Winter 2015

# gateway

THE BAHAMAS FINANCIAL REVIEW

# A Focus on Family Offices

THE BAHAMAS ADVANTAGE


SOVEREIGNTY

# The Bahamas:
## A Paradise for Many Reasons

The business community has come to realize that The Bahamas is truly a paradise for many reasons. This is not the least because of the stable and attractive investment climate the government has created to facilitate the ease and effectiveness of doing business in The Bahamas. Our skilled professional workforce, stable government and economy, sound legal framework, modern infrastructure, proximity to key markets and investment incentive policies are just some of the elements which create this ideal investment climate.

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# From the Chairman & the CEO

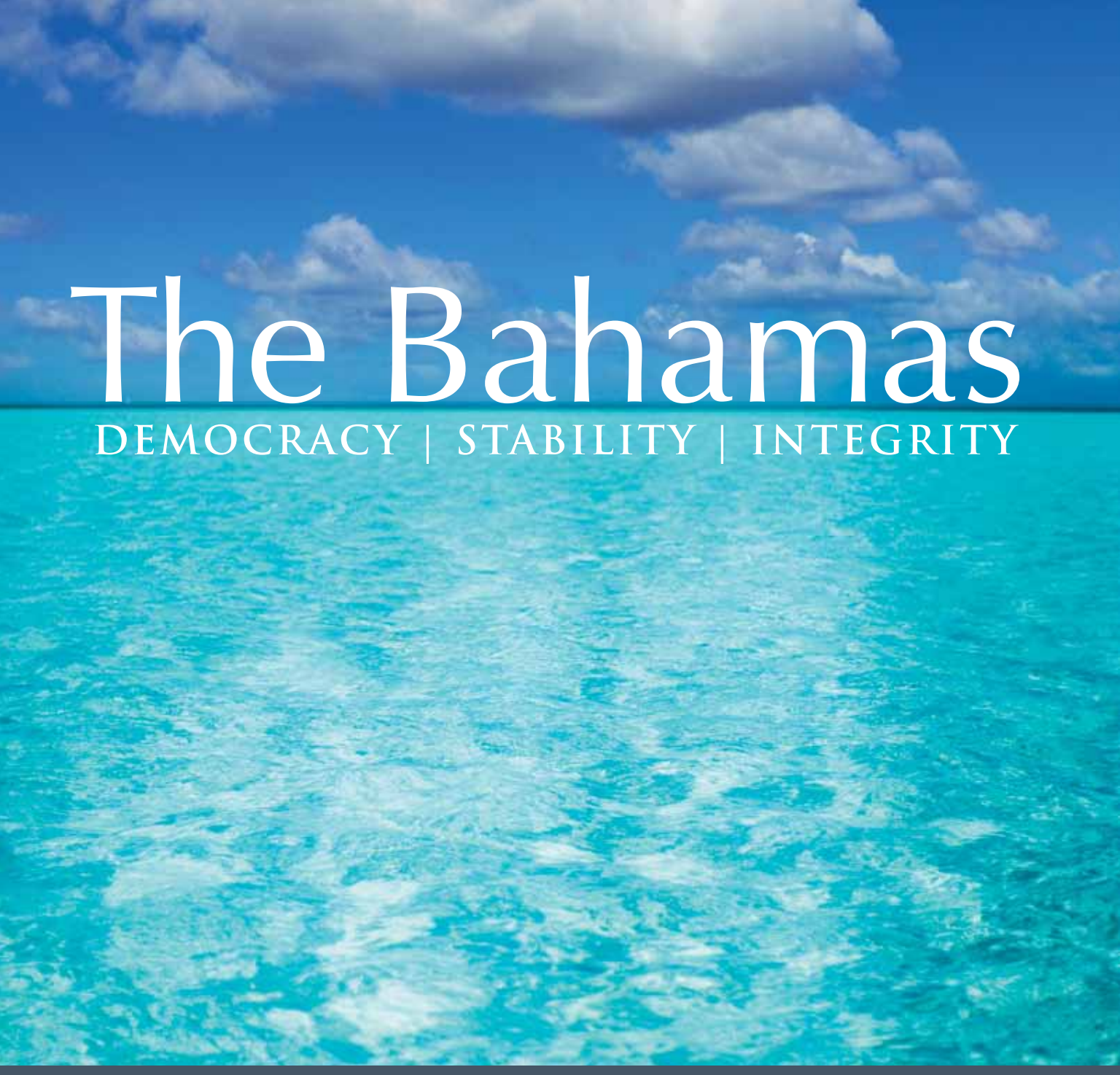
**Prince Rahming,** *Chairman, Bahamas Financial Services Board (BFSB)*

**Aliya Allen,** *CEO & Executive Director, Bahamas Financial Services Board (BFSB)*

In 2001 BFSB introduced the Bahamas Financial Services Review (BFSR), a magazine devoted to highlighting developments in the industry, while promoting products and services on offer. Produced as part of our external communications and marketing initiatives, successive editions focused on areas of opportunity that have been defined in the strategic framework for the sector, with a decidedly client-centric approach. BFSB in its early years also had established a policy of engaging with key stakeholders locally and internationally to promote the development of the right financial services platform for the evolving global markets and clientele. As such, the magazine provided the opportunity for articles by guest authors who had engaged with BFSB on various projects, including the annual International Business & Finance Summit (IBFS).

BFSR evolved into GATEWAY – The Bahamas Financial Review in 2011, maintaining its primary objectives but aligning the look and feel with "The Bahamas Advantage" rebranding announced at that time. In ensuing years, GATEWAY has continued to target the HNWI bracket as well as intermediaries and institutional business, focusing each year on specific themes of relevance to the industry. Wealth Management is our business, but we are more than this and the articles have spoken each year to the broader toolkit of service offerings, always with a focus on how the culture of innovation adds to the culture of excellence, long a trademark of the industry. GATEWAY is a serious "read", and one that is a credible resource that is read and utilised by members and international intermediaries alike. It remains a vehicle that profiles The Bahamas as a premier choice for financial services.

