

TRUST SURVEY - REPUTATIONAL RISK FOR CLIENTS BEING ASSOCIATED WITH STRUCTURES IN OFFSHORE JURISDICTIONS

07 May 2020 | London

As part of our recent trust companies survey, we asked the participating trust companies what risk and compliance issues pose the greatest challenges to their business.

REPUTATIONAL RISK AS A BUSINESS CHALLENGE

As we reported in our previous publication on the results of the survey, the respondents identified beneficiary disputes as the least pressing issue. Reputational risk for clients being associated with structures or offshore jurisdictions was identified as the second least challenging issue (out of a list of seven), behind other matters such as (listed in alphabetical order, so as to continue not to give anything away) Anti-Money Laundering (AML), Cybersecurity, Data protection, Regulatory compliance and Tax compliance.

Although it is impossible to identify a single explanation for this result, the following observations may go some way in explaining why trust companies identified the reputational risk for client being associated with offshore structures as a relatively low priority issue:

1. This result may be surprising to those based in the UK, where the use of offshore structures has garnered some negative publicity. Negative perception is also an issue in Indonesia, where our experience is that the tax authority is generally suspicious about the use of trusts and offshore structures.

As Lydia Essa of Trust Corporation International in Guernsey says “there has been a

measure of global hostility towards the offshore finance industry in recent years, and the influence of the “court of public opinion” has been felt by some in the fiduciary industry. We have had conversations with clients around “onshoring” where the reputational risk of simply being associated with the offshore world is just too high, irrespective of the reputation of our jurisdiction or whether the structure is tax driven.”

Offshore investment structures came under intense (and negative) media scrutiny recently with confidential information leaks such as SwissLeaks, the Panama Papers and the Paradise Papers. Although there were examples of wrongdoing amongst some of these leaks, the more recent leaks in particular do not appear to have highlighted many examples of this and seem to have gained less traction in the public consciousness.

2. Even if there could be said to be a negative view of offshore structures amongst the British public, trust company clients might not share that view. Some of these clients are from jurisdictions such as Hong Kong, Singapore and the Middle East, which are generally low tax environments in any event, and where offshore structures have been used commonly and openly for decades. As a result they have historically been viewed as legitimate wealth structuring tools, rather than the “dirty secret” they are often perceived as in the UK. The trust companies’ clientele simply might not view offshore structures as a potential reputational risk, but perceives them as a legitimate wealth structuring option instead.
3. It may also be that the idea of leading offshore centres being a hiding place for “dirty money” and a hotbed of tax evasion is simply considered to be an outdated notion particularly given increasing sharing of information and transparency. The offshore world can still very much appeal to those undertaking legitimate estate/succession planning, asset protection structuring or seeking structuring solutions when making investments outside of the UK. This could explain why trust companies do not seem to be particularly concerned about the reputational risk aspect of offshore structuring.
4. Even if the reputational risk of being associated with offshore structures may be a concern for some, it is clearly not significant enough to discourage such offshore structuring in practice. According to a recent study that combines the OECD statistics on foreign direct investment with the IMF’s Coordinated Direct Investment Survey, offshore investing accounts for almost \$12 trillion worldwide, which is around 40% of all foreign direct investment in the world.¹ In fast-growing economies such as India, China and Brazil, this amounts to 50-90% of outward foreign direct investment, while in the UK and the USA, the proportion is still high, at approx. 50-60%.² Not to mention that 73% of the Fortune 500 operate one or more subsidiaries in offshore jurisdictions.³ The Paradise Papers identified the offshore activities of over 120 politicians and world leaders.⁴
5. There are numerous legitimate reasons why trust company clients may wish to use offshore structures. These (alone, or together) might outweigh any potential reputation risk of being associated with an offshore structure or jurisdiction. Just to name a few:

- It may be unsafe for an individual to disclose substantial investment in certain emerging markets due, for example, to their high or public standing, or the political environment in certain jurisdictions. Using an offshore vehicle in such circumstances might be the safest solution.
- Individuals located in different jurisdictions may be seeking to combine their investments in a neutral third-country in order to establish an investment fund or joint venture.
- In certain jurisdictions, establishing an offshore company may provide an additional level of legal protection, including protection under various bilateral investment treaties, as well as increased efficiency of business operations, cheaper administrative costs and access to a better banking infrastructure and judicial system.
- Some offshore jurisdictions have vehicles and structures such as purpose trusts, which simply do not exist in some onshore centres. Indonesia is a good example of this, where there is no local equivalent of a structure which offers the traditional advantages of a trust for succession planning. This can lead to an increased demand for the use of offshore structures by Indonesian clients for succession planning.

The English High Court commented in a decision in April 2020: “The use of complex offshore corporate structures or trusts is not, without more, a ground for believing that they have been set up, or are being used, for wrongful purposes, such as money laundering. There are lawful reasons – privacy, security, tax mitigation – why very wealthy people invest their capital in complex offshore corporate structures or trusts.”

FUTURE CHANGES

In recent years, the OECD and a number of jurisdictions have become particularly focused on increasing transparency of offshore investing, and are in the process of introducing more laws that may significantly increase regulatory scrutiny. These often include new reporting regimes and registers that record the names of ultimate beneficial owners, which may have a significant effect on potential reputational risks if anonymity is a major concern.

Enhanced transparency regimes and increasing disclosures of offshore holdings might have the effect of pushing reputational risk further up the risk scale for trust companies in future years, in jurisdictions where offshore investments are perceived negatively.

However, it is perhaps more likely that increasing transparency will demystify the offshore world, thereby having quite the opposite effect. Trustees report that the majority of their clients (and particularly the “next generation”) are accepting of transparency and information exchange as features of the modern world and, increasingly, clients wish to align themselves with jurisdictions that have internationally recognised regulatory frameworks, sophisticated court systems and advisory networks as well as reputable fiduciary and corporate service providers.

This is the “flight to quality” that Lydia Essa reports to be more noticeable now than ever. Clients are, in her experience, generally attracted to those offshore jurisdictions which have a global reputation for quality, security, and meet international standards on transparency, and information exchange, even if that comes at a slightly higher cost. Whether these enhanced regimes will assist in reshaping public opinion in time and reducing (or perhaps even eliminating) the reputational risk of an association with the offshore world is yet to be seen but early signs are that certain jurisdictions may be well placed to thrive in these conditions, whilst others may well find the going a lot tougher. Only time will tell.

Listen to our accompanying podcast below

[Herbert Smith Freehills Podcasts · Private Wealth And Charities podcast EP7: Trust Companies Survey – Reputational Risk](#)

1. Damgaard J., and Thomas E., “The Global FDI Network: Searching for Ultimate Investors.” IMF Working Paper 17/258, 2017, International Monetary Fund, Washington, DC.
2. Damgaard J., Elkjaer T., and Johannesen N., “Piercing the Veil”, Finance & Development, June 2018, vol. 55, no. 2, available at: <https://www.imf.org/external/pubs/ft/fandd/2018/06/inside-the-world-of-global-tax-havens-and-offshore-banking/damgaard.htm>
3. United States Public Interest Research Group, available at: <https://uspirg.org/news/usf/study-73-fortune-500-companies-used-offshore-tax-havens-2016>
4. BBC news, “Paradise Papers: Queen's private estate invested £10m in offshore funds”, 6 November 2017, available at: <https://www.bbc.co.uk/news/uk-41878305>

To review the other articles in this series, please click on the link below.

[Herbert Smith Freehills Trust Companies Survey: Navigating Troubled Waters](#)

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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