

The Sustainability of IFCs



By Helen Hatton, BDO Sator
Regulatory Consulting Limited, Jersey

The issue facing many international financial centres (IFCs) today is whether, realistically, they can survive increasing transparency on tax and beneficial ownership. Is the model broken?

The answer to this popular question varies from jurisdiction to jurisdiction. However, clear themes emerge which rationally predict sustainability of the offering.

A sustainable IFC must balance the needs of five stakeholder groups:

- The international community
- The international client
- International business and professional counterparties
- Local business needs and aspirations.
- Local citizen needs and aspirations

Whilst these various stakeholder groups can be identified separately, many of their needs are complementary to each other, whilst others generate partial or more significant friction.

Stakeholder 1: The International Community

The G20 serves as a powerful influencing bloc drawing strength from the respective agencies of its member states and supranational bodies such as the United Nations, the OECD, the IMF and the World Bank. The recent initiative on transparency of beneficial ownership is a particularly strong example. Similarly, the OECD sets a variety of international standards, the adoption of which are monitored via a programme of evaluations and published results. One standard relevant to IFCs is that relating to unfair tax competition and, more recently, base erosion and profit shifting. The FATF also sets the methodology for assessment against its anti-money laundering/terrorist financing standards and drives the programme of assessing compliance.

A further source of influence from

the international community relates to regulatory standards set down by the Basel Committee of Banking Supervisors, the International Organization of Securities Commissions and the International Association of Insurance Supervisors.

These various standards are written largely for home state countries. There is, quite rightly, no allowance or leeway granted to small IFCs. There is no acceptance of the notion that smaller centres should be allowed to evidence less skill or capacity to meet, implement and enforce the international standards, and why should there be? The view is, quite clearly, that if you want to play the game of international financial services, you have to meet the international standard.

Outcome 1: Evidence that international standards are met in legislation, implemented in practice, compliance tested and enforced. The IFC must also work to establish a reputation as a responsible member of the international community.

Stakeholder 2: The International Client

The international client might be a natural person, or a legal person. Their needs may relate to wealth preservation — looking after what they have already accumulated, or wealth generation — growing, earning and making more.

An international client who is a natural person will have a collection of needs relating to wealth management, to be achieved either through investment advice, portfolio management services or safeguarding of asset type arrangements (such as inheritance planning and property holding/protecting). The property might comprise real estate or patent, copyright, image or intellectual property rights — all, or any of which might be held through

a variety of means including directly in their own names, through a discretionary portfolio management structure, trusts or foundations and privately held companies, or combinations of the same.

Alternatively, the international client might be a legal person with their own corporate needs, many of which echo those of the private client or include other needs ranging from holding company structures, finance, borrowing facilities, securitization arrangements, franchise and distribution rights protection, issuing and listing services, fund raising, joint venture structures, and vehicles through which to deliver in-house services, particularly in multi jurisdiction operating businesses, such as employment companies, group pension schemes, executive benefit schemes, treasury management, insurance or captive arrangements, etc.

For all these various requirements, the private or institutional international client has a fairly standard checklist when choosing which jurisdiction to locate within. The main factors they look for are:

- a) Surety to rights — of title, contract or other forms of proper claim
- b) Assurance of political stability, i.e. a sound and solvent government
- c) A reliable, swift, non-corrupt judicial system, with expertise in financial, commercial or trust law matters
- d) High quality, professional advisors (lawyers, accountants, tax advisors, actuaries, investment specialists, trustees, bankers, etc.) of sufficient number and diversity such that matters do not become conflicted beyond representation
- e) Competent trustees and client directors capable of providing proper control and oversight of client structures, as well as delivering competitively priced administration
- f) Confidence that the regulator ensures that licensed financial services

businesses are solvent, owned and staffed by persons with integrity who keep proper records, segregate client assets properly, disclose fees and charge honestly, act in the clients' best interests and avoid or disclose conflicts of interest