In 2015, we again are making changes as we address the best mechanisms to reach our targeted audiences. With this edition and going forward, GATEWAY will be released bi-annually as a smaller publication, with focused themes, each showcasing the "Bahamas Advantage". For the Winter 2015 edition, we have selected Wealth Management and the Family Office. We also are enhancing the online presence of GATEWAY, as this has been determined to be the preferred method of distribution. Enjoy! ⁘

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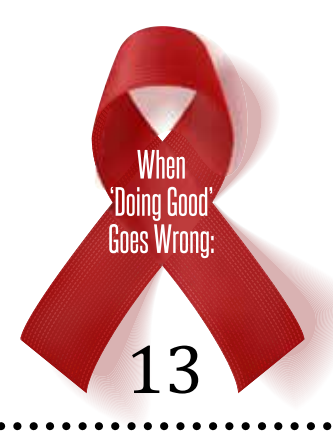






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# private office is the new black

Katie Booth Discusses Fashion in the Field of Family Office……

The term 'family office' has become a little pedestrian, having been applied to so many offices that fulfil the wide array of functions necessary to support a multi-jurisdictional wealthy family. I much prefer the term 'private office' which is now sometimes used to describe the more sophisticated of these offices and the service providers who support them.

When pressed to describe the most common form of 'family office', I have used the following definition: 'A vehicle that performs a wide array of functions and services for the family it represents from staff and travel management services through to the supervision of trusts and personal investments that fall outside of the family's core operating business interests'.

One thing that has become clear to me is that these offices are increasingly institutionalised in terms of their organisational and operational framework. Families have come to recognise the importance of structuring their private office in a similar manner to their operating business interests with clearly defined roles, responsibilities and performance measurement.

The more sophisticated private offices have opted to be licensed to provide company and trust administration services to the vehicles through which the family wealth is held. As licensed companies (in the jurisdictions in which they operate), they are capable of assuming responsibility for administration and record keeping services that previously were outsourced by the private trust companies and other vehicles adopted to hold the family's assets.

The significant emphasis that is now placed on risk management and performance measurement has resulted in the procurement of sophisticated consolidated reporting and company management systems. I have observed a marked emphasis on governance and purpose with greater definition being applied to the processes, policies and procedures under which a private office operates.

So as to avoid the tax perils associated with controlled foreign corporation and permanent establishment rules, many private offices have established themselves in tax neutral financial centres that offer the requisite advisory support and communication services as well as a mature legislative framework for asset structuring.

It is in this context that I perceive a particular opportunity for The Bahamas with its well respected trust and company legislation, its financial services infrastructure (advisory and regulatory) and its communications and transport links, all of which make it an attractive centre for the establishment of a private office. As with all things, much depends upon whom you are able to recruit to handle the day to day administration of the office. but with an increased emphasis on outsourcing and using the private office as the 'conductor of the advisory orchestra' it is often possible to limit the number of actual senior staff required as long as the outsourced functions that remain under their supervision are discharged by the correct counterparties on an independent and transparent basis. More on that later….

In some cases the former Chief Operating Officer of the family business or other members of its senior management team may be reassigned so as to assume responsibility for the management of the family's personal

assets. Equally, it is not uncommon for former legal or accounting advisors to be hired in house to assume responsibility for the operation of the private office.

Partnerships with boutique merchant banks also have proven popular amongst some of the more sophisticated private offices to meet their direct investment objectives. Private offices are attracted to these merchant banking platforms as they offer alignment as regards investment risk and strategy, transparency, a lack of conflict of interest and a broad range of collateral services, including corporate and personal due diligence and assistance with private security arrangements. One particular attraction is the opportunity for certain private offices to principal co-invest alongside the merchant bank, with both parties putting capital at risk in the same transaction. This degree of alignment and the reputational warranty that both parties must necessarily provide is of enormous benefit and often increases the chance of a successful transaction being concluded. Deals sponsored by boutique merchant banks also have an investment time horizon more closely associated with that of a private office. Private capital generally is patient capital, affording the merchant banking partner time to back deals which derive value through long-term enhanced operational performance.

I had mentioned the outsourcing of key functions as being a manifest trend in the private office community, and one such function that is more easily delegated now is the role of Chief Investment Officer. Increasing numbers of specialist firms that offer this service to a private office have emerged. The outsourced CIO can handle strategic and tactical asset allocation, manager selection and performance measurement (as well as offering a sophisticated consolidated reporting service) on an independent basis. These firms also offer bespoke solutions to address the more complex investment objectives and risk profiling pursued by some of the larger private offices.

Many of the respected multi-family offices that have emerged in London and New York now offer independent asset management and support services (including consolidated reporting and investment oversight) to individual private offices on a la carte basis, and recent mergers in the UK are evidence of their growing market share in this area.

As regards other trends emerging in the realm of the private office, I have observed a marked increase in the segregation of the administration of business and personal assets. It is now not unusual to have a team dedicated to the administration of personal assets only, with separate trustees and administrators handling the management of the core operating business interests, the legal ownership of which is often held in entirely separate vehicles. This is a particularly useful strategy where the ring fencing of business interests is advisable from a jurisdictional and/or asset risk perspective.

Of particular interest to me has been the emergence of 'deal clubs' whereby a private office will seek to cornerstone a transaction

and then syndicate it amongst like-minded families with similar investment and risk profiles. Whilst this private co-investment activity is not in of itself a particularly new theme, what is relatively new is the emergence over the last five years of a number of specialist software platforms and organisations established not only to facilitate this co-investment activity but to provide a transaction execution service that includes due diligence on the project and the requisite corporate finance advice.

This is particularly helpful to private offices seeking to deploy cash in a low interest rate environment who often wade through the small corporate finance houses looking for asset backed deals that offer long term capital growth in popular themes such as real estate (student accommodation, mezzanine finance in the commercial development sector), infrastructure, renewable energy (solar/wind farms), agriculture and transport.

Also proving to be popular themes amongst private offices are impact investments in the technology and health care sectors, especially green tech and sustainable investments that offer long term social and environmental benefits. Private capital is socially aware and the private offices are investing accordingly.

So, in this fashionable world of streamlined private offices with unique access to attractive investment opportunities and holistic estate and succession planning, what are the remaining challenges?

