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OFFSHORE PILOT QUARTERLY

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Private Thoughts

In today's regulatory climate, it seems that the United States has apparently vaccinated itself from many of the tentacles of transparency, whereas elsewhere the word "private" is an anathema. In the context of traditional English trusts, privacy went hand in glove with the concept, but today that fundamental element is being challenged. But not in every case.

Needs must when the Devil drives, and although claimed by many 21st-century trust practitioners to be new to the fiduciary stable, the Private Trust Company, or PTC, has successfully, and quietly, operated since the last century. It was not formed in the minds of today's young, wily offshore practitioners, concocted over cocktails beneath palm fronds; perhaps dodging mosquitoes between sipping mojitos. Directed towards a specific family (usually) it is not a commercial enterprise in the strict sense of the word. It can be argued that it is a cousin of the captive insurance company which, essentially, insures, and therefore manages, its own risk, detouring the regulatory burdens placed on an insurance company dealing with the public, and which also applies to licensed trust companies.

Now, however, since the structure has been so widely publicised, it has achieved its own place on the list of financial tools and has become another marketing opportunity in many common-law jurisdictions – although not so much, as with trusts, in civil-law countries. It is, possibly, the only legal entity that can boldly use the word "private" in its formal title and face the regulators without blushing. Inevitably, it has fallen under the glare of the regulatory spotlight and so has to follow, and carefully, conditions and rules, otherwise the protection it offers is illusory. If some regulators are already perplexed by trusts, however, one can only imagine how the PTC presents a jigsaw puzzle that will find them struggling to put all the pieces together.

The prime benefit of the PTC is its capacity to keep the client directly or indirectly in control of those managing its assets, by being able to remove one or more of the PTC's directors, either as the PTC's shareholder or by retaining, indirectly, sufficient legally-sanctioned influence over the shareholder to achieve the same purpose. Today, however, the degree of transparency expected, and related reporting to authorities – particularly with the introduction of the Common Reporting Standard – can make the direct shareholder route no longer a wise choice. Even so, the regulatory requirements which a PTC falls under when compared with a licensed trust company are significantly less; it follows, of course, that the PTC can engage a licensed trust company as its agent (an important step) and which is very attractive for the latter because its responsibilities are considerably less while, possibly, the fees generated still remain significant.

The material issue, however, which crops up time and again is the control of a PTC. "Control" has become the key operative word in terms of the ubiquitous Common Reporting Standard which, because of its very broad application, makes, as I say, direct ownership of the PTC by the client as shareholder no longer advisable because by being the owner (i.e. controlling person) it triggers heightened in-depth disclosure. An alternative mechanism, therefore, is required to retain the power to remove the directors of a PTC, so that new directors (managers) can be appointed if this becomes necessary for a variety of reasons.

On the question of PTC reporting obligations to the relevant authorities there are distinct advantages. Provided the correct jurisdiction is chosen, comprehensive details of trusts managed by the PTC (a PTC can represent more than one related trust) need not be disclosed to the authorities and, importantly, there will be no governmental licensing or supervisory oversight of the PTC provided the rules are followed. Significantly, it is possible to use a jurisdiction which is not automatically identified as an offshore financial services centre, such as the Bahamas or the Cayman Islands. Better still, one can choose a jurisdiction that also enjoys the status of being a member of the Organisation for Economic Co-operation and Development (OECD).

Happy Families

The PTC construct is ideal for family businesses because it enables the family to continue to manage its affairs directly, unhampered by any outside controls. So the daily management of any commercial businesses which form the main base of the assets held by the PTC remain in family hands – although supplementary investments, distinct from the family business itself but still the fruit of those endeavours, such as share portfolios and mutual funds, can be administered separately and directly by the PTC as trustee. The various businesses belonging to several family members can have, as I mentioned, their own separate trusts which are consolidated and come under the umbrella of the PTC.

Above all else, however, a PTC requires skilled, experienced and trustworthy hands at the helm in order to protect the pool of assets held, to see that the underpinning business or businesses are secure – and continue to be – within the structure. Importantly, a trained eye must ensure that the provisions of the trust or trusts managed by the PTC are followed to the letter. Having been a practising professional trustee for nearly 50 years, 40 years of which has been spent in the offshore trust business, I cannot believe otherwise.

Forming a PTC is normally straightforward, but finding the level of proficiency that the structure demands is not – especially if the services of a licensed trust company, as agent, are not employed. Finding the right directors for the board of the PTC, representing the corporate trustee, can often be difficult, but the ideal solution is to have access to the necessary expertise while at the same time enabling the trust company chosen by the PTC to ring-fence it from the list of ordinary clients subject to the statutory reporting obligations normally placed on the trust company.

Ideally, the trust company enters into a principal/agent contractual agreement with a PTC in terms of which it will manage the accounting and administration and serve as an adviser. Be sure, however, to have a trust company by your side that is well-rounded with knowledge of the rapidly changing international scene in order to serve, whenever necessary, as a sounding board for your future plans; a world view, in other words, is very beneficial (see last December's OPQ) and this aspect might never be of more importance than it is right now when reaching decisions, regardless of how you go about assembling a plan. As I also observed in December, it does look like the world, or at least countries comprising the important constituents of it, are heading towards troubling times.

