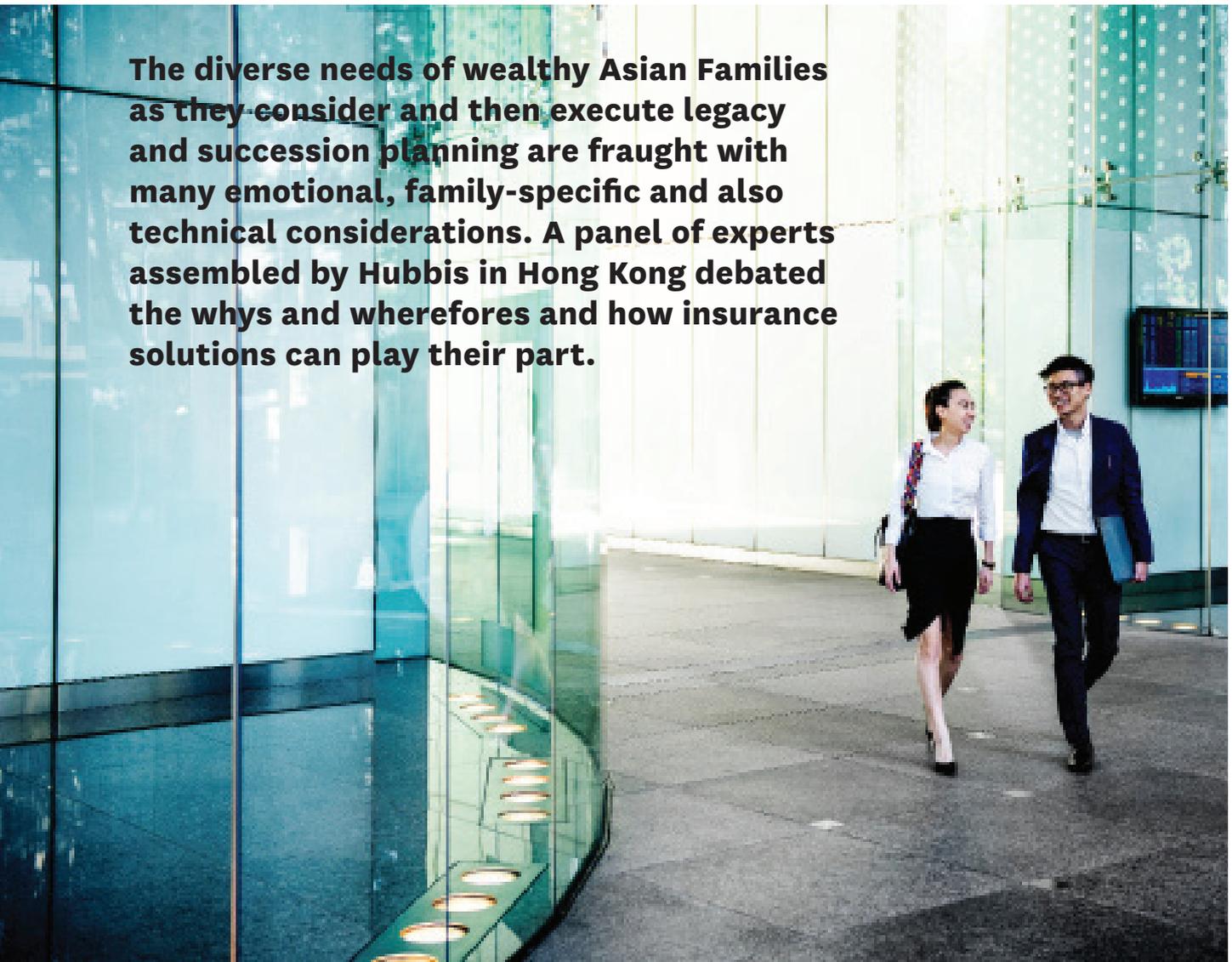


The New World of Transparency that Asia's HNWIs Must Today Inhabit

The diverse needs of wealthy Asian Families as they consider and then execute legacy and succession planning are fraught with many emotional, family-specific and also technical considerations. A panel of experts assembled by Hubbis in Hong Kong debated the whys and wherefores and how insurance solutions can play their part.



Executive summary

The new era of transparency and compliance is here to stay. The days of hiding assets in some esoteric structure in an exotic location and hoping no one will find out are well and truly over.