The first is cyber security. It is my humble observation (and technology is definitely not my preferred outfit) that many private offices, notwithstanding their considerable resources, are using systems that are unfit for purpose and their procedures as regards data security are still relatively unsophisticated. Equally, when you come to assess their family's digital presence you realise just how damaging social media can be to a family's reputation (younger members of the family are often painfully unaware of the unintentional reputational damage they sometimes cause). There are some terrific firms that can be engaged to manage a family's reputation, digital and otherwise, with quite spectacular results, both in terms of media management and in terms of crisis management. These are phone numbers you need to have on speed-dial as well as the best litigation firms in each of the jurisdictions where you may be required to defend the interests of the family you represent and the vehicles through which the family wealth is held.

Invisibility is no longer seen as particularly beneficial and some families are now proactively 'managing' their digital presence and reputation, especially where counterparties need to be able to independently verify identity and source of wealth.

Whilst tax mitigation is still on the agenda, many families increasingly are sensitive to the 'moral obligation' they face to pay a 'fair share' of tax irrespective of where they choose to reside or from where they conduct their investments and business operations. Social attitudes towards the rich certainly have hardened and private offices are far less interested in aggressive tax planning. Personal tax reporting for family members and tax compliance with respect to asset holding vehicles is a constant challenge and increasingly has become complex and onerous (not to mention expensive). The cost of compliance has increased dramatically as private offices have been forced to recruit additional accounting and administration staff. Managing the treasury function in a private office as regards the monitoring of debt arrangements, margin-calls, currency risk (and hedging) as well as inter-company loans and other debt financing often now warrants either subcontracting or the recruitment of specialist personnel.

Equally, maintaining the integrity of the trustee function in the discharge of the fiduciary decision making process is critical where the private office is acting as trust administrator for a private trust company or other vehicle that is the legal owner of the family's assets.

Managing immigration issues and the monitoring of statutory residence tests where family members are resident in multiple jurisdictions has become an exhausting task and often involves day counting, passport

> The expression, “shirtsleeves to shirtsleeves in three generations” remains a universal challenge, irrespective of culture or religion. Many have come to realise that a succession plan only works in practice if successive generations subscribe to it and share in its vision and philosophy

**Katie L. Booth**
Managing Director
Amber Private Office

shopping and endless reminders to family members of how important it is not to push the envelope! The importance of being tax resident somewhere is something that many families underestimate. Attempting to be a global citizen with no defensible tax residency is sure to create headaches for the private office unless of course the family is able to become wholly tax resident in The Bahamas, in which case matters become rather more straight-forward.

Successful generational transition is still a key focus for private offices and the families they so closely guard. The expression, "shirtsleeves to shirtsleeves in three generations" remains a universal challenge, irrespective of culture or religion. Many have come to realise that a succession plan only works in practice if successive generations subscribe to it and share in its vision and philosophy. Any such plans, however entrenched in the asset structuring and governance documentation, will only be of real practical benefit to the family if they are capable of responding to the family's changing circumstances. A successful legacy family is one where the succession plan is based on a shared vision, not simply by the decree of the patriarch. The key in my view is to educate successive generations of the family in the stewardship of the family wealth and to grant them sufficient oversight of the management of the family's assets such that they may genuinely consider themselves as contributors to the family's legacy. ::

**Katie Booth**
Managing Director
Amber Private Office

Over the last 20 years Katie Booth has managed the consolidation, preservation and succession of the assets of some of the world's wealthiest entrepreneurs. She practised as a private client lawyer before becoming a senior director at MeesPierson, NM Rothschild and Butterfield Bank. She established her own private wealth consultancy in London in July 2011 which she now operates from The Bahamas. Katie is also the founder and Managing Director of Amber Private Office, a business dedicated to the support of single family offices.

In structuring her clients' personal and business assets, Katie has ensured not only the mitigation of taxation and the protection of such assets from the vagaries of litigation but she has facilitated the seamless succession of wealth from one generation to the next. Through the establishment of private trust companies, foundations, family governance vehicles and independent single family offices, Katie has given her clients the opportunity to enjoy a significant measure of influence and control over the administration and succession of their assets whilst ensuring that they avail themselves of the tax mitigation and other benefits associated with sophisticated financial planning. Via her network of specialist advisers, Katie is able to assist her clients with every aspect of their personal planning from immigration visas and residence applications through to the establishment of every type of asset holding vehicle designed to accommodate real estate, private equity, public market investments, chattels and any other personal or business assets that her clients own. Katie has been appointed to act as Protector, Private Trust Company Director or Family Governance Advisor on an independent and personal basis for clients from a variety of different geographies and backgrounds. She provides practical and strategic advice on asset structuring and succession arrangements, leveraging her exceptional experience in this field. Ranked Citywealth Woman of the Year in 2009, Expert Advisor in Spears Wealth Management Index and member of the Institutional Trust Company Team of the Year at the 2010 STEP Awards, her reputation in the private client advisory community is both established and celebrated.

# A Modern Day Bleak House

By Caroline Garnham

I have a friend who I will call Gordon who owned a company which I will call Artus Limited. In accordance with good corporate governance, he appointed a non-executive board and invited his friend Martin to chair it. The company did not do as well as he expected and the bank of Artus asked Gordon to cut his salary and bonus; Gordon refused. The bank then approached Martin to tell Gordon to cut his salary and bonus; Gordon again refused.

After some time of negotiations and cross words Martin asked the board to vote on Gordon's removal, they did and Gordon was removed from his own company. He was left with shares of a company but at the mercy of a board of which he was not part.

Compare this to the situation I came across recently. A wealthy man Mark made a Will and appointed three of his five children as Executors together with a family friend. The decisions of the Executors needed to be unanimous. One of the three children, Harry, was obsessed with calling in a loan, whereas the others were more relaxed about letting it lapse. Harry flatly refused to renounce his office as executor. As a result there ensued three years of litigation.

This is a problem which wealthy families have faced for centuries. Jarndyce v Jarndyce the chancery court case referred to by Charles Dickens throughout his book Bleak House is about a family fighting over the fortune of a deceased. Miss Flite had long since lost her mind when the narrative begins. Richard Carstone dies trying to win the inheritance for himself after spending much of his life so distracted by the notion of it that he cannot commit to any other pursuit. John Jarndyce, by contrast, finds the whole process tiresome and tries to have as little to do with it as he possibly can. The court case goes on interminably and finally ends up with the entire estate devoured in legal fees so there is nothing further over which to fight!

