FAMILY OFFICES IN CYPRUS: FIVE PITFALLS TO AVOID

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Ever since antiquity, wise Kings and Queens upon entering middle age would often take the steps needed to ensure that their kingdom, bloodline and legacy continued to thrive long after their personal demise. This would usually involve training their young and building their armies, walls and castles (complete with emergency escape passages leading to a safe place) to protect their descendants from future predators. They would also create alliances in the form of trusted, institutional relationships that would transcend generations and they would build an ecosystem of skilled advisory and governing bodies that would provide the checks and balances to help avoid fatal errors in the judgment of a single person, as well as protect and maximize the wealth of the Kingdom.
Many of today's billionaires are not so different - and much of the above thinking is effected through their Family Offices.

ENTER CYPRUS

At PwC Cyprus, we are seeing a growing number of our billionaire and Ultra High Net Worth (UHNW) international clients transition their various existing structures into a more organized and focused Family Office – the same applies to an increasing number of new clients, whose wealth has only recently grown sufficiently to justify their own Family Office.
This rise in Family Offices is not unexpected. According to the PwC/UBS publication The Billionaire Effect (November 2019), over the past 5 years, the number of billionaires globally has grown by 39% and their aggregate wealth by 35%. Furthermore, the top 5 billionaire country groups consistently include China, Russia and India. Unlike billionaires from the US (the largest group), many from those countries choose to set up their Family Office, at least in part, outside of their country of origin, with Cyprus often being one of the candidates.
While Cyprus has attracted some Family Offices from the West (US, UK and several shipping and other families from Greece, Germany and Scandinavia), most come from the East: Russia/ CEE, the Middle East/Israel and Asia, especially China and India. Such families find Cyprus attractive as a second base. EU-membership, English-based law, stability, strategic location, reasonable taxation and a wide

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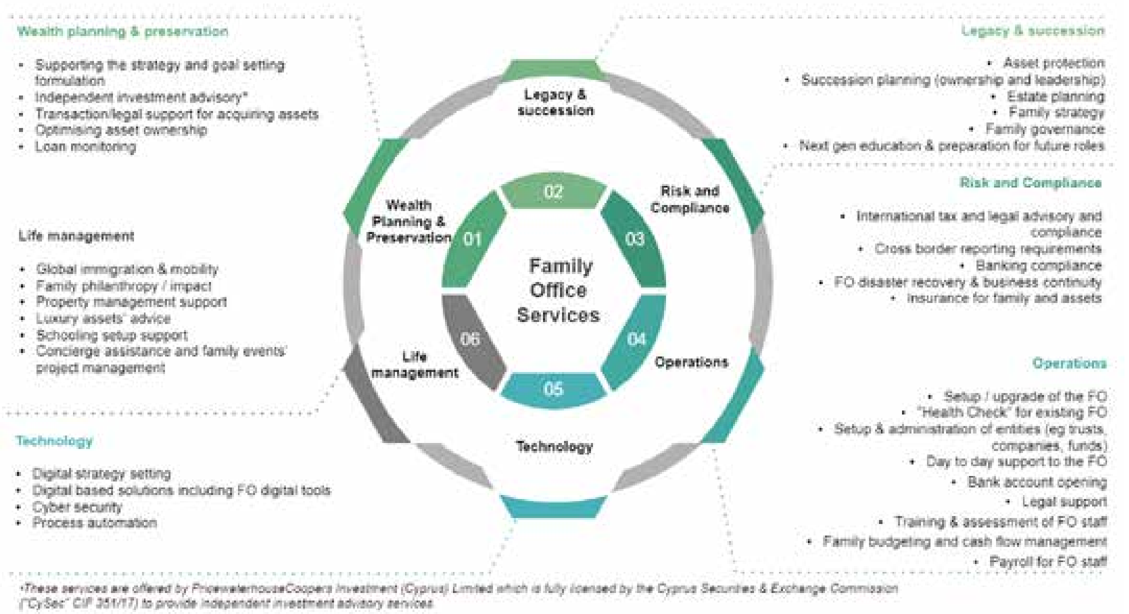
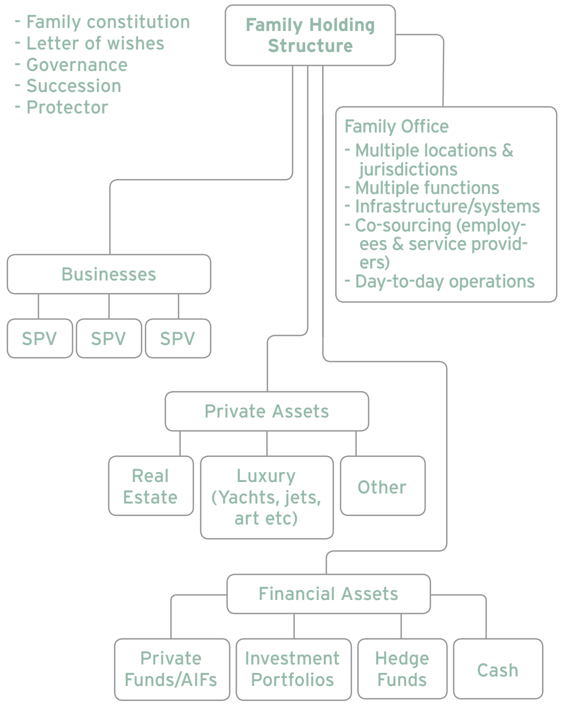


treaty network, immigration rules that are very friendly to investors, and the quality of professional services are all helpful traits in this respect.
Most importantly, however, many see Cyprus as a great and safe place for family members to live in at some point in their lives – one of the world's sunniest places, with excellent infrastructure, educational and leisure facilities, a cosmopolitan lifestyle, nearly crime-free and, as proven during the COVID-19 pandemic, quite effective in handling crises (owing to its being an island with a relatively small and not dense population and a high standard of medical resources).

