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Invisible Men

One of life's little quirks occurred recently at a local business conference at which delegates heard from the Organisation for Economic Co-operation and Development's head of the organisation's Global Forum secretariat which, inter alia, is concerned with transparency. As readers know, in the United States of America the Delaware Limited Liability Company has received a lot of flak from the Offshore Pilot Quarterly in the past (as recently as the September issue) because it is a blatant example of the pot calling the kettle black (let me add, other US states offer the same anonymity, but Delaware is the most famous for it in terms of which LLC owners can choose to be invisible men, the ultimate form of anonymity). The US government condones this and these LLCs have featured in tax evasion and money laundering investigations over the years; this newsletter has previously detailed some of them, while the US continues its blitz against several international financial centres, purveyors – it claims – of unwarranted privacy. Why has this situation still not been remedied?

At the end of his presentation the Global Forum head, having detailed the dangers caused by secrecy in international commercial activities, was asked by a delegate to reconcile his concerns with those posed by US LLCs. The question was greeted with applause when suddenly the lights failed and his microphone went dead; was there a cohort from the OECD strategically placed somewhere? No, within seconds both malfunctions were corrected; not that this made any difference because silence would have improved the explanation given and we were still all in the dark. It seems to me that it is more a matter of clout rather than confidentiality.

Meanwhile, the Financial Action Task Force, an inter-governmental body, concluded its October Plenary meeting by highlighting countries that “need to establish and implement an adequate legal framework for identifying, tracing and freezing terrorist assets”. Recalcitrant governments include Cambodia, Mongolia, Sudan, Yemen and Zimbabwe. But why go into the shadows? Have your middle man contact, say, Delaware for an impenetrable LLC that rivals anything on offer anywhere.

Speaking of things impenetrable, Jersey in the Channel Islands with its close links to the City of London, and very much a stepping stone between the rest of Europe and the United Kingdom, is said to have some offshore trusts with a blanket of secrecy that rivals US LLCs. Its trust business has been buttressed by a thriving trust company industry and like many IFCs, Jersey has a privacy-inclined government (PIG) that supports the right to it, unless valid circumstances dictate otherwise. This minuscule IFC in the Channel Islands has also successfully developed banking services and so perhaps Chanel, rather than Channel, Islands is more appropriate when one considers the amount of wealth managed from there; doubtless perfidy and not perfume is the word which comes to mind at OECD gatherings.

One can only imagine the degree of concern the OECD must have over trust companies, wherever they are located, when it is already exasperated over the ownership (as it puts it) of offshore trusts. Much of the frustration is driven by ignorance on the part of those bureaucrats charged with the task of bringing transparency to these trusts. So for the benefit of my readers, and although I have written on the subject before, I will try to be as transparent as I can about just what a traditional British offshore trust company



is, having had a close working relationship with them for more than forty years.

Bankers and Blizzards

Tim Rice and Andrew Lloyd Webber have written very successful musicals over the years, such as *Evita*, and in 2010 they collaborated on a *Wizard of Oz* musical. Once, over dinner, Tim Rice told me that he understood that I was “some kind of financial wizard” and I was quick to dispel that notion for him. But there’s no denying the fact that, unlike bankers, trustees (and by extension trust companies) are more of a mystery than musicals and that this mystique can fire the imagination, either positively or negatively. Everyone understands what banking means (although one wonders today if bankers themselves do, after its natural boundaries have been lost in a blinding financial blizzard of complexity) whereas the role of trustee is a function that is unlike any other. 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 [a phrase used by Walter Bagehot to describe the mystery (once) of England’s royalty] to be found in the world is “trustee.” So let me shine some of Mr. Bagehot’s light on trust companies and their trustee function.

Trustees need enough common sense and business acumen for a role which involves financial and family affairs, calling for careful management of both assets and relationships with families 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. But it is also a tool that never changes shape, unlike car models do, although attempts are being continually made to do just that. Often its activities are necessarily secretive, but when these take place offshore this can add intrigue to the mix. Be that as it may, the central business today of these offshore trust companies is to provide a range of services centred around the management of not only trusts but companies and foundations too, so the activities become less defined than other offshore activities such as insurance, for example.

On a point of criticism that the OECD should heed, many IFCs appoint the same regulator to supervise both banks and trust companies and whilst the

distinction between insurance policyholders and bank depositors is clear, the difference between a bank’s obligations to customers and those of a trustee to beneficiaries is not. This doesn’t stop the OECD, as I have said, from seeing trusts as having owners, like deposits in a bank do; this has produced a stumbling block in reconciling trusts with transparency. Nor is clarity advanced by the fact that, traditionally, some insurance companies and banks include trust administration as part of their services and yet many of them do not possess the necessary skills.

Banks and trust companies both manage assets, but the fundamental difference between them is revealed in their respective balance sheets. A trust company isolates its trust assets from its balance sheet but a bank’s audited accounts incorporate customers’ deposits and loans because these have an intrinsic link with a bank’s financial health; this is unfortunate because, as we know, many banks today are in the medical equivalent of intensive care. Fortunately, 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 bank depositors and trust beneficiaries.