Sadly the case of Jarndyce v Jarndyce has not given succession and estate lawyers a good name. Many UHNW families are suspicious of professionals putting in place structures and plans which in due course feather their nest rather than that of the family.

I set up Garnham Family Office Services to provide families with independent, neutral advice without any conflict of interest since I instruct, monitor and report on the process of lawyers to implement the best solution for the family. All solutions are designed with the aim of saving money and resolving conflicts without the need for legal dispute resolution.

Family Governance is a term I coined with this aim in mind. Many years ago I took the time to study the Cadbury report, the Greenbury report and then latterly the Combined Code of Common Conduct to see what lessons families could learn from good corporate governance to avoid conflicts turning into a costly nightmare.

In many offshore trust structures private trustee companies have been set up to take decisions with an appointed board that knows the family and the settlor's intentions and wishes. However, if there is a board within the private trustee company, can a troublesome director be removed and what can be done to stop that power being abused? A settlor does not want his chosen board sacked by a stranger in favour of his preferred officers.

This was the discussion I had with the head of one of the wealthiest families in the Middle East, Mohammed. He wanted to have the same checks and balances he had in his corporate structure in his private structure, but did not want it weighed down with compliance for which he resented paying. I suggested we go to see the Bahamas Financial Services Board to see if it would be prepared to consider creating a new entity to hold the shares of his private trustee company in Jersey which would act in the same way as a non-executive board, but with the protection of limited liability. After numerous meetings and discussions, and in consultation with Bahamian advisors, I drafted the Executive Entity Act which became law in 2011 and operational in February 2012.

The beauty of the Executive Entity is that because it does not hold any value it does not need to have the full weight of compliance which other structures need. A private trustee company although it may be holding billions of dollars of assets in trust does not itself have any value. The assets which are held in trust are not on the balance sheet of the company. The only assets of the company are those needed to pay its directors and to run the offices which are relatively insignificant.

Mohammed's was one of the first families to have the shares of his Jersey private trustee company held by a Bahamas Executive Entity. He was delighted. He now did not need a complicated Governance memorandum which he was concerned would fuel disputes rather than avoid them. He was confident he had the right people in the right place who knew him well enough to take the right decisions at the right time, taking into account changes of law and circumstances. Furthermore, while alive he could chair the board of the private trustee company so that he could watch over those he had appointed to make sure they knew his wishes and his way of doing things.

Mohammed is not alone in wanting private succession plans simplified, easy to manage and to save on fees and running costs. He was delighted to be able to save thousands of dollars annually, simply by making a few changes in the holding structure which we instructed lawyers to implement. ::


**Caroline Garnham**

Founder & CEO, Garnham Family Office Services


Caroline is a Fellow of the Chartered Institute of Taxation and was a private client lawyer for more than 30 years. She was partner at Simmons & Simmons and head of their Private Client Department for 15 years. Caroline also wrote for the Financial Times as a contributor on tax and trusts for 12 years and all of her articles were published. She was a pioneer in Non Dom planning and coined the phrase ‘family governance’ which is widely used by lawyers and trustees today. In 2011 she proposed and drafted legislation known as the Bahamas Executive Entity (BEE) which became law in The Bahamas in late 2011 and operative in early 2012. She left the law in 2008 to provide family office services to private clients from around the world. The majority of her clients followed and Garnham Family Office Services now serves 400 UHNW clients and works with 5,000 professional advisors. Garnham FOS is fully independent, unbiased and aims to advise on succession, estate, non dom planning and cut costs while doing so. The firm monitors professionals on the client’s behalf to make sure they deliver top quality service. Contact: caroline@garnhamfos.com

# Arbitrating Trust Disputes in The Bahamas

By John Fritzgerald Wilson

When one considers the crux of 'Arbitration', logic would seem to dictate that arbitration ought to be a central cog in resolving trust disputes in International Financial Centres (IFCs) like The Bahamas. After all, we (and other IFCs) promote confidentiality as one of the advantages to the Ultra and High Net Worth Individuals in structuring their financial affairs in The Bahamas and away from their home jurisdictions.

Arbitration is a private system of justice which exists parallel with, but independent of the judicial system. It is the consensual, private process by which commercial disputes are resolved, outside of the court system, by an impartial tribunal. Accordingly, it would seem to follow that this system of settling disputes ought to be an indispensable complement to the private client arena. However, the trust industry has been slow to embrace the utilization of arbitration and has lagged behind the commercial industry in encouraging and enacting the necessary laws which would make the resolution of trust disputes amenable to arbitration or other forms of alternative dispute resolution.

In commercial matters, the current trend is to resolve disputes, wherever possible, via alternative dispute resolution. Recognizing this trend, The Bahamian dispute resolution laws were thoroughly modernised and updated through the passage of the Arbitration Act 2009 (AA) and the Arbitration (Foreign Awards) Act 2009 (AFA). The AA, which was modelled partly after the English Arbitration Act 1996 and the UNCITRAL Model Law, imported into Bahamian law some established and accepted principles and practices from case law and

widely-used arbitration agreements. The overarching general principles of alternative dispute resolution have been enshrined in the AA; these are (i) the ability to obtain the fair resolution of disputes within a reasonable time and at a reasonable cost; (ii) freedom of the parties subject to necessary safeguards in the public interest; and (iii) limited intervention by the courts except as provided for in the AA.

Certain important provisions deserve special mention:

- A clear distinction is drawn between arbitrations for which The Bahamas is the seat of the arbitration and those in which The Bahamas is not the seat, where none has been designated (AA s.3);
- Consistent with international financial confidentiality in The Bahamas, the confidentiality of the arbitral process has been codified (AA s.4);
- Appeal to the court on points of law can only be made with the agreement of all of the parties, or with the permission of the tribunal, provided the court is satisfied that substantial savings in cost will result and the application was made on time (AA s.56);
- An arbitral award is final and binding (AA s.80); and
- An arbitral award is enforced as a judgment of the court (AA s.88);

As adverted to above, arbitration historically has played no part in the resolution of trust disputes. This is due to the fact that beneficiaries of a trust or foundation typically are not parties to the instrument creating the trust or the foundation charter. The applicability of arbitration clauses to trustee beneficiary disputes may be further complicated by the fact that the beneficiaries of a trust may not be ascertained or may not be of full legal capacity. Coupled with the jurisdictional uncertainty of an award made by an arbitrator affecting the interest of an unascertained beneficiary or a minor, even where there is a court appointed guardian of the minor, these issues generally have prevented the inclusion of arbitration clauses in trust instruments.

