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WEALTH MANAGEMENT
US mid-term elections and populist issues

The forthcoming US mid-term elections are scheduled for 6th November 2018 and will undoubtedly be an important factor to watch in the coming weeks.

Opinion polls can of course be quite misleading as voters stated intentions do not always translate into an actual decision to make the journey from their homes to the ballot box. As usual, the result will depend greatly on the number of Republicans and Democrats who feel 'fired up' enough to vote on the day. The battle between the two opposing camps is becoming interesting as both Republican and Democrat party bases seem more engaged than usual.

A closer inspection reveals three populist concerns on both sides. The common issues include immigration, the perception that the rust belt states are being 'left behind' by the coastal elites, and of course gender politics.

Will the Democrats take both houses?

Current readings from respected American commentators suggest that there is perhaps a 60% chance that the Democrats will take the Lower house, whilst the Republicans will maintain control of the Senate.

For financial markets on the day after the elections, the focus will be on whether Trump has been de-railed. For example, if the Democrats win both houses they may feel emboldened enough to start impeachment measures against Mr Trump. However, as we witnessed with Clinton during the 90's impeachment measures can backfire and make your own voters more determined than ever to rally around their leader.

Even if Trump was impeached due a major fresh scandal, Mr Mike Pence could quickly step in to fill his shoes and the stock market may actually rally on the news as the Vice President is credited as being perhaps less volatile in nature.

Democrats – 'waiting on a sunny day'

Looking further down the line towards the next Presidential election, it seems clear that Trump is becoming hard to stop. It may take a series of very witty and perhaps waspish final 'put downs' during a televised debate or perhaps a fresh Republican scandal before the Democrats feel they have regained any sort of momentum.

A quick look at the current list of Presidential hopefuls from the Democratic Party seems to leave most of the party faithful feeling un-inspired.

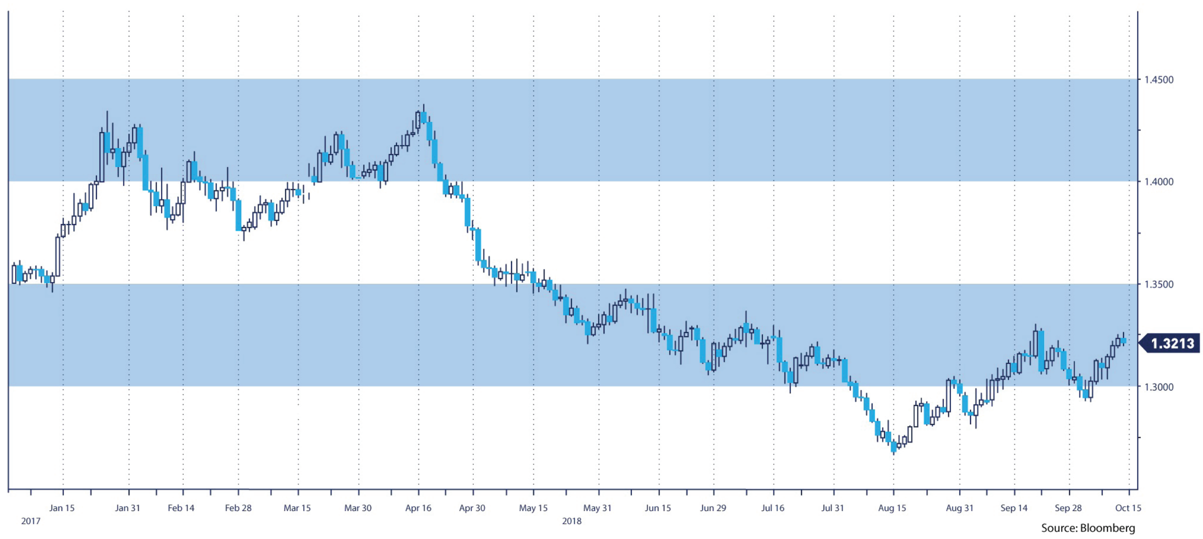
However, not all is lost for the 'Left' in America as Californian Senator Kamala Harris is popular with voters and of course, there can always be surprises. After all, not so long ago Obama came from nowhere to win the Presidency.

Brexit - PM May has several strings to her bow

Current indications from the Brexit discussions suggest that Britain is edging closer to a deal with Europe on the terms of its departure. Hopes that a deal would be completed have been clearly visible as sterling rallied against both the US Dollar and the Euro in recent weeks.

