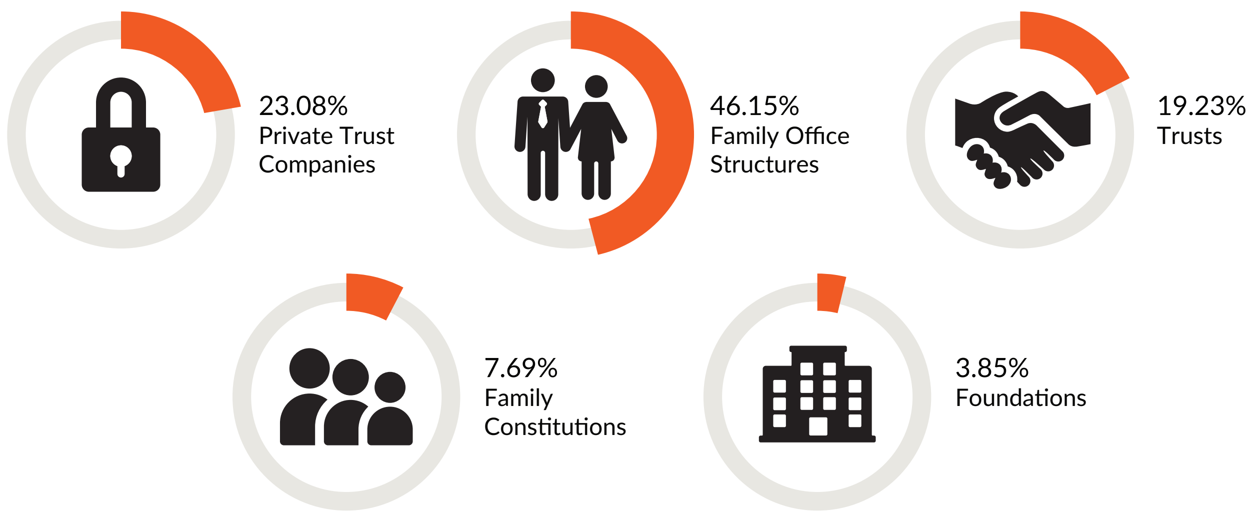
A need to be creative in the GCC

Professionals say that trusts are not the ultimate problem-solver in all cases.

In the absence, therefore, of being able to simply place assets into a trust to ensure their protection, practitioners say there are a few options for advisers in guiding HNW GCC clients:

- Use bespoke corporate structures
- Structure through the DIFC
- Implement the right family governance structure
- Put in place insurance contracts
- Make donations
- Create wills
- Put together shareholders agreements

WHICH OF THESE STRUCTURES IS MOST LIKELY TO BE POPULAR AMONG GCC FAMILIES IN 5 YEARS' TIME?



Such arrangements allow, by extension, share allocation, asset protection, property transfer, extraction of liquidities to occur without a trust being involved.

The most popular structures today among GCC families today, meanwhile, are family office structures (54%), according to the survey results.

Private Trust Companies (PTCs) and trusts (both 17%) are next, with some appetite for family constitutions (7%) and foundations (4%).

This is expected to be broadly the same in five years' time, say the same respondents. However, while family office structures will still dominate (46), PTCs are expected to grow in popularity (23%) and trusts are likely to get slightly more common (19%).

Family constitutions and foundations are not expected to be in demand any more than they are today, say respondents.

Pre-empting future disputes

Industry practitioners say that there are also structures and solutions to help HNW GCC clients prepare for and minimise the impact of future disputes.

Various corporate solutions and legal settlements are conceivable, they explain, but most important is to understand the angle from which the client perceives his reality.

From that point, advisers must adopt the right approach judiciously.

This involves addressing questions such as: do we want, together with the client, to put in place a unilateral mechanism of blockage against potential complainers? Or, do we want to work more transparently and create consensus to prevent complaints from arising at any time?

The best way to prevent a conflict, suggest practitioners, is to opt for the latter – be transparent and reach an agreement with all the parties involved or interested in the case.

When this is not possible, however, lifetime arrangements with a compensation approach could be privileged, for example, in respect of succession planning.

"The most popular structures today among GCC families today, meanwhile, are family office structures."

"Attention should always be paid to the presence of imperative rules."

Enforcement-related considerations in the GCC

When talking about wealth structuring, attention should always be paid to the presence of imperative rules – such as rules of forced heirship and rules of ownership restrictions that may apply, in certain scenarios.

When cross-border elements are involved, risk of conflict of laws in the eventuality of death or litigation, for example, should also be taken into consideration and addressed properly.