However, the advantages of using arbitration over litigation in trust disputes are extensive. First, in the context of family trusts, one of the major concerns is privacy and confidentiality. Court proceedings put families at risk of having personal details of the settlor and/or beneficiaries exposed to the public. Similarly, disputes regarding high value trust funds may give rise to security concerns as very few settlors want their wealth, its location and the identity of those benefiting from it to become public knowledge through court proceedings. Although there are steps

which can be taken in court proceedings- through applications for gag orders, applications to have the court file sealed or to proceed in camera - these measures while they ameliorate the privacy concerns do not completely eliminate them. Further, given the general presumption that the dispensation of justice is a public matter (which is why all trials are in open court), specific applications must be made to the court and the Judge convinced on established principles why the matter should be regarded as private. This is not the case with arbitration since the very nature of the process is entirely confidential.

Additionally, the cost and speed of arbitration should also make it attractive to trust disputes. The timetable of the arbitration is determined principally by the parties with guidance from the arbitrator, thus the parties by being masters of their own proceedings can decide what issues are relevant and the duration of the arbitration, and these decisions cannot be overridden by a Judge. Further, where the settlor's and the beneficiaries' domiciles are different from the domicile of the trust there always is the risk of multiple proceedings with litigation being commenced in both the onshore and offshore jurisdictions. This inevitably will lead to increased costs and a lengthy process. Consequently, the cost of resolving a trust dispute through arbitration generally is expected to be significantly lower, which avoids the depletion of the trust fund through expensive litigation.

Recognizing the value of arbitration to resolving trust disputes, The Bahamas amended its Trustee Act 1998 ('TA') through the passage of the Trustee (Amendment) Act 2011 ('TAA'). The TAA seeks to encourage the use of arbitration in resolving trust disputes by addressing the structural deficiencies which previously made it impractical if not impossible to submit trust disputes to arbitration. Concerns of enforceability of arbitration clauses in the trust instruments in the absence of privity of contract between parties to the dispute are addressed under section 18 of the TAA, which repealed section 91A(2) of the TA and now provides that:

"(2) Where a written trust instrument provides that any dispute or administration question arising between any of the parties in relation to the trust shall be submitted to arbitration ("a trust arbitration"), that provision shall, for all purposes under the Arbitration Act, have effect as between those parties as if it were an arbitration agreement and as if those parties were parties to that agreement."

Additionally, the new section 91A(3) of the TA, inserted under the TAA applies the provisions of the Arbitration Act generally to arbitration of trust disputes, automatically importing the statutory rules to the agreement creating the trust. The section provides:

"(3) The Arbitration Act shall apply to a trust arbitration in accordance with the provisions of the Second Schedule to this Act."

The Second Schedule of the TAA creates deeming provisions in aid of enforceability of the arbitration process, e.g. provisions which dis-apply the principle of separate agreements in the instance of trust instruments, and which deem the settlor the person who is free to determine in the trust instrument how disputes are to be resolved. These rules obviate the possibility of a beneficiary contending that he/she is not bound by the settlor's choice of an ADR provision for settlement of trust disputes. The TAA also allows for a settlor to provide for forfeiture of a beneficiary's interest upon challenge to the validity of a trust, which serves as another safeguard against a beneficiary's objection to involvement in the arbitration process. The inclusion of a forfeiture provision by a settlor reduces the likelihood that a party to arbitration will be able to override the provisions dis-applying the separate agreement rule by a challenge on grounds of invalidity of the whole of the trust instrument. Section 91B(2) also vests an arbitration tribunal with the jurisdiction of an equity judge to exercise all powers conferred by statute or under the court's inherent jurisdiction including powers of variation of trust instrument. One such provision which incentivises participation in arbitration mandates that parties to arbitration shall recover costs out of the trust fund unless the tribunal otherwise directs. The tribunal is also vested with the power to appoint a representative of a class of persons or interests within the trust dispute, providing viable solutions to protecting the interests of unascertainable beneficiaries within trust disputes. Moreover, the Second Schedule provides the Court with the discretion to stay proceedings on its own volition, obviating the need for a party to the dispute having to make specific application to the Court for a stay in order to utilize an arbitration provision in the trust deed. The TAA legislation promotes arbitration as a viable process of resolving trust disputes.

Complementing the TAA effort to promote the use of arbitration and other alternative dispute resolution processes is the significant strides manifested in our Supreme Court

Rules to promote mediation as a means of settling disputes. Order 31 A of the Rules of the Supreme Court states that the objective of the jurisdiction of the Court under its general case management powers is to encourage the parties to utilise any dispute resolution avenues to settle their disputes. Further, under O.31 A 8(4), the judge has a general discretion to refer the parties to a mediator to consider the claim or any issue in it.

The Judiciary's support and encouragement of alternative dispute resolution are summed up in the sentiments of the former Chief Justice of the Supreme Court:
"…To those practitioners who have grumbled…of the judges who conduct Dispute Resolution Conferences being too assertive in their conduct of conferences, I remind them that that is the intent of the reform. It is in the public interest that civil litigation comes to be directed by the court and not by the convenience and or whim of the parties and their lawyers and, to the extent that parties can be 'encouraged' to resolve matters at this stage before incurring the additional expense and delay of a trial, dispute resolution is in everyone's interest."

As a result of the amendments introduced into Bahamian law by the TAA trust practitioners and advisors should now seriously consider incorporating arbitration clauses in their trust deeds. ::

**John Fritzgerald Wilson**
Partner,
McKinney, Bancroft & Hughes

In 2006 John F. Wilson became the first non-English Barrister to appear as lead counsel before Her Majesty's Privy Council in the landmark case of Massai Aviation and Another v Attorney General and Another Privy Council Appeal No 58 of 2006 during their first ever sitting outside London when they sat in Nassau, Bahamas. Baroness Hale commented in the Judgment of the Privy Council that he presented the case with "skill economy and charm". Baroness Hale's description of John's level of advocacy reinforces why he is one of the most sought after commercial litigators in The Bahamas. His specialties include Trust and Commercial Litigation and private client advisory work and he currently chairs the firm's Private Client and Admiralty practice groups.