Under the Volcano

Are we living under a volcano and is it ever going to erupt? If so, the importance of securing assets behind a high, protective wall is key to planning, especially for families with worldwide business interests – and whether or not, I should add, that there's a need to use a PTC. This second quarter has not slowed the slide into uncertainty. We have been here before. "Under the Volcano" was the title of Malcom Lowry's book which was published in 1947, the year I was born. It concentrates on a day in 1938 in the life of a doomed alcoholic who is a British consul living in Mexico. The day chosen may be Mexico's Day of the Dead, but the book, aptly titled, is a reflection of the traumatic times at the end of the 1930s, as the world heads towards war. It has been described by critics as a modernist masterpiece. The comfortable relationship enjoyed by Great Britain and Germany ended well before that day in 1938 and culminated, as we know, in the First World War. The previous economic boom which those two former Great Powers had shared lasted for almost 80 years, and saw global trade practically doubled. Today it is the US and China which are protagonists; both may have different economic models but share a common thirst for rising nationalism and the international order put in place since the Second World War by the US is now being dismantled by it, nearly 80 years after its birth. One economic commentator believes that 2019 may turn out to be "the official time of death of globalisation".

Global sovereign debt levels have become higher than they were when the last period of deglobalisation took place after the First World War; there is now more debt in the world than ever before. A group of Wall Street advisers who counsel the US Treasury has estimated that the Federal Government will have to sell US$12 trillion-worth of bonds in the next decade to fund its national debt and, at the same time, we read that Chinese purchases of treasuries are falling. The relationship between China and the US is worsening at present as trade talks between the two countries come unstuck.

At the beginning of the 20th century there were far more players in the power game, with 16 empires on the world stage. Whether one takes the Churchillian view that 21st-century empires can also be just of the mind the US still qualifies, in my view, as an empire because conventional wisdom suggests that an empire is a state which rules over territories outside of its original borders, regardless of conquering them, by simply wielding significant influence. So they do not exist only by conquest alone; in the past they have been formed from dynastic marriages or from mutually beneficial pacts, such as the purchase by the US of the Virgin Islands from Denmark, Alaska from Russia and the Louisiana Purchase from France. The whole of North America, in fact, may have flown the American flag had not every attempt by the Americans to advance into Canada been thwarted by Great Britain.

Great Britain and its empire were seen as a hindrance towards the US desire for domination at the turn of the last century and it kept chipping away at that supremacy until, finally, after the Second World War, it was able to deliver, because of circumstances, the death blow. As far back as 1780, Thomas Jefferson, the principal architect of the Declaration of Independence, spoke of his country being an "Empire of Liberty", a term first used by the British. In 1783 George Washington said that the US was a "rising empire" and subsequently went on to write that "there will assuredly come a day, when this country will have some weight in the scale of Empires", seeing himself "as a member of an infant empire". The little boy who apparently could not tell a lie never spoke a truer word. In fairness, through the centuries grand ambition and the desire for dominance have been all part of the human condition whose characteristics become interlaced with key events and situations. In the 1950s there were just 3 empires left: the British, the US and the Soviet. Two have disappeared, but history tells us that this may not be the final number; perhaps, however, as the sun rises in the east, so might an empire.

Future Perils

President Trump calls for China to make a "Real Deal" on trade with the US. The backdrop to this is the fact that China's growth in 2018 has been its slowest in almost three decades (at 6.6 per cent last year it was the weakest result since 1990). Time, however, to really get "real". The size of the Chinese economy resulted in the country last year generating a record figure for new production. Nominal Gross Domestic Product increased by approximately US$1.2 trillion from a much larger (and growing) base. True, foreign sales still matter but not as much as they did. Domestic consumer demand accounted for three-quarters of last year's growth rate – the most since 2000. Caution, however, is called for: already the country has seen debt surge in the past decade; debt to GDP levels have continued to increase; sales of cars fell in 2018 for the first time in over 20 years. It is in China's best interests to secure a trade deal, but President Trump would be foolish to assume that the Middle Kingdom wants one at all costs, and that he holds all the cards.

The fear of Muslims at the beginning of this century is similar to sentiments felt in the early part of the last one towards the perceived Oriental hordes thought to be moving west in swarms and engulfing "civilised" societies. This fixated fear was popularly described at the time as the Yellow Peril, a term first used after Japan's military defeat of China in 1895. The advent of the First World War, however, concentrated minds elsewhere and consigned thoughts of the Yellow Peril to the shelf. A new threat, Soviet communism, manifested itself after the Second World War, giving birth to unrestrained McCarthyism and pushing back further any thoughts about China.

Modern American foreign policy was defined in 1950 in a paper written by the National Security Council for president Harry Truman. It was believed that US national interests would be best served, and preserved, through international leadership, the thought of which is unlikely to have been even imagined by Jefferson or Washington. Future American foreign policy, however, is in a state of flux and how long it will be that way is anybody's guess. What is not in doubt is the delight that would be shared by the Russian and Chinese presidents if the American-led order endorsed by Harry Truman collapses in a political, volcanic eruption.

Unlike the Mexican Day of the Dead you cannot find a Day of Reckoning on the calendar, but that doesn't mean there won't be one.

Offshore Pilot Quarterly (independent writing for independent thinkers) has been published since 1997 by Trust Services, S. A. which is the British face of trust business in Panama where it is licensed under the fiduciary laws. It is written by Derek Sambrook, our Managing Director, a member of the Society of Trust and Estate Practitioners and the International Tax Planning Association, and a Fellow of the Institute of Bankers in South Africa who was both a member of the former Latin America and Caribbean Banking Commission and an offshore banking, trust company and insurance regulator. He has over 50 years combined private and public sector experience in the financial services industry about which he has written extensively and our website provides a broad range of related essays.

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