Adapting to the World of Regulation: How Asia's HNWIs Can Overcome the Hurdles Ahead

The world is seemingly undergoing a full-on assault from acronyms - whether they might be AML, KYC, FATCA, CRS, AEOI, BO, BEPs, or perhaps MDR – all launched in recent years by the acronym instigators, whether the US, the OECD, the EU, or whichever local regulatory body. The impact on the acronym targets – from the mass affluent to HNWIs and the super-wealthy – is dramatic. A panel of experts gathered at the Asian Wealth Solutions Forum to debate how the Asian wealth management community is reacting, and whether this is all producing a windfall of business for the industry or choking off the market's air supply.

These were the topics discussed:

- *Is the idea of mid-shoring gathering momentum?*
- *Are Asia's HNWIs and their advisers getting to grips with CRS reporting?*
- *What impact is CRS reporting having on the proclivity of Asian client to multi-bank?*
- *Are CRS audits manageable or cause for concern?*
- *What pressure will the Mandatory Disclosure Rules that the OECD has published impose?*
- *Are clients adapting to FATCA and FATCA audits?*
- *What is the impact of the new Economic Substance regimes on clients?*

PANEL SPEAKERS

- **Mark Smallwood,** Chief Executive Officer, Rapier Consulting
- **Michael Olesnicky,** Senior Consultant, Tax & Wealth Management, Baker & McKenzie
- **Fiona Chan,** Partner - Corporate, Appleby
- **Edmund Leow,** Senior Partner, Dentons
- **Zac Lucas,** Founder, Head of Legal, Centenal
- **Sebastien Hayoz,** Managing Director, Asiaciti Trust

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THE KEY TAKEAWAYS

CRS and substance driving change in the family office space

In the world of HNWIs and UHNWIs, the Common Reporting Standard (CRS) and new economic substance rules are pressuring clients to consolidate jurisdictions and to wean out those centres that might have negative connotations.

CRS audits next - joy to all mankind

The CRS audits are gearing up in number and depth, imposing a lot of internal pressure on the banks and the advisory community, and especially and ultimately on the end-clients. The wealth management community is advised to prepare, but thus far, they seem generally ill-prepared.

What exactly is substance?

The economic substance regulations and guidance are quite complex, and each jurisdiction appears thus far to be adopting a slightly different interpretation.

How much do you benefit?

The rising prominence of beneficial ownership (BO) registers is another spectre now haunting the wealth management community. There is little doubt that over time, the truth will out, so clients and advisers beware.

Will new pillars hold up the structures?

If the current pace of regulatory change persists in the future, even new structures and new supporting pillars are potentially unlikely to survive. Does this mean everyone should think about heading mid-shore, for example to Singapore, or to Hong Kong, where they can easily comply with all the required regulations and where there are fiscal and other incentives for the very wealthy to house their assets?

Trusting the trustees

The proliferation of new rules and guidelines and the demands of compliance are both pressuring the trust industry. Clients who do not appreciate the absolute need for an arms' length relationship are fooling themselves. Again, this might be driving more assets and structures mid-shore.

Could the US be a viable alternative?

The US has not signed up to the CRS, and while it does have FATCA, generally it is not reciprocal. Yes, and no. On the surface, the US is away from the grasp of CRS, but the US will stamp down hard on activities deemed to be avoiding FATCA and moreover, who is to say that the next US administration does not embrace CRS, especially if a Democrat is in the White House?

Disclosure no longer optional

The Mandatory Disclosure Rules (MDR) appear at least in part designed to prevent moving financial assets around into non-CRS jurisdictions, perhaps specifically the US. Reporting obligations for advisers and others in the wealth industry are becoming ever more intense, and the industry must be extremely cautious about advice that might be construed towards non-compliance.

Complexity is irreversible, transparency is here to stay

The journey towards full compliance and transparency is tough for all parties, but it is a journey that must be made. Ignore the road signs at your peril.

MARK SMALLWOOD
Rapier Consulting

"**WHERE I SEE MOST OF THE ACTION ON CRS IS IN THE FAMILY OFFICE SPACE** because the family offices are much more geared towards looking after the wider interests of the family," an expert began. "The economic substance laws are clearly applying pressure to clients who have companies in the offshore jurisdictions, whether the BVI, Cayman or the Channels Islands and the next step is you have to put up with the OECD minimum tax proposals which are designed to impose tax on companies in these tax-free jurisdictions. Whenever you leap over one hurdle, there always seems to be something new emerging."

