Family Office Insights
2018 Collection

Family Office Insights

Wealthy families around the globe are increasingly looking to manage and preserve their assets and relationships across multiple generations and countries through a "family office" – a formal or informal structure established to maximize the efficient transfer of wealth to future generations, preserve and consolidate family wealth, promote charitable endeavors, enhance communications and avoid family conflicts.

For family groups with significant assets, a family office can provide greater control over their worldwide investments and can tailor investments and asset ownership structures to the family's specific requirements. We have worked with single and multifamily offices and family investment groups around the world to help them achieve these goals.

In an attempt to help our clients and potential clients think and act strategically, we have created the Family Office Insights series. Authored by members of our global Family Office team and distributed to our family office contacts around the world, we address the key issues and trends affecting family offices, today and in the future.

With this philosophy in mind, we are pleased to present the Family Office Insights 2018 Collection – an assembly of thought leadership distributed throughout the course of the past year. Included herein are the following pieces:

- The Single Family Office Roadmap
- Family Office Insights: Foreign Investment Into Australian Agricultural Land Assets
- Family Office Insights: Impact Investing for Family Offices
- Family Office Insights: UK Register of Beneficial Owners – The Details
- Family Office Insights: Opportunities in the Global Revolution Into Renewable Energy Market for Family Office Investors
- Family Office Insights: Forgiveness – The Missing Piece of the Family Puzzle
- Family Office Insights: "Death of Retail" Rumors Overblown, Opportunities for Returns Still Exist
- Family Office Insights: Happy Families?
- The Dynamics of Successful Family Wealth Transfers
- Family Office Insights: Beneficial Owners of German Subsidiaries

We hope that you find these perspectives to be both informative and thought provoking, and we look forward to providing you with future installments of our Family Office Insights series.

Sincerely,

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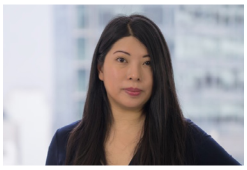

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The Single Family Office Roadmap

The single family office structure is increasingly the platform of choice for ultra-high-net-worth families to manage wealth and provide a wide range of services to their family members.

Just as no two families are exactly alike, neither are any two family offices.

However, there are a few basic structural approaches that characterize many single family offices, and certain categories of services that single family offices most frequently provide.

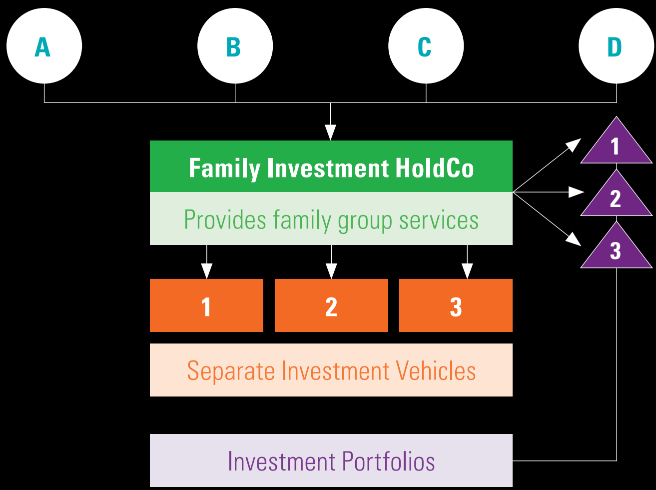
Thinking about these structures, categories of services and some of the key formation considerations outlined here, can be a helpful jumping-off point for families and their advisers considering the single family office approach to wealth management and family services.

Here we show two basic, commonly used single family office structures.

Example One

Family Group Members A-D

In this example, the family members form a single entity through which the family's investments are managed and family group services are provided. This is a basic structure through which family investments can be aggregated and managed collectively, providing efficiencies of scale and administration.

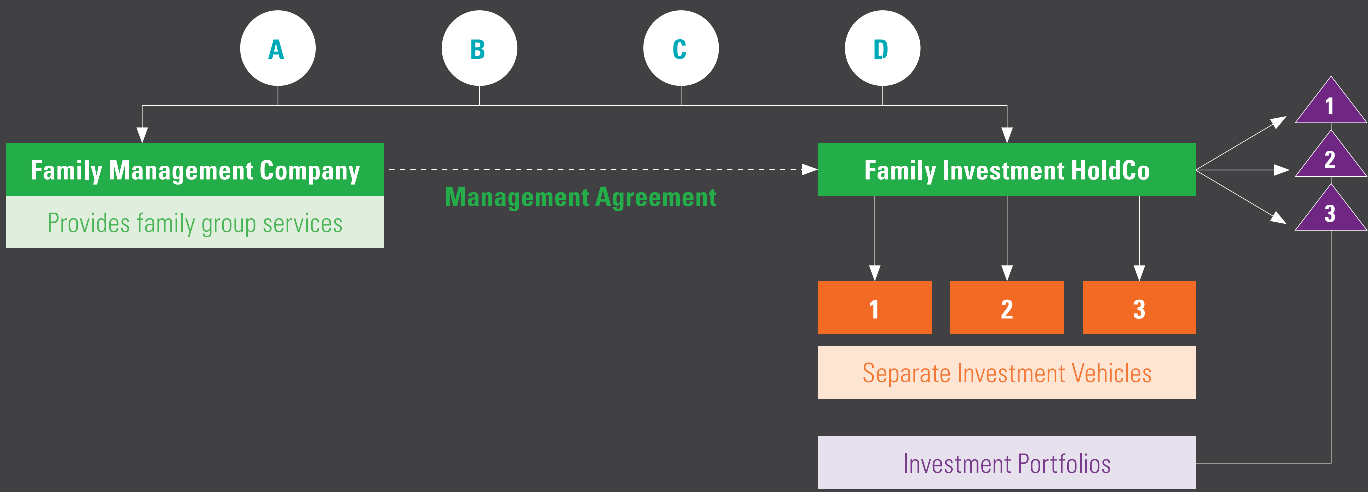


Example Two

Family Group Members A-D

In this example, two separate entities are established – one to be an investment holding company and the other to be the family management company, through which the family group services are provided and the family's investment management activities are undertaken.

By separating the ownership of the family assets from the entity that provides investment management and other family group services, this structure allows for differing ownership between those functions and a separation of the family's assets from the legal entity that maintains investment management, employment, and other contractual relationships, which can provide beneficial liability protection.



The Single Family Office Roadmap

Key Initial Considerations

Choice of legal entity/jurisdiction

Identify family members participating in the collective entity

- Will the structure be designed to contemplate successive generations?

Desired scope of "collective" activity

- Investments
  - "Internal" direction of investments or outside investment staff?
  - What is "success" and how will it be measured?
  - How will "internal" investment staff be compensated?
- Philanthropy
- Coordinate family legal/tax/accounting matters
- Household services and bookkeeping

Governance structure and communication planning for the collective entity

Identify collective strategy for investments and philanthropy

Examples of Family Group Services

Investments

- Traditional portfolio approaches
- Alternative investments (private equity, venture capital, real estate)
- Management by family members or employees
- Education of successive generations on investment and asset protection planning

Philanthropy

- Pooled family charitable planning
- Charitable foundations and foundation administration

Legal

- Cross-generational estate planning and asset protection strategies
- Investment transactions and structuring

Accounting

- Family group tax accounting and compliance
- Investment accounting and reporting

Insurance

Bookkeeping

- Bill payment, payroll management, household accounts, budgeting

IT services

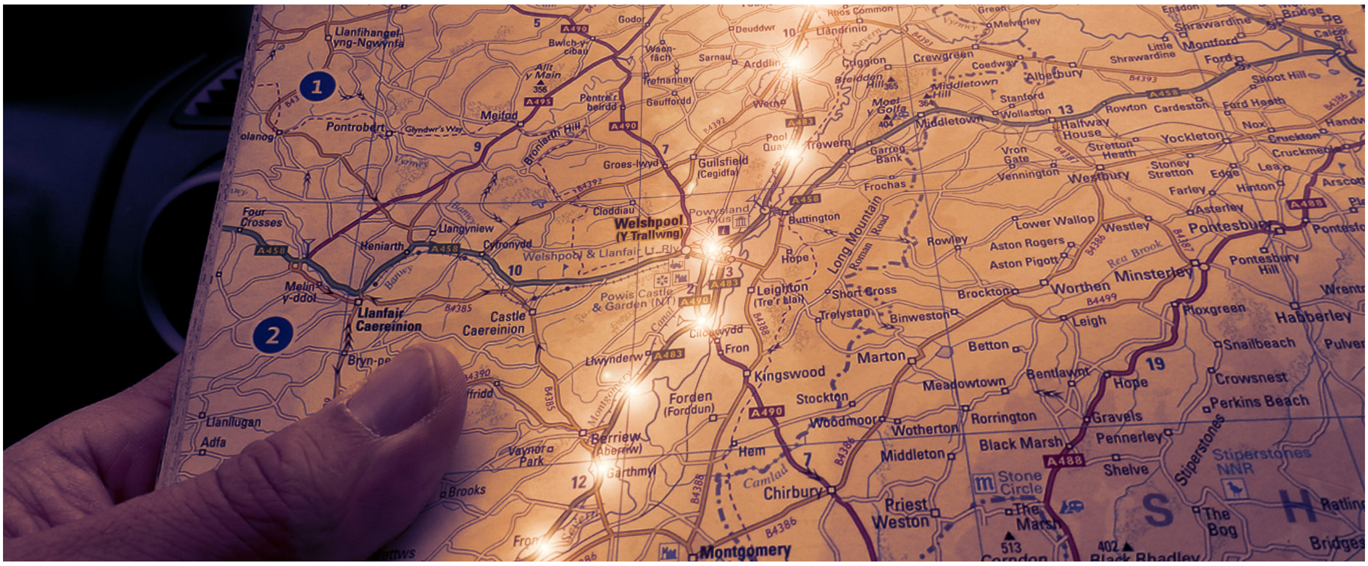
- Family group technology services and data security

Transportation

- Ownership and operation of automobiles, aircraft, yachts, etc.

