

# **Bahamas: Proposed amendments to the Foundation Act, Dynasty Planning and getting our message across.**

- **Traditional structures and problems**
- **The Bahamian solution**
- **A Dynastic Wealth Ownership Structure**
- **Family Purpose**
- **Family Procedure**
- **Family Governance**
- **Keeping the dynastic Structure on track**
- **Family Bhive**

**Caroline Garnham  
Lawrence Graham LLP  
STEP  
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## 1. The Traditional Structure with a Protector

There is no point in having an offshore trust structure unless there is some advantage in doing so, which is invariably either tax or succession.

To meet the demand for this service many small island jurisdictions have enacted a trust law, this has been very successful in the Channel Islands as well as many of the Caribbean islands.

Whereas, if you were going to set up a trust onshore you would pick people to be your trustees who were capable of taking difficult decisions, such as when and how much to distribute, when and whom to sell the family business, most prospective settlors, do not know anyone they trust to take these decisions who is a resident of any of these islands, and so they appoint a professional trustee. This has resulted in booming professional trustee business in these islands over the last few decades.

Of course there are good professional trustees and poor professional trustees, and good professional trustees who turn into poor professional trustees when key personnel leave and vice versa. In setting up a trust offshore the settlor wants to have some comfort that a poor professional trustee can be removed.

This power is often therefore reserved to a third party – now commonly referred to as a “Protector”.

The settlor may also wish to reserve other powers to the Protector. He may feel that the Professional Trustee no matter how good, is ill equipped to make decisions on when and how much to distribute, and when and to whom to sell the family business.

Of course, if the Protector is given too many powers, even though he does not have the trust assets in his name, there is the concern that he could be treated as a trustee. In Re X and Charles Richard Blampied and Abacus (C.I.) Limited (1994 unreported) the Royal Court accepted that the late Ned Ram as

“the protector of the settlements, although not, in our opinion, the equivalent of a trustee and certainly not a trustee proper under our statute, acted throughout with the best interests of X’s family and of her beneficiaries in mind. This will be relevant when we come to consider his request to be indemnified and to receive certain remuneration. However, we are bound to say that some of his actions seem to us to come very close to inter-meddling”.

This shows that a protector who oversteps the mark may in certain circumstances be treated like a trustee and be exposed to additional fiduciary duties and liabilities.

A fiduciary relationship is defined as one that exists:

“wherever there is a relationship of confidence such that equity imposes duties of disabilities upon the person in whom confidence is reposed (the fiduciary) in order to prevent possible abuse of confidence.”

This does not preclude a situation where a Protector’s powers could be treated as personal, but it will depend not only on the drafting, but the manner in which the Protector exercised the duties given him.

If a protector is treated as a Trustee, there is the added danger that the trust may become taxable in the jurisdiction in which the Protector resides. His powers, other than the removal of the trustees are usually therefore reactive rather than proactive. He cannot therefore

compel a sale of the family business, but any sale the trustees may wish to make, may have to be with his consent.

## 2. Protector Liability

A Protector is now an accepted role, but still very little is known about his legal status. From the few cases that are beginning to emerge, it is becoming evident that the Protector is in a far more precarious position than a Trustee.

In Sociedad Financiera Sofimeca v Kleinwort Benson (Jersey) Trustees Limited and Others L(13 July 1992 unreported) trustees held shares in a company which had subsidiaries forming a large banking and financial operation in Venezuela. There was a commercial battle in Venezuela to control the operation. The plaintiff's sought to gain control whilst the second defendants, who were protectors, sought to retain control and prevent "the raiders" seizing control. The protectors also sat on the boards of directors of the underlying companies.

The Court said at page 27

"This case is particularly difficult because the protectors in effect wear two hats. Wearing one they have a fiduciary duty towards the trust, the trustees and ultimately all the beneficiaries; wearing the other they are director of companies that are locked in the throes of an enormously complex take-over battle where they might well be loath to yield up information to those mounting the take-over because it might be used to their disadvantage."

The leading protector case is Jurgen von Knieriem v Bermuda Trust Company Limited and Grosvenor Trust company Limited (commonly known as the Star Trusts case).

The Court held

- (1) the protector's power was fiduciary;
- (2) if the power was exercised for a corrupt purpose, for example, to appoint or benefit himself improperly, it would be void and be set aside;
- (3) the power must be exercised honestly for the benefit of the object of the power and not for personal benefit;
- (4) the new trustee was not shown to be an improper choice of trustee;
- (5) the power had been properly exercised.

Professional trustees have a higher standard of care than a lay person, as per the decision in Bartlett v Barclays Bank Trust Co Ltd 1980 which will probably also be true of a protector.

In Bartlett v Barclays Bank Trust Co Ltd [1980] 1 All ER 139 a trust had been set up in 1920. its major asset was a controlling shareholding in a family trading company. By the 1970s another generation had taken over the management of the company and the board of directors decided to invest in two property development schemes. One of these schemes was a financial disaster the effect of which was to reduce the value of the trust assets by a significant amount. A beneficiary sued the trustee company and restitution of the loss to the trust assets was awarded. The records showed that the bank had, as a major shareholder, receive annual reports and accounts but had remained a passive observer throughout and had never intervened or queried the director's proposals. The decision of the English Court of appeal is summarised in the head note as follows:

