Shaping the future of fiduciary services in the Middle East

At an exclusive roundtable discussion hosted by Amicorp Group in Dubai, banking and professional services experts from some leading wealth management and advisory firms discussed the future of the trust industry – including changes to future operating and business models and how they will offer wealth structuring solutions going forward.

According to the 2015 World Wealth Report by Capgemini and RBC Wealth Management, while the Middle East and Africa recorded higher growth rates than Europe in 2014 (8.2% versus 4.6%), the overall levels of HNW population and wealth remained much lower.

By contrast, regions like North America and Asia Pacific pushed global investable wealth to record levels to USD56.4 trillion, with North America still maintaining its position as the wealthiest market with USD16.2 trillion compared with Asia at USD15.8 trillion.

Looking forward, the main growth will continue to be in Asia Pacific, with India and China leading the way. The Middle East is predicted to grow at 6%, slightly below the global average of 7.7%.

Regardless of the numbers, however, what has become increasingly clear is the growing uncertainty that the global private banks face over the strategic positioning of their fiduciary services businesses.

This is against a backdrop of regulatory complexity, global tax transparency, compliance cost pressures, scalability hurdles and a shortage of talent.

As a result, many banks are at a tipping point in their decision-making around whether to remain in the business of wealth structuring and fiduciary services at all.

"These organisations are grappling with fundamental business objectives such as cost and risk reduction on the one hand, and scale and operational efficiency on the other," explains Peter Golovsky, managing director and global head of institutional sales at Amicorp Group. "Now, increasingly, the question of how – and indeed, if at all – they choose to deliver fiduciary services most effectively, is being put under the microscope."

Participating firms
(In alphabetical order)

- *2i Capital Group*
- *Al Khaliji Bank*
- *Banque Internationale A Luxembourg*
- *Bank J Safra Sarasin*
- *Bo Fric Associates*
- *Deloitte*
- *International Business Consultants*
- *Standard Chartered Private Bank*
- *Wragge Lawrence Graham*

Link to Amicorp / Scorpio report

In Dubai, these were among some of the high-level talking points at a discussion hosted by Amicorp.

This event also formed part of a series of global discussions that the firm has

led throughout 2015 and early 2016 with business heads – including in Hong Kong, Singapore, Miami, New York, Mumbai, Zurich, London and Sao Paolo.

Each roundtable aimed to examine the key strategic and critical issues facing banks around the important options and choices around how best to deliver fiduciary services – and also to explore these issues in light of a strategic report by Amicorp and Scorpio Partnership on the future of the trust industry.

STRATEGIC DILEMMA

The upshot of the various business challenges for the private banks around the world is that some of them either have already sold – or are now looking to sell – their trust arms.

They are considering exiting this business as the appetite for doing everything in-house has disappeared.

Other private banks continue to rely on these divisions to provide what they consider as value-add to clients.

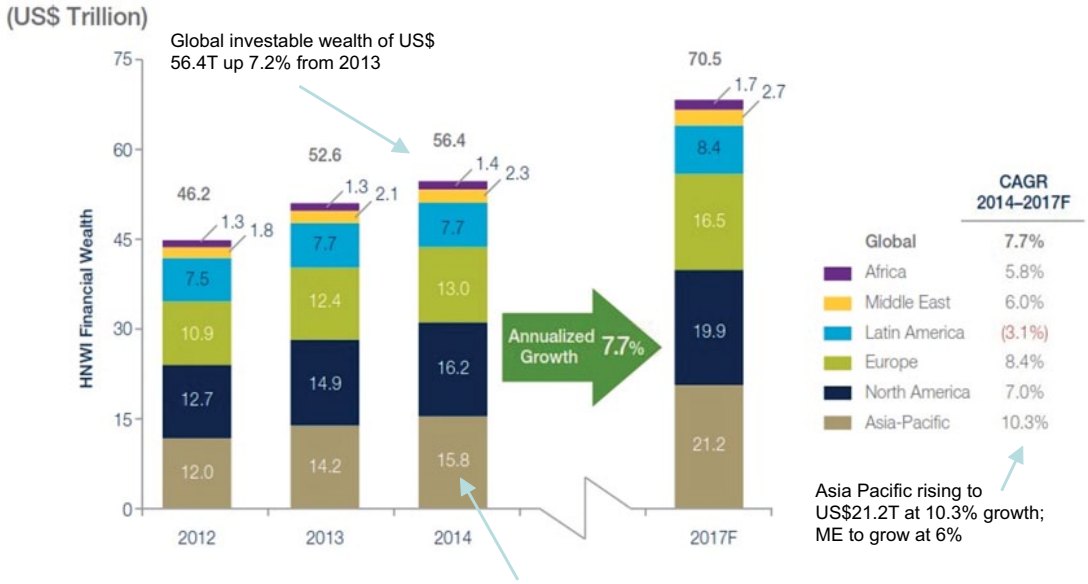
As banks of different types and sizes weigh their options, they are looking at the extent to which the fiduciary business is a 'cost' or 'profit' centre, depending on the institution's wider strategy and wealth management offering.

