ARC RESEARCH LIMITED

Story ARC: in conversation with industry leaders

James Hambro & Partners: The challenges of looking after US clients

James Hambro & Partners

Introduction

ARC's consulting, research and reports are designed to help investors and advisers make informed decisions. There are many challenges facing US-connected investors – and especially for families domiciled internationally and with assets held in multiple jurisdictions.

In this Q&A, based on a recent webinar for an audience of advisers, ARC's Chris Curtis asks leading experts how they navigate the complex minefield of rules and regulations.

Discussants

Chris Curtis
Manager – Research, ARC

Chris is responsible for ARC's Suggestus research platform and for the company's investment manager assessments.

Sanna-Liisa Valtanen
Director – Consulting, ARC

Sanna-Liisa heads up investment consulting activities for ARC in Guernsey.

Rosie Bullard
Partner – James Hambro & Partners

Rosie is a portfolio manager who heads up JH&P's US client service team.

Chris Macklin
Partner – James Hambro & Partners

Chris is head of business development and works closely with trustees and advisers globally.

Key findings

- Advisers and trustees with US-connected individuals can benefit from having an investment manager with SEC authorisation and expertise in building bespoke portfolios without PFICs to avoid tax pitfalls that can be costly for clients.

- JH&P specialises in building portfolios with direct equities and has experience of managing portfolios for a wide range of US-connected clients. It works closely with specialist US advisers, both in the US and elsewhere.

- ARC works closely with a select range of advisers and can help build teams or guide advisers and trustees towards the right investment partner – based not just on technical expertise but also on issues like investment performance, type of institution and personalities.

- JH&P has technology in place to prevent managers inadvertently buying PFICs and to ensure US-connected clients enjoy the same quality of stock selection as other clients.

- The rising number of global families means this is an issue for more advisers and trustees. Political tensions in the US are encouraging more families to move assets out of the US.

Q&A

CC: Looking after US-connected individuals is considered a minefield from an investing point of view – there are lots of rules and regulations and complex US tax considerations. What counts as a "US connection" and what does it mean from an investment perspective?

S-LV: We think about four prongs. We can have a US person and a US structure, which is relatively simple from an investment point of view; a US-linked person and, say, a UK structure; a US person with an offshore structure; and – the most complex – a foreign person with a US-based structure.

CC: We hear the acronym "PFIC" used. What is a PFIC and what are the implications if you buy one as a US-connected person?

S-LV: These are Passive Foreign Investment Companies. Any non-US collective investment vehicle – for instance, a mutual fund or ETF – would be classed as a PFIC. From a US tax perspective the consequences of holding one can be penal if you are an American, so we usually ask for no PFICs to be included in portfolios for these clients. You can have a Qualified Elective Fund – which could be a Dublin fund, but they have elected to be a QEF.

CC: So you really need someone who can run a bespoke portfolio investing in direct equities and bonds. JH&P tends to pick direct equities and then balance the risks of investing in equities using other things such as fixed income, gold, alternatives and some funds. Rosie, how do the restrictions impact on the way that you choose investments for someone with US reporting requirements?

RB: Well, the good thing is that we do not need to move away from our core investment process and expertise in direct equities to do so. For US-connected clients we would buy direct bonds, direct equities, some gold, and hold some cash. The alternatives element can be more challenging to populate – often absolute return funds or infrastructure funds will be classified as PFICs because they're Dublin registered OEICs, for example, and don't have the QEF associations. You might have to accept more volatility without these.

CC: So what happens if you have a client with a cautious mandate?

RB: We have to really understand the client's needs. So, for example, we have a case at the moment where the client wants low risk across all of their asset base but still wants access to our expertise, particularly within the direct equity component. So we are running a balanced portfolio for this individual – half in equities and the other half in bonds and gold and some cash. They have kept some cash themselves separately, so if you add all the elements together you get right balance.

CC: Where the assets are physically held is important. You can't buy US mutual funds to get around the PFIC problem if you can't execute the custody there. So how did you cope with that situation?

RB: If you have a US person living here in the UK, you could custody through London. Or they might be a UK resident non-dom who wants to keep assets outside of the UK, and we have facilities for that. We are also able to custody assets in the States for very specific clients, and we're working on a case with you at the moment that is interesting.

S-LV: This particular case falls into the most complex category of foreign person with a US structure and with inheritance planning in place, which has meant that in certain instances we have had to have two separate portfolios – one for US assets only and one for non-US assets for tax-related reasons. But we are then looking at those two portfolios as an aggregate for structuring purposes. It clearly makes the job for managers a little bit harder, because they're running something that we view as a single portfolio across two separate portfolios.