“It was a trustee’s duty to conduct trust business with the care that a reasonably prudent businessman would extend to his own affairs, and, in the case of a private company in which he was a majority shareholder, a prudent businessman would not be content to receive only such information on that company’s activities as was dispensed at annual general meetings. Moreover, a professional corporate trustee, such as the bank, owed a higher duty of care and was liable for loss caused to a trust by neglect to exercise the special care and skill which it professed to have. It followed that, notwithstanding the calibre of the board, the bank, as the controlling shareholder under the settlement, was under a duty as trustee of the settlement to ensure that it received an adequate flow of information from the board on [the company’s] activities in time to enable it to make use of the information to protect the beneficiaries’ interests by prevent the... project from being commenced and later from becoming the financial disaster it did. The bank was therefore in breach of trust in neglecting to ensure that it received such information and in confining itself to the receipt of the information dispensed at the annual general meetings. Even without such information, however, the bank had known enough to put it on enquiry about the projects. Since the loss to the trust fund would not have occurred if the bank had intervened to prevent [the company’s] participation in the... project, as it ought to have done, it followed that the bank’s breach of trust had caused the loss and that it was liable for that loss”.

It was evident that the board of directors were reasonable people who would have followed any reasonable policy desired by the bank had the bank’s wishes been indicated to the board. As the judgment went on to state:

“The loss to the trust fund could have been avoided (as I find) without difficulty or disruption had the bank been prepared to lead, in a broad sense, rather than to follow”.

Bartlett v Barclays Bank Trustee emphasises the importance of trustees safeguarding the trust assets and in this connection makes it clear that a trustee has a positive duty to keep itself informed and a positive duty to act if the trust assets are in danger. This may also be true of a Protector.

Although the duties of a protector may be fewer than those of a Trustee in a well drafted trust, the standard of care is not likely to be lower for a protector than a trustee.

### **3. Should a legal adviser be a Protector?**

It is not uncommon for a Settlor to want his legal adviser or accountant to be the Protector of his Trust and to remove and replace the Trustees. As everything is running smoothly it is not uncommon for this Protector to be contractually bound to and be paid by the trustee. However, when it comes to removing the trustee the Protector will be in a position of conflict and will have to retire.

The legal adviser should also check whether any costs or expenses, or liabilities arising in carrying out his duties will be covered by his insurance policy.

### **4. Protectors Rights**

#### **4.1 No trust assets under his control**

A trustee has the comfort of knowing that the trust assets are under his control, the Protector has no such comfort.

#### 4.2 No statutory right of indemnity on retirement

A trustee has a statutory right to an indemnity on retirement. A Protector has no such statutory right. Furthermore, if he asks for such a right the trustee must consider whether to give it will be in the best interests of the beneficiaries and if not is obliged to refuse to give such an indemnity.

#### 4.3 No statutory right to information

Article 25 of the Trusts (Jersey) Law, 1984, as amended, states that, subject to the terms of the trust and any order of the Court, a trustee is not obliged to disclose to any person any document which discloses the trustees' deliberations, the reason for a particular exercise of a discretion or to disclose the accounts save that beneficiaries have a right to call for accounts. Without appropriate terms in the trust instrument, a protector needing information in order to exercise his fiduciary duties properly would have to rely upon the Court finding there was an implied power to require such information. Such power would have to be an implied term of the trust deed.

#### 4.4 No right to engage and pay agents

It is not clear whether a protector has a legal right to engage and pay agents or employees in the performance of his duties, for example, to seek legal or accountancy advice. A clause in the trust instrument should therefore be included, failing which he will need to rely on all the beneficiaries agreeing, or the court making an order, or on the ability to claim expenses. Indeed, the protector may be doing his job very well but in a way with which the trustees do not agree and it is in just such a position that it is even more important to ensure that he will be properly compensated.

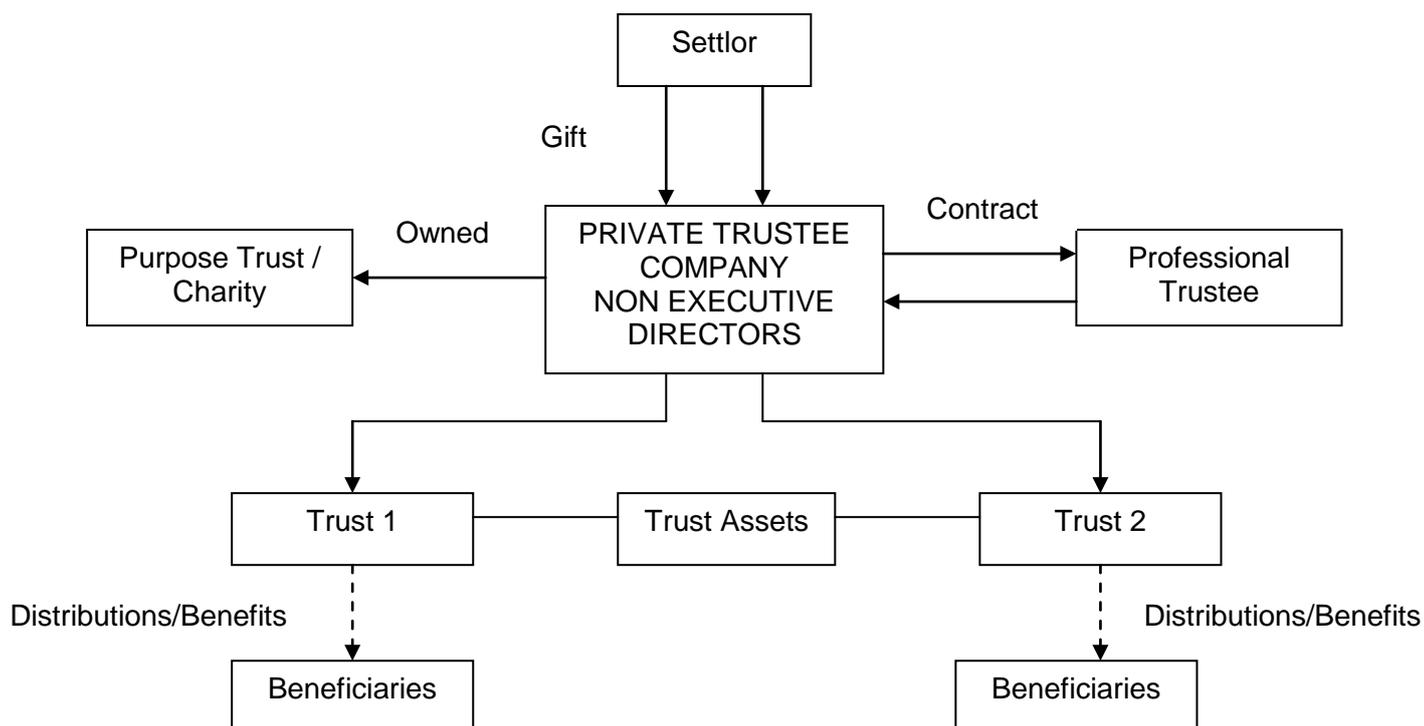
#### 4.5 No right to apply to Court for directions