Here come the (CRS) audits

The arrival of CRS audits are imposing a lot of internal pressure on the banks and other institutions. "There is a lot of nervousness about sitting in front of an inspector, and there is a universal lack of readiness," he reports. He added that from his viewpoint, almost no institutions in Hong Kong, for example, seem to yet have rules embedded into their AML manuals, or have a CRS specific manual, so the reviews are likely to fail every time. "Most financial institutions haven't even done the first trial audit internally, so they don't even know anything about staff competency, knowledge," he explained. "Desperate times ahead, we feel, for everyone, and the clients have yet to see the full ramifications."

FIONA CHAN
Appleby

EDMUND LEOW
Dentons

The good thing with Singapore is that the MAS are really consulting the financial institutions and they are trying to understand the hurdles that a financial institution has to go through. "This all has to be dealt with, so, of course, it does impact the financial institutions and the way we can operate, but I feel we can through this create a better world, a better industry, so I am supportive."

The economic substances regulations are and guidance are quite complex, with different approaches for the Caribbean jurisdictions and the Channel Islands, for example. "One would have to carefully look at all the guidance notes issued by the jurisdictions, because even though they are supposedly coming from the same orders from EU, they are fairly different in terms of how they define certain terms and consequently, it impacts how we would advise the clients to deal with the different aspects."

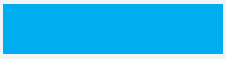
The guest also highlighted the rising prominence of beneficial ownership (BO) registers. "There are some interesting developments," the guest advised, "so for example in the Caymans now you can pay a small fee and obtain a list of current directors of any Cayman company. It is not like a full-blown register of directors with the history, or even full details on the current directors, or shareholders, but it is an interesting development. In short, beneficial ownership information is opening up."

"The result of all this regulatory change," said another panellist, "is people are wondering what is

ZAC LUCAS
Centenal

DO YOU BELIEVE YOU HAVE A FIRM GRASP OF CRS AND HOW IT APPLIES TO STRUCTURES?

Yes



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Source: Asian Wealth Solutions Forum 2019

going to happen in the future, and what is the future of the revised structures, even whether all these structures can continue in the long run? There was a time when people really thought that as long as they incorporate BVI, it is not going to be taxable, and would claim they were not aware that they were taxable. Then the question today becomes if they are not viable, then what can they do."

Pack up and go mid-shore

Should they, for example, all go mid-shore, to Singapore, or Hong Kong, where they can easily comply with all the required regulations and where there are fiscal and other incentives for the very wealthy to house their assets? "For example," this expert added, "you have Singapore clients holding BVI companies who have decided that they want to declare themselves to be resident in Singapore but of course they are taxable, they must comply. People need to realise they must be compliant and transparent."

Trusting the fiduciary providers

The discussion moved on to the role of trusts, trustees, and evolving fiduciary duties. "The area where we have the biggest difficulty is under the investment entities, and within that is all of the fiduciary industry, the core problem surrounds what is an account holder and what is a controlling person and the tension that has risen between the OECD and the industry on this," said one expert.

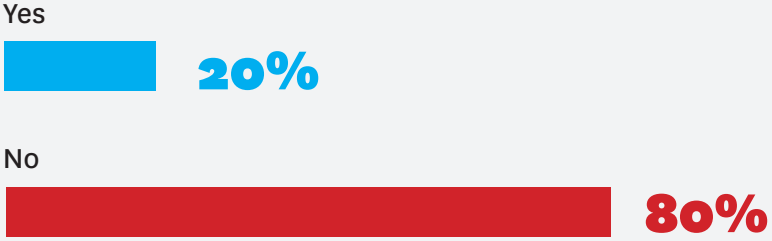
"So," he continued, "under a controlling person analysis, a protector would be captured, under an account analysis he would not be, and therein lies the issue with the OECD, because they got it wrong. There should have been alignment between the two, it is very apparent that they had made a mistake, the protector should have been the account holders from the beginning. This creates issues of interpretation between the OECD and the local regulators."

SEBASTIEN HAYOZ
Asiaciti Trust

How much control is controlling?

Another guest commented that there will be a

ARE ASIAN CLIENTS YET ABLE TO GIVE UP CONTROL OF STRUCTURES?



Source: Asian Wealth Solutions Forum 2019

global consensus before too long, after which no jurisdiction can step out of line. "In Singapore," he added, "the big question is, does the settlor who has created the irrevocable trust, and who can never get the assets back, does he really own anything? If it is a true trust, if the trustee is the one assigned discretion then in principle, the settlor has nothing at all. But of course, some people don't believe it, particularly people in the OECD."

The issue of significant power holders was also addressed, with a panellist noting that there are questions still on what this means in practice. "People have different views and we all need to keep an eye on documents coming out to clarify this and other matters, said the same guest. Another expert added that the settlor and protector are most obviously defined in the trust deed.