The stumbling block for these institutions is that they remain undecided. But the urgency of finding a solution is pressing.

In addition to FATCA, data leaks, increasing trends to any other exchange of UBO data, the new expansive nature and scope of financial information to be reported under the global standard of Automatic Exchange of Information (AEOI), commonly known as the Common Reporting Standard (CRS), Anti Money Laundering (AML) regulations, and increasing supervisory oversight, and the end of banking secrecy

PETER GOLOVSKY
Amicorp Group

GROWTH IN GLOBAL WEALTH – THE OUTLOOK FOR THE MIDDLE EAST



North America still ahead, but Asia Pacific rising? Whilst the ME and Africa recorded higher growth rates than Europe in 2014 (8.2% v 4.6%), the overall levels of HNWI population and wealth remained much lower. Looking forward, the main growth will continue to be in APAC with India and China leading the way. ME will grow at 6% slightly below the global average of 7.7%.

Source: Capgemini Financial Services Analysis, 2015

STATE OF THE GLOBAL TRUST INDUSTRY

10% per annum growth in trust industry business volumes

US$5trn worth of assets held by Latin America and Asia Pacific in offshore markets

475,000 trust structures held worldwide

50 - 60 interviews undertaken across the globe with leading market professionals

4 business models covered
- Universal banks
- Private banks
- Local banks
- Multi family offices

5 geographic regions analysed and covered around the globe

Amicorp brought together 50-60 participants across Asia, Europe and the Americas to disucss the future of trust and examine the key factors driving change in the industry.

Source: AMICORP / Scorpio Partnership

are all significantly changing the game of international private wealth planning.

More than 100 jurisdictions have committed to AEOI regarding foreign accounts and related income earned by tax residents of CRS-participating jurisdictions. With these commitments, all major financial centers are now part of the efforts to enhance international tax cooperation. Well over 50 jurisdictions will commence AEOI under CRS in 2016 with first automatic exchange of information in September 2017.

It is noteworthy that the US has still not signed up to the CRS, on the premise that FATCA and the Inter-Governmental Agreements (IGAs) with more than 100 jurisdictions is an equivalent regime to the CRS. But as the IGAs are not yet fully reciprocal, this has caused certain UHNW individuals to consider restructuring their investments to make greater use of US structures.

Yet this seems to be a short-term strategy, as the US has committed in these IGAs to implement a look-though approach in the IGAs. The consequence will be that all US banks and US investment entities (including trusts) will be subject to a look-through to the controlling persons with the resultant reporting under CRS for such persons to the extent they are resident in a CRS reportable jurisdiction.

With fewer and fewer places to legitimately hide assets, the time of "do not ask, do not tell" is over.

As a result, it is time to regularise the past. It is also time to assess whether there is a need to restructure investments such that the new transparency over beneficial ownership (actual or contingent) does not result in unintended consequences for the settlors and beneficiaries.

CATERING TO LOCAL TASTE

One of the noteworthy characteristics that some practitioners highlight about Dubai, for instance, is that the major banks remain quite conservative and less nimble than their international peers when it comes to providing fiduciary services, and trust structures in particular.

Indeed, in some cases, keeping a trust in-house at the bank can actually damage the wider relationship with the client. As a result, many individual bankers will avoid selling their own in-house services in favour of proposing to their client an alternative solution.