Household services and employees

- Housekeeping, landscaping, administration of vacation properties, etc.



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Family Office Insights

Foreign Investment Into Australian Agricultural Land Assets

Introduction

The Australian government recognises that foreign investment plays an important and beneficial role in the Australian economy[1]. The current approach of the Australian government is to strike a balance between encouraging foreign investment while ensuring foreign investment is not contrary to national interest[2].

Despite this general approach, foreign investment into agricultural land assets has been a contentious issue that has often prompted public debate on the matter in Australia. This, in part, has led to recent changes to Australia's foreign investment rules for agricultural land assets. These changes include:

- Reducing the screening threshold for agricultural land assets that triggers the requirement to seek prior foreign investment approval
- In some cases, approval for a proposed acquisition may not be given if the asset was not offered for sale as part of an "open and transparent sales process"
- All acquisitions of agricultural land assets need to be recorded in the Australian Register of Foreign Ownership of Agricultural Land (regardless of their value)

Reduction in the Foreign Investment Review Board (FIRB) Approval Screening Threshold

A "foreign person" who proposes to acquire an agricultural land asset in Australia will need to notify, and seek a no objection ruling from, the Australian treasurer (commonly referred to as "FIRB approval") if the screening threshold is met. There are limited exemptions from this general rule.

Prior to 2015, the threshold was AU$252 million per acquisition. The current screening threshold for most foreign investors is if the cumulative value of all agricultural land holdings of that investor exceeds AU$15 million[3]. This significant reduction has resulted in a larger number of smaller agricultural land transactions by foreign investors requiring FIRB approval.

1 Foreign Investment Review Board Annual Report 2016-17, page vii.

2 Foreign Investment Review Board Annual Report 2016-17, page 7.

3 There are higher thresholds for investors from some of Australia's free trade agreement partners. For a foreign government investor, the threshold is AU$0, meaning that all acquisitions of Australian agricultural land will require FIRB approval.

In addition, foreign investors will need to calculate all of their holdings in Australian agricultural land when determining whether a particular target acquisition requires FIRB approval (and not just consider the value of the proposed acquisition in isolation). The concept of Australian agricultural land has a wide meaning under Australia's foreign investment rules. Without providing an exhaustive outline, it includes direct and indirect holdings, an interest in a fund that holds Australian agricultural land assets and a leasehold interest with a term of over five years (including extensions or renewals).

Open and Transparent Sale Process Is Now Part of FIRB's National Interest Assessment

The Australian treasurer can refuse a foreign investment application if, in the treasurer's view, it is contrary to national interest. The treasurer may also apply conditions to any FIRB approval granted to address any national interest concerns.

Earlier this year, a new national interest test was introduced for certain agricultural land assets. As part of this new national interest test, FIRB[4] said that it will assess whether there was an opportunity for Australian investors to acquire the particular agricultural land asset. It will also have regard to whether the proposed acquisition by the foreign investor was offered for sale as part of an "open and transparent sales process".

FIRB's published guidance states that a sales process for an agricultural land asset is likely to be open and transparent if it is conducted as follows:

- There was a public marketing or advertising campaign for the asset, using channels that Australian bidders could reasonably access (for example, the asset was advertised on a widely used real estate listing site or in a large regional/national newspaper)
- The sale of the asset was marketed for at least 30 days within the six-month period prior to the proposed acquisition
- There was equal opportunity for bids or offers to be made for the asset while the asset was still available for sale

This is likely to limit the ability for off-market transactions to occur between foreign investors and local Australian vendors if the foreign investor would need FIRB approval for the particular transaction.

4 FIRB reviews foreign investment applications and provides advice on these applications to the treasurer. The treasurer ultimately makes the decision on a foreign investment application.

There are certain exceptions when this national interest test will not be applied. Examples include:

- Where the asset is already held by a foreign person and there is no change in control (for example, internal reorganisations)
- Acquisitions that allow Australian investors to participate in a significant way (for example, where the applicant is majority Australian controlled or where Australians or Australian entities have the opportunity for significant participation in the business)

Register of Foreign Ownership of Agricultural Land

The Register of Foreign Ownership of Agricultural Land (Register) was established on 1 July 2015 and is administered by the Australian Taxation Office. A foreign person is required to register an interest in agricultural land (regardless of its value) within 30 days of acquiring, or disposing of, the interest. Details of individual foreign investors listed on the Register are not publicly available. However, published reports contain aggregate data on the amount of foreign ownership in Australian agricultural land.

Conclusion

Foreign investors considering an investment into agricultural land in Australia should consider early on in the transaction whether FIRB approval will be required (and, if so, whether the open and transparent sales process applies to the particular transaction). FIRB has 40 days to provide a decision to an applicant, but it can (and often does) request an extension of this time. Appropriate conditions precedent should be included in all agreements where FIRB approval is required, but not granted, at the time transaction documents to acquire the asset are entered into (even if settlement of the acquisition is scheduled for a later date).

Australia's foreign investment rules provide for a number of enforcement powers, which include criminal and civil penalties, as well as divestment powers. Accordingly, it is important that foreign investors seek the requisite FIRB approvals (and the conditions of any FIRB approval granted are satisfied).

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Family Office Insights
Impact Investing for Family Offices

Introduction

Since our previous piece discussing what at the time appeared to us to be an emerging investment theme for family offices, we have seen widespread evidence of increasing interest and awareness levels around impact investing in numerous sectors, both amongst our clients or contacts and more generally.

Whilst it is difficult to track the extent to which proclaimed interest is being converted into executed investments, and it is likely that the volumes of capital remain relatively insignificant, the appetite amongst investors for stakes in impactful businesses looks to be fairly well established and on an upwards trajectory.

We thought, therefore, that a fresh look at what might be driving this from the perspective of the family office was merited and why this may be an increasing area of focus.

Why Might This Be Happening?

Many wealthy families have of course long been associated with philanthropy, often seeking a social impact via purpose-specific donations or endowments. Under a traditional model, these philanthropic endeavours may be undertaken entirely independently of the family's commercial and investment activities. Successful execution of the latter generates the funds required to engage in the former, but there might otherwise be very little overlap or connection between the two concerns.

What appears to be happening more frequently, however, is that family office investors are targeting assets through which they can simultaneously make a positive social impact and achieve market rates of return. In the family office space, one of the most oft-cited explanations for this shift is that we are going through an era of significant wealth transfer and, as a consequence, the next generation of younger family members, who may be more socially conscious than their predecessors, are taking up decision-making positions and demanding that their family's wealth be deployed in a way that benefits a broader group of stakeholders.

Another factor to consider is that there are undoubtedly more and more for-profit businesses that are developing innovative ways to tackle specific social and environmental problems (think of renewable energy, healthcare and financial services and the technological developments in those sectors). In some jurisdictions, we are also seeing innovative legal structures encouraging this approach, including the development and growth of the "benefit corporation", or "B Corp", in the US and elsewhere, which seek to enable directors to move away from a "shareholders first" fiduciary model. These developments are influenced by more than just a strengthening of social conscience, with advances in technology or perceived failings by the non-profit or public sector also catalysts, but no matter the cause, the result is that it seems increasingly the case that for-profit enterprises are finding market-oriented solutions to issues that historically may have been the preserve of governments and non-profit organisations.

These sorts of businesses are, therefore, presenting investors with opportunities to invest capital for growth and profit, as well as social impact. Supporting such businesses so they can continue to grow and innovate may also be better for the overall ecosystem as, whilst some will undoubtedly succumb to market pressures and fail, the wider effect should be the promotion of self-sustaining, scalable enterprises with greater potential to make lasting social impact.

Family Offices Are Well Positioned…but There Remain Challenges

Given its innate flexibility, family capital seems very well placed for allocation to impact investments, especially those early-stage, higher-risk undertakings that might not otherwise be in a position to take investment from more mainstream investors. Un-restricted by investment mandates, return targets and fund life spans, wealthy families generally have the freedom to determine their own requirements as far as the ROI is concerned, both economic and social.

On the other hand, family offices will not always have the resources or expertise to identify, monitor and support these businesses in perhaps the same way that more sophisticated or institutional investors would. Whilst there may be approaches to mitigate this, by co-investing, for example, this may preclude some family offices from investing in higher risk enterprises. Complexity relating to structuring and/or challenges relating to certain geographic locations can also present significant obstacles, making investments prohibitively inefficient in terms of the execution time/cost required.

An impact investor will, of course, also need to find a way to measure and assess the impact and value the business has for society or the environment. This may not be straightforward, as in many instances, the impact may be intangible and difficult to quantify so investors will need to put considerable thought into what the most appropriate methodology or units of measurement are and how accurate data can be obtained and then purposefully interpreted.