In many jurisdictions protectors may not have the right to apply to the Court for directions or to seek relief from liability. Furthermore, it is hard to see how the terms of a trust deed could bestow this right since it involves a third party not bound by the Trust Deed, in the absence of law on the subject. Fortunately, in Jersey, Article 47 of the Trusts (Jersey) Law, 1984 allows a wide variety of applications to be made concerning trusts, and the Court may make such order as it sees fit relating to the execution and administration of the trust or orders concerning the trustees, including their appointment and removal, their submission of accounts and their conduct and payments. The Court may also make orders relating to beneficiaries or any person having connection with the trust. This could include a protector. The court is empowered to make a declaration as to the validity or enforceability of a trust and may rescind or vary any earlier order or declaration.

#### 4.6 No right to remuneration but right to be reimbursed expenses

On the basis that protectors are fiduciaries, the general rule relating to trustees is likely to apply, namely that, unless permitted by the trust instrument, they are not entitled to remuneration but would be entitled to reimbursement of expenses and liabilities reasonably incurred in connection with the trust. There should be administrative powers dealing with this. In the absence of them, the Court or all the beneficiaries will have power to order or agree that the protectors remuneration as well as his expenses is paid. Boardman v Phipps 1967 2 AC 40.

## 5. What is a Private Trustee Company?



A Private Trustee Company (PTC) is a company which can, under the local relevant law and in accordance with its memorandum and articles of association carry out the services of a trustee.

Many founder settlors are attracted to setting up a Private Trustee Company the directors of which are the people the settlor wishes to exercise the dispositive powers of the trust with an underlying investment holding company which is responsible to the Private Trustee Company, the directors of which are the people the settlor wishes to exercise the investment or trading functions for the beneficiaries.

The perceived difficulties with a private trustee company are:

- (A) The private trustee could be more easily attacked as a sham;
- (B) The company could become UK resident for tax purposes;
- (C) Where to incorporate;
- (D) Who to choose as directors; and
- (E) Who to own the shares of the Private Trustee Company.

None of these problems are insuperable if care is taken.

## 6. How to avoid the Sham Argument

To avoid an argument of sham it is essential that there is evidence that both the settlor and the trustee intended to set up a trust (Re Esteem). In addition the trust should be run as if it

were to be treated as a trust (Re Rahman). It is therefore essential that the directors of the private trustee company, especially if they are professional non family members:-

- (A) Have sufficient information regarding the nature of the private trustee company structure and their duties;
- (B) Insist that board meetings are held regularly;
- (C) Seek professional advice where the directors are in doubt as to how to proceed, as regards the administration of the family trusts;
- (D) Act together as a board, rather than one or two directors taking decisions which are then ratified by the others;
- (E) insist that trustee resolutions are properly recorded and are proactive not reactive.

In most cases the directors of the private trustee company will not have the time or the inclination to carry out the day to day duties of the trust administration. This can therefore be done by a professional administrator under a "Service Agreement". This agreement needs to be carefully drafted to include matters not covered by the normal trustee terms and conditions such as:-

- Provisions of the registered office of the private trustee company;
- Ensuring the trustee license is retained by following the laws of the jurisdiction in which the private trustee company is registered, including paying the annual return and license fee and arranging for the accountants to be audited;
- Record keeping, including a disaster recovery plan and insurance;
- Preparation of trust accounts;
- Limitation of liability and indemnity.

The composition of the Board and the mechanism by which it is replaced, monitored and supervised is invariably at the heart of the Family Governance. It is not however a position which a person, whether a family member or professional, should undertake lightly as there could be both common law and statutory implications if loss is suffered to the trust as a result of any actions or lack of actions taken by the directors.

As a limited liability company it must be remembered that it is subject to the corporate law of the jurisdiction in which it is incorporated and registered. It is also governed by the legislation/regulations governing the provision of financial services and money laundering.

## **7. Residence status of a Private Trustee Company**

A Private Trustee Company like any other company will be resident where it is managed and controlled. The residence status of the company will determine where the company, and trust is resident and whether they are each subject to tax.