Asia's high-net-worth individuals (HNWIs) and their families must be made aware that they need to be more open with their wealth management and other advisers in order that those professionals can help them devise the best solutions for asset protection, estate transition and more broad succession planning. Structures and trusts can help achieve these goals, often supported by tailored insurance solutions that both protect assets and achieve liquidity in the event of a death.

The diverse needs of wealthy Asian Families to plan and execute legacy and succession planning are fraught with many emotional, family and also technical considerations. Moreover, Asia's wealthy are increasingly global in their spread of businesses, property, investible assets, lifestyles and family members, all bringing more complexity and potential pitfalls to the process.

The thinking surrounding the needs of wealthy families in Asia as they seek structures and processes to transition their wealth to the next generations have become, by necessity, far more sophisticated due to the proliferation in recent years of new regulations and often arduous compliance requirements. Transparency is no longer a vague concept, it is an essential instrument without which the best-laid plans will go awry, torn asunder by the authorities here or there, and sooner or later.

Structures put into place that might appear to have as their primary objective the avoidance or even deferral of tax obligations in any jurisdiction are now shunned by the private bank and wealth management community, or at least they should be. Any planning conducted for HNWIs and their families must be above board and transparent, with a clear and distinct non-taxation purpose. For example, succession planning and asset protection are "bona fide" reasons.

Each family is different, everyone within each family is unique, so a core challenge - possibly even a major responsibility - for the private bankers and wealth advisory community is to be bold enough to raise matters of life and death with the founder patriarchs or matriarchs, as well as with the younger generations. And then they must be imaginative and competent enough to structure transparent and regulatory compliant structures that will withstand the possible inspection of authorities in any of the relevant jurisdictions in which those families operate, reside or hold assets.

But to do this effectively, the bankers and other wealth management advisers must be highly sensitive to the cultures in which they operate, and the feelings of the individuals and the families concerned. This is far from easy, requiring the advisers to almost think like psychologists as they approach these delicate matters.

Hubbis invited a group of experts to a private, off-the-record discussion in Hong Kong to discuss precisely these topics and to debate how, for example, to incorporate insurance solutions into broadly-based HNW family estate and succession planning.

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The discussion began with one guest recounting the parable of a typical mainland Chinese family. Having built up a successful manufacturing enterprise, they sent their oldest son to America a decade ago to expand the business there and he has subsequently secured a US passport. They also have two daughters for whom the father bought properties in Hong Kong.

The bank which has been working with the family on wealth management has so far focused only on the investible assets the family has with the bank, the expert continued. The father wants to follow the Chinese tradition of leaving all the assets to the eldest son, but if he inherits everything then the entire business empire will become subject to American tax. Further complicating the picture is the son wants a more rapid expansion plan, so he wants to sell the Hong Kong properties and reinvest in another factory.

Globalisation of family wealth brings many issues

“So, we try to tell this client that by following what he thinks is Chinese tradition will create considerable problems,” the

panellist explained. “Moreover, when we raise the issue with the son he becomes entrenched against us, thinking that we are plotting against him, whereas actually, it is the US government that will take most of the money in this scenario. Our solution is that we are trying to convince the family to put not only their money but also the business into a trust in a structure to avoid most of these American taxes, and still achieve family cohesion where people work together and make sure that the daughters are not thrown out of the properties.”

The family, the story continued, said they preferred to hide the money in a BVI entity, but what they did not fully appreciate is that a host of new global regulations such as CRS, FATCA AEOI, tax changes going through in China at the moment, will combine to create huge problems for the family, if they take that route. “We can solve these issues to a considerable extent,” said the expert, “but we need to do so sooner rather than later, while the parents are of sound mind and healthy.”

China: inching towards global regulatory norms...

The tax changes in the pipeline in China were expounded on by a lawyer on the panel. “China is, in fact, a high tax jurisdiction,” he noted, “although Hong Kong, which is part of China, is not. A significant personal income tax reform passed in China this September [2018] and will now move to more international standards as well. This is changing things significantly, because in the past, for more than a decade, wealthy Chinese have tended to set up a low tax jurisdiction, special purpose vehicle, usually a BVI, to hold offshore assets, which

was ok as there were no anti-avoidance regulations, allowing them to defer the tax which is otherwise be payable from their own pocket by not declaring any dividends or getting any payments from the BVI company.”

However, he explained that the Chinese authorities have now passed a rule saying that whatever income is earned by the BVI or the low tax jurisdiction company, with no commercial purpose, or actually no point setting up the company other than to defer tax, then the earnings by the BVI company, even if there is no declaration of dividend, will be deemed as personal income.