Being able to assess and monitor impact in a meaningful way will also be important for governance and accountability purposes, both for investors and investees, whilst effective monitoring will help the investor with managing reputational risk/benefit. Having the data to demonstrate clear and positive outcomes may also facilitate public reporting, which in turn has the potential to improve the overall environment for and narrative around impact investing, setting off the virtuous circle.

Looking Forward

Greater transparency from investors about their impact investments, raising awareness about impact investing and the emergence of common standards and analytical tools may assist with some of these difficulties, though assessing impact is likely to remain quite a subjective and imprecise exercise. However, with regulatory mandated reporting in some jurisdictions, classification systems such as the UN's Sustainable Development Goals and the rise of "benefit corporation" or "B Corps" systems, there has been significant progress in these areas and as a result of legislative changes and work by various organisations, frameworks of standardised metrics that can be used to assess social and environmental impact are becoming more widely adopted and understood.

Notwithstanding the difficulties around defining and measuring the concept of impact, given the recent progress and the wider social forces at play, it seems likely that we are going to hear much more from the businesses and investors involved in this space and can expect to see family offices playing a part in this story.

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Family Office Insights
UK Register of Beneficial Owners – The Details

In April 2017, a call for evidence issued by the UK government introduced the concept of a register of beneficial owners of non-UK corporates, aimed at improving transparency in the UK real estate market.

Evidence has been gathered, consultations made and now in July 2018, the Department for Business, Energy & Industrial Strategy has published the draft legislation that would implement this register – the Registration of Overseas Entities Bill – and it is very much in the form trailed over a year ago. The bill is subject to technical consultation, but if enacted in its current form, will impose a fairly significant compliance burden on affected entities.

Who Will Have to Register?

The Registration of Overseas Entities Bill, as the name suggests, will not only catch companies. An "Overseas Entity" will include any body corporate, partnership or other entity that is a legal person under the law by which it is governed. Any Overseas Entity may apply to be entered on the new register, but there will be little benefit to registering an Overseas Entity that does not own a relevant interest in land. Entities that do own land in the UK will have an 18-month window to apply for entry on the new register or dispose of the land, and will commit an offence if they fail to do either.

Who Are Beneficial Owners?

An Overseas Entity that applies for registration will have to provide information about its beneficial owner or owners, which are defined in very similar terms to the "people with significant control," which UK companies are required to disclose already. A person will be regarded as a "beneficial owner" for the purposes of the new register if:

- They hold more than 25% of the shares in an Overseas Entity (whether directly or indirectly)
- They hold more than 25% of the voting rights in an Overseas Entity (whether directly or indirectly)
- They directly or indirectly hold the power to appoint or remove a majority of the board of directors of the Overseas Entity
- They otherwise have the right to exercise, or actually exercise, significant influence or control over the Overseas Entity, or
- They have the right to exercise, or actually exercise, significant influence or control over a trust or firm that is not a legal entity which meets one of the four conditions mentioned above

As an anti-avoidance measure, persons who hold shares or rights in a "joint arrangement" will each be regarded as holding all the shares or rights that are in that arrangement.

A "joint arrangement" is an arrangement, whether formal or not, but having at least some degree of stability about it, that the parties to it will deal with their shares or rights in a pre-arranged way. That would mean, for example, that a married couple who each own 20% of the shares in an Overseas Entity, and who informally agree always to vote the same way, will each be regarded as owning 40% of the shares and will each be a beneficial owner.

What Details Will Be Held on the Register?

In order to be registered, an Overseas Entity will need to declare to Companies House whether it has any beneficial owners, together with details of those beneficial owners, which include their name, nationality, country where they usually reside, address for service, the nature of their control over the entity and the date on which that control began. These details will, subject to the comments below, be in the public domain. Additionally, the register will hold the beneficial owner's date of birth and usual residential address, but these will not be publicly accessible.

If an Overseas Entity declares that it does not have any reasonable cause to believe that it has any beneficial owners, in order to be registered, it will instead need to provide the same information for its managing officers (which includes a director, manager or secretary), as an entity would have to provide for its beneficial owners. It will also be possible for an Overseas Entity to declare that it has reason to believe that it has at least one beneficial owner that it has not identified, and that it cannot provide the required information in respect of. In this situation, the Overseas Entity must provide the required information for all its beneficial owners that it can identify, and for its managing officers.

Before making an application for registration, an Overseas Entity will have to take reasonable steps to identify its beneficial owners and to obtain the required information about them. These reasonable steps must include serving an information notice on any person that the entity knows, or has reasonable cause to believe, is a beneficial owner. That notice must ask the recipient to confirm if they are a beneficial owner, and if so to confirm that any required information about themselves set out in the notice is accurate, and to correct and provide missing information as necessary.

The bill provides that the Secretary of State may make regulations in respect of what information, which would otherwise be in the public domain, should be kept confidential. The guidance gives the example of a beneficial owner who may be at risk of physical harm if his or her identity were known.

Annual Updating Will Be Required

Once on the register, the Overseas Entity must provide an annual update of the information submitted to Companies House, and before doing so, the information notice procedure will need to be undertaken again. While there will be exemptions for any beneficial owners whose details are already registered elsewhere (e.g., a UK company that is already covered by the register of persons with significant control), for most Overseas Entities, the new law will introduce a new compliance obligation that could, for more complex holding structures, be quite onerous.

Restriction on Dealing With Land

Once the legislation comes into effect, the Land Registry will be required to enter a restriction on every registered title relating to real estate owned by an Overseas Entity. This will include both residential and commercial properties and both freehold and leasehold interests (although, it will exclude leases of fewer than seven years, as these are not registrable). The restriction will effectively make it impossible for unregistered Overseas Entities to deal with real estate in a legally binding manner, by prohibiting the transfer or charge of the affected property, or the grant of a lease of it for more than seven years, unless the Overseas Entity has been registered on the new register or is exempt from registration. For titles that are already owned by an Overseas Entity at the date the legislation comes into effect, the effect of the restriction will be deferred for 18 months (so giving the entity the opportunity to dispose of the property if it would prefer not to register).

Sanctions for Non-Compliance

New criminal offences are also being introduced by the bill. Overseas Entities and their managing officers will commit offences if they:

- Fail to comply with the annual updating obligation
- Deliver any document to Companies House that is misleading, false or deceptive in a material particular
- Make any statement to Companies House that is misleading, false or deceptive in a material particular
- Fail to register the Overseas Entity within 18 months of the bill coming into effect (if they already own land in the UK), or if ordered to do so by the Secretary of State, or
- Make a disposition of land that is prohibited by a restriction on the title

It will also be an offence not to comply with an information notice.

These offences will carry fines or, in all cases other than the failure to comply with annual updating obligations, possibly prison sentences of up to 12 months (or even up to five years in the case of disposing of land when that is prohibited).

Limited Exceptions

The bill does provide limited exceptions to the obligations to register and from the definition of beneficial owner. The Secretary of State has the power to exempt an Overseas Entity or a particular beneficial owner from the registration requirement – guidance suggests that this would mainly be applicable to entities and persons already subject to similar registration elsewhere.

An important exception is also made for limited partnerships, which are most commonly used as vehicles for investment in commercial real estate. To reflect the fact that limited partners in such partnerships are barred from participating in their management, limited partners will not be regarded as beneficial owners under the first three tests set out above (that is, ownership of shares, voting rights or rights to appoint directors) merely because they are limited partners.

Practical Example

To illustrate the effect of the draft bill, consider PropCo, a company incorporated in the Offshore Islands. PropCo has a single shareholder, Mr. Ecks, and its officers are two professional directors resident in the Offshore Islands. Company registration in the Offshore Islands is confidential, so members of the public cannot find out that Mr. Ecks is the shareholder. PropCo owns a freehold residential property in London, 1 Acacia Avenue, which is registered at the Land Registry.

If the bill comes into effect, the Land Registry will place a restriction on the title to 1 Acacia Avenue, deferred for 18 months, stating that a disposition of the property is prohibited unless PropCo is registered on the Overseas Entity register. The directors of PropCo, knowing that Mr. Ecks is the sole shareholder, have reason to believe he is a beneficial owner of the company, so serve him with an information notice. He provides the details required by that notice and with that information, the directors apply to register PropCo on the new register. Having done so, PropCo will be able to deal with the property in the future. The directors will have to repeat the information notice procedure annually and provide an update to the register.

The effect is that whereas today it is impossible for an interested person to find out who benefits from PropCo owning 1 Acacia Avenue, in the future, it will be a matter of public record that it is Mr. Ecks who does so.

Potential Weaknesses

Whilst the greater transparency that the new law would introduce is a welcome step in curbing the use of UK real estate for money laundering, there are sufficient weaknesses in the proposed bill to mean that it will be no silver bullet – and, in fact, if it creates false confidence that criminals are being deterred, it may be counterproductive. What are these weaknesses?

Consider the case of PropCo above, and assume that the Offshore Islands directors are honest, professional and competent and want nothing to do with criminal activity. They investigated Mr. Ecks when he set up PropCo and checked his identity thoroughly – he is a citizen of Onshoreland. They also established that he has a chain of restaurants in Onshoreland that generate the funds to buy 1 Acacia Avenue. So when they serve Mr. Ecks with the information notice, they are not surprised when he confirms that he is the beneficial owner.

However, Mr. Ecks has not been honest with the directors. His restaurants are, in fact, a front for criminal activity by Mr. Krook, and it is Mr. Krook's proceeds of crime, which are being used to buy 1 Acacia Avenue. Mr. Ecks has provided false information in reply the information notice. The Overseas Entity register will not show the true beneficial owner.

