Euro break-up: Planning for the possibility

A note to GAT members

With growing concern surrounding the future stability of the Euro, together with the clear lead given to us by the Guernsey Financial Services Commission to plan for this possibility, Trustees can be under no illusion that to do nothing is not seen as a responsible option. However, the question some trustees are asking is: what can trustees do about it? This note aims to set out some of the considerations that responsible trustees might be undertaking at a time when banks and other financial institutions are giving serious consideration to the impact and risks to their businesses of an unplanned withdrawal from the Euro by a Eurozone member state.

By kind permission of RBS, we are attaching a discussion document released by the Bank in January 2012. Some members may have seen this document already. Some of its content is aimed at banks and investment institutions, but the framework of the document applies to all situations where assets, revenue, liabilities or expenses exist within the Eurozone on the balance sheets or P&Ls of entities located outside the Eurozone.

GAT Members are urged, at the highest level within their organizations, to read through the attached RBS document, and to interpret its message in the context of their responsibilities as trustees.

Some pointers arising from the document, for trustees to consider:

Do any of your trust structures have:

- Euro liabilities presently (whether presently matched against Euro assets, or not)? If so, consider the legal issues surrounding the liability – in case it remains denominated in Euros whilst the underlying asset exits the Eurozone and subsists in a substitute currency which carries the risk of significant depreciation. Do you need to seek legal advice now, before it is too late? Are there any other legal issues concerning liabilities (see Legal issues below).
- Bank deposits in any currency with banks in the Eurozone, especially the member states most at risk? To the extent these are necessary to support or maintain local assets, it may be an unavoidable risk to retain such balances, but otherwise, should you consider relocating these movable assets to less risky locations? Would there be any risk if exchange controls were to be introduced in the jurisdiction, at very short notice, where the bank is located?
- Bank deposits denominated in Euros, and held outside the Eurozone? If so, are the risks being considered by your investment advisers/managers?
- Marketable investments: Should trustees conduct a special review in conjunction with investment managers, to ensure that the risks/opportunities are understood and being managed actively? Trustees will take comfort from checking with their managers that these risks and opportunities are indeed being considered and, where necessary, acted upon in the context of the risk profile of each trust, separately.
- Assets under custody within Eurozone jurisdictions? Should a review be undertaken with a view to moving custody to a neutral jurisdiction? Should the contractual arrangements surrounding the custodial services be reviewed and tested for a failure of the Euro in that jurisdiction?
- Legal issues: Contracts denominated in Euros may be subject to legal issues where counterparties reside in a departing Eurozone state. Some contracts may need to be rewritten or novated and enforceability issues may exist. Should trustees/directors be

making contact with legal advisers now, in order to ensure that communication channels will be open in the event of an unplanned withdrawal of a Eurozone member state? Can any action be taken now to minimize negative impacts thereof?

- Revenue streams in Euros: How critical are these? If they depreciate significantly, or if they become unavailable due to exchange controls, how would this impact on your underlying company or trust?

Summary of these and other points for consideration:

- Type and strength of € liabilities and receivables
- Ability to reduce € currency risk
- Counter party risk and choice of third parties (move to more stable EU country/institution)/strength of third parties and covenants
- Consider default currency of choice
- Hedging strategies if relevant
- Contractual terms/law and forum/termination or default position and cascading impact analysis
- Retain sufficient resources to meet contingent or known liabilities for required period in stronger currency or match debt location to asset exposure and cash flows
- Consider alternative strategies to maintain optimum flexibility and security
- Communicate with customers and advisers

In addition:

- Should trustees speak with principal beneficiaries or key persons to find out if they have any specific concerns about a possible unplanned withdrawal of a Eurozone state?
- If a trust has Euro as its reporting currency, should thought be given now as to what alternative currency might be adopted, in the relatively unlikely event of a total collapse of the Euro?

This list is not exhaustive and nor is it intended to be. Its intention is to provoke thought and instigate action by trustees who might otherwise be wondering, as some have expressed, what can be done about the situation. Trustees are urged to:

- review all of their trust structures
- categorise them by order of risk to Euro exposure with particular attention to those Eurozone states considered to be the most vulnerable to unplanned withdrawal from the Euro
- consider the impact of an unplanned withdrawal by any one or more of the most vulnerable states
- take reasonable steps to mitigate the perceived risks
- share concerns and discuss the situation with principal beneficiaries and key persons
- document their findings

Guernsey Association of Trustees
February 2012