At the same time, the increase in private wealth management offerings is being driven by the growing wealth and number of millionaires in the UAE, while there is also a shift in the risk appetite of these HNW individuals as they adopt a more cautious approach. And in a volatile economic environment, these clients are increasingly looking at capital preservation.

Further, and according to the sixth annual Middle East Asset Management Study by Invesco, family offices in the GCC are also becoming more sophisticated with generational changes as they continue to seek professional help in wealth preservation and generation.

In line with these trends, more and more clients are becoming savvier around the concept of setting up such structures.

6 KEY FACTORS DRIVING CHANGE IN THE GLOBAL TRUST INDUSTRY

Source: AMICORP / Scorpio Partnership

They want to know who owns them, and the likelihood of the bank selling the trust business – and what this might mean for the client.

Cost is another challenge which arises, since some clients don't want to pay anything extra for the trust. They think their banker should handle everything related to their wealth.

More specifically in relation to CRS, participants have several questions in terms of the implications for Dubai, and the wider region. These include, how the authorities will collect and validate tax residencies, especially for more recent immigrants; and how to ensure data security and protection.

At the time of the discussion, the UAE, Saudi Arabia, Qatar and Kuwait were the only jurisdictions in the Middle East who had committed to sign up to CRS. And there had been no guidance yet from any of the central banks.

Yet, the time for them to start what's known as the 'second phase' is 1st January 2017, collecting all the relevant information with a view to exchanging this information in 2018.

RESPONSE NEEDED

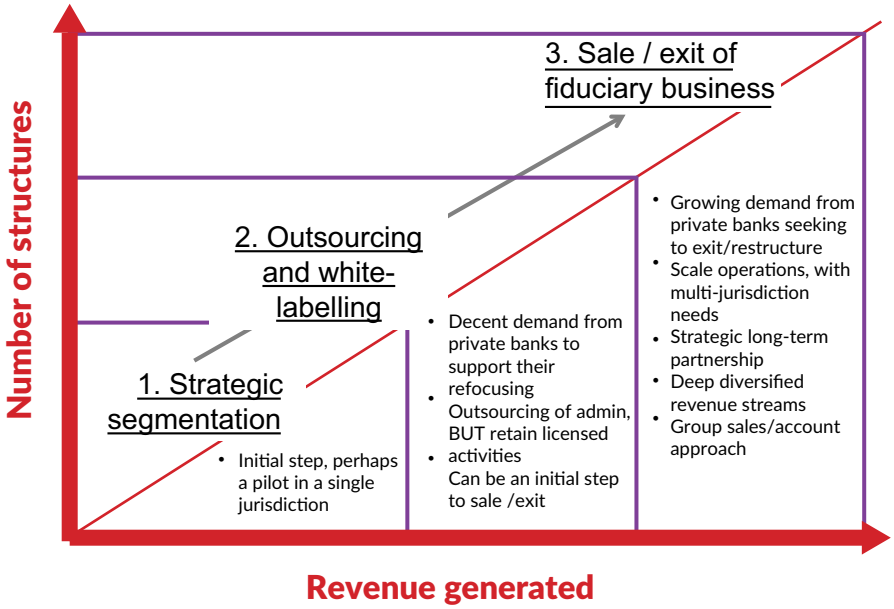
The latest developments around the world clearly impact bankers as well as their HNW / UHNW clients.

On one hand, the banks will require the account-holders to provide confirmation of full compliance or alternatively supported by professional opinions. On the other hand, the role of private bankers, wealth planners and other intermediaries is to support taxpayers in this process.

More than ever there will be a greater need for collecting client data and for understanding a client's business and objectives. Private clients have to be informed and educated about these global AEOI developments as well as rules in domestic legislation.

It may even be required to terminate relationships with those clients that fail to cooperate in a legitimate manner. "We are focused on helping the leading global private banks by supporting them as part of their review and consideration of alternative choices around optimally delivering fiduciary services," says Golovsky, which is working with more than half of the global top 10 private banks on such projects.

WHAT ARE WE SEEING - 3 MAIN APPROACHES BY THE BANKS



Recent work by one global bank, highlights that risk and cost reduction, together with need for growth scalability were key to exploring which options make sense.

Source: AMICORP

The starting point, however, needs to be to decide on the core business. As a result, determining the way forward is easier said than done.