GBP BGN Curncy

EUR BGN CURNCY · 01.01.2018 – 12.10.2018



Prime Minister May has a number of highly respected business advisers around her - some of whom are well removed from the public eye. However, they do understand the fundamental need for Politicians to keep Britain at work and stay elected.

If it looks like a deal cannot be agreed before the end of Q1 2019, we would expect sterling to weaken. However, at that stage the Conservative party may decide to issue a series of business tax cuts specifically designed to help Britain survive in a low tax world.

A stable judiciary and legal system created over 300 years ago could mean that the UK may even become the next big offshore Centre, with its own straightforward set of regulations.

Italy (spending a little more)

The new populist political parties in Italy are spoiling for a fight with the European club. Following, several years of low consumer confidence and jobs growth, Italy wishes to loosen fiscal constraints in order to boost spending patterns.

As usual, the EU is pushing back on such reforms, as they are mindful that such moves can easily send European Bond yields higher. The move by Italy is important for investors as it could embolden other countries who feel that it is time to try something new.

At the end of the day, such measures are completely understandable, especially given the very poor employment prospects for under 25's in Italy, many of whom have opted to work in London and elsewhere in recent years. However, as usual, the bond market may have the final say and most politicians will have noticed the rising bond yields in Italian debt markets of late – as a warning sign.

Sub-prime lending (taking a little off the table)

Elsewhere, perhaps as a sign that US credit markets are tightening a little, Goldman Sachs recently announced plans to scale back its unsecured lending to Consumers. In the last 2 years, the firm has built over $4bn in revenues but perhaps senses that as rates rise American consumers may feel the pinch in 2019.

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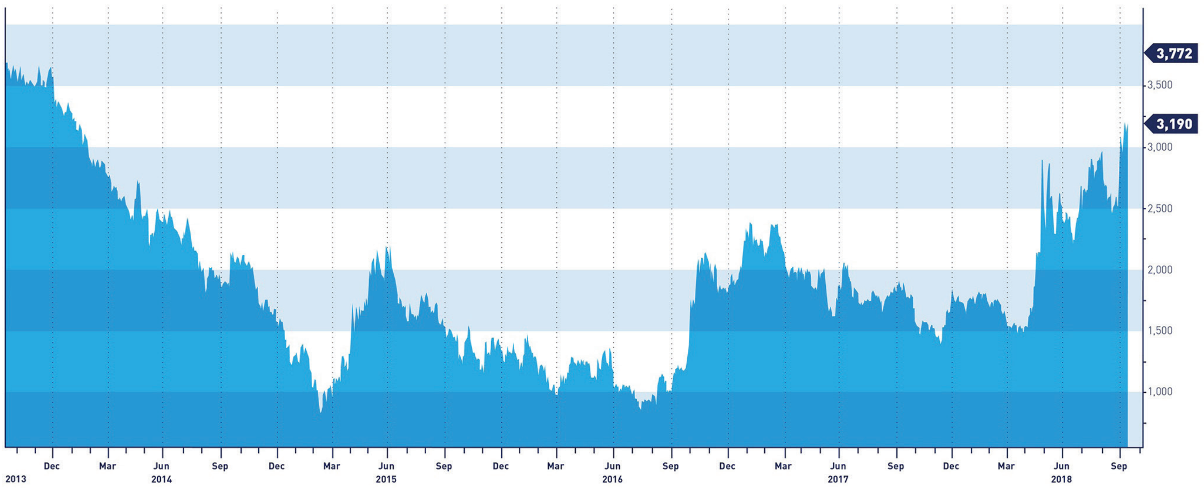
GBTP10YS Index

GBT10YR Index · October 14th 2013 – October 12th 2018



Source: 12/10/18 Bloomberg, Italian 10 year yield (BTP)

Fundamentals versus momentum

As equity markets fell during October, it seems clear that the market is looking to re-test several key technical support levels. In the financial press, commentators have been quick to highlight fund managers which have made consistent gains in recent years by combining various growth and momentum filters.

In the case of the latter, this frequently involves looking for companies where the share price moves higher and the profit upgrades keep coming. They tend to couple this with a good understanding of the technical support levels and of course, the PE ratio is still for many a deciding factor in stock selection.