John completed his LLB with Honours at the University of Buckingham in England and then went on to complete his bar examinations successfully at BPP Law School where he became one of the few Bahamians to ever receive honours on the Michalemus Bar exams. He was admitted to the English Bar in July 1994 and called to Bahamas Bar in September 1994.

He is amongst the most extensively published attorneys at The Bahamas Bar, being a contributing author in Carter Ruck on Libel and Privacy (lexisNexis) and The International Real Estate Handbook (Wiley). He recently contributed a chapter to a soon to be released international publication on dispute resolution for trustees and fiduciaries. John has been named the Bahamas' Chamber of Commerce Business Person of the Year, and Jones Communication Person of the Year.


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## SMART SOLUTIONS DELIVERED BY EXPERIENCED SPECIALISTS

Our Trust and Private Client group advises on international trust and private client matters, and are frequently called upon to advise high net worth individuals and families on the use of offshore Bahamian corporate vehicles. Our lawyers are trained to innovatively address and tailor products and solutions to meet our client's needs.

McKINNEY , BANCROFT & HUGHES is one of the largest and oldest firms in The Bahamas and conducts an extensive international and domestic practice from its offices in the cities of Nassau and Freeport.

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# When 'Doing Good' Goes Wrong: Abuse of Charities & the Risks to Fiduciaries

By Gina M. Pereira

Unsurprisingly, jurisdictions offering the most attractive tax incentives for charitable giving are the most highly regulated, restricting innovation and flexibility. Mandatory public disclosure requirements, minimum annual disbursements, taxation, narrow definitions of charity and public benefit, corporate holding restrictions, and economic activity restrictions are common. Without the same fiscal concerns, International Financial Centres ("IFCs") do not regulate privately funded grant-making charities as strictly and thus are an attractive complement or alternative to onshore jurisdictions for cross-border philanthropy.

However, regulators in major financial centres globally are taking a robust stance on financial crime compliance failings, leading the banking industry to adopt a careful risk management approach in response. This has lead certain banks to abandon clients or refuse prospects connected to certain countries or institutions, effectively cutting them off from the global financial system. These policy decisions extend to charities, raising questions about how to navigate these restrictions while servicing areas of need.

Anti-money laundering and fraud and financial crime regulation are entrenched in the global financial centre culture yet the unique risks affecting charities are often underappreciated, leaving mitigation strategies lacking. Trustees and board members of charities are vulnerable to fiduciary duty breach claims where insufficient steps are taken to identify and mitigate the risks of charity abuse. Further, association with financial crimes causes a loss of reputation to the charity, the fiduciary service provider, and ultimately the private client donor.

This article examines the risks affecting charitable trusts and foundations, why and how charities are vulnerable to financial crime and fraud, and the steps trustees or board members can take to mitigate these risks.

## Why are charities particularly vulnerable to financial crime and fraud?

Typically, charities enjoy high levels of public trust and confidence. Association or partnership with a charity offers legitimacy and respectability, which makes them vulnerable to exploitation.

Charities are diverse in nature and provide a broad range of services across all parts of society. Complex financial operations, investments and currencies are typical, particularly when working across borders. They may work in conflict prone or developing economies with cultures of bribery and corruption. Income and expenditure streams may be unpredictable, making suspicious transactions harder to identify. The use of intermediary partner organisations to deliver services also increases the risk of abuse. Resistance of donors to invest in infrastructure, staffing and operations leads many charities to depend on a small number of individuals, who often play an unsupervised role, which contributes to lax operations and controls. Cross-border transactions increase complexity and the risk of financial abuse. Grant-making trusts and foundations rely on operating charities to fulfil their charitable objects, compromising controls over fund expenditure.

## How are charities vulnerable to financial crime and fraud?

Charities are vulnerable to fraud and theft, including bribery

and corruption, money laundering and terrorist financing. Some common techniques used include: raising funds in the name of a charity and then redirecting the funding; using a charity as a legitimate front for transporting illicit funds; using a charity that distributes aid or relief as a front to conceal other illegal activities; making donations to fraudulent charities; creating fake grant applications, inflated or false expenses; banking system theft and fraud; and identity fraud (i.e., providing services to non-existent beneficiaries).

The banking industry globally is striving to comply with increasingly stringent rules on money laundering and terror financing. Charities can be targeted as conduits for money laundering, offences that are prohibited under proceeds of crime and anti-terrorism legislation. In a step towards so-called 'de-risking', charities have been refused basic bank services, particularly those with links to Muslim organisations. This gives rise to a number of increased fraud risks for charities, which can be forced to operate with cash.

Charities are vulnerable to exploitation for terrorist financing yet terrorist abuse is not limited to the diversion of charitable funds away from legitimate charitable work to support terrorist activities. It extends to the exploitation of charitable services to recruit, radicalise and cultivate support of vulnerable populations.

## What are the legal duties and responsibilities of trustees and board members?

Charity trustees and boards of directors are in a position of trust. Not only do they have a responsibility to protect charity funds and assets and to act prudently; proper controls must be put in place to be aware of risks, and to monitor and manage them.

Trustees and board members have a duty of care to comply with charity laws and laws targeting fraud and financial crimes. There is a duty to safeguard the charity's assets against fraud and theft. They must ensure that assets are properly used in furtherance of the charity's objects, spent effectively, and financial affairs well managed. This requires the exercise of proper controls, failing which a trustee can be vulnerable to charges of mismanagement or misconduct. Trustees and board members have a duty to not engage in activities that cause undue risk to assets and the charity's reputation.

How trustees or boards respond to suspicious transactions or incidents of fraud and crime also is essential in fulfilling their duties.

## How do trustees or boards protect themselves from financial fraud and crime?

Trustees and board members must take reasonable steps to help prevent financial abuse and ensure that there is no misuse of funds.

