Launching into headwinds with confidence
17/04/2015 by James Anderson

The competitive environment amongst Switzerland's professional trust and fiduciary businesses is witnessing accelerating changes, which will alter the make up of the sector significantly over the next few years and beyond, according to Herman Krul of Geneva-based Reliance Trust Company.

Mr Krul, a Dutchman who spent 30 years at Cargill, a US-based multinational, subsequently joined Netherlands-based ATC Group in 2003, to head up the company’s Swiss fiduciary and corporate services business in Geneva and Zug. ATC Group was acquired in June 2013 by Intertrust, another Dutch-headquartered fiduciary and corporate services business (see eprivateclient 06/06/2013).

In 2014 he joined Reliance Trust Company (Reliance), an independent trust and corporate services business, based in Geneva, established by his daughter Annemarie de Wit-Krul, previously in practice at Bonnard Lawson, a local Geneva law firm.

A market in flux

The establishment of a new trust business in Geneva might appear to be counter-intuitive. There is ample evidence to show that Swiss-based trust companies, many of which have centred their business models on non-tax compliant work (for clients with undeclared assets), are either going out of business, or being subsumed into larger organisations.

Banks are amongst those either exiting, or paring back their trust businesses in Switzerland, as part of a wider strategy to reduce compliance risks in their business. Schroders, J.P. Morgan, HSBC and RBC are just four recent examples. An ongoing challenge for many banks is the risk that individual bankers typically have little interest in reporting undeclared clients to their management, as this negatively affects their income.

Mr Krul forecasts that the exit by banks from the trust business will accelerate over the next two to three years. But he thinks this could be reversed thereafter. "Some banks may want to re-enter the market in four to five years, when business has been cleaned up," he asserts.

Mr Krul asserts that a large number of firms will be forced to shut
down in Switzerland in the near future, due to increased regulatory pressures, as they don’t have the resources and skills to adapt to the ever-widening scope of regulation and legal pressure.

"Most companies will either be forced to clean up, or go out of business. Many of these old style businesses never learnt to be tax compliant, so they can’t make the transition. From the outset, we are only interested in dealing with tax-compliant business, so for us this isn’t an issue," says Mr Krul.

“We have positioned our business at the middle to higher end of the spectrum. We only want to deal with the right sort of clients. Our aim is to make sure our clients stay out of trouble, so they can maintain their reputation. They recognise that keeping all records and structures up to date is a critical part of the service they need. These clients appreciate quality work and understand the fee structure related to it."

**Industry consolidators ignoring private clients**

Another factor contributing to sector consolidation in recent years is the advent of private equity (PE) backed trust consolidators. A low interest rate environment and the prospect of recurring annual fees and economies of scale has made the trust and corporate services sector an attractive proposition for PE firms. However, most of the consolidators they have backed have been targeting corporate, rather than private client business.

According to Mr Krul, most of the world’s corporate business is primarily based around the Netherlands and Luxembourg and has been growing at a rate of anywhere between 10 to 25 percent a year over the past decade. With earnings before interest, taxes, depreciation and amortisation (EBITDA) levels estimated at 35-45 percent, there has clearly been huge value creation.

Corporate business has been seen as low risk. Managing Know Your Client (KYC) has typically involved lower costs, as large corporate customers tend to be surrounded by armies of legal and tax advisers, providing “armour-plated” advice.

This model doesn't work for private client-centric businesses, which have traditionally been smaller scale, says Mr Krul. Private client businesses typically involve more KYC, which means more resources and higher costs, especially given the additional work involved with issues such as FATCA. “Because clients often have not taken the same levels of legal, or tax advice, the risks in the business can be higher as well, so you need experience to know what you are doing,” says Mr Krul.

Additionally, the need to develop long term client relationships typically leads to higher staff costs over time, which result lower EBITDA, typically less than 30 percent.
The larger PE-backed consolidators usually assume a corporate business value of at least 10 times EBITDA, whereas to sell a private client business, you are usually looking at only five to seven times EBITDA.

As a result, Mr Krul contends that consolidators have often not invested in their private clients businesses, focusing instead on reducing costs and finding ways to increase fees.

"Private clients don't like this," he says. "Moreover, a PE owned trustee is a contradiction in terms".

**Direct regulation as a benefit**

Reliance is one of the few fiduciary businesses currently regulated directly by the Swiss Financial Market Supervisory Authority (FINMA), with the remaining firms subject to oversight by self regulatory organisations (SROs).

Mr Krul believes that firms directly regulated by FINMA provide greater comfort to clients and make doing quality business much easier.

"I have been used to high standards of corporate governance throughout my career and clients really appreciate that," he opines.

Mr Krul says that professional organisations, such as the Swiss Association of Trust Companies (SATC) have been working to raise professional standards across the sector. The SATC has tightened its entry requirements in recent years, to reflect the changed business environment.

Reliance is a member of the SATC. Mr Krul points to the fact that the association is actively working to promote higher standards of ethics and best practice.

**Prepared for an uncertain future**

Mr Krul maintains that the OECD's base erosion and profit shifting (BEPS) initiative is going to create massive changes to the way the corporate services sector works.

"The BEPS train is going so fast, it looks like it's going to be implemented very soon," he argues.

The recent Luxleaks scandal has created a lot of uncertainty for private-equity backed businesses, as the whole basis of upon which multinational companies have established their international structures is being challenged by media and policy makers.

Mr Krul believes that specialist independent professional companies, which are there for the long term, are the future for
private clients. A fragile European Union and a fast-changing situation in relation to taxes have combined to create a lack of clarity and a negative business environment as a result. The future looks bleak for all those companies that are not equipped for, or used to working in the new world.

Asset protection, both corporate and private, is receiving more attention. The prospect of windfall taxes imposed by governments is real.

"If there is another financial crisis, a tax on the rich is coming," he advises.

But Mr Krul remains phlegmatic about the prospects for the future, emphasising the value of Reliance's independent ownership and management.

"We are not affiliated with any financial institution, bank, private equity investor, or law firm, so we can avoid the conflicts of interest common to so many other fiduciaries.

"Clients still value privacy and confidentiality, to provide security and protection for them and their families. With OECD automatic exchange of information on the horizon, clients are naturally concerned about how they are going to be able to stay out of the public eye. At the same time, more rich people are prepared to pay their taxes. These are the sort of clients we are happy to work with."

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