From reading through the various data points in the equity markets, it seems that some of the most successful investors are starting to question whether ever-increasing PE ratios can be justified, even when supported by strong growth. In simple terms in some sectors, some PE's and even PEG ratios (Price Earnings to Growth) are comfortably above their 10 year ranges.

In our view, it may make more sense for the market to scale back on its expectations that certain groups will grow forever and focus on the deviation from the long-term averages.

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FINANCIAL PLANNING
Annuity or lump sum?

Planning for retirement can raise a number of unanswered questions. One of the main aspects to consider – and also the most consequential – is what is the best way to draw funds from a pension pot. Most pension funds give their policy holders the option of drawing the funds that they have saved in their pension pot over many years either as a recurring annuity for life or as a full or partial lump sum.

This is a particularly important decision that can only be taken once and will determine the course of your financial future.

Those who opt for an annuity have the major advantage of not having to make any arrangements. They simply receive monthly or quarterly payments for life once they have retired, which makes budgeting easier. For retired persons who are married or in a partnership, a widow's or partner's pension is paid after their death. If opting for lump sums, it is important to bear in mind that regular annuity payments will be lower or not paid out at all. This means that you will have to be prudent in managing your funds and – to some extent at least – make decisions on rationing your money.

However, various other points also have to be considered. First of all, the entire pension pot will be subject to income tax. This is in addition to taxes on old age and survivor's pension annuities, imputed rental values or other rental income and investment income. However, many of the usual deductions such as work-related expenses, dual earner deductions and pillar 2 & 3a deductions under the Swiss pension system will no longer apply. As a result, the tax burden may not be materially lower than it is when you are employed, while your income will be substantially reduced.

Partial or full lump sums are subject to what is known as a lump sum tax. This is a separate, one-off tax charge that is significantly lower than the rate of income tax. There are vast differences in the rates of tax applied by different Swiss cantons. The lump sum amounts are also taxed progressively, but the tax rates range from around 5% to almost 30%, with the highest rates of tax payable in the canton of Zurich.

It is therefore imperative to consider the tax situation as a whole, especially aspects such as how pension planning can be optimised before retirement and what the long-term implications may be. Obviously, the canton in which you are a resident makes a big difference. Moving home may also be an option on retirement if the tax burden is an issue.

However, a number of other criteria play an important role in addition to tax aspects, especially the individual's current situation. For example, is there a significant age gap between spouses/partners? Is emigration an option? Are there any health conditions to consider? Is the individual experienced in accumulating large amounts of wealth? What arrangements has the individual already made with regard to estate planning/are there any heirs?

As we can see, there is no one-size-fits-all solution. Everyone should seek individual and, above all, independent advice well in advance of retiring.

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FIDUCIARY SERVICE SWISS
Tax deduction of asset management costs in Zurich

At some point – at the very latest on preparing their tax return – anyone who opts to have their assets managed by a third party has to consider what exactly can be deducted under "asset management costs" and what the rules are for deducting actual or flat-rate costs.

What costs can be deducted using the actual cost method? There is no straightforward answer to this question as many banks and asset managers charge an all-in fee. This includes mixed costs that are not broken down into individual services, making it impossible for both the client and tax authority to determine the level of deductible or non-deductible costs.

Non-deductible costs primarily relate to financial and investment consultation services or the buying/selling of securities and the associated commissions, fees, broker fees and commercial fees.

The actual costs incurred by third parties for the passive management or custody of moveable assets are the only ones to be accepted as asset management costs according to accounting rules. These relate to the costs of a safe deposit box or safe, custody fees and fees for preparing tax documentation (tax statements).

Besides the method of deducting actual asset management costs, the canton of Zurich (like some other cantons) offers the option of applying a flat-rate deduction for the management and custody of securities by third parties, i.e. without providing evidence of the actual costs. The following practice applies up to and including the 2017 tax period: for portfolios with a value of up to CHF 2 million, the flat rate is 0.3% (up to a limit of CHF 6,000) of the portfolio assets under management.

Eligible securities are equities, bonds and financial products such as investment funds. However, bank balances, loans, trust assets, fixed-term deposits and interests in own companies are excluded.

For portfolios managed by third parties with a value exceeding CHF 2 million, the flat rate of 0.3% is only permitted if the flat fee that has been paid cannot be broken down, is equal to or higher than the amount of the flat-rate deduction and corresponding documentation can be provided.