The nature and extent of internal controls necessary to mitigate risk and prevent fraud and financial crimes will vary depending on the size and complexity of the charity, the nature of the investment, the jurisdiction(s) involved, and the amounts. While trustees cannot apply a risk-based approach as to which duties they chose to comply with, the nature and extent of controls implemented in adherence of their duties will vary depending on these variables.

Charities can be protected through the implementation of adequate levels of governance, accountability and transparency that will mitigate reputation and legal risks that arises from financial crimes and fraud, including:

- Safeguarding methods for transmitting funds abroad;
- Internal and financial controls in place to ensure that all funds are fully accounted for and spent in a manner consistent with the charity's objects;
- Adequate monitoring and proper financial records for use of funds with audit trails of decisions made;
- Requiring donee charities to certify no dealings with any individuals, entities or groups subject to government sanctions or known to support terrorism;
- Checking lists of designated terrorist related individuals

and organisations;
- Dealing responsibly with incidents when they occur, including prompt reporting to relevant authorities;
- Reducing the risk of the charity being used as a vehicle for money laundering by following source of funds due diligence principles.

## Conclusion

International pressure to regulate fiscal crimes and terrorism, coupled with the increasing demand for transparency and information exchange has compelled IFCs to revamp their business models and offerings.

While IFCs offer a base from which philanthropists can launch innovative programmes that accommodate investment and growth, legislation and regulation must reflect the evolving nature of philanthropy, ensuring flexibility and encouraging innovation while providing for appropriate oversight to encourage best practices and mitigate abuse. Financial crime and fraud mitigation strategies should be tailored to address the vulnerabilities of the charitable sector, protecting the reputation and legal standing of the charity itself, its trustees or board members, and private client donors. ⁘

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Gina is the Founder and Principal of Dana Philanthropy and a practicing lawyer. She has extensive experience working as a trusts & estates lawyer and fiduciary in the international wealth management and planning industry, servicing private clients from Asia, the Middle East, Europe and the Americas. This has included broad international experience while she developed her career operating from Zurich, New York, The Bahamas, Brazil, Toronto, and Bermuda.

Dana Philanthropy is a donor advisory firm specialising in cross-border philanthropy and offering comprehensive advisory services to international private clients and corporations throughout all stages of the giving lifecycle, including: strategy development and planning, structuring grant-making vehicles, conducting due diligence on prospective beneficiaries, overseeing implementation and monitoring, and coordinating measurement and review.

Committed to community investment, Gina serves as a board member and on the advisory boards of a number of international non-profit organisations. She is a frequent guest speaker at international wealth planning conferences, promoting the business case for philanthropy advisory services and educating advisors on current industry developments and professional best practices. Through her publications, Gina strives to raise the profile of private client philanthropy and to inform advisors about strategic social investment and giving.

# Innovation in Private Placement Life Insurance

By Paul Cooper

Everybody likes a guarantee, whether it be that your investments will grow at a certain rate each year, your car will run trouble free for 5 years, or the retailer will honour your return of goods if you are not fully satisfied. To borrow from any dictionary, a guarantee is a formal assurance (often in writing) that certain conditions will be fulfilled.

However, the downside is that this often comes with an additional fixed cost, whether explicit or embedded in the price of the good or service, and often this cost turns out to be disproportionate to the perceived peace of mind or value the guarantee brings.

What if you could just pay for the guarantee only when you need it, and only for the level of guarantee that you need? Innovations in Private Placement Life Insurance are developing to provide a way of offering protection of the value of a certain amount payable to loved ones upon the death of a policyholder, whilst still offering full upside growth potential of the assets underlying the insurance contract.

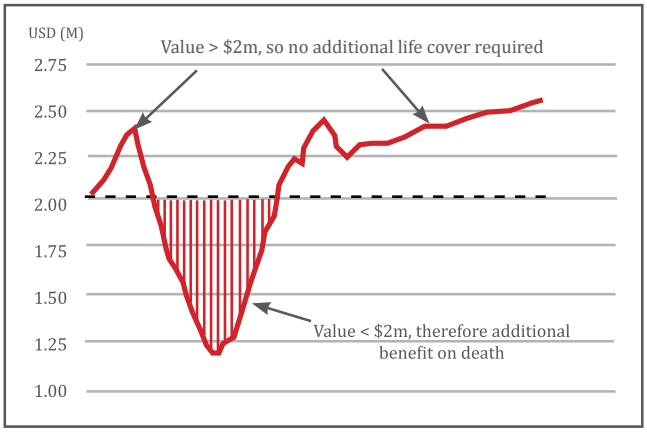
By moving the mind-set of protection away from the hedging of asset values using complicated and often expensive market derivatives contracts, to instead using periodic short term life cover to make up any shortfall against an initial investment, the process can be materially simplified and the cost consequently reduced.

The simplicity is best illustrated with an example.

A policyholder wishes to invest $2m into a Private Placement Life insurance for succession planning. He would like to continue with his existing investment strategy that has successfully provided long term growth. However, he is mindful that he has worked hard to build an inheritance for his family and wants to ensure they receive this full legacy. He could instruct, as part of the investment mandate, to put in place financial instruments to regularly protect against the downside market risk; however, the cost will likely impact the upside potential growth of his funds.

Instead, as part of the Private Placement offering, the life insurance company is able to provide a series of short term life covers, which in the event of death will top up the value of the underlying invested funds to the initial investment of $2m but, importantly, only if the underlying assets have fallen below this value. Typically this is repeated on a regular cycle, usually quarterly; however, it can also be monthly or annually.

At the start of the cycle the underlying market value of the invested funds is compared with the $2m initial premium. If the market value exceeds $2m then no additional life insurance is needed for the period and therefore there is no cost of life insurance for the period. This is illustrated in the graphic below.



If the market value is below the $2m initial investment, then a temporary life insurance cover is guaranteed for the period - let's say a quarter - that will provide in the event of death the additional fixed shortfall determined at the start of the quarter. The cost of this life cover is determined purely on the amount of cover required, the short period of risk, and the demographics of the policyholder.

This process is repeated throughout the lifetime of the policy.