RB: The key for us in this particular case, as in all cases, is working as a team with all of the client's advisers to make it as simple as possible for the client. Hopefully, being still a relatively young and nimble business, we're able to adapt quite quickly to what clients need – everything from structuring through to the investment restrictions, through to how they like to be communicated with – and that's really important. That's all part of perhaps what is an overused word – bespoke – but it is, as the name suggests, all about doing what the client wants.

CC: How do you ensure there isn't any drift away from the JH&P experience that clients should be getting?

RB: We'll often have situations where you might have most family members being unrestricted from an investment perspective and others who are restricted because they are beneficiaries of a trust or have decided to move to the US, for instance. We don't run model portfolios, but what we do believe is that if Microsoft is a good idea for one client then it should be in as many clients' portfolios as possible, except for where they might have ethical restrictions or they might work for the company. We use a third-party system, which monitors divergences between portfolios that are unconstrained and those modified to cope with US reporting restrictions, to ensure we don't have style drift.

CC: So there's a clever bit of kit that keeps you on the straight and narrow! And how do you avoid buying a PFIC unintentionally?

RB: Thankfully, we have technology on our side there, too – our systems would block me from buying PFICs even if I wanted to. It also goes for any other restrictions that clients put in place, whether ethical or for other tax reasons.

CC: With cash rates so low and even negative in certain jurisdictions, are you seeing clients more willing to take on more equity risk?

RB: Yes. They don't want to be stuck in an environment where they are seeing losses on their cash because of the impact of inflation. If they don't need this money in the short-term they are saying why would they not be comfortable investing into a range of high-quality individual companies offering an element of return through dividends and backed by supportive structural growth stories. That's not to say that they won't go through periods of volatility – markets climb the wall of worry. But if clients are able to leave cash invested for the next five to 10 years, certainly from our perspective, even just thinking about negative rates makes one more and more positive about having equities within an element of a client's total wealth.

S-LV: We're also seeing worries about the bond element of portfolios, because bond yields are so low and in some cases negative. There really aren't that many areas to go to where you can make returns without now taking a significant amount of risk. Bonds are the element of the portfolio that is meant to be safe, but if they are effectively offering equity-like risk clients would rather take the risk in equities.

CC: Sanna-Liisa, how do you decide which manager to go with?

S-LV: Of course, performance is a major factor. But also client wishes as to the type and size of the institution – some might want to avoid the big American banks and have a smaller house. Personal chemistry is important, too. So we think about all of those questions when we put together a list of managers to put in front of a client.

CC: Finally, one for Chris – are you seeing more of these cases or fewer?

CM: Over the past two to three years, speaking to client intermediaries, we're finding more global families that have a US connection. Middle Eastern families often send their children to be educated in the US, as do African and European families. Families are buying real estate in the US and then needing advice around that from tax and investment advisers. The other side of the coin is the US election and a very polarised society. I was speaking to a lawyer in Houston the other day, and he had a number of high net worth individuals in both political camps looking to move assets out of the US because they're scared of increased taxes or other political situations. We're seeing those individuals needing an ex-US strategy. Given our direct equity capability, that's a need that we can fulfil.

RB: We've also seen quite a lot of trusts that maybe don't have a US connection now but think they may in future. They could need a manager with an SEC licence to cope with that future issue. We have the ability to adjust the portfolio if and when a US connection materialises, so it saves extra work for the trustees, not having to move investment managers if one of the members of the family decides to move to the US.

About ARC Research

ARC Research Limited is the research arm of the ARC Group and is best known for producing the industry leading peer group Private Client Indices and the Suggestus.com Research Platform. Suggestus was launched in 2011 to meet the needs of professional wealth advisers and their clients, who make use of discretionary investment managers. In partnership with the investment management community, we are striving to address the issues of transparency in our industry. The site provides client Risk Profiling, qualitative Manager Selection based on style, a library of standardised due diligence and a comprehensive reporting step for trustees, private client advisers, Independent Financial Advisors and wealth planners.

Learn more at www.suggestus.com

About James Hambro & Partners

James Hambro & Partners is an independently owned wealth management group, established in 2010 by Jamie Hambro and seasoned industry experts.

The Hambro family has a long and distinguished history in financial services in Europe, dating back to the 18th century.

The founding partners wanted to create a wealth manager that offered the high standards of personal service often associated with smaller businesses while also delivering strong investment performance by capturing the best aspects of expertise and process found in some of the larger, less personal investment houses.

www.jameshambro.com