The ongoing case of Wood v Holden (Inspector of Taxes) [2005] EWHC 547 (Ch) involved a tax scheme set up by PriceWaterhouseCoopers involving a Dutch company, with a single corporate director. The Director understood the nature of the documents he was signing.

The Special Commissioners decided that the Dutch company was resident in the UK, rather than the Netherlands, on the basis that the Director had been told what he had to sign.

Park J reviewed the authorities, and stated that the general rule under the central management and control test is that a company resides where its directors meet, unless there is an exception. One exception is the leading case of *Unit Construction Co Ltd v Bullock [1960]*. Park J held that for the Dutch company to be resident in the Netherlands it was sufficient for the single Director to have actually decided to enter into the transaction, even though if UK law applied, the Director might have been in breach of his general duties as a director.

In practice, to avoid being resident in the UK

- (A) a single director for an offshore company is not recommended.
- (B) Directors of the Private Trustee Company must understand what they are doing, and they should meet as directors of the company to discuss and at least be aware of the ongoing business of being a trustee. They should also meet as trustees to take decisions, review the administration, consider the distribution policy and investment policy of the trusts. The administration of the trusts must be offshore.
- (C) directors must make resolutions to sign trust deeds or any other documentation or decision.
- (D) directors should know what they are doing, not only for tax reasons, but also because of the general fiduciary obligations, which they owe to the company.

## 8. Liability of directors of a PTC

Family members, trusted advisers and others will generally only be willing to accept appointment as directors of a PTC if they can be suitably reassured that they will incur significant personal liabilities.

In Bath v Standard Land Co. Ltd. 1911 1 Ch 618, it was held, in the judgment of Cozens-Hardy MR, that:

"Directors stand in a fiduciary relation to the company, but not to a stranger with whom the company is dealing. It is of course true that a company acts through its directors. But that does not involve the proposition that if a breach of trust is committed by a company, acting through its board, a beneficiary can maintain any action against the directors in respect of such breach of trust".

More recently, in Bishopsgate Investment Management v Maxwell (No 2) 1994 ALLER 201 the Court of Appeal held that a director of a trustee company could be liable for breach of fiduciary duty. This case provides some authority that the right of the trustee company to take action against the director is an asset of the relevant trust.

The real danger, of course is dishonestly assisting a breach of trust, and the test of dishonesty.

The case of Agip (Africa) Ltd. v Jackson and Others [1992] 4 All ER 451 concerned a reputable firm of accountants in the Isle of Man which took over an existing arrangement from a large and well know international firm under which payee companies were provided to receive and transfer money on behalf of the plaintiff. Unfortunately the plaintiff's chief

accountant was systematically defrauding his employer by altering the names of payees and the substituted payees were all companies set up and controlled by the Isle of Man accountants. Although not parties to the fraud, the directors, who were the partners and an employee of the Isle of Man firm, were held liable to repay the moneys defrauded as constructive trustees. The evidence showed that the directors of the companies knew that the arrangement involved some impropriety but thought it concerned avoiding Tunisian exchange control. They, however, made no enquiries and therefore knowingly assisted in a dishonest scheme which turned out to be rather more dishonest than they had suspected. The court also thought that they knew they were laundering money even if they did not know the precise reason. They ought therefore to have made full inquiries and were liable as constructive trustees for their failure to act prudently.

Agip was followed by Royal Brunei Airlines SDN BHD v Tan [1995] 3 WLR 64 where it was held that a third party, be it knowingly or innocently, who dishonestly assisted a trustee to commit a breach of trust will be liable to the beneficiary for the loss caused by the breach, even though the third party had not received trust property and the trustee had not been dishonest or fraudulent. For these purposes the dishonesty of the third party will be assessed objectively. Dishonesty means not acting as an honest person would act in the circumstances and could be equated with conscious impropriety in contrast with negligent conduct or carelessness. In this context the court will take into account the personal attributes of the third party such as experience and intelligence. The decision, which extends the rules for deciding when a third party can be liable as a constructive trustee, is of particular importance to financial intermediaries, such as banks and their trustee companies.

The whole matter was thoroughly reviewed in HR v JAPT 1998/99 2 OFLR 252 Chancery Division, 19 March 1997. This case concerned a company incorporated to act as sole trustee of a company's pension scheme. The issued share capital was six shares of 5p each. One of the directors was also a director of the employing company. The plaintiffs (the current trustees together with an individual beneficiary, apparently acting on behalf of the beneficiaries of the pension scheme) argued that there were five distinct means by which that director should be personally liable for a breach of trust.

The action was a preliminary "striking-out" action, under which the judge, Lindsay J, merely needed to decide whether, even if all the facts alleged were true and proved, they were capable of constituting a cause of action at law.

It was decided that (under English law) a director of a trust company may be liable to beneficiaries of a trust administered by that company, but only if he or she has dishonestly assisted a breach of trust by the trustee, or on the basis of an indirect fiduciary duty or duty of care (a "dog-leg" claim). The basis of this claim is that the director owes a duty of care as a director to the shareholders of the company, but the level of care would be that owed by a director, and not the more onerous fiduciary duty owed by trustee.

## **9. Who to own the shares of the Private Trustee Company**

The main concern many settlors have in creating a Private Trustee Company is what or who should own its shares. If held by a purpose trust, what is the purpose and who is to be the professional trustee. If a professional trustee is the trustee, ultimate power of appointment and removal of the directors of the Private Trustee Company rests with the professional trustee which, of course, must exercise its powers in accordance with its purpose.