The beauty and simplicity of this approach is that there is only a cost when there is a shortfall at the start of a cycle and the cost of the additional life cover is minimised because it is just for a short period coupled with it only being for the amount needed at that point in time; i.e. no excess and unwanted life cover is provided, or charged for.

Putting a number to this cost: for a male aged 50 in normal health, with a shortfall of $200k at the start of a quarter, the cost for that period would typically be of the order of just $75.

For many quarters it might be expected there will be no shortfall (as illustrated in the previous graphic) and therefore no cost. Further, in the event the policyholder decides at some point to surrender his policy he will have paid only the life cover costs relevant to his age. This contrasts with level premium life assurance where the future higher charges are averaged over the lifetime and therefore the cost is comparatively greater in the early years.

Underwriting takes place just at the start of the policy and may consist simply of a short questionnaire on the policyholder's health. After this point the process of assessing the need for life cover at the start of each cycle is automatic and the process is guaranteed to be repeated.

Having illustrated the simplicity of this solution we should, for balance, explore the possible downsides.

One of these is that the level of protection is assessed only at the start of the cycle. During that period the exposure to further market falls is not protected. The shorter the cycle, the lower the risk that any pay-out on death falls below the original investment. However, the shorter the cycle, the greater the frequency of determining the additional potential premium for life cover as well as the administrative cost of the exercise. A quarterly cycle achieves a good balance, especially in the context of a mind-set of long term whole-of-life investment. A policyholder is not looking for daily protection when succession planning.

A second possible downside is that life insurance companies, or their reinsurers, like to put a cap on the amount of protection. Typically this may be set to offer protection down to 50% of the initial investment. This protects both the life office and the policyholder against an aggressive or volatile investment strategy.

Both of these limitations generally are acceptable overall to policyholders and the approach works best in the private placement segment as opposed to a retail product. The benefits of long-term protection and succession of wealth, coupled with an efficient cost effective mechanism to achieve this broad protection, can provide a compelling offering in many circumstances.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Paul Cooper is Co-founder and Chief Actuary of Premium Life Insurance Ltd., an independent private wealth insurer founded and located in Nassau in The Bahamas. It prides itself on offering secure and flexible wealth management solutions both for succession and estate planning as well as asset protection.

Paul has over 25 years of experience in the insurance industry. He is a Fellow of the Institute and Faculty of Actuaries in the UK and holds a degree in Mathematics from the University of Warwick.

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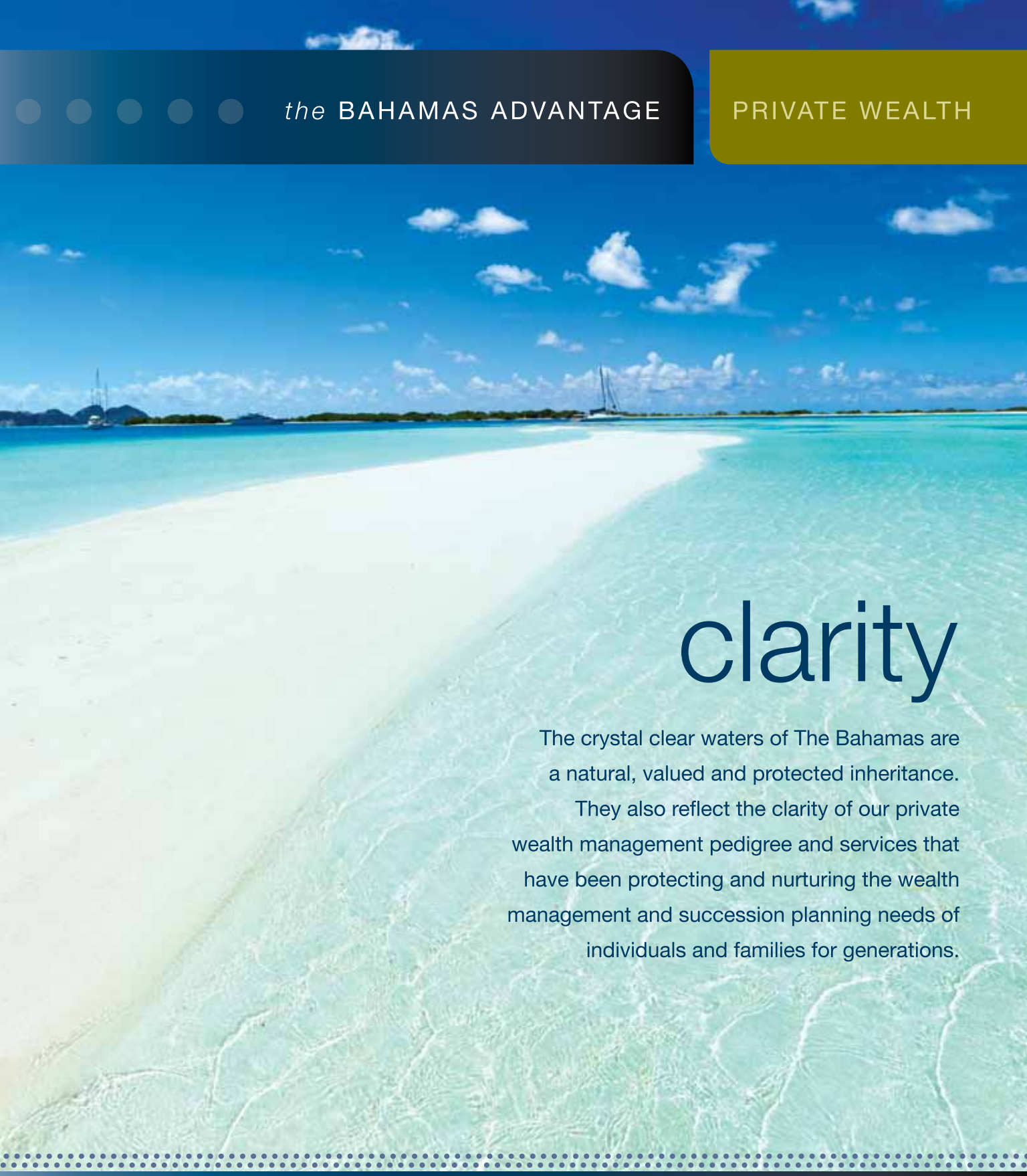


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