A more sophisticated situation would be if Mr. Ecks were not the sole shareholder, but instead one of five shareholders, each of whom owned 20% of the shares. These shareholders all appear to be independent businessmen, and the Offshore Islands directors had satisfactory ID and source of wealth information for them all. The directors serve all the shareholders with information notices and the shareholders confirm they do not have a joint arrangement in relation to the shares. In these circumstances, the directors' duty would be to register PropCo as having no beneficial owners and to give their own details for the record. In reality, Mr. Ecks and his four fellow shareholders are all part of Mr. Krook's crime organisation and again, the register will be incorrect.

The situation is considerably worse if the directors are themselves corrupt. If the directors were willing to commit an offence by making false statements, they could declare that PropCo has no beneficial owners even if they know that this is not the case.

In all of these examples, criminal offences have been committed by Mr. Ecks, the other shareholders and (in the last case) the directors, but how will Companies House know that this is the case? Without investigation in the Offshore Islands and Onshoreland, there is simply no basis on which to establish this, and in the first two examples, the directors are blameless. Even if the false statements are discovered, will the UK police have sufficient resources to track down Mr. Ecks and his fellow shareholders? And even if they do track them down, will Onshoreland extradite them to the UK to face trial?

Conclusion

Technical consultation may amend the draft bill somewhat, but in its current form, it is a well-intentioned though flawed attempt to introduce more transparency into the UK real estate market. Those people who have used offshore vehicles to acquire UK property for the confidentiality this confers will have to think about whether the loss of that confidentiality is a reason to sell up, or to look to co-investment, so they genuinely do not have a 25% or greater share of the entity that owns the property.

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Family Office Insights

Opportunities in the Global Revolution Into Renewable Energy Market for Family Office Investors

Investment in renewable energy is increasingly popular amongst family offices and other ultra-high-net-worth investors, with enormous advancements in technology and opportunities to invest across a wide range of renewable assets, at different stages of development cycle, making this a rewarding asset class for both direct and indirect investment in many parts of the globe. In Europe alone, a staggering US$58 billion was invested in 2017 in renewable energy projects. It is a revolution set to continue, as renewable energy technologies develop to a cost base, which is parity with fossil fuel-generating assets.

For most family offices, capital preservation ranks first among the primary objectives in investment decisions, but also with the low-interest environment today, it is often desirable to take higher risks to achieve decent returns. We are seeing a big increase in family office and high-net-worth individuals investing in renewable energy projects as part of a secure but dynamic diverse asset allocation.

We are also seeing an increasing desire to co-invest, often alongside other family offices and high-net-worth individuals. Such investors often prefer to work together, either eliminating or significantly reducing the need for control over the assets to be given one way or another to a lending bank or financial initiative/PE Fund.

Direct investment should, however, have an eye for future exit, as such investments do not always have the necessary liquidity at least initially. There are no shortages of buyers for completed projects – for example, large renewable energy companies that constantly need to add to their portfolios, or funds specialising in renewable energy looking for investors with completed projects.

The renewable energy market is changing rapidly, which provides ever more opportunity for family office/high-net-worth individuals to invest directly in projects and companies in this sector. Such investors have a big advantage over other sources of capital chasing such investment – a larger degree of flexibility over investment structures, and a faster decision making process.

In addition, we are seeing investors target a wide range of technologies: solar (including rooftop), onshore wind, biomass, waste to energy, anaerobic digestion plants and wood pellets for power generation. Even major projects such as 4th generation nuclear and large tidal projects begin their project lives with capital from this community.

There really are opportunities to invest across the full food chain – from start-ups with fintech, requiring small amounts of capital to take forward already proven technology to manufacturing levels, which achieve reductions in cost per unit, to 4th generation nuclear, requiring capital to advance the opportunity to prototype.

Solar has made incredible strides in terms of both cost reductions and efficiency, so much so that many countries no longer have subsidiaries for solar – solar power has reached a cost that is “grid parity” with other forms of generation, and is displacing traditional forms of energy, even gas. For example, our client Esparity Solar is developing 1 GW of solar in Spain – a country that until a few years ago needed tariff subsidiaries for solar plants. The investors in Esparity are high-net-worth individuals who have already developed nearly 1 GW of solar in Australia and are looking to dispose of these assets now they are generating electricity.

Many of these renewable energy projects can be deployed locally, avoiding the high costs of transmitting energy down long distance transmission lines.

There is a global revolution going on in energy. As the world has moved away from polluting power plants like coal (UK emission from power stations are now at historic low level pre 1890s). Now the focus is moving to tackle head on the pollution caused by cars in our cities. Electric vehicle charging points are springing up all over the world. Recently, the UK saw Pivot Power announce ambitious plans to build 2 GWs of battery storage connected to the transmission network – the aim being to balance the grid and simultaneously charge entire car parks of electric vehicles within minutes. Starting small, with a £25 million project, they are aiming at £1.6 billion of investment.

The UK government has announced that petrol and diesel car sales will be phased out by 2040, a policy widely criticised as not being sufficiently stretching; perhaps the automobile industry will drive change rapidly. Nissan announced in March its aim of selling 1 million electric vehicles by 2022.

As we move from oil to electricity, where will the electricity come from? There is no advantage in burning high sulphur fuels to generate electricity for cars, etc., so it only makes sense for electricity to drive cars to come from renewable energy. We are seeing huge interest and investment in this asset class because it is here to stay, and technological development means a wide choice of proven technology.

We share with our partners the opportunities for investment in this existing sector, via our award-winning Marketplace platform – a tool to connect market investment opportunities to clients, targets and business intermediaries.

Given the importance of this sector for our clients, we will be following this further in future bulletins, looking in more detail at certain geographical areas attracting most interest, as well as the technologies being deployed.

Family offices with an interest in investing in renewable energy are welcome to speak with the members of our renewable energy team (and should in the first instance contact henry.davey@squirepb.com).

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Family Office Insights

Forgiveness – The Missing Piece of the Family Puzzle

Among moral or spiritual values that families would consider most important, many would agree that forgiveness should be ranked high on the list if not at the very top.

For ultra-high-net-worth (UHNW) families where family processes could be managed professionally and systematically, are moral or spiritual virtues more encouraged through the use of family trusts and family offices compared to other families?

Typical family constitutions would contain a list of family virtues and qualities the leaders of the family want to instil in the generations to come, but we rarely see forgiveness included.

Traditionally, trust arrangements might even point to the other direction. In trust deeds, there are often provisions to exclude a family member irrevocably, or by revocable means, from taking benefit from the trust either by removal as a beneficiary or being named an "excluded person" if he or she acts in ways against the family's value, abuses a family member, commits a crime or simply becomes a "black sheep".

Another example is the no-contest clause in a trust where any beneficiary objecting or bringing action with respect to the trust arrangement would be banned from benefiting. Some families might have rules to remove certain "deviant" family members from important offices such as protectorship of a family trust or directorship of the family office or other committee membership.

Unconscious Messages

It is understandable that a UHNW family wants to protect its assets from being taken away by a deviant family member and does not want the stability of the family to be upset and the family's name besmirched. But if we pause and think, the question we should ask is: what kind of message are these documents or arrangements conveying to the family members?

Key succession planning documents such as trust documents and internal policies for the family office do not only make clear how the family should be run, how family assets should be invested and distribution, and how family members should behave around one another.

They are also sending unconscious yet clear messages. What does the family truly value? What kind of family is this really? Does the family encourage competition or cooperation or a mix of both? Is control an implied or explicit theme?

As advisers to UHNW families, we should ask if the family office is equipped to assist and facilitate, besides the economic and administrative processes, the family processes, which include the personal growth path of family members.

Particularly, we have to consider whether the concept of discipline is appropriately expressed in the family documents. Are the consequences optimal? Are we disciplining or punishing? Would the family give an impression of being overly defensive by excluding the misbehaving family member totally from the family system? Would the "good" kids who have not done anything "wrong" be affected by witnessing the consequences on others?

Overcoming Failures

Then we come back to the concept of "forgiveness". We all make mistakes. By overcoming failures, we get back on our feet and become stronger and hopefully wiser. To be at peace with the past, forgiveness by others and of oneself is essential in the process.

People learn from their mistakes but rarely do they improve due to the feeling of shame. If the current arrangements inflict pain, economic loss, and a sense of isolation, they create all sorts of unwanted impacts. Improvement happens at fundamental levels when we are accepted and we acknowledge the past.

The family office could assist the family in formulating a mechanism to bring the relevant family members back at an appropriate time. The family should consider if it wants to be positioned as being inclusive. Does it want to encourage a forgiving culture? Is it willing to give the family member a chance and believe in him or her again? How should the family encourage forgiveness without become too forgiving?

It is a good opportunity for the family office to play a key role as a fair observer.

Through the lens of the family office, which offers a higher perspective, we can consider whether we have made it clear that forgiveness is important in the family.

Have we made it clear in the family constitutions? Are the trust arrangements in alignment with this particular family value? Have we assigned sufficient resources to help identify potential problem areas in the behaviour of the family members? Have specific family members and experts been designated to take on the responsibility?

Alertness, Awareness and Compassion

The family office should be the ultimate meta-communicator which is armed with alertness, awareness and compassion to help family members communicate consciously and constructively.

Rather than simply expelling the misbehavers from the system, could there be an observation period?

Is it possible to find out the reasons and events that lead to the situation?