We have been working with the Bahamian Financial Services Commission to amend the Foundation Law in the Bahamas to include not only a purpose foundation to mirror the Bahamian purpose trust but also to create an ideal vehicle to resolve this concern. This new vehicle can also be used as an Enforcer or Protector and is called an Executive Foundation.

## 10. Creation of three types of foundations

10.1 We have amended the Foundation Act 2004 to provide for three types of foundations in the Bahamas (at section 4):

- (i) Ordinary Foundation - for the benefit of beneficiaries;
- (ii) Purpose Foundation - for:
  - (a) purposes; or
  - (b) for both purposes and the benefit of a beneficiary or beneficiaries; and
- (iii) Executive Foundation - established to carry out executive functions and the assets of the Foundation (other than the shares of the PTC) are to be used to meet the cost of carrying out such executive functions only and not for any other purpose or a beneficiary. It is envisaged that this would be the appropriate vehicle to act, for example, as an enforcer or a protector of a trust or to hold the shares of a Private Trustee Company.

10.2 The Purpose Foundation and the Executive Foundation incorporate certain relevant provisions already contained in the Bahamian purpose trust legislation.

10.3 It will be necessary for the charter of the foundation to contain a statement as to what type of foundation it is (section 11).

## 11. Bodies

11.1 Other than in the case of a Purpose Foundation we have provided flexibility regarding the appointment of officers and/or a foundation council. This facilitates the use of the most suitable body or bodies to run/supervise the foundation depending on the type of foundation being used and the structuring requirements of the settlor.

11.2 As we have discussed, as a general principle, it is important that there is a body or person who can supervise the running of the foundation by the officers/foundation council and who has enforcement powers. This is not, however, as important for an Executive Foundation which will hold limited assets.

11.3 In the case of an Ordinary Foundation, the beneficiaries will fulfil this function.

11.4 We have provided in section 19(1) that in the case of a Purpose Foundation (whether for purposes or for both purposes and the benefit of a beneficiary) both officers and a foundation council must be appointed. This mirrors the authorised applicant type role contained in the Purpose Trust Act.

11.5 Further, section 19(1) provides that in the case of Ordinary or Executive Foundations where officers have not been appointed under section 15(1), a foundation council must be appointed.

11.6 As mentioned, in the case of an Ordinary or Executive Foundation, it is possible to appoint a foundation council if it is considered necessary, but the requirement is not mandatory.

## **12. Allocation of powers**

- 12.1 These are dealt with in section 14.
- 12.2 It is envisaged that unless otherwise provided, the officers of the foundation shall have the powers as set out in the Act. While provision may be made in the charter and articles (if any) for these powers to be amended or varied, it would not be appropriate, where there is both a foundation council and officers, given the foundation council's supervisory role, for the officers to be able to exercise the foundation council's functions (section 14(2)).
- 12.3 We have moved the provision (formerly at section 15(8) and now at section 14(3)) which provides that in the absence of any officers of the foundation, the foundation council shall perform the duties and powers of the officers prescribed in the Act.
- 12.4 As a result of the creation of the three types of foundation, we have amended section 11 which deals with the requirements of the charter so that a charter must include the number and descriptions of the officers of the foundation and, where no officers have been appointed or a Purpose Foundation has been established, the charter shall include provisions for the appointment of a foundation council.

## **13. Beneficiaries**

- 13.1 As discussed above, we have removed the general requirement for a beneficiary.
- 13.2 However, a beneficiary will still be required where an Ordinary Foundation (or a Purpose Foundation for purposes and for the benefit of beneficiaries) is being used. Where this is the case, the beneficiary should be designated in the charter (section 11(1)(e)).
- 13.3 **Termination:** One of the key issues in the previous draft of the Act was the question of what would happen to the assets on termination of a foundation. We have mirrored the wording of the Purpose Trust Act and provided that termination provisions shall be dealt with in each individual charter (section 58).
- 13.4 In the absence of a provision dealing with the termination in the charter or articles, where there is more than one beneficiary willing to accept the transfer of the remaining assets, these should be divided equally between them (section 58(2)).
- 13.5 Where there is no relevant provision in the charter or articles, the remaining assets shall be deemed to be bona vacantia (section 58(3)).
- 13.6 This removes the need for a default beneficiary.

## **14. Foundation agent / secretary**

- 14.1 Although we have maintained the need for a foundation agent or secretary who will have a Bahamian presence, in light of the three different types of foundations with differing requirements as to governing bodies, it proved to be unwieldy to retain the requirement that the foundation agent or secretary must be an officer (particularly because some foundations will have foundation councils only).
- 14.2 We have amended section 17(1) so that the agent or secretary may be appointed as an officer or a foundation council member. Alternatively, if you preferred, this

could be amended to state that the agent or secretary shall be a designated officer or foundation council member.

## **15. Miscellaneous points**

- 15.1 We have amended section 6(1) so that whilst a foundation's purposes shall include the management of assets, this is not required to be the foundation's main purposes or objects.
- 15.2 We have simplified the provisions at Part II dealing the establishment by a Will and establishment by an administrator and these are now contained in sections 9 and 10.
- 15.3 In sections 15 and 19, dealing with the appointment and qualification of officers and foundation council members respectively, we have removed the prohibition on spouses or persons in direct line or in a collateral line of relationship with an officer or foundation council member from being appointed on to the other body. This is because in the context of dynastic planning, it is likely that different family members will be required to serve different roles on the various bodies in order to ensure there are adequate checks and balances.
- 15.4 In the case of Purpose and Executive Foundations (both formed to fulfil purposes/functions), we have included provisions at sections 70 to 71:
- (i) stating that a Purpose or Executive Foundation is not rendered void by uncertainty; and
  - (ii) that the charter or articles may empower the officers or foundation council to reform a Purpose Foundation or Executive Foundation where it becomes impossible or impractical, or contrary to public purpose or obsolete.