- g) A tax neutral or tax advantageous jurisdiction, with a network of tax and inter-regulatory agreements sufficient to gain access or prevent exclusion from relevant markets
- h) No risk in terms of inappropriate use of information or information leaks
- i) The offering of sufficient staffing levels and communication infrastructure in place to ensure timely and accessible contact with the service provider such as their structure requires (this may be by phone, electronic or internet link, or in person via physical travel)
- j) A good reputation – the jurisdiction therefore does reasonably well in evaluations and presents little risk of being blacklisted or sanctioned by the international community
- k) Reasonable and accessible dispute resolution via appropriate complaints procedures offered by professional bodies, the regulator or ombudsman; mediation procedures, fair trade, or other similar mechanisms prior to the need to launch litigation
- l) Depositor, policy holder, investor and unit holder compensation schemes
- m) A high quality service

Outcome 2: Establish a robust infrastructure, including solvent and stable government, a sound legislative and regulatory framework, a trustworthy law enforcement and judicial system, a strong professional skills pool, a properly resourced regulator, land and companies registries, together with relevant tax agreements and appropriate information exchange rules.

Stakeholder 3: International Business and Professional Counterparties

Service providers who do not have a direct relationship with their clients are less likely to succeed in the long term.

IFCs that sit passively, acting merely as a registered office, completely fail to secure the economic benefit achieved by being a 'relationship hub'. The 'relationship hub' is secured by the provision to a structure of IFC resident, active, skilled and responsible directors

and trustees, administrators, book keepers, bankers, lawyers, accountants and investment managers.

Clients, too, are mindful of the influences exercised by the international community and will be acutely aware of the dreadful reputational damage suffered by many high profile business and celebrity figures of being associated with certain offshore schemes and the costs of tax investigations. Increasingly, the potential tax savings are outweighed by the risks of investigation and penalty, or loss of shareholder confidence and public regard. Active, skilled and professional directors and trustees increase the real presence argument by fulfilling a proper 'hearts-and-minds' management function within the IFC, reducing the risk of allegations from the press or revenue agencies of 'brass plates' or 'shell companies', aiming to strengthen the client's defences from attack.

The strongest means by which an IFC can establish itself as a 'relationship hub' is to make itself attractive to overseas investors as an inward investment target location for financial institutions and professional services. Typical issues, which major corporates consider when deciding where to place their operations, certainly include those listed under the client needs above. However, there are additional considerations:

- Can they keep full ownership and control of their investment?
- Can they put their own choice of management and staff into the branch?
- Can the partners of their staff find interesting and well-paid work?
- Is decent housing available at a reasonable cost?
- Is good schooling available for their children?

Outcome 3: Establish strong relationships with high quality, international firms, to the extent that they wish to set up operations in the IFC; provide real 'heart and mind management' to client structures as well as full administrative services; earn recognition as a 'relationship hub'.

Stakeholder 4: Local Business Needs and Aspirations

Whilst to some extent both locally owned and foreign owned businesses have shared needs, there are also potential conflicting interests between them.

Many major IFC regulatory authorities have 'stature' criteria in their licensing policies which make attaining regulatory approval difficult for locally owned and controlled businesses (track record, capital adequacy, qualifications and international experience). There is a trade-off between attracting global names versus facilitating home grown talent.

Outcome 4: Consider balance between international firms and local firms.

Stakeholder 5: Local Citizen Needs and Aspirations

Many jurisdictions would argue that the purpose of establishing an IFC is to benefit the ordinary citizen rather than to create opportunities for international high-net-worth individuals. However, if the regulatory framework is cast in a manner that demands little real presence or services to be delivered locally, how are the local people to benefit? It is true of course that some jobs for the more able and more educated may be created but, without large numbers of jobs and/or an income tax system, where is the revenue stream for ordinary folk? Indeed, without a tax system that supports wealth redistribution, an IFC industry can exacerbate the gap between the privileged and the underprivileged.

Revenue from financial services is commonly referred to under the category of 'invisible earnings' because the financial services products and resultant revenue is not linked to material imports or exports. Jurisdictions which derive government revenue solely from import duty on material goods, such as desks and laptops, will derive little benefit for the ordinary residents of the jurisdiction as the financial services industry is merely performing the duties of a 'booking centre'.

Outcome 5: Consider how 'invisible earnings' can be made tangible – company tax, income tax, payroll tax, business rates, etc.

Conclusion

The conclusion finds that the interests of all stakeholders are oddly aligned. Value added, compliant services, delivered by competent staff, within a well-regulated jurisdiction comprise a sustainable offering, which is good for business, good for employees, good for clients, and unbecoming for international bodies. For some jurisdictions, there is a great deal of work to be done. 