Adjustment to the practice of deducting asset management costs

The practice of applying flat fees of 0.3% for portfolios managed by third parties with a value of up to CHF 2 million has not changed. However, as of the 2018 tax period (beginning with the 2018 tax return), the Zurich Cantonal Tax Office is introducing a change to the tax deductibility of flat fees. The new practice affects portfolios worth more than CHF 2 million managed by third parties with flat-rate management fees that cannot be broken down into deductible and non-deductible costs. In such cases, it is now possible to deduct CHF 6,000 plus half of the flat fees charged by the bank after the CHF 6,000 has been deducted.

Here is an example of the charges involved for a CHF 5 m portfolio with costs of CHF 30,000:

COSTS FOR THE FIRST CHF 2 MILLION:	CHF 6'000.00
COSTS FOR THE REMAINING CHF 3 MILLION: (CHF 30,000 - CHF 6,000)/2=	CHF 12'000.00
TOTAL DEDUCTIBLE COSTS:	CHF 18'000.00

This change is the result of a ruling by the Zurich Tax Appeals Commission dated 31 January 2017. In this case, taxpayers applied for the deduction of actual deductible costs that had been paid in addition to indeterminable flat fees totalling CHF 945,000 on a portfolio worth some CHF 417 million. The Zurich Tax Office reduced this amount on the basis that it was less than the flat rate of 0.3% of the portfolio's value (CHF 1,251,000). As a result, an amount of only CHF 200,000 was applied at the authority's discretion.

The Zurich Tax Appeals Commission ruled that this interpretation was unduly disadvantageous to taxpayers paying a lower flat fee and approved the deduction of the declared costs. The commission also found that the previous directive should be revised.

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TRUST & CORPORATE SERVICES

Protectors of Anglo-Saxon trusts: an old concept with a few pitfalls (part 2)

Summary: protectors of trusts (and foundations) are often friends or longstanding business partners of the trust settlor. We strongly advocate appointing independent and professional protectors.

Background

In the first part of this article, we provided a summary of the different types of protectors as well as their rights and obligations. Below, we will outline situations in which the protector of a trust plays a really important role and highlight what can go wrong in dealing with protectors.

When is the role of a protector really important?

In practice, protectors usually only come into play when they are advised by the trustee of forthcoming decisions that require their approval. Another example is when a change of trustee is required for various reasons.

We believe that protectors should take a rigorous approach to interpreting their role as a watchdog. Protectors have a right to access information and should exercise it, for example to request the annual financial statements, or to monitor the costs of the trust and gain an impression of how the asset managers are performing. Assuming the role of an active watchdog can protect the trust's assets and avoid any unpleasant surprises for the beneficiaries.

"IT'S LIKE RIDING A MOTORBIKE: PROTECTORS PROVIDE A SENSE OF SECURITY, BUT THEIR TRUE WORTH IS ONLY REVEALED WHEN PROBLEMS OR ACCIDENTS ARISE."

One extremely difficult task borne by the protector is to act as a mediator between the beneficiary and the trustee.

A friend of the family or a longstanding associate at a bank may have closer ties to the family than a professional protector, but generally tends to be a "sunshine" protector who will be emotionally and professionally challenged in a complex dispute situation. Moreover, there is a risk that a friend of the family will be torn between their amicable ties to the founder and possible litigious relationships within the family. In short, protectors cannot be impartial if they are a friend of the family as they will have to take the side of one of the parties in the dispute. This can shatter the relationship between the beneficiary and the protector and prevent the latter from fulfilling their assigned role.

Thus, it is important to raise awareness of the job of a professional protector. Professional protectors have to fulfil their role as defined in the trust deed and conscientiously exercise their function as a watchdog. In addition, they should establish and maintain regular, confidential contact with the family and act as a mediator to provide any necessary advice and support to the trustee and the family. We therefore recommend that protectors take a pro-active approach to their duties and demonstrate their commitment to the trustee and family.

What can go wrong?

There is no guarantee that protectors will not take advantage of their position in accordance with the trust deed to act against the interests of the beneficiary. To provide an example: after the settlor dies, the protector fundamentally and consistently refuses to sign off payouts to the beneficiary as he disapproves of the beneficiary's lifestyle ("good-for-nothings who don't deserve to receive anything from the trust property"). Although this is an extreme example, it is a possibility.

How do I get rid of a protector?