These provisions mirror those contained within the Bahamian purpose trust legislation.

- 15.5 We have amended sections 11(5) and 12(3) to provide for the foundation charter and articles to be signed in the presence of the secretary or another witness (instead of a notary public as formerly provided). This is because in many jurisdictions it will not always be possible or practical for founders to sign these documents in front of a notary public.

## **16. The Dynasty Concept**

Many ultra high net worth families are under the delusion that trusts will preserve family wealth for the next one or two generations. From my experience trusts even with the most up to date innovations, whether they be private trustee companies, foundations, purpose trusts, reserved powers trusts or a STAR, will not of itself preserve family wealth for anything more than a decade or so after the founder's death. The structure is hardware. What is needed is Family Governance, the structure's software, which must be implemented as soon as possible, while the founder is alive.

Family Governance is an area of law based on company law and the principles set out in, and developed in the Combined Common Code. The aim of Family Governance is to avoid the entropy of family wealth beyond the third generation. In most countries there is an expression to cover the making and dissipation of wealth over three generations, i.e. shirt

sleeves to shirt sleeves, clogs to clogs, paddy fields to paddy fields etc. The preservation of wealth beyond the third generation, i.e. the creation of a Dynasty, is possible, but it requires "energy" (to continue with the physics analogy). To create a Dynasty a family purpose is needed to align family members towards the same goal and benchmarks, a procedure to avoid minority disagreements becoming substantial family conflicts and a governance which incorporates checks and balances at every level of control. In addition, and possibly of equal importance, is the family determination to implement and operate the structure with rigorous discipline.

## **17. Creating a Family Office Structure to include Family Governance Procedures**

Family Governance, therefore, falls into the following three distinct sections:

- **Family Purpose** - equivalent to a company's Memorandum of Association;
- **Procedure** - equivalent to a company's Articles of Association; and
- **Governance** - equivalent to a public company's Corporate Governance which introduces checks and balances at all levels of control.

## **18. Family Purpose**

The Family Purpose is unique to each family. Where the family wealth is created out of the Settlor's business empire, the Family Purpose usually covers:

### **A Business focus, ethics, morals and philanthropic ambitions**

The Settlor's business focus, ethics, morals and philanthropic ambitions, e.g. the health, education and leisure interests of the family.

### **B Distribution Policy**

To create a Dynasty, the attitude of the Settlor's heirs should be focussed on the preservation of wealth for future generations rather than the dissipation of the wealth. The heirs must consider themselves custodians of family wealth with no right to spend the wealth, or part of it, as they choose, unless set out specifically in the Trust Deed.

The family members must, however, be able to budget for themselves and their families. If their expectations are uncertain, it is not unusual for family members who like an extravagant lifestyle to exploit this uncertainty to their advantage. Each beneficiary must know what he or she can expect, who is in control of the distribution and how and in accordance with what rules they are appointed and the parameters of the distribution policy.

A distribution policy can be defined in a number of ways. Some families stipulate a standard of living, others permit access to wealth by the beneficiaries only after a certain investment or business profit has been made and, in some cases, this may only be up to a specified cap. For other families, they want their children and remoter issue to receive only a reasonable distribution and whatever else is made should be re-invested. This could be coupled with access to wealth for achievements and success and on approval of a business or philanthropic plan. It is possible to have distribution models built which determine the maximum spending permissible to preserve the capital. The distribution policy can, where appropriate, be incorporated into the Trust Deed.

## **19. Procedure**

### **19.1 Summary**

To be effective, Family Governance needs to introduce processes into a wealth preservation structure which provide for:

- an effective reporting by the trustees to the beneficiaries in the way that company directors must report to their shareholders;
- a forum for discussion to ensure that the views of the beneficiaries are properly communicated to the trustees such that the trustees can decide whether their views accord with the purpose of the trusts;
- the aims and objectives of the trustees to be properly communicated to the beneficiaries;
- the trustees or in this case, where there is a Private Trustee Company, the directors of the Private Trustee Company, to be accountable and there should be a mechanism for their removal from office in certain circumstances;
- protection for minorities; and
- dispute resolution.

### **19.2 Communication, meetings, decision making procedures, monitoring and review**

19.2.1 Communication and decision making procedures to be effective, must be formalised to ensure that all issues are properly addressed. Meetings also need to be properly chaired and minuted. There must be proper monitoring and review, annual, six month, quarterly or monthly reports, financial and legal audits and a five year review to ensure the effectiveness of the structure. This process will assist in harmonising the management of the family wealth.

19.2.2 The family should be encouraged to meet at least once a year for a purpose other than collecting a distribution. This purpose could be to elect or re-elect their representatives, for example as a director of a Private Trustee Company to review the Trust investments as set out in an annual report and review the tax and estate planning. Consideration should be given to this purpose as well as notice for these family meetings, participation, attendance of others by invitation, quorum, voting, resolutions etc.

19.2.3 Proper and continued use should be made of the Family Office and the importance of using this central administrative entity made clear to each generation.

19.2.4 The family representatives, for example as directors of the Private Trustee Company, can then be responsible, on behalf of the family, for a distribution policy, wealth management and the business decisions relating to the family wealth. The top holding company can report to the Private Trustee Company and the family on business decisions. The skills required to be a director of the top holding company may be different from the skills required to be a director of the Private Trustee Company.