How can we help the other family members understand and make sense of the onset of consequences?

Under what circumstances and conditions should a family member be allowed to come back?

Meaningful answers would come from a family office displaying the qualities of understanding, compassion and awareness.

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Family Office Insights

"Death of Retail" Rumors Overblown, Opportunities for Returns Still Exist

While family office investments in retail real estate are facing a number of challenges, opportunities for returns remain in brick-and-mortar stores.

Real estate remains the third largest asset class in the average family office portfolio. This makes sense, as returns on commercial real estate tend to be stable and their correlation to equities is low. Investments in retail real estate can provide family offices with agreeable income streams and long-term appreciation.

Last year was a difficult one for the retail sector. There were a reported 662 retail bankruptcies in 2017, up 30% from the previous year. Store closings tripled, with nearly 7,000 locations shutting their doors. Some of the largest "big box" retailers have begun retrenching, impacting already struggling regional malls. With recent high-profile retail bankruptcies, including brand names like Toys 'R' Us, Claire's and Nine West, many real estate investors are scrutinizing their investments in the retail sector.

While it is true that the retail industry is facing a number of challenges, those challenges come with opportunities as well. From shifting shopping preferences of Millennials to experiential services, tightening of disposable income and the rapid rise of e-commerce, there are a lot of factors that retailers are working to contend with and forecast. The US retail space is also high compared with its peers, with 40% more space per capita than northern neighbors in Canada. However, with consumer confidence increasing and promising prospects of rising wages, combined with the new tax bill that reduces the corporate tax rate and interest rates still being relatively low, there is reason for investors in the retail commercial real estate space to be optimistic.

Signs of Strength

The reality is that the retail sector remains strong, but is evolving in its use of real estate and engagement with customers. Despite calls of a "retail apocalypse," and the aforementioned bankruptcies, occupancy rates at US malls remain at about 93%. Moody's has predicted that US retail operating income will increase a full percentage point this year, with sales jumping 4.5%. Retail bankruptcies are expected to slow this year as well, and M&A activity is likely to increase. Not all the headlines are doom and gloom either: Best Buy has opened its first US store in seven years, while losing their mall-based phone stores; Nordstrom is bucking the trend by opening a Manhattan store; outdoor retailer REI celebrated its 80th year with record sales and opened four new stores in 2017; and long-time catalog and online retailer LL Bean has announced plans to add 100 new stores to its current 26 by 2020.

Two brands in particular can give family offices insight into the shifts taking place in the commercial real estate space. The first is Walmart, which is closing 63 Sam's Club locations, 12 of which are being converted into e-commerce distribution centers. The shift to industrial real estate warehouses and distribution centers is indeed taking place and will have important consequences for retailers and family office investors alike. Walmart is adapting to this shift to e-commerce, recently acquiring two e-commerce-driven companies, Jet.com and Bonobos. According to CBRE, momentum for additional construction of US warehouse space continues to climb. Likewise, the data center industry has increasing need for space. Repurposing retail stores into these alternate uses is only set to rise.

Another brand that is shifting its retail to better reflect consumer demand is the Gap. Though they are closing a reported 200 Gap and Banana Republic stores, they are set to open 270 Old Navy and Athleta stores over the next three years. With stagnating wages in recent years, discount retailers have been the beneficiaries and "athleisure" wear has benefited from Millennial shoppers' preferences. As retailers continue to refine their inventories and fulfillment models, we are likely to see other retail refocusing of this kind. Given increased scrutiny over retail leases, they may also be able to negotiate more beneficial terms than they could 10 years ago.

Opportunities Abound

Apart from apparel, food retail is booming. Despite high failure rates, restaurant space continues to do well in urban areas, especially multi-unit food halls and pop-up spaces. There are now 33,000 coffee shops across the country, and that number is expected to increase by 2% this year. Grocery-anchored malls are also remaining steady, even though some grocery stores themselves have become concerned about their footprint. CoStar has found that commercial square footage of retail food space per capita is hitting record highs, with 4.15 square feet of food retail per person. Many grocers have taken note and are increasingly opting for "boutique-style" markets with a smaller footprint and specialty offerings. Indeed, in the era of e-commerce, family office investors should generally be looking at smaller-format retailers. Many former big-box locations such as K-Marts are being subdivided and filled with specialty retailers and more service-oriented offerings (such as gyms, salons, indoor play space and healthcare services).

Family office investors can also look for opportunities in secondary markets. While JLL found that New York remains the retail hub of the country in its recent *Destination Retail* report, many secondary markets are offering exciting prospects. Texas makes a strong showing in the top 140 retail cities, with Houston, Dallas and Austin all in the top 40. Orlando, Tampa and Washington DC are also in the top 60. Marcus & Millichap's 2018 *Retail Investment Forecast* also reported that Dallas/Fort Worth made the largest jump in its National Retail Index this year, followed by Denver and Atlanta.

While family office investors in retail commercial real estate are facing various risks and challenges, there certainly remains opportunity within the sector for favorable returns. With traditional e-commerce merchants now opening up brick-and-mortar stores and many retail niches doing better than ever, the traditional retail store is certainly not disappearing anytime soon.

Please contact your principal firm lawyer or the lawyer listed in this publication for additional information, or for help on these matters from our global Family Office team.

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Family Office Insights
Happy Families?

Spiritual capital has been used as a general term to describe the work of family office with respect to the ethical aspects of the family. A better way to explain the term is to perhaps divide it into three distinct, narrowly-defined concepts, namely, moral capital, religious capital and spiritual capital.

Moral capital is reflected in family constitutions, which describes the family's core value, mission and beliefs, usually closely tied to the family's entrepreneurial history and how the patriarch created the wealth and wanted to give to the society.

Religious capital represents the family's belief in an organised form of religion such as Christianity, Buddhism, Hinduism and how the family embraces the values particular to such religion's tradition and faith system.

Spiritual capital is different from religious capital in a sense that it derives from the family members' belief or mystical experience in direct connections with Source, which could be totally independent from and does not require the participation in any organised form of religion.

How are these capitals useful in bringing the family together? They help give the family an identity to which its members can relate.

How really can a particular family be defined? Its net worth? Ranking on the rich list? How much political and social influence it has? How many magazine covers the family members have graced?

All these are about looking outward for recognition. They are not the true identity of a family, which can only be found by looking inward.

Looking Inward

Religious and spiritual practices provide the best opportunity to look inward. Many ultra-high-net-worth families recognise the importance of the transpersonal element of such practices and that they are part of an order that transcends or reaches beyond the personal level.

Spiritual capital encompasses religious, culture, economic variations. It might have the highest potential in achieving the objective of bringing people together.

I have been advocating education as one of the most important functions of a family office. Family members should acquire financial literacy and understand succession planning, tax, how to run family office, how to deal with private bankers, corporate finance and family business.

Increasingly, I realise that real education happens when one gets to know oneself. This is a lot more fundamental as the ultimate role a family office can be to help family members learn about love and unlearn fear.

Resolving Conflict

Take meetings of the family council as an example. In those meetings, what is usually brought to the table? Self-interest. It is inevitable, because in most family office procedures design, the representative on the family council attending the family meetings represents the interest of the respective family branches.

Conflicts of interest are expected. For this reason, family offices have in place well drafted set of constitutions, code of conduct, trust documentations to clarify how conflicts can be resolved.

Conflict resolution is important, but the understanding of a few concept of spirituality might be helpful in bringing real peace to these situations.

Family offices can help family members become aware of the "ego". Our ego makes assumptions about others (and their egos). More likely or not, these assumptions are a source of fear.

The real root of conflicts is the fear of lacking, competition and an inherent sense of insecurity. The ego and fear are the veils that block the family members from the inner peace and security that they are born with.

Forgiveness and acceptance are another set of spiritual notions a family office should instil.

Unspoken tension, so commonly experienced in a family setting, can accelerate if not dealt with. It can come from "unfairness" in distribution of trust funds, appointments in family business and even fights between the family members when they are kids or favouritism shown by parents.

Only forgiveness and acceptance (of others and one-self) can free the family members from the burden which keep them from walking the path of life freely.

Family members can easily feel that they are born with the wealth and status. Works will have to be done to remind them that they should be thankful not just for the luxury they have but the little things in life and appreciative of the lessons learnt from the seemingly bad in life sometimes.

The concepts of oneness and togetherness seem to be very abstract but they are extremely important in a family context (though in spiritual belief we are inextricably linked with everyone whether family or not).

There is no real separation. When one person is better off, all are better off, and vice versa. It is the key to reduce competitive mentality among family members and to truly bring the family together.

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The Dynamics of Successful Family Wealth Transfers

Notes From the Field

Overview

The family office is increasingly a preferred vehicle for centralizing the stewardship of family assets across multiple generations. When coupled with a variety of family wealth transfer techniques, ranging from the cutting edge to the traditional and long established, a family office can provide the benefits of centralized wealth management, efficiency and privacy while safeguarding a family's financial legacy.

However, even with the growing importance of family offices among ultra-high-net-worth families, issues relating to the formal governance of families and family offices are often overlooked. While family offices and centralized family wealth transfer plans are created with the intention of preserving wealth and family cohesion for future generations, poor planning and a wide array of potential pitfalls can derail those plans.