Ultimately, the optimal outcome for each institution will come down to how it addresses the three-pronged challenge of managing costs, controlling risks and increasing revenue. And there is no right or wrong way to do this.

BRIGHT FUTURE FOR TRUSTS

A first-of-its-kind joint research project between Amicorp and Scorpio Partnership proves a useful benchmark in relation to the current state of the global trust industry.

In seeking to uncover the perspectives of industry leaders at global private banks across the Americas, Asia and Europe, the findings shed more light on four main aspects of the topic today.

First, the challenges and issues for the future of the trust industry; secondly, how senior executives view the fiduciary business in the context of a broader wealth offering; thirdly, the approach of different banks to the challenges from initiatives related to global tax transparency; and finally the focus of the remaining key benefits of trust (i.e. asset protection, confidentiality, estate planning for future generations etc).

"[From the research], we found that Asia Pacific and Latin America represent the two largest international offshore markets with an estimated value of USD5 trillion of the total USD8.5 trillion," explains Golovsky.

Plus, while there are an estimated 475,000 trust structures worldwide, only around 5% of the HNW population seems to have a fiduciary structure.

"That presents interesting opportunities for us in this segment, and in terms of the growth rate in business volumes across the trust sector," he says, "which is estimated at 10% per annum, with the emerging markets of Asia Pacific and Latin America to lead the way."

CHANGE DRIVERS

The Scorpio report highlights six key factors driving change in the trust industry. And many of the private banking leaders at the discussions in several financial centres agreed with these as key issues shaping the future of the fiduciary business.

First, is a combination of cost management, business profitability, consolidation and polarisation. Bank-owned trust companies are reviewing their operating models for fiduciary services, evaluating what is core versus non-core, and what aspect of the offering to retain in house, said a number of the banks represented.

"Their options include a sale, strategic segmentation, or outsourcing / white-labelling," says Golovsky. "I expect to see consolidation as banks review their strategies and re-assess their core businesses, markets and offerings."

CRS – KEY DATES

January 1st, 2016	New account opening procedures to record tax residence to be in place from January 1st 2016
December 31st, 2016	Due diligence for identifying high-value pre-existing individual accounts to be completed
March 2017	First CRS reporting by financial institutions
September 2017	Exchange of information between Competent Authorities commences
December 31st, 2017	Due Diligence for identifying low-value pre-existing individual account and entity accounts to be completed

Key dates for late adopters: 1 year later

Source: AMICORP

Secondly, there is an emergence of new operating models. These include specialist independent trust firms, challenging the traditional operators. According to some of the banks, one of the benefits this provides is the ability to access an open-architecture platform which offers scale, flexibility and reliability.

A third factor relates to cross-border complexities and regulation. To cater or HNW clients, given the changing regulatory environment and transparency that global regimes such as FATCA and CRS impose, there is much greater complexity required when creating structures across borders.

The G20 has since endorsed the AEOI standard, which went live in January 2016 (for the early adopters), with more than 50 countries signed up, and in addition 40 more who committed to sign the CAA's and apply the CRS.

FATCA is only about automatic annual reporting on non-US assets held by US individuals and entities (excluding active businesses) with US controlling persons.

Whilst the policy objectives of FATCA and CRS are identical, FATCA paved the way for CRS, a regime which focuses on AEOI on a multi-lateral basis.

Both FATCA and CRS create an enormous compliance impact for financial institutions (FIs) – under the latter regime, all tax residents of all Reporting Jurisdictions will have to be identified and information about their financial accounts reported on an annual basis.

And based on the look-through approach applied to passive entities, the FIs also have an obligation to identify and report the controlling persons of the entity account holders.

This all will require FIs to make significant investments on compliance and systems, to assign a FATCA and CRS officer and project team, to assess the gaps and to adapt IT systems, onboarding procedures, policies, forms to undertake the required due diligence and annual reporting of these account holders who are tax residents of Reporting Jurisdictions.

Service providers are developing solutions to assist FIs in being compliant without compromising the client experience. Yet regardless of the type of fiduciary offering, whether these are standardised or more customised, roundtable participants are focused on high-quality services. And those that can develop specialist expertise in particular country and markets, in light of these changes in the regulatory environment, will have a key role going forward.

"There is a need for operators that can deliver 'product excellence' that offer transparency for regulators and governments," confirms Golovsky.