19.2.5 From my experience, it is advisable that the directors of the Private Trustee Company are appointed by the family in the same way that directors can be appointed and removed by a shareholder. Unless the family members feel involved with the decision making process and have a safe forum in which to express their views, distrust and conflict may develop which can lead to the break up of the family wealth in one way or another. Whilst this may not be of concern as regards the first and second generations, it may apply further down the line with beneficiaries who have not yet been born.

19.2.6 It must be clear which family members are involved in running the structure and what their specific role is.

## **20. Governance**

### **20.1 Spread of Power**

20.1.1 Whilst the settler may wish to retain control of the wealth structure during his lifetime, it is important to have a spread of power sharing once he has passed away. Ideally, the Settlor should begin to divest power during his lifetime, so as to observe any potential family conflicts which he can iron out while still alive, although this may not always be possible.

20.1.2 A spread of power is important. It is not unusual to see one competent and motivated second generation individual with too much power within the wealth structure during his lifetime. This is not always a bad thing, but a proper spread of power can help to avoid sibling rivalries and jealousies which can lead to damaging conflict. The Thyssen Family failed to spread power with expensive consequences, similar conflicts arose within the Kaiser Family. This is of less relevance while the Settlor is still alive, but becomes of increasing importance for the generations who did not have a close relationship with the settler (like the first and second generations) and who may not have understood the Settlor's values and thinking behind the Trust structure.

### **20.2 Accountability and responsibility**

20.2.1 Accountability and responsibility are essential. Officers in a family preservation structure cannot be asked to make decisions, whether to buy or sell a business or appoint or remove officers, unless they are fully briefed in an impartial and full manner. The person responsible for disseminating information should also be accountable. Just as a director can be removed by his company's shareholders, so the person providing the information and implementing the decisions should be accountable to the family. It is not unusual to see disharmony between the trustees and the beneficiaries (who are not the Settlor) because the trustees have adopted the policy that the less the beneficiaries know of the value and extent of the trust fund the better. There should, of course, be a mechanism to remove the trustee if necessary.

### **20.3 Family Governance Paper**

20.3.1 It is often helpful for the relationship between the various parties and advisers involved in a wealth preservation structure to be set down in writing in a Family Governance Paper and wherever appropriate incorporated into the structure's legal documentation.

- 20.3.2 The formality of this procedure is necessary even where the family fortune consists primarily of the family businesses and can often be overlooked. Complex issues such as the fair treatment of family members working in the business and those not in the business, family business succession and resolving family conflict need to be addressed and are best put down in writing, especially when the family is on good terms, or a change is about to take place.
- 20.3.3 A Family Governance Paper helps to ensure the proper, efficient and cost effective enforcement of the family's wishes and in my experience requires:
- each party or adviser involved to understand their role in the enforcement of the family's wishes;
  - adequate reporting to the family;
  - a proper procedure for reviewing, monitoring and supervising all functions of each party operating within the wealth structure;
  - regular meetings to be held in an appropriate jurisdiction and properly attended, minuted and carried out and, in particular, an AGM;
  - proper appointment, removal and replacement of directors of the PTC, directors of underlying holding companies and Protectors; and
  - proper procedures for resolving any disputes and disagreements.

## **20.4 Implementing the Family Governance through the Wealth Structure**

The structure must be adapted so that it becomes dependent on a process rather than specific people to achieve the family's objectives. For example, the appointment and removal of the directors of the Private Trustee Company and its underlying asset holding companies, the procedure for family meetings, the investment policy and the distribution policy can be incorporated into the Trust Deed if it is to be binding, or if it is to be for guidance only then it can be set out in a Family Governance Paper which can be a single document which all trusts are guided by. Whether the terms are to be set out in a Family Governance Paper or the Trust Deed, will depend upon tax consequences, disclosure and whether the term is to be for guidance or an obligation.

## **20.5 Family Database and Bank of Knowledge and Tradition**

Some families like to stipulate that all family members contribute to a Family Database by writing a yearly paper setting out events, disappointments and achievements. This not only begins to record a family history, but it is also helpful for the trustees (or other relevant body) to help the family decide the next year's distribution and investment policy. The family may also like to consider a mechanism, such as bonuses, to encourage all adult beneficiaries to contribute and attend the family meetings. The Family Office may also wish to create a body of knowledge and traditions which will be an important reference tool for future generations.

## **21. Additional advantages of creating a Dynasty Structure**

- Value enhancing – dynastic structures can actually improve the equity and credit rating of the underlying business and investments (where applicable)
- Risk management – management of risk and the avoidance of costly litigation is a fundamental aspect of dynastic structures

- Engaging the family – implementing corporate-style governance and involving family members in a democratic system with clear succession mechanisms
- Central administration – creating a family office, an efficient hub to administer and manage family wealth
- Unique – each dynastic structure is a bespoke creation designed specifically for the founder, family and assets involved

## 22. Disadvantages of not creating a Dynasty Structure

- Breach of confidentiality – without protection, disclosure of underlying beneficial interests, and the associated risk to reputation and privacy, is a significant and ongoing concern
- Wealth entropy – wealth outside specially designed dynastic structures is likely to be dissipated in a few generations, may be vulnerable to third party attack and is more likely to be frozen in response to external disputes
- Family division – one of the most effective ways of destroying a family and the businesses and investments which it represents
- Cost – family ownership of assets, outside a centrally managed dynastic structure, can become over complicated with replicated administrative and reporting functions

## 23. Family Bhive – our interactive website

Family Bhive is an online interactive website for two communities, the wealth owners and their advisers. The two communities are to exist separately but symbiotically. The wealth owner can look in and learn from the private client industry, they can also, without disclosing their identity, communicate with and ask questions of advisers. The private client industry, on the other hand, can showcase their expertise, but will not have access to the private chat rooms or the identity of the wealth owners.