Again, proper due diligence and understanding of the legal framework relevant to each case is essential to lead the client towards the right solution over both the short and long term.

A Will to create new initiatives

Two years ago, in May 2015, Dubai implemented a novel succession planning solution to offer a first-of-its-kind in the Middle East and North Africa (MENA) region for non-Muslims – the new DIFC Wills and Probate Registry.

Its mission has been to address the concerns and issues in terms of certainty of inheritance, especially for the expatriate community of Dubai. It provides these individuals with the ability to register English-language Wills that allow their Dubai-based assets to be transferred upon death according to their wishes.

Although the rules governing the Registry were developed based on international best practice, they also reflect the spirit of the existing UAE laws.

The latter has meant that non-Muslims can choose an alternative legal system to govern distribution of their estates.

More broadly, this development also broadens private banking propositions for long-term planning, essentially giving bankers more options to offer to their clients.

So while HNW individuals may still opt for various instruments to plan for the long-term, such as trusts, special purpose vehicles and offshore structures, they can now also consider a simple, straightforward mechanism in the DIFC Will.

MANAGING THE IMPACT OF TRANSPARENCY

The reality of cross-border tax transparency is creating daunting new challenges for HNW GCC clients and advisers alike – just as it is for their counterparts around the world.

The likely impact of new global tax compliance measures, for instance, include:

- Increased reporting, tax residence, information exchange
- Lack of awareness
- Necessity of review of extent of compliance, including closure of amnesty schemes / voluntary disclosure
- The fact that authorities will soon have the information, so it is no longer 'unprompted disclosure'

Concerns over advice

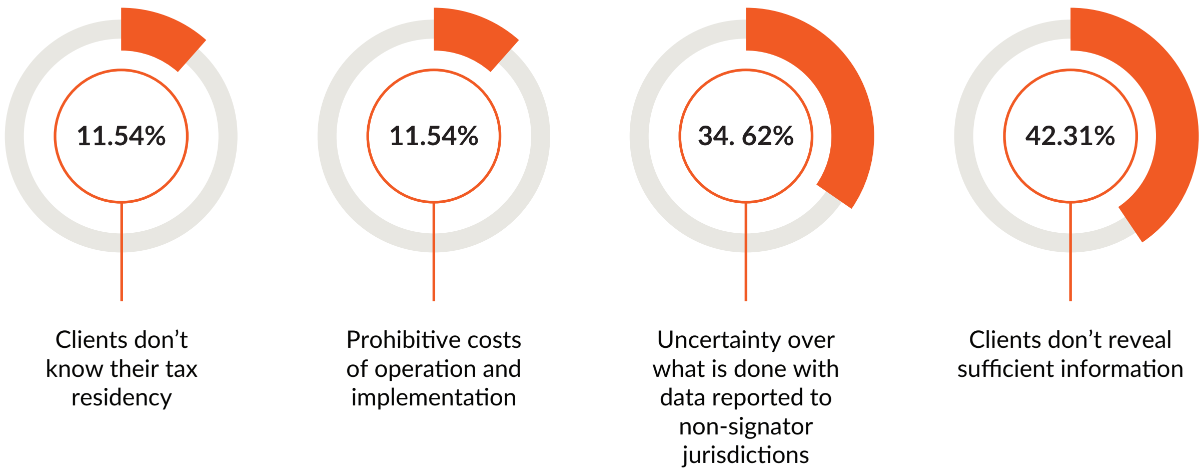
However, as information about offshore investments and structures starts to find its way back to a client's home country, the sweeping impact of CRS will also extend well beyond personal taxation; it will shine a spotlight on the practices of wealth managers too.

In particular, CRS will test their approach to advice, and their compliance with cross-border rules, forcing many of them to rethink the way they conduct their business.

This is raising significant concerns for practitioners when advising families around AEOI and CRS.

"The sweeping impact of CRS will also extend well beyond personal taxation; it will shine a spotlight on the practices of wealth managers too."

WHAT'S THE BIGGEST CONCERN WHEN ADVISING FAMILIES AROUND AEOI AND CRS?



The biggest, according to respondents to the survey, is that GCC clients don't reveal sufficient information about their situation and assets (42%).

This is closely followed by uncertainty over what is done with data reported to non-signatory jurisdictions (35%).

Other concerns include clients not knowing their tax residency and the prohibitive costs of operations and implementation (each option was 11% of responses).

Turning uncertainty into opportunity

Despite all of these issues, the more proactive practitioners can find ways to use this situation to be able to stand out.

