CHARGED WITH MAGIC:
UNDERSTANDING OFFSHORE TRUST COMPANIES

Prudence, integrity and expertise is the essential trinity in the profession of trust management. The role of trustee is a function that is unlike any other and it is why the observation has been made that there is a vast deal of magic in words and the word most highly charged with magic to be found in the world is ‘trustee’.

Trustees must be honest and prepared to devote sufficient time to the administration of the trusts under their control, some of which can last for years or generations in the case of families. They must have enough common sense and business acumen for the task which involves both financial and human affairs, calling for careful management of both assets and relationships with beneficiaries and others. The trust is an ancient tool which has been continually adapted to changing times and its application in financial structures is, like its potential benefits, manifold. Although light has been shone on magic in recent years, the trust still maintains a certain mystique. Often its activities are secretive, and when it is transported offshore this can add intrigue to mystique. Regrettably, in an era of transparency and a lack of respect for privacy, it has become a target for criticism in developed countries.

The central business of offshore trust companies is providing fiduciary services but their role can present a blurred picture, unlike the sharply defined image of other common offshore activities such as banking and insurance. Whilst the distinction between insurance policyholders and bank depositors is transparent, the difference between a bank’s obligations to customers and those of a trustee to beneficiaries is not. Nor is clarity advanced by the fact that, traditionally, some insurance companies and banks include trust administration as part of their services. There are, nonetheless, similarities between banks and trust companies in that both manage assets, but their fundamental difference is revealed in their respective balance sheets. A trust company isolates its trust activity from its balance sheet but, in the case of a bank, its audited accounts incorporate customers deposits and loans, because these have an intrinsic link with a bank’s financial health. Depositors entrust their funds and place their faith in the bank to take care of them. The guidelines and controls introduced by the Basle Committee on Banking Supervision, especially concerning capitalisation and liquidity levels of banks, bear this out. If a bank does happen to engage in trust work, the auditors record such business as being off-balance sheet activity in recognition and confirmation of the difference between the two services. Beneficiaries do not suffer the risk that depositors do.

Unfortunately, some bankers wore blinkers when they jumped on the offshore trust bandwagon that started rolling in the last century and many have since paid dearly for the folly of placing more emphasis on profit than precaution. They accepted nominations as trustee, without having fully qualified and experienced staff and so stepped into a legal minefield. Numerous lawsuits were filed and countless out-of-court settlements were reached. A sharp lesson was taught about the difference between contractual obligations to specified parties and those which fell under equity when claims against the trustee came from beneficiaries previously only names in a trust deed. Not only that, claims could emerge from beneficiaries with vested rights even although they were not born when the trust was created.

The shareholders of these banks soon understood, however, that although the trust business administered may not feature in the annual audited accounts, the related legal expenses brought about by lawsuits most certainly did, and that the potential for an action being brought against a trustee for breach of trust was ever-present. More alarming, the bankers had to face the fact that even where a trustee has taken and has followed legal advice, it does not automatically excuse him from liability. Dismissing the loss of depositors' funds as the result of everyone's monies (shareholders and customers) being pooled is one thing, whereas in the case of funds belonging to trust beneficiaries it is quite another.

The eagerness to introduce more regulation into the offshore financial services industry, particularly in the case of fiduciary activities, governments and their regulators must first fully understand the distinctiveness of trust work and the importance of the trinity of qualities mentioned at the beginning of this article. On the present evidence it suggests that very few regulators and their staff have a firm grip of trust fundamentals, not unlike the popular press who do not appreciate the personal, private nature of the relationship. In a world awash with the confusion caused by the Common Reporting Standard, is it little wonder that frustration, irritation and vexation rule? Just because the applicant for a trust licence is a bank or large corporation, it is not sufficient reason to short-circuit essential elements of the licensing process.

The same attention given to a bank's capital by Regulators should be paid to the ability to provide an adequate level of expertise in trustee law, accounting and administration. In recent years regulators have become more focused on transparency and money laundering, for example, but there is a danger of them losing sight of the importance of competence. Once a licence has been granted, and if the degree of expertise subsequently drops below a certain level, then Regulators should insist on immediate remedial action, just as they would if a bank's capital reserves were too low. Regulators do have an easier time supervising banks which must provide regular financial data that enables liquidity and other important financial statistics to be studied closely and which serves as a barometer for measuring whether or not the customer's welfare is being protected.

A trust company's accounts, on the other hand, will not do this and impressive audited accounts can still mask poor trust fund management. It follows, therefore, that a trust company's real strength lies in the reservoir of skills which it has at its disposal and unlike a bank, the fact that its capital is perhaps only in low six-figures, should not be of any significance. Financial propriety is still important for the smooth running of a trust company's business, of course, and the prudence necessary for the stewardship of trust assets should be reflected in its own accounts by low levels of debt and a healthy cash flow.

Offshore financial services are still big business today and the attractions of large fees have taken inexperienced domestic providers offshore into uncharted waters. Amateurs managing trusts can be like children with matches in a fireworks factory, unable to perceive the dangers present. Critical errors can be made even before the administration of a trust begins. In some instances, corners are cut by cannibalizing precedent trust deeds and a defective document is presented to the inexperienced client as perfect for his needs. Concealed defects in a deed can have a long incubation period and might not become apparent for some years, by which time the problems may well have been compounded. Remember my comment about unborn beneficiaries when the trust was put in place? This does not diminish their legal rights.

More dangerous than the enthusiastic amateurs, however, are the sharks that swim these offshore waters and who have totally amoral intentions. Modern advances mean that it is possible for these unscrupulous individuals and companies to operate a large part of their business over the internet. Considerable amounts can be spent on a very impressive website. They have scant regard for the best interests of their victims and, whether their company has an issued capital of $2 or $2 million, by skilful presentation this electronic shop window can illustrate Bishop Berkeley's maxim, "esse este percipi", (perception turns into reality). A flawed diamond can still sparkle.

The individual in search of safety, then, without the help of a guiding hand, should first look at the jurisdiction rather than the trust companies operating from it. Panama now has a supervisory regime in place that puts many similar systems onshore to shame and the licensing requirements are demanding; I make these comments as a former offshore trust company regulator in a British overseas territory. The size of the trust company, as I indicated earlier, does not necessarily have any correlation with the degree of safety or skill you can expect to find. A small, but well-established trust company which has been in business for many years has had minimal staff changes – particularly at a senior level – and displays some permanence (perhaps by way of owning its premises) should not be automatically ruled out. Transient trust officers abound these days, particularly in large trust companies, and the interruptions in continuity are the bane of many a client's life.
I also think that the choice of trustee should be made after a personal visit to a short-list of trust companies. The initial meetings themselves send you positive or negative signals, although it is very important to look beyond pleasing personalities and smiles when trying to determine the quality of management. "What are your trustee qualifications and what is your experience?" Plush carpets cannot conceal the hard questions. What is pleasing to the eye may not be pleasing to the ear and that question which, in my view, is all too

infrequently asked has been known to remove a smile or two from the faces of some friendly trust company executives. Listen to the reply carefully.

At the beginning of the article I mentioned an essential trinity and, in fact, this article forms part of another important one, and so I recommend that you cross-reference this article with two others: "Trust Management: Warts and All" and "Stranger on the Shore: The Trust in Panama".

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