### Advantages of Family Bhive for Individual Members

- (1) It empowers and educates the wealth owner about the Private Client Industry

50% of wealth owners do not use the services of the private client industry. They find it opaque and mystifying and are suspicious of its value because they do not know what they are paying and for what benefit. Family Bhive aims to put wealth owners back in control. Family Bhive has produced a Guide on How to Choose their Adviser, which is available to members and non members alike and a Guide on How to Instruct, Evaluate and Monitor your Adviser which is available only to members (both Corporate and Individual). It also encourages the Private Client Industry to display its expertise by warning wealth owners of dangers and highlighting opportunities to show case the value of the industry.

- (2) It provides a forum for discussion

Wealth carries with it a unique set of problems and concerns such as spoiling children, conspicuous consumption, kidnap, philanthropy, reputation and fraud. These issues can be discussed privately or on the corporate pages if the opinions of the Private Client Industry are sought.

- (3) It provides the wealth owner with a collective and anonymous voice, not that it need be a public voice, but it could expect respect from Governments and the press for their contribution to taxes and charity as well as employment and support for art, architecture, the environment and the world.
- (4) It will put on events exclusive to Individual Members who have verified their wealth profile with a professional.

It is a fundamental feature of Family Hive that the identity and address of the Individual Members is at all times private and confidential and is never shared or sold to any corporate member or other third party without the specific consent of the Individual Member.

Individual Members can join any one or more of the following wealth profiles

Amber	-	£5m - £20m net worth Professional wealth verification required if the Individual Member wants to be invited to events, otherwise no verification is required
Jade	-	£50m - £100m net wealth Professional wealth verification required
Jet	-	£100m net wealth Professional wealth verification required

Families with different wealth profiles have different concerns and require different advice, advisers and peer groups.

The wealth profile filters are not currently in operation, but will be put in place in January 2009 at the earliest.

#### Advantages of Family Hive for Corporate Members

- (1) It empowers and educates the Private Client Industry about the needs and concerns of wealth owners.
- (2) It provides a forum for discussion.
- (3) It provides the Private Client Industry with a voice to demand consultation on important issues such as regulation, taxes and confidentiality.
- (4) It provides each Corporate Member with an efficient, cheap and effective marketing tool.
- (5) It will provide events exclusive to Corporate Members for networking, education and learning.

Corporate Members can showcase their services in any one or more of the following market wealth profiles

Amber	£5m - £20m net worth market wealth profile
Jade	£20m - £100m net worth market wealth profile
Jet	£100m + net worth market wealth profile

(The wealth profile filters are not currently in operation, but will be put in place in January 2009 at the earliest)

Corporate Members will need to set out their services on a landing page which is similar in effect to “your stall”. This will need to be particular to a specific Micro Zone and a specific wealth profile. It is possible to have multiple membership, but a separate fee is required for each.

The Zones are divided into Macro Zones and Micro Zones, as follows. (This is not as yet complete).

Macro Zones	Micro Zones
Invest it	Private Banks Multi Family Offices Investment Banks Fund Managers IFA's
Give it	Philanthropy advisers
Enjoy it	Life coaches Public Relations Fashion Consultants
Preserve it	Insurance Advisors Private Client Accountants Private Client Lawyers and Trustees Family Lawyers

(The Macro Zones are not currently in operation, but will be put in place within the next two months)

Family Bhive has an Advisory Board made up of 20 of the most respected names in the Private Client Industry. This is subject to a written constitution and its members will rotate in due course. They are expected to encourage transparency and the need to make the Industry more accountable to the market they serve. After each event during the year, the Advisory Board will review the talks and the responses to the talks by the Individual Members and the selected Corporate Members. The Advisory Board will discuss how best to deal with any issues which arise whether it be through further events, quiet lobbying, debates on Family Bhive or for further discussion at the annual Corporate Members discussion forum.

The strap line for Family Bhive is “be connected”

- (1) Wealth owners need to “be connected” to their peers of a similar wealth profile to enable to learn from their knowledge and experiences and for them to share their knowledge and experience with others in a totally anonymous and confidential manner;
- (2) Wealth owners need to “be connected” to the industry which serves them in a symbiotic relationship where they can demand a better service in a confidential and meaningful manner, but also to learn how to evaluate, monitor and instruct the industry and so learn how to value it without being identified;

- (3) The Private Client Industry needs to “be connected” with each other to learn about the services of others and to share their knowledge and experience with others thereby marketing their services and products;
- (4) Wealth Owners and the industry which serves them need to “be connected” to governments. Wealth owners make the biggest contribution to governments both in taxes and employment. Governments should understand and respect this contribution through an increased dialogue and debate; and
- (5) Wealth owners and the industry which serves them needs to “be connected” to the media. Most Wealth owners are keen to be responsible, law abiding, tax paying citizens who are keen not to be associated with the drug taking and the irresponsible celeb culture which is filling our press. The wealth owning community does not want and neither does it deserve to be the scapegoat for today’s discomfort and economic downturn.

Family Hive is a tool, but to achieve its aim it needs to be used for the purposes for which it was designed, with both Individuals and Companies joining and participating online and in events as Members.