A challenge for many clients dealing with unfamiliar taxes and legal systems, for example, is not that they don't know all the answers, it is more that they don't even know some of the questions.

And that is where advisers from IFCs can help clients rationalise the use of specialists such as lawyers and tax professionals when dealing with specific issues of each country.

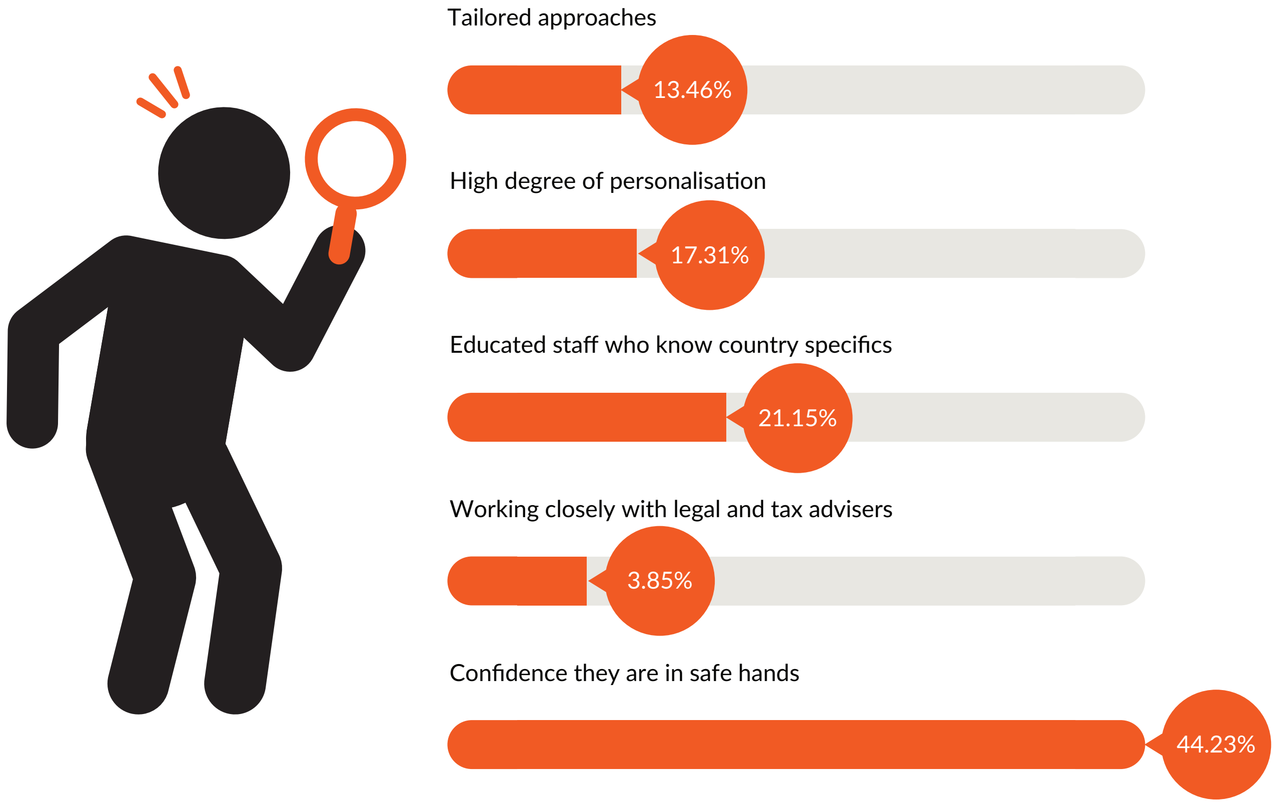
By knowing a little about a lot, advisers can flag potential problems clients may face relating to conflicts of law, taxation, reporting and so on – and then guide them to specialists.

At the same time, some GCC practitioners believe that increased transparency measures such as CRS bring a real opportunity to revisit the structuring models to ensure that greater substance is brought into individual jurisdictions.

As service providers look to position themselves to benefit from all of this, survey respondents believe that clients will be most focused (44%) on how confident they feel that they are in safe hands.

Clients will also look to advisers which have staff who are knowledgeable about country specifics, according to 21% of respondents. Other important considerations the survey highlighted are a high degree of personalisation (17%) and tailored approaches (13%).

WHICH OF THE FOLLOWING IS THE MOST IMPORTANT SERVICE GCC CLIENTS LOOK FOR FROM THEIR FIDUCIARY PROVIDERS?



hubbis

hubbis.com