SETTING UP A FAMILY OFFICE: THE BASICS

One can easily find extensive online information about what a Family Office does. There is no fixed definition of what it is but an example is set out below.



The top family holding structure is selected after analysing legal, asset protection, succession and tax planning considerations and operational requirements and the desired degree of involvement and influence of family members and others. Structures most often used include Trusts or Private Trust Companies (PTC); other options include foundations, Alternative Investment Funds (AIF) and companies or Companies Limited by Guarantee (CLG).
Equally important is designing how the various components of the structure will work together and introducing mechanisms to make it functional – the "glue" that will hold it together (such mechanisms relate to role/ people matching, reporting and ensuring sponsorship).
Numerous technical areas are involved in setting up and running a Family Office and it takes months, sometimes years, for such an operation to reach full efficiency. The main areas of a Family Office and the support typically provided to clients in each area are shown adove.

FIVE PITFALLS TO AVOID

Here are some of the challenges we have seen our clients face over the years:

1. NEVER USE A STANDARD, READY-MADE SOLUTION FOR A FAMILY OFFICE

A Family Office must be right for the specific family. No size or type fits everybody.
Most of the documented "best practice" and, hence, standard models naturally relate to the US. With many families having already gone through multiple succession events, US Family Offices often serve numerous family members and resemble a public company with fragmented ownership. Their priorities (beyond regular activity) might relate to philanthropy, sustainability, impact investing and legacy maintenance. Their constitution and set-up would reflect these.
Conversely, a first-generation Family Office in a developing country might be more concerned with risks and eventualities that may bring about quite dramatic effects with binary outcomes. Core businesses there may be

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more sensitive to shifts in the political environment or changes to Government policy. In certain countries there is little experience of vast wealth being passed over to the next generation and it is uncertain if and how rivals, financial and other players will react in case of the unexpected passing of a top-tier patriarch. Would the resulting power vacuum make the underlying businesses (now owned by the young successors) vulnerable to takeover efforts? Are there powerful and incentivised allies in place who would help? Have such matters been considered in the Family Office set-up? Family Offices must therefore be designed based on the specific needs, circumstances and concerns of the families they serve.

2. NEVER NEGLECT TO PLAN FOR A BAD SCENARIO. BE STRATEGIC AND ANALYTICAL

The strategy of the Family Office needs to be the strategy of the family. It is perhaps the single most important task of the Family Office to identify and address the key risks for the survival of the family – physical, financial and reputational. An obvious event for which planning is needed is succession – and leaving it too late might lead to serious problems. (see 3 below). But it's certainly not the only one!
There are strategic analysis tools that allow for a thorough evaluation of the family's external and internal environment, drawing on local expertise in each country of relevance. This can lead to the development of key scenarios addressing each major threat, together with possible actions to counter or mitigate it.
Such threats can vary from those mentioned in (1) above to legal disputes, divorce, war or even a pandemic! Indeed, during the recent crisis, Family Offices were reportedly in position to fly family members from high-risk countries to low-risk ones and place them in secure and comfortable surroundings (on land or the sea), with immediate access to state-of-the-art medical/ ICU facilities. Significant preparatory work would have been required years ago, in the areas of immigration, jets/ yachts, medical resources planning, real estate, logistics etc.

3. DON'T LEAVE SUCCESSION PLANNING TOO LATE

One important strategy to help ensure wealth is passed on smoothly is to start preparations for succession early. The earlier the planning and implementation begin, the more influence a patriarch can have on achieving his wishes and objectives.
In addition to implementing strategies for the protection of the wealth, Family Offices should also plan the preparation of the next-generation from early ages. This entails addressing educational matters of the children and their exposure to the business world. At the same time, the patriarch may have to be prepared to pass on control earlier and not wait until he is old enough to be forced to do so.
The sooner succession begins, the smoother the transition will be – ensuring that the next-generation will be strong enough in time to 'fight off' any potential challenges. As with many types of surgery, doing it by election and on your own terms provides better survival rates than being forced to do it in an emergency!

4. DON'T KEEP IT ALL IN-HOUSE OR IN ONE LOCATION. FIND THE BEST SKILLS FOR EACH JOB

A Family Office is almost never actually a single office or building – or in a single country. It's not just about the money management, it's not just about the legal or the tax structure. It involves a wide range of issues and complexity and requires a wide range of specialist skills to get it right. Successful Family Offices tend to use the best possible skills for each job, regardless of geographical factors or whether these are in-house or external. The technological solutions and dedicated Family Office software available today easily enable virtual operations.

5. DON'T MANAGE THE INVESTMENT PORTFOLIOS: MANAGE THE MANAGERS

Family Offices must ensure that investment portfolios are managed effectively. There is usually a decision to be made as to whether these should be managed by in-house investment managers or given to private banks and fund managers to manage for a fee. While this depends on the quality and cost of in-house resources, the size of portfolios, the ability to obtain institutional discounts, synergies etc., it has been our experience that, in many cases, it is beneficial to draw from a wider pool of expertise and utilise best-in-class investment management skills for each asset class from across the market. Using external investment managers may prove problematic and inefficient unless those managers are monitored very closely. It is the responsibility of the Family Office (which could also be outsourced to a credible external independent investment advisor) to run effective and structured processes for manager selection and monthly or quarterly monitoring of performance, involving risk-adjusted market benchmarks, and making changes in managers whenever necessary, to optimise performance.

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