“And that,” the lawyer explained, “is why more and more Chinese mainland HNWI are looking into trusts nowadays.”

However, he also highlighted China’s GAAR, or General Anti-Avoidance Regulation, which he said is a potentially fierce weapon. “In fact, the GAAR does not even mention structures or similar, it simply states that no matter what legitimate structure the individual has, a trust or whatever entity or structure, if the primary purpose of it is deemed to be tax avoidance then they can act. The GAAR has been in effect for a decade now and there are so far few cases of it being used against taxpayers, but it does exist and could be used.”

Accordingly, his message was that whatever planning is conducted for HNWI and their families must be above board and transparent. “Make sure that there is a clear and distinct non-tax purpose in the planning, so succession planning and asset protection are bona fide reasons.”

Where there is a Will...

Another guest referred to research from a leading international bank



that found only 46% people of Hong Kong died having a Will, in other words, 54% die intestate. “In countries such as the UK, Canada or Australia, more than 90% of people have a Will. Why then would people in Hong Kong want to throw themselves to the mercy of the intestacy rules here, especially if they have wealth and complex families? Why do people not face this problem head-on?”

Clearly, a core reason was that discussing matters of life and death with advisers or family was troublesome. “It is easier to put it off,” he said, “if there is no immediate imperative to address this. The Chinese, in particular, worry that to contemplate mortality is to invite it. However, as a lawyer today I find that old-fashioned and always advise people to organise a Will.”

Another guest highlighted the trillions of dollars equivalent that will be transferred between

families and generations in the next two decades. “The older generations in Singapore, or Hong Kong and the business-founder generations in China still hold most of that wealth. The careful and structured transition of that wealth is vital, and a Will is preferable, even if there are those who will fight the contents later on, for whatever real or spurious reasons.”

He added that trusts are not widespread in Hong Kong, even if they have considerable merits for succession planning and efficacy. Education is part of the process to make clear to clients that effective planning will achieve their goals, rather than leaving things to chance or to the whims of the legal system and its constituents.

Trusts are not bulletproof if lawyers get involved

Another lawyer present at the table raised the issue of disputes surrounding the trust themselves,

arguing that having such structures is no panacea for estate planning and succession. “Trusts can be the subject of disputes, as well,” he stated. “We have seen this in the Hong Kong newspapers, so sometimes clients feel trusts have negative associations, even when I am trying to convince them that a trust is a good idea.”

Nevertheless, he also noted there are plenty of cases where the clients have decided that a family trust is a good idea. “In these cases, we have to make sure that the trusts are carefully structured in light of the realities of the situation tailored to each family environment.”

Another attendee highlighted just how complex families anywhere can be and that when money is thrown into the mix it can bring out the worst tendencies in people. “One almost needs a qualification in psychology to fully understand family emotions and family dynamics, but the key

is dialogue with the key players, whether those are the patriarchs and matriarchs, often the key protagonists in Asia, to develop understanding of their objectives, their needs, of the assets, of the family members and so forth.”

Then, he said, it is a case of looking at all those issues, trying to come up with a scheme effective for all the parties involved and from that plan then use building blocks for succession planning to ensure a smooth and successful intergenerational transfer of assets.

Insurance an ideal partner in estate planning

“One of those building blocks is most certainly the trust, as far as I am concerned,” he elucidated. “But

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He then added that solutions such as insurance can also attract inheritance tax bills and that a trust might also be employed to hold the insurance product. “I do not think there is a single solution to any family situation, it is a case of looking at the total facts, circumstances, needs and objectives and coming up with

a plan and using the right tools to meet the succession planning requirements, taking into account a host of concerns such as jurisdictions, legal issues, tax issues, aside from as the specific family-related issues.”

Another guest took up the matter of the lack of Wills in Hong Kong, explaining that as there is no inheritance tax, people might think that there is no inheritance tax problem, but noted that many of the wealthier people from here have overseas properties and other assets, where there is a hefty inheritance tax.

Liquidity essential at times of family crisis and stress

“Accordingly,” he commented,

“one of the things that we use insurance for is to make sure that there is money to pay that offshore inheritance tax because if we do not plan for that and if there is insufficient cash available within the estate, then the family would be forced to sell that property, or that family business, just to pay the inheritance tax bill. This is insurance more related to risk mitigation rather than an investment product in itself.”

Another participant expressed his agreement, noting that it is easier to sell insurance as part of a more holistic approach to planning, knowing the client’s

needs. “Insurance is a great tool for the wealth transfer strategies or succession planning of most of my Chinese clients, especially linked to trusts which are more popular as BVI become less useful and less accepted.”

