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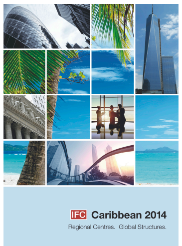

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Due Diligence - The High Net Worth Individual's Circus

By L Burke Files, CDDP, President, Financial Examinations & Evaluations, Inc (01/06/2014)

High Net Worth Individuals (HNWIs) do not play by the rules, or at least the rules the rest of us have to play by. It is both part of their success and part of their charm.

I have enjoyed working with my HNWIs clients. The problems they have are rich with peril, opportunity, and the need for creative solutions.

That being said, whoa - are they difficult to keep up with. With the variety of investment choices and opportunities available to them, due diligence and compliance becomes complicated. HNWIs think about the return and the edge needed to harvest that return. HNWIs think not a lick about compliance. It is not that they do not care about compliance – they do – but it is an afterthought.

Some of it has to do with how HNWIs allocate their time. Time to us is valuable, but to HNWIs time is all they have and they will not see it wasted. Their time allocation is ferocious and efficient. Thus, HNWIs as a whole are intolerant of fatuous dissent or red tape – as these are time wasters. Often this is what they will pay their legal and financial advisors to deal with, or clean up if you will, after they have made their choices.

HNWIs are not mutual fund investors and many of their investments are not marketable securities. The HNWIs are very proficient at seeing private or business opportunities, targeting these opportunities and cutting investment agreements in days, not weeks or months.

For example:

> *A HNWI, as many do, had several financial advisors that he used from time to time and for differing purposes. But he told all of them that, for a portion of his portfolio, they had discretion to invest in event driven opportunities. As Myanmar opened up – all of the financial advisors took long positions with companies mining prospects in Myanmar leaving the HNWI ridiculously over exposed to the future on Myanmar.*

How could the HNWI allow this to happen? It is the nature of the beast. HNWIs may review statements, and bank accounts balances twice a year. The statements, be they brokerage, bank, insurance, etc... are (if they are in hard copy) usually held at the firms or sent to a central family office. The HNWI leans heavily upon their trusted advisors to keep things moving for them.

HNWIs typically have several legal advisors. Advisors for their businesses, advisors for their residencies, tax advisors and so forth. Often these professionals are consulted only for a given purpose, a purpose in which the advisor is a top specialist. But each action taken by these highly mobile HNWIs can impact their carefully crafted multi-national structures and agreements crafted by these professionals. Each jurisdiction has its legal and tax advantages and disadvantages. As good advisors we aim to assist our clients so they can enjoy the advantages and avoid the disadvantages of each.

> *A couple agreed to a prenuptial that was drafted in France where they were married. In France, before marriage, one visits a notary and signs a marriage contract entering as a way of deal with property if the couple is to separate. An*

> *agreement such as* separation des biens*, which is binding in the event of a divorce in France, is common. But as this French agreement does not comply with English Law, the French agreement is not binding in England. As a result of François Hollande's punitive tax scheme on the wealthy, the couple chose to move to England. The wealthy French business woman and her husband moved to a wonderful London address as more or less tax exiles and away from their beloved Strasbourg. After a year or two in England, the wife filed for divorce, she had found a new man. To her great frustration, the* separation des biens *signed in France was not binding in England and she was required to make substantial equalisation payments to her ex-husband.*

The tax advisors undid the careful and considered work done by the marital advisors, by shifting the couple's domicile.

HNWIs are very conscious of what is called TIC v TOC, or Total Incremental Cost versus Total Ownership Cost. They are not impulse buyers. They look at the cost of ownership of an item over time. If their intentions are to buy a property for a retreat, they begin by asking the right questions. For example, is it less expensive over 20 years to have a Tuscan gentleman's farm or an apartment unit on the Côte d'Azur? They will consider the farm exemption in Italy, value of both properties appreciation over time, as well as what would their grandchildren like to have to visit. They are not looking at payments or affordability. Debt is only something the HNWI uses to leverage a return, and not used to bring something they like into the realm of possibility by way of an affordable monthly payment.

I have one client who lives, as he calls it, GKW - (God Knows Where). Each time I speak to him he is off on another adventure and living in another GKW county. To him and other HNWIs, financial independence is more important than fitting in socially. He would prefer to explore the world, a new GKW county every 30 to 90 days, than fit in to the convention that he has to live in one place. Commercially, he is the same. If a country does not like his business or he has to pay too much in tax – he moves the business. Now, he does everything possible to avoid this as he becomes very attached to his staff – but move his businesses he will. While he will try and take as much of the staff as he can with him – that will not stop the relocation. Like geese, once the climate becomes too cold or hot, the HNWIs migrate because they can. HNWIs are terribly mobile.

A key to the puzzle of due diligence and compliance for a HNWI is to earn their trust.

You earn their trust by not wasting their time or your words but by your deeds. You will need to have access to their statements, brokerage, bank, insurance as well as foundational agreements such as business ownership documents, martial agreements as well as trust and wills. Their transactions need to be reviewed to ensure compliance with the HNWI's wishes and instructions and report to the HNWI as agreed such as weekly, monthly, by exception, etc.

A new and sinister problem, as a professional servicing HNWIs to which you should be sensitised, is identity theft. As we know HNWIs typically review their accounts much less frequently than the rest of us – as such, they have become a prime target for account takeovers and embezzlements.

I often suggest that the person in charge of a HNWI's due diligence does not have control of any assets or power of the pen for any reason. Lacking discretion over choices and the power of the pen, you will remain above suspicion of mischief. The due diligence person for the HNWI is there to ask the right questions at the right time and ensure that what the HNWI has put in place, is doing what they designed. The due diligence reviews are to be periodically based upon investments or life changes of the HNWI, monthly for brokerage and banking accounts, and no less than annually for the totality of how investments, agreements, structures and life choices are meshing.

Once the trust of a HNWI is earned, and it does take time and deeds, it is very valuable. Once the trust has been broken, the trust is dead forever and so will be your reputation for all HNWIs.

Work with your HNWIs, by asking them the right questions to ensure that you, as one of their experts, keeps them safe, their eyes open to the consequences of the choices they may make and allow them to be them.

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