When all is said and done, the purpose of the protector is to protect the beneficiary from incompetent, uninterested or dictatorial trustees. But what happens if the protector himself is or becomes incompetent, uninterested and dictatorial? The conditions under which a protector can be dismissed are set out in the trust deed. Beneficiaries usually have very limited opportunities to take legal action against a trust protector. In the above case, the trustee has to appeal to the relevant court to remove the protector from office. It is possible that a dispute will continue in court for several years at the expense of the trust property. However, this is a step that the trustee cannot avoid.

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Spotlight: protectors as controlling persons in the automatic exchange of information:

And now for a health warning: protectors are registered as "controlling persons" or even "account holders" under the automatic exchange of information and are reported to the relevant tax authorities. Depending on the particular configuration, this may mean that the value of the trust property and information on payouts will have to be reported together with the name of the protector. Private protectors may be in for an unpleasant surprise if at some point they are asked by their tax authority for additional information on a trust in which they are a protector.

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INSURANCE
Life Insurance Companies in Liechtenstein

Message: In case of bankruptcy of an insurance company, its clients are well protected

With swisspartners Insurance Ltd., Vaduz, and its branch in Feldkirch, we are very active in the international life insurance market for wealthy families. Our clients sign up for life insurance policies for themselves and their family members, and transfer considerable private assets to our insurance company as insurance premiums. Their intentions usually are the following:

- Long-term inheritance and estate planning for the family of the policyholder
- Wealth preservation and protection against third parties
- Tax advantages, such as tax deferral or reduced taxes upon cancellation of the policy or death of the policyholder, as the case may be in the policyholder's country of residence

Our clients (and their families rely on the long-term financial stability of our insurance company and trust that the above mentioned intentions can and will be safeguarded in the future.

It is widely known, that Liechtenstein employs very strict solvency requirements for insurance companies. It is also common knowledge that the Liechtenstein Financial Market Authority (FMA) which is the supervisory body of the financial services sector, has a number of measures at hand to prevent and manage crisis situations of regulated insurance companies. For example, the FMA may order the transfer of an entire insurance portfolio to another regulated life insurance company in Liechtenstein which will administer the policies thereafter.

There has never occurred a bankruptcy case of an insurer in Liechtenstein, But what would actually happen in case an insurance company in Liechtenstein came into such a financially desperate situation that it had to declare itself bankrupt and open bankruptcy proceedings?

«Help! Where is my money?»

We wish to use this forum for a short summary of the legal and technical consequences of an insurance company filing bankruptcy. Here are the steps:

- Firstly, the debtor (the insurance company) or a creditor files a petition with the Court of Justice (Landgericht) and by order of the court, bankruptcy proceedings will be opened.
- The FMA will withdraw the license of the insurance company without delay. It will also inform the competent authorities of member states of the European Economic Area and the respective European authority, the EIOPA.
- The withdrawal of the license has an important effect: The policyholders will have the right to terminate their insurance contracts with immediate effect. If a policyholder does not terminate the policy, the insurance contract will automatically expire four weeks after the announcement of the opening of the bankruptcy proceedings. In both cases, the policyholders are entitled to reclaim the policy reserve ("Deckungskapital").
- The insurance claims are given preferential treatment during the bankruptcy proceedings. The assets to cover the claims are the technical provisions, i.e. in broad terms, the sum of all premiums paid plus any income and gains. They constitute a separate estate for the purpose of satisfying all insurance claims. They are separate assets, segregated from the insurance company's "own" assets.
- The policyholders hold preferential claims, and they are to be satisfied immediately after the establishment and maturity of their claims.
- In case the policy reserve is not sufficient to satisfy all insurance claims, such claims will rank first-class in the bankruptcy proceedings.

In plain language, what does the above mean to the protection of the policyholders?

1. Policyholders' financial interests are protected and their claims are segregated from the insurance company's own assets.

2. In case the segregated funds are not sufficiently high to meet all claims, the policyholders will rank top before any ordinary creditors.

3. In view of the specific business model of life insurance companies in Liechtenstein, i.e. relatively low additional risk cover and high reinsurance cover, there is only a very remote danger that at any point the segregated funds ("technical provisions") will not suffice to cover all policyholders' claims. In other words, even if an insurance company goes bankrupt, the policyholders' claims will be protected.

It goes without saying, that an insurance company may face bankruptcy for a variety of reasons. This is part of business reality. But our message is: policyholders should not worry about "their" assets. They are safe and well protected, even if the insurer goes belly up.

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