"There is no universal power that a protector has," he noted." In some trust deeds, there is a lot of power, in others there is none. One of the problems I suppose is that people have attempted to use these labels, but they don't know exactly what they mean, and of course there is no fixed meaning anyway. So, if you want a protector but you don't want to call him a protector, then you just call him something else, whatever that name might be. A trust is actually a very flexible product, it is not a form that is set and ready to be signed."

MICHAEL OLESNICKY
Baker & McKenzie

Alignment essential

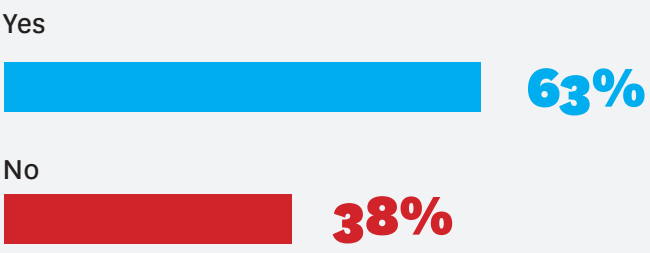
Perhaps the message here," came another voice, "is that there is greater alignment of all the rules and regulations and the regulators, the OECD and other bodies understand how people might circumvent, so the key message is 'don't try and be too clever', largely because it won't work in the long run anyway. People have to recognise that transparency is here to stay, and this kind of arbitrage wouldn't last very long."

Is the US a viable alternative as a jurisdiction? The US has not signed up to the CRS, and while it does have FATCA, generally it is not reciprocal. "Accordingly, said one panel member, "there is a view that you can put everything in the US, all our bank accounts, securities accounts, and 'bingo', so there has been a movement of people doing that, setting up trusts in the US for example, setting up entities in the US to hold these accounts."

A double-edged sword

However, he also warned that this is a bit of a dangerous strategy. "If you are doing it to avoid

ARE YOUR CLIENTS SIMPLIFYING EXISTING STRUCTURES (YES) OR PLAYING WAIT AND SEE (NO)?



Source: Asian Wealth Solutions Forum 2019

reporting and if you have tax income that is not being taxed but that should be taxed, the danger is that you are committing an offence under the US rules. Not only that, you are probably also committing an offence under your local CRS rules, as anti-avoidance provisions in CRS rules are directed at stopping the avoidance of CRS reporting. Moreover, there are dangers in the US, which is focused on those who move their accounts to avoid FATCA reporting. Be careful therefore not to make yourself vulnerable to be prosecuted later for tax evasion."

He added that if people are moving to the US, they need a rather solid non-tax reason for doing that, and that might need to be proven later. "And there are dangers for an adviser or a trustee or a bank that facilitates that type of tax-driven move."

MDR here to stay

Shifting the debate to the arrival of Mandatory Disclosure Rules (MDR), an expert observed that the rules pick up on moving financial assets around into non-CRS jurisdictions, perhaps specifically the US, although it is worth mentioning that from an OECD perspective I understand 51% of their budget comes from the US taxpayers, so they tend to be light on them."

Another guest remarked that the OECD is now encouraging countries to make it such that if anybody gives advice - a lawyer, accountant, trustee, or another expert - on how to avoid CRS reporting, they must tell the local tax authority." A fellow panellist added that a client asking specifically for such advice might also trigger an obligation to report them to the relevant authorities.

Advice will have ramifications

The panel then debated at some length the evident lack of certainty on what might be construed as non-compliant advice, even discussing to what extent trustees might at some point, due to some advice or action, become caught up in the global regulator nets. The reality is that these are still early days, that the overall guidance is still unclear and only time will inform the wealth management community. But the ramifications are clearly that even as there is uncertainty, clients and the advisory community must be extremely caution, certainly erring on the side of conservatism, and not venturing into uncharted waters.

"If you look at the penalty section of the Economic Substance Act," warned one guest, "there are the USD40,000 type fines if you get it wrong, and they also talk about custodial sentences, so on the enforcement side it is a very aggressive regime, I would suggest. If you really screw up on all this, and after all, we are all still learning here, there are significant penalties. Surely the authorities will achieve some level of sample cases to try and establish a baseline so that people can actually clearly comply."

A clear message

"The message is pretty clear," another panel member observed, "namely that it is really getting very complicated out there, and certainly the clients require detailed advice, but we all need to look at many areas of consideration, including economic substance, which is not easy to define, as we have all agreed. Clearly, this journey towards transparency is difficult, but from what we heard today is likely to become clearer. But the overriding and constant message to the clients must be to get themselves sorted out, that there is nowhere to go and hide, and they accordingly either need to start reporting properly, wherever they reside, operate from or move to." ■