Cross-generational family assets generally result from the endeavors of visionary entrepreneurs and business leaders. Although these founding family members may be well versed in corporate governance and business management issues, family governance is more complex. Family governance requires fostering consensus among disparate family members, who may have different expectations for the allocation of the family's assets. The challenges to family unity are more pronounced than ever as family members are increasingly geographically dispersed, and generational differences in investment and philanthropic philosophies can fracture a coherent family vision. Even beyond the success of a family's investment strategy, the preservation of generational wealth depends on critical internal family dynamics. This paper outlines considerations for success in developing effective family governance, identifies common pitfalls from the field and highlights potential functions of the family office – beyond serving as an investment manager – that can foster inter-generational cohesion and empower and position successive generations to continue to build the family's assets.

Considerations for Success

Effective wealth stewardship requires attention to a family's culture and a plan for the development of family cohesion in successive generations, through relationship building, information sharing and attention to family governance. Building culture and cohesion helps to align disparate family members' values and investment priorities, while mitigating the potential that conflicts will arise among them. Established governance processes within the family can help promote a coherent vision and set of objectives and facilitate smooth leadership transitions across successive generations. Formal governance structures involving family members and external advisors, such as advisory committees or boards of directors, can help facilitate the discussion of issues among family members and reduce friction that may arise from emotional business and financial decisions.

Avoiding Common Pitfalls

Divergent values and financial objectives among family members can dissipate a family's assets. Particularly as successive generations become more removed from the generation that accumulated the initial wealth, a sense of entitlement and lack of familial ties can threaten the success of generational wealth transfers. Leadership that encourages transparency within the family and buy-in of a shared philosophy across the generations can help overcome these pitfalls.

The Role of the Family Office

In order to promote a sense of family cohesion, the family office should play a role beyond that of investment manager. The family office should be viewed as a vehicle for consensus building, the transmission of family culture and values, and communication of information. Some family offices establish an internal family bank and provide education programs to support entrepreneurship among younger generations. Moreover, effective family governance, using the resources of a family office, can promote efficiency through centralized management of the family's philanthropy, risk management, personal budgeting and other concierge services.

This paper also examines considerations for establishing effective cross-generational wealth transfers and family office governance that can help to preserve and grow a family's assets. We refer generally to "family offices" in this paper, although we recognize the wide variation in structural approaches that can be taken by different families, from the establishment of formal legal entities at one end of the spectrum to an informal collection of family members at the other.

Considerations for Success – Culture and Information

The fundamental dynamic in cross-generational wealth transfer planning is the tension between transparency among family members – that is, the provision of and access to information about the family's finances and investments – and the control of information and assets by the senior generations.

Building cohesion and culture among family members requires information, as well as trust, but that trust has to extend across generations, as well as among members of the same generation.

What Is G1 Willing to Share and When?

The dynamics between parents and their children are perhaps uniquely complex among all human interactions, and are well beyond the scope of this paper. However, in looking at how families plan for cross-generational wealth transfers, we continually return in our practice to a very small list of fundamental questions: What is the senior generation (G1) willing to do and when? How much information is G1 willing to share – with G2 or G3? How will G1 answer the "Are we rich?" and "How much money do we have?" questions? At what ages will members of succeeding generations be provided with participation in, or even access to information about, the family's decision-making processes? And at what point will members of succeeding generations be given control over any portion of their inheritances? The answers to this suite of questions can establish the framework for a family's wealth transfer planning for generations to come.

Considerations for Success – Culture and Cohesion

In our experience, successful multi-generational wealth transfers depend on family culture and family cohesion more than any other factors. Families that are able to articulate and communicate a family culture and a sense of mission build the connections and relationships among generations and across members of the same generations that provide the "glue" that keeps families functioning as a unit. All too frequently, one sees families splinter – and their assets dissipate – as succeeding generations fail to maintain the connections and relationships necessary to continue to shepherd their family's wealth collectively, especially when faced with economic or family stresses.

But building this cohesion takes effort and communication – and requires trust, information, cooperation, and the ability and willingness to recognize and accept the different strengths and weaknesses of family members. Successful family offices and family groups use a variety of tools to build family culture and develop that critical element of cohesion.

Communication

Open and regular communication is a key element in building cohesion and connections among family members. Whether it is financial or business information or the more quotidian news that any family shares, regular intra-family communication supports the development of cohesion and the transmission of culture. It is critically important, as a family's wealth moves from G1 and G2 to G3 and beyond, that family members know each other and feel a sense of connection, both to each other and more broadly to the family as an "institution." The opportunity to tell the family's story to succeeding generations, and to transmit the core elements of a family's values to those generations, provides some of the "glue" that is essential to keeping families together over time. Family offices can play a central role in facilitating this communication, and the proliferation and widespread acceptance of social media provides family members with an expanded range of additional platforms and methods to maintain connectivity with each other.

Building cohesion through communication can help instill a sense of shared heritage and mission among family members, and can foster connections among and across the generations. These connections, when formed early and maintained over time, are invaluable when a "junior" generation succeeds to family leadership and its members must have trust in each other, as well as familiarity with each other's strengths, weaknesses and foibles, in order to assume the stewardship of their family's wealth. It is much more difficult to try to build those connections in what can be the emotionally charged circumstances of the point of succession: family members who have deeply rooted connections with each other and with their family's mission are far better positioned for a seamless transition than those who are less connected with each other, and thus are more likely to be able to preserve the economic unity of a family across a generational transition.

Family Retreats

Many families find that a regular program of family retreats can build culture and cohesion, through the formal sharing of information and ideas, and simply from spending time together. Family retreats can provide a platform for family members to create alignment to existing goals, report on progress, educate and to make important decisions. Successful family retreats often involve an educational component, frequently on financial or philanthropic matters, and can provide succeeding generations with a greater sense of familiarization with the family's businesses and investments and with their fellow family members. Some families use an "annual report" approach to provide "State of the Family" information in advance of the family's annual retreat. The annual report can provide a mechanism for the senior family members to communicate the state of the family "business," the state of the family and their aspirations for the years ahead.

Programming at family retreats can include presentations from the family office professionals and outside investment managers, to provide portfolio updates and performance information, and from philanthropic leaders, as well as recreational activities and team-building exercises. Expanding the scope of a family retreat to include members of younger generations can provide opportunities for social activities that can lay the foundation for relationships that will be valuable inside the family for years to come. And families with operating businesses can often use the retreat format to provide an opportunity to familiarize members of the family who are not involved in the business with the products and operations of their family's business, through site visits, meetings with management and similar activities. Annual family retreats often resemble a cross between a family vacation and a shareholder meeting, while monthly or quarterly update meetings tend to be short and focused on financial results. The choice of location of the family retreat can be an important success factor as well. While there is no single "ideal" location for a family meeting, family office professionals typically avoid family homes or family business offices, as those locations are rarely "neutral ground." A destination hotel resort with business conference room access can provide a more ideal combination of privacy, recreation, neutrality and formality.[1]

Participation

One of the most vexing questions families face when trying to plan for generational wealth transfers is, "When should members of junior generations become involved in decision-making processes regarding the family's assets?" This question is deeply rooted in the issues of control, transparency and communication discussed above, and every family has a different philosophy on how to address it. In looking at families that have successfully managed generational wealth transfers, one of the tools that has been successful is the establishment of one or more "subfunds" as to which allocations and management is overseen by a junior generation. We have seen examples of successful "cousins' funds," where the senior members of a family make a separate allocation of assets that will be managed by members of a junior generation, who are tasked with determining asset allocations, investment return parameters and targeted investment classes, and with making formal reports to the family as part of the family's overall investment reporting. These subfunds can be set aside specifically for venture investments, social impact investing or any of a number of other investment approaches. A similar approach is to establish a philanthropic or grant-making fund to be overseen by members of a junior generation along the same lines. In either case, the goal is to build investment oversight experience among the junior generation, and – perhaps more importantly – to familiarize the members of that younger generation with each other and with their family's broader investment philosophy and goals, as well as to accustom them to working collaboratively with each other (and with the professionals in their family office), before they have to take over the reins of the family's wealth more comprehensively.

Families with operating businesses have an additional set of challenges, as they must manage the participation of family members not just in the process of overseeing investment decisions, but also in the management of an active business. As the spread of generations increases the number of potential family members who might seek a role in management, families find themselves in the sometimes awkward position of having to choose among themselves to allocate roles and responsibilities in operating companies, and to deal with the associated issues of promotion, compensation and the like. Some families make the decision early in the generational lifecycle of a business to turn to external management, with the family retaining ownership and, perhaps, board roles. Conversely, other families have taken the "independent trustee" approach and have included non-family members on their businesses' boards of directors. This approach allows a subset of the board to act as the intermediary between the family stakeholders and the family member or members who have management roles in the business. Trusted and respected non-family member directors can help lead a family through difficult business or management decisions, or through unexpected management transitions, by providing some measure of emotional detachment in what can be very fraught situations.

1 My thanks to Edward Marshall, Director – Family Office Group, Citi Private Bank, for his valuable input on the family retreat and family bank discussions in this paper.

Notwithstanding the challenges, many families have been able to successfully identify family members in successive generations to take leadership roles in family businesses. This identification process can be undertaken with varying levels of formality, ranging from consensus-style decision-making by senior members of the family (a "council of elders" approach) to the retention of executive search consultants to review and analyze the qualifications and capabilities of potential executive leaders from within the family (or a combination search of both family and non-family members). In some families with very successful cross-generational family controlled businesses, the family has developed formal guidelines to provide a process for family members who wish to work in the business, setting forth minimum educational and work qualifications (often involving work experience outside the family business) for family members seeking to join the family enterprise and an application process specific to them.