He also highlighted how even after recent tax reforms, the rule persists stating that if there is any distribution from life insurance to beneficiaries, even though the beneficiaries are all China tax nationals and, or tax residents, they should be tax exempt, so that is why we like insurance as a very useful tool in combination with other wealth planning strategies.”

China – will they, or won’t they (introduce estate taxes)?

He also alluded to planned changes in China to inheritance tax. “Nobody knows when China will implement estate taxation, even though the process has been under consideration for many years. The fear is that if it comes in, the highest tax rate on estates that has been mooted is 50%, which is even higher than the US, the UK or most other countries. So, for this potentiality and for those jurisdictions where people have assets overseas insurance can be a very good tool and it is worth noting that at present China does not differentiate between onshore and offshore insurance products. We must hope that remains the case, or they might follow the Taiwanese lead of some years ago and have a threshold ceiling for exemptions.”

Digging further down into the detail of insurance solutions, another expert commented that insurance has three core roles. “Traditional risk management is one facet,” he said. “Then there is liquidity through life insurance



that pays out cash to the family members. There is even life insurance that can be taken out by individuals on other lives, in order to be able to, for example, buy out business partners or investment partners and so forth, what we might call commercial ‘keyman’ arrangements.”

A safe pair of hands

The discussion turned to the kind of advice that should be proffered to bankers aiming to engage their clients in discussions on succession planning, estates, structures and insurance solutions.

“In your capacity as a trusted advisor to the client, as a relationship manager on their bank account you already have a privileged position, they already have trust in you,” offered one expert. “This means you, in fact, have somewhat of an obligation to broach what can be difficult topics with your clients, a bit like a doctor who must give results

to his patients, good or bad. We all know that many clients have a big mess in their financial affairs, they have no will, one can foresee a big family fight that will arise when they pass away, but there are many things that we can do to help those outcomes. In short, you need to start the discussion with the client. But begin selectively and with easier topics, then bring in other elements and perhaps other professionals.”

Another professional from global advisory and services firm said the key is to listen. “You must not be product driven,” he advised, “and do not try to fit the client to products, especially in complex family situations. Sometimes, especially with Chinese people, these can be complex and confusing discussions, but we need to mine down to the real issue behind their concerns, to understand more completely before we see how to strategise for the client. There are always trade-offs to

any type of planning, but we can only try our best to provide the optimal solution.”

Knowledge-based selling

Another panel member observed that aside from understanding the client, high levels of knowledge are vital. “You might not be an expert in many areas,” he noted, “but you must have a strong grasp of the issues in order to be alert to potential pitfalls. You should be willing to open the door to other experts where there are needs and to ensure that the solution delivered to the client is the very best for that client and that will likely entail involving banking experts, insurance experts, the legal and tax experts and the trust experts.”

He added that with most of the major HNWI clients his firm works with it is not a single dialogue between trustee and client, it is a multi-party discussion, working cooperatively with other professionals to ensure that the

client ends up with a succession plan and structural solution that is really fit for purpose.

Another guest cited the example of a non-US individual who wished to set up a trust for US beneficiaries. “As soon as we asked where this person got his assets from there was a stony silence,” he recalled. “As it turned out, it was a US person who gave or was about to give these assets and we quickly raised that as a red flag issue. We should not be afraid of being upfront with concerns.”

The end of (non-transparent) days

In conclusion, one attendee said that the era of transparency and compliance is here to stay. “The

days of the safety deposit box key, the bearer shares, no one knows anything, no one will find out, those days are over. Clients have got to be aware that they must tell you the facts, so you can advise them properly. Moreover, we must speak in a way the client and follow the client’s sensibilities in delicate areas of discussions, especially about mortality, or possible loss of cognitive faculties, divorce and so forth, all difficult areas to touch on.”

He advised the banker to turn this around, to tell the client that the wealth and well-being of the family will be affected by some of these events if they do not plan effectively. “They also understand value, so in fact, they know that

a 51% shareholding is worth more than three sets of 17% holdings. Discussions like these focus their attention on real-world outcomes if there is no plan for example for the 51% holding. Reduction of the family’s wealth really does tend to get the family’s attention. In short, speak to the clients in a manner and a language they can understand, or identify with.”

Collective responsibility

The wealth management community has what is tantamount to a collective responsibility, both to raise these delicate matters of estate planning, and to then help structure transparent, accountable and compliant solutions. ■