It follows from this that there is much to think about before and after one becomes involved in the business of professional trust management and which reminds me of what Alexander Pope observed: “A little learning is a dangerous thing, drink deep, or taste not the Pierian Spring”. Those wishing to administer trusts as a profession need to acquire a real thirst for the work – and slake it generously. Unfortunately, some bankers wore blinkers when they jumped on the offshore trust bandwagon that started pitching trusts to its customers several decades ago and many have since paid dearly for the folly of placing more emphasis on profit than precaution; as we can see, however, this policy has extended to their banking business as well and for which a very high price will be paid.

They accepted nominations as trustee without having qualified and experienced staff and stepped into a legal minefield which produced even more opportunities for some lawyers to exploit. 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 the rules of equity, when there were claims against the trustee which came from beneficiaries previously only names in a trust deed. The shareholders of these banks soon understood, however, that although trust assets have no direct impact on the balance sheet, costly legal expenses emanating from them do.

A Loaded Gun

We are now in an era where regulation of all financial services is sure to increase but governments must fully understand the distinctiveness of trust work. Sadly, like the OECD with trusts and transparency, many just don't get it. As a result, unnecessary bureaucratic body blows can reign down on professional trustees while, irrationally, because trust work will be undertaken by a bank or large insurance corporation, regulators are disposed towards a short-circuit approach of the initial licensing process. Haven't we already seen sufficient evidence in banking to know where such ignorance can lead us? The same attention paid to a bank's capital should be given to the level of expertise in trustee law, accounting and administration that it offers. Human capital, therefore, replaces any normal capital adequacy rules and equally, of course, just because a trust company's balance sheet is impressive, it can still mask poor trust fund management. It follows, therefore, that a trust company's real strength lies in the reservoir of skills at its disposal; this is, of course, a truism for all businesses.

In my mind's eye every offshore trust company must have a few staff with a minimum of 10 years international experience at a senior level, backed by a professional trust-related qualification; and I would want the shareholders to also display a clear understanding and appreciation of the trust business, with all its demands and risks. The motives of both the shareholders and management should never stray from the three certainties of a trust rule that the nineteenth-century British law reformer Lord Langdale established, by only placing a priority on the certainty of a client's willingness to pay. The use of offshore trusts (and, increasingly, foundations) has become very popular and like transatlantic travel, they are packaged and promoted internationally. I

have even seen advertisements in leading international financial magazines offering offshore trust companies for sale that are "legal, legitimate and affordable". That tag can apply equally to firearms which, like trust companies, are potentially hazardous in the wrong hands. Amateurs managing trusts can be like children with matches in a fireworks factory, unable to perceive the ever-present dangers. Concealed defects in a trust or foundation 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.

Pigs and Perception

Regrettably, the degree of competence, prudence and integrity present only becomes apparent once the client agreement has been signed. What's more, the degree of safety or skill you can expect to find has no bearing on a trust company's size: big can be either beautiful or bad and so the value of a referral from a trusted source cannot be emphasised enough. These last few years, however, have displayed the remarkable resilience of small, specialised businesses - not just those dedicated to trust work - many of which are not only small by design but built on expertise. Shareholders in public companies usually don't know what management is up to (how many disastrous examples has the Great Recession provided?) which is rarely the situation with small, focused businesses when the shareholders, more often than not, are also the managers.

More dangerous, however, than the enthusiastic amateurs are the finless sharks that swim in offshore waters. One of them indirectly turned a short consultancy 15 years ago for me into a salvage operation which led to my permanent move to Panama. One must appreciate that modern advances allow such unscrupulous individuals and companies to operate a large part of their business over the internet. The trouble is that this electronic version of a shop's front window can be just that and nothing more: a front. Considerable amounts can be spent on a very impressive website but which is only like a set for a Western: facades propped-up by supports. These people 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 they confirm what the seventeenth-century Irish philosopher Bishop George Berkeley, who influenced both David Hume and Immanuel Kant, said: *esse este percipi* (perception turns into reality).

A fine example of the Bishop's assertion must be Delaware (besides Wyoming and the other US LLC states) where commercial transparency is taken as a given by most people (let's call them God's creatures for the reason which follows) and yet it bears the characteristics of a PIG, such as Jersey in the Channel Islands; this may not be the perception but, conversely, it is the reality. On this point, has, I wonder, anyone ever asked the OECD to distinguish the risk levels between, on the one hand, the

invisible-man ownership of Delaware LLCs and, on the other, bearer shares issued in an IFC? I suspect that neither sunlight nor being within earshot would help with the answer but as we know from George Orwell's *Animal Farm*, a satire of equal unequals steeped in double standards, the end result seems to be much as it was for Orwell's pigs and humans: "The creatures outside looked from pig to man, and from man to pig, and from pig to man again; but already it was impossible to say which was which". In other words, privacy for some, persecution for others, only in this case an acronym is substituted for an animal. The Romans and my form master at school were right: *errare humanum est, perserverare diabolicum*: to err is human, to persist in erring is diabolical.



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Engaging an offshore representative is an important decision and we advise all persons to seek appropriate legal and tax advice from professionals licensed to render such advice in the appropriate jurisdiction before making offshore commitments.

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