Family Governance

In almost no aspect of the family wealth dynamic is there as wide a range of approaches taken than those relating to family governance. Decision-making – difficult enough among siblings – grows vastly in complexity with transfers of wealth to children and beyond, as cousins and their descendants proliferate, bringing additional numbers of voices to the discussion, and who might be spread across geographies and have had widely different upbringings. In many parts of the world, where the extended family as a societal unit has long been the norm, a traditional "family council" or similar approach has shown itself to be easily transmuted to the generational wealth preservation role, and families have been able to adapt what is a traditional cultural element to their management of family wealth across generations. Even in this cultural context, families are increasingly finding value in memorializing the structure and governance of a traditional family councils in written documents such as "family charters" or "family constitutions."

In other cultural settings, where the nuclear family is the more typical family unit, familiar legal structures, such as trusts and partnerships, have long been familiar vehicles for ownership of assets and for asset protection across generations. As families now increasingly use family legal entities such as partnerships and holding companies to own and direct the management of their assets across generations, they and their advisors must undertake careful planning to anticipate and address the governance and succession issues that inevitably arise as the generations unfold. The use of a legal entity can provide the means for formalizing thorny governance and succession questions by establishing a framework for the composition and selection of governance bodies, and for allocating voting rights among elements of the family and providing criteria for distributions. As is the case with operating businesses, families often look to independent trustees or directors to participate in the governance of their family entities, even those that are purely investment holding vehicles, in order to provide external perspectives and to add an element of independent judgment to the governance process. This can be especially valuable when a family engages in strategic planning processes around overall investment strategy, succession planning and the like.

Pitfalls From the Field

The Entitlement Trap

Recognizing and taking steps to address the "entitlement trap" is a challenge that is as old as the family unit itself.

The problems that can be caused within a family unit by the entitled child of privilege, and the intra-family resentments that can be created by the proverbial "prodigal son," do not admit of any easy solution.

Families that are sensitive to this issue struggle to inculcate a sense of responsibility, discipline and balance in their children, who grow up in conditions of privilege, and to convey to them the message that creating and maintaining wealth is difficult and requires work and dedication. Communication among the wider family group, and with it the transmission of family heritage and values, has helped families instill a sense of broader responsibility and purpose in succeeding generations. Likewise, providing visibility into the work required to oversee and direct a family's investments, and even providing early opportunities to participate in that investment oversight process, can help convey a sense of what is involved in the stewardship of family wealth. Family retreats and other avenues for education can help families prepare junior generations for their roles as responsible stewards.

The "Problem Child" Problem

An equally perennial issue for wealthy families is how best to address the circumstances created by the problem child, and the ripple effects caused in a family arising from criminal behavior, substance abuse or similar issues, improvident personal relationships, or other problematic personal matters. A structured approach to wealth preservation and generational wealth transfers can provide some insulation against the financial effects of problem child behavior, by interposing legal protections and formal entity structures between the problematic family member and the family's assets. Analogous to this problem are the complications that can arise from divorce, remarriage and multiple marriages, as families look to navigate the sometimes difficult wealth transfer and succession issues involving ex-spouses and step- and half-siblings. A family that has a rigid tradition of fixed succession parameters (first-born child, eldest son or any similar formulaic approach) is especially vulnerable to problem child risk, as it does not have either a history of, or any commonly accepted process for, dealing with leadership succession when that mechanical approach produces a patently unsuitable candidate for family leadership.

This unsuitability can manifest itself in ways that are less dramatic, but equally require an ability to come to a consensus within the family regarding the leadership of the family or a family business enterprise. It can be a difficult and painful process for a family – and, particularly, the family member in question – to accept that a family member is not suited for the role that traditionally had devolved on the person with his or her position in the family. Trusted outside advisers and family office professionals can play a crucial role in effecting the changes in leadership that those situations require.

Lack of Connection

While the entitlement trap and the black sheep problem focus on issues relating to individual family members, the issues caused by lack of connection among family members are both less obvious and more insidious. As discussed above, transmitting culture and fostering cohesion are key elements in creating the connectivity that keeps wealthy families from splintering over time. It is a huge challenge for a family whose successor generations do not have that sense of connectivity to deal with family leadership succession and to find a common ground from which to work collaboratively to steward their family's wealth. That sense of connection is extremely difficult to manufacture when needed – it either is developed organically over many years of planned and purposeful communication and engagement or, in most cases, it simply will not exist. In our experience, families that are unable to develop and maintain that connection across the generations are much more likely to fracture over time, leading, at a minimum, to the "Balkanization" of a formerly unified vehicle of family wealth into a number of much smaller, separate units and, at worst, to the dissipation of family assets in protracted, painful and expensive intra-family litigation. Building relationships among members of successive generations early gives them the mutual familiarity and relationships that allow for cohesion and resilience in the face of change and transition.

Alignment of Goals

Part of maintaining unity and successfully stewarding wealth across generations is communicating a sense of unified mission and shared goals to family members in those successive generations. This, in turn, can require a family to periodically undertake a process of identifying and assessing those goals and ensuring that they remain aligned with the goals and objectives of those new generations. Family leadership needs to recognize that successive generations may have different values and priorities than those of their predecessors. In recent years, we have found that this value shift has frequently manifested itself in junior generations' strong interest in impact investing – for example, in environmental and social governance projects – with such interest being reflected in both venture investment projects and philanthropic priorities. As the Millennial generation comes to the fore, families seeking engagement with their Millennial family members increasingly look to strategies such as impact investment to find a basis for alignment of goals, connection and a sense of family mission and purpose.

Conversely, the failure to transmit that sense of family connection and purpose, and the failure to develop an alignment of goals across generations, can lead to fracture and disunity. Members of a junior generation who do not feel that their voices are heard or that their goals are taken into consideration are less likely to feel a sense of engagement with, and connection and commitment to, the family as a unitary cross-generational entity, and thus, are less likely to maintain that unitary family when they succeed to seniority.

The failure to find alignment and compromise regarding investment strategy and goals among family members, even absent generational shifts in emphasis, can be equally problematic. For example, one member of the family may be interested in short-term liquidity to finance lifestyle ambitions, while other family members might be more interested in holding investments for longer-term wealth creation, or to enable substantial philanthropic endowments or the like. Misalignment can also occur when there is a pressure from a family member to devote significant family assets to a vanity project: investing in an asset that is not of interest to the family members more generally, or engaging in high-profile and expensive philanthropic or political activity. Finding a way to mediate these individual priorities in the context of a more broadly based family strategy can take creativity, patience and no small measure of diplomacy.

Training and Education

A family puts wealth preservation at risk when successor family members have not been prepared for their stewardship roles. That preparation can take many forms, depending on the specifics of the family and its assets, but without adequate training and education, successor generations can find themselves in positions of responsibility for their family's wealth without having been provided with the tools to discharge that responsibility successfully. In our practice, we have seen family education and training events cover a wide range of topics, depending on the family and its particular activities. Families frequently use educational programming to provide family members with a measure of basic financial literacy on investment and accounting topics, but also use training and education sessions to provide family members with a fundamental understanding of the family's operating businesses and philanthropic activities.

Assumptions and Expectations

Among the most challenging and sensitive issues in effective generational wealth transfers are those arising out of assumptions and expectations concerning family members' roles. These issues can arise in various contexts, but in each case, demonstrate the importance of open and honest assessment of skills and aptitude when considering family governance. Assumptions regarding roles of, and expectations for, sons versus daughters can be a challenging mindset to change, and can vary widely across cultures. Family-controlled businesses that have "always" had a family member as CEO can be faced with difficult succession issues where there is no suitable family candidate, particularly where a family member has an expectation of assuming that role. Conversely, a family member can feel an obligation, because of those same assumptions and expectations, to assume a role for which he or she is not suited and that would be better filled by an outside executive. The addition of sons- and daughters-in-law to the mix can make those succession questions even more complex.

The Role of the Family Office

Beyond Investment Management

Family office professionals increasingly find themselves filling broader roles in the process of stewardship of family assets than the traditional functions of investment management and bookkeeping.

With these broader roles has come a realization that family office leadership can require an additional range of skill sets than previously considered. In the role of facilitator and convener of families, the family office can play a central role in guiding a family through the process of consensus building, values-setting and the transmission of a family's culture and values, in much the same way as a private foundation's leadership is central to the communication and transmission of the foundation's mission and history, in addition to the stewardship of its assets.

Information Hub

The family office is often, in its investment management role, the clearinghouse for family financial information. The family office will typically be responsible for coordinating the collection, collation and dissemination of information regarding the family's investments and performance. In that role, the family office will be the source for information for the family and, therefore, it is of critical importance that the financial information disseminated by the family office be transparent, accurate and verifiable. For that reason, many family offices undertake the organization and review of that audit or verification function centrally, on behalf of all of the family members.

The family office can likewise be the hub for sharing a range of information, not just investment results. Using social media and other technologies, the family office can perform a valuable role in maintaining connections among far-flung family members, and can serve as a repository of family history and experience. As "convener" and "communicator" the family office can serve as a brain trust to succeeding generations as they consider new business ventures, personal investments or commercial relationships, facilitating intra-family connections for information-sharing on a wide range of topics and acting as a central repository of the family's prior relationships and experience with external service providers and vendors.