The demand for talent is another key issue for the industry, regardless of business models and geographic diversity of the offering. And it is something at the forefront of the minds of many senior executives, given the limitations it imposes on the business model – regardless of other components which might be in place.

In short, this comes down to finding, attracting, training and then retaining talent. That includes wealth planning specialists as well as client advisers, to help banks keep up with projected growth rates in the HNW population.

Having sufficient knowledge is also more important given the need for practitioners to anticipate issues relating to the structures.

A fifth factor driving change stems from the goal of operational excellence and efficiency in administration, especially in light of margin compression. This again comes down to putting in place 'smarter' systems for functions such as trust administration, reporting, IT, compliance, client onboarding and AML.

At the same time, improvement is needed in the communication channels between adviser, trustee and client.

A final change-driver is in terms of the models to support the direction of the business. "The objective is to identify and implement operators and platforms that offer scale and open architecture to support growth," says Golovsky.

Diversification and a focus on new markets where real growth is taking place is another part of this strategy.

MAPPING AGAINST UNCERTAINTY

The choices private banks make about the extent and type of fiduciary services they will offer within today's changing regulatory environment has the potential to significantly re-shape the look and feel of the industry.

Some of the fundamental questions banking leaders are increasingly asking of themselves, and their senior management, include how best they can respond to tax transparency? And given regulatory scrutiny and complexity, along with enforced business changes, how can they deal with the cost of non-compliance of existing account holders with their offshore investment structures?

At the same, time, banking leaders expect to see structures getting more customised given clients' evolving needs, cross-border assets and movement, reporting obligations and the impact of the regulatory dynamics.

Yet complex structures are not necessarily appropriate. What fiduciaries need to provide is a combination of a tailored approach, a high degree of personalisation, staff knowledgeable about country specifics, close coordination with legal and tax advisers, and confidence that clients are in safe hands.

The choices for banking heads seem to boil down to one of two broad options, according to the conclusions of the roundtable discussions.

Either they remain in their core businesses and exit all non-core activities; or, for those operations which are considered to be more peripheral, outsource or white-label the offering. The benefits are essentially a de-risking that fits with their overall objectives in today's environment. Ultimately, they are striving to find clear points of differentiation in their strategy and value proposition.

Indeed, standing out is a key objective for many, which, by extension, is also likely to drive whether they in-source or outsource as a strategic priority.

However, that decision seems to be somewhat connected with the size of the organisation, according to participants at the recent discussions.

The larger banks have more capacity to invest in compliance systems and appear to have less appetite to exit the fiduciary services capability.

Mid-sized and smaller banks see the increasing burden of compliance as a moment to review their strategy to potentially exit or segment their portfolio to an independent service provider, while keeping the key relationship between the private bankers with the ultimate HNW / UHNW client.

Scale is seen as a vital ingredient. Finding a winning formula to re-align certain businesses to deliver the right service for a client who is willing to pay a reasonable amount of money for it, is akin to the holy-grail of wealth planning.

Plus, it is a way for organisations to achieve sustainable, controlled growth in priority markets. Yet doing that in a way that also enables the bank to control the risk – not just from a fiduciary point of view but also a franchise perspective – continues to leave executives stumped.

FINDING THE RIGHT PATH

It seems a growing number of banks are looking at their options from a practical perspective. In particular, they are focused on resolving the challenges in a way that suits their core strategy and also their approach to client segmentation.

"If you don't have wealth planning as a core strategy, you should outsource it", is a comment that sums it up well for many.

In general, private banks fall into one of three camps at the moment in terms of their thinking and positioning.

Strategic segmentation of the wealth planning and fiduciary services part of the business is one avenue that some are pursuing. This involves, for example, an initial step where perhaps a pilot is launched in a single jurisdiction. This might be done by fee threshold, or per market or product, for example. This is typically a first step to a more significant change down the line.

Other banks are looking at selling their fiduciary business, or otherwise exiting this space. In particular, this has been a growing trend, confirms Golovsky.

An alternative to the first two options is outsourcing / white-labelling. That can also be, for instance, an initial step to sale or exit.

"We have seen decent demand from private banks to support their refocusing through outsourcing of the administrative function, for instance, but they do retain their licensed activities." ■