Training and Education

Along with organizing, analyzing and communicating financial information and investment performance results, the family office can play a valuable role in planning and coordinating family retreats and other educational and training activities. Many families combine a tradition of family retreats with a regular program of seminars and other educational sessions for family members. Depending on which generation is being addressed, these educational sessions can develop familiarity with basic financial and investment topics, and frequently involve interviews and teach-ins with the family's investment managers and other topics related to financial and risk management matters. For families that have active operating businesses, the family office can help coordinate the process of familiarizing family members with those businesses and assist in preparing family members for roles at the board or management level. For families that have a program of regular family retreats, the family office is typically responsible for the preparation of family meeting materials and meeting planning, sometimes in conjunction with outside consultants or meeting facilitators.

Risk Management

A family office's most important role is to protect the assets of the family it serves. Beyond investment management, families are increasingly looking to their family office professionals to advise on risk management issues more generally. In this risk management function, family offices can, for example, review a family's overall suite of personal and business insurance coverages, and work with insurance advisors to optimize coverage and cost, while reducing exposure for the family as a whole. Increasingly, families are concerned with cybersecurity, data privacy and identity protection, and family offices are acting as the central hub for data protection services for their families, even coordinating the establishment of family IT networks and information security for a family's computers and smart devices around the world.

Ancillary Services

Beyond investment management, family offices have historically provided a range of related services, such as bookkeeping and bill-paying, and overseeing tax return preparation. In our practice, we find our global families looking to family offices and their advisers to assist in an increasingly wide range of other ancillary services. These can include arranging the vetting and hiring of household staff, philanthropy management, assisting with personal budgeting and providing "concierge" services such as vacation home management, travel planning, aircraft rental and the like. As described above, families are also increasingly responding to data security concerns by looking to centralize their personal technology, with group cell phone plans covering multiple generations of family members and their personal devices, family websites and private networks.

Family Bank

Inevitably, families with substantial means will be the recipients of seemingly endless requests for investments or loans from business associates or others seeking capital, as well as for philanthropic donations. The family office can serve a key role as a gatekeeper and evaluator of those requests and, by interposing itself between the family and those seeking funding or donations, provide a helpful element of objectivity, distance and, if need be, deniability for the family members. Perhaps even more valuable is the role the family office can play in addressing those same kinds of requests from family members, which inevitably are more emotionally charged and more difficult to address as purely business propositions.

Many families will earmark an amount of funds for intra-family disbursement as the "family bank," to finance everything from purchases of residences or other personal property to investments in business ventures and, in coordination with family office executives, create a systematic process through which family members can request funds for identified projects. A family bank can provide a way for a family to build cohesion across generations, encourage intra-family collaboration, expand financial literacy, instill family values, prepare future generations for leadership and encourage innovation. The funding of business ventures can be combined with entrepreneurship or other financial education programming. Project selection can be done by family office professionals or by a family committee, either of which selects the "best" projects and works with the recipients to ensure success and accountability. The interposition of family office professionals in the process can add a measure of objectivity to the intra-family lending dynamic, lessen the inevitable potential for discord, ensure appropriate legal protections for the family lenders and optimize the tax effects of such transactions.

The family office can play a critical role in establishing criteria for funding requests of various kinds and, by establishing those criteria and a process for intra-family funding, can help avoid difficult inter-personal issues that can otherwise frequently arise from these transactions. This establishment of a funding process, and appropriate legal documentation for various types of funding transactions, can have the further benefit of ensuring that those transactions can be appropriately vetted by legal and tax counsel and can be audited as part of the family's overall asset monitoring. Creating "market standard" documentation to evidence intra-family loan and investment transactions can protect family members from potential creditor claims, legal questions arising from ambiguous documents, and potential gift tax and other tax issues arising from non-arm's-length transactions among family members.

Conclusion

In our practice, we see our clients around the world looking to address the two critical elements of successful stewardship of family assets across multiple generations: family culture and family cohesion. Although the approaches that different families take can vary widely, and cultural norms can influence those approaches as much, if not more, than legal structures and financial planning, almost all families seek ways of building cohesion across generations to maintain family cohesion as stewardship of the family's assets passes to succeeding generations. The range of potential pitfalls to effective family wealth transfer are seemingly endless, but the family office can play an important role in supporting a number of the most critical elements of successful generational wealth planning. By being the family's information hub, convener and intermediator, a successful family office can provide the structure, training and management that can bridge the generations and can provide a path for family succession, moderate challenges to intra-family unity and support the successful stewardship of family wealth.

SQUIRE PATTON BOGGS

Family Office Insights
Beneficial Owners of German Subsidiaries

As of October 1, 2017, pursuant to the modified German Money Laundering Act (*Geldwäschegesetz* – Act), legal representatives of corporate entities (companies, partnerships), other private law corporations and trusts are obliged for the first time to report their beneficial owners to the newly established German transparency register (*Transparenzregister*).

Reports must be filed electronically via the following website: www.transparenzregister.de. The transparency register is available for inspection as of December 27, 2017.

Overview

Overview and summary of the main new reporting obligations are:

- Legal entities, registered partnerships, trusts, fiduciary entities and incorporated foundations have the duty to report their beneficial owners to the German transparency register as of October 1, 2017.
- The reporting obligation does not apply if the information has already been published in the German commercial register or certain other public registers.
- There are no exceptions for non-German beneficial owners, e.g., trustees resident in Germany have to fulfill the transparency duties for foreign trusts and their beneficiaries.

Reporting Obligation

Legal representatives of legal entities (e.g., GmbH, AG, SE, KGaA), registered partnerships (e.g., OHG, KG, Gmbh & CoKG), trustees and custodians are obliged to report their beneficial owners or ownership to the transparency register. A beneficial owner in this regard is any natural person who, directly or indirectly, (i) holds an equity interest of more than 25%, (ii) controls more than 25% of the voting rights or (iii) exercises control in a comparable way. The exercise of control in the latter sense is determined pursuant to section 290 (2) to (4) of the German Commercial Code (HGB), i.e., determined by the factual power of control in the company. In addition, the parties involved in trust relationships and holders of special voting rights are also classified as beneficial owners, which entails a corresponding obligation for the company to disclose information. The information regarding the beneficial owner that the obligor has to report is the full name, date of birth, place of residence and the nature and extent of the beneficial interest (e.g., shareholding and number of shares/voting rights or function as a managing shareholder or legal representative).

Consequently, in case of corporate entities, each natural person who ultimately owns or controls more than 25% of the shares or votes or who exercises similar control is considered a beneficial owner. The corporate entity must trace the ownership up to the top to a natural person who ultimately owns or controls the corporate entity.

If no such natural person is identifiable, managing directors, managing shareholders (*geschäftsführende Gesellschafter*) and any other legal representatives, such as a CEO or board members, are deemed beneficial owners.

Consequently, such legal representative, managing director and partner will be recorded in the transparency register as the beneficial owner. Likewise, shareholders who are beneficial owners or who are directly controlled by the beneficial owner also have the duty to report the information required to comply with the duty to report and any changes to this information without any undue delay to the company. Furthermore, the legislator demands that associations subject to reporting duties have to verify at least once a year whether the beneficial owners have changed and to document this. Changes must be reported immediately to the transparency register.

Further, each natural person who acts as custodian of a fiduciary entity, or is entitled as trustee or protector of a foreign trust, qualifies as beneficial owner. The same applies for beneficiaries of trusts and individuals who can control distributions of profits or exercise control over investment or administrative decisions. The same applies for incorporated foundations, including charitable and private benefit foundations, each represented by their board. Members of the foundation's board who are natural persons are always beneficial owners. There are no constraints with regard to possible control and influence of a single board member, so that any board member must be reported.

Transparency duties are deemed to be fulfilled if the respective information has already been published in the German commercial register or certain other public sources (i.e., association register, register of cooperatives). Furthermore, corporations with natural persons as sole shareholders are not required to register due to the compulsory filing of the shareholder list with the commercial register. In contrast, in the case of foundations, the federal states' registers of foundations are not considered to be sufficient, as they do not contain the complete information required.

Further, the registration obligation does not apply for stock corporations that are listed on an organized (not an open) market.

Practical Challenges

The registration obligation presents a challenge in particular for legal entities with complex shareholder structures and/or non-resident shareholders. In this context, information on the shareholders has to be gathered, recorded and updated in a timely manner. Where necessary, careful checks need be made to ascertain if there is in fact a beneficial owner to be reported. Further, legal entities are required to ensure that changes to the shareholder structure within a group are reported. In addition, vote pooling and pool arrangements are leading to levels of transparency at family-owned companies and shareholdings who may not have been observed for reporting in the past due to economic or personal reasons.

The legal requirements should be a reason for reassessing the entity's legal structure. Even so, the explanatory memorandum to the Act expressly denies that there is an obligation to carry out subsequent investigations; information that will become available in the future must be carefully managed.

Finally, care should also be taken to ensure that different data sources in circulation (in particular by banks, customers or other official registers) are consistent in order to avoid any reports regarding a suspicion of money laundering due to discrepancies in data sets. However, it should be noted that the entries in the transparency register have no constitutive effect.

Compliance Violation

Legal representatives and beneficial owners should become acquainted with the reporting duties, taking into consideration the specific circumstances of their case. Subsequent changes in reported data have to be addressed and reported by the parties themselves. The reporting party is obliged to review the completeness and correctness of the reported information at least once per year.

Violations of this reporting requirement could be punished by a fine of up to €100,000. Severe, repeated or systematic violations of this requirement could be punished by a fine of up to €1 million.

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