Perception and reality: Forces driving the offshore industry
Contents

2 Foreword

3 Introduction

4 Key trends

- Big picture: A public relations problem
- Jurisdictions: Victims of their own success
- Regulation: Uncertainty and inevitability
- Customers: A broader base, but still a China story
- Market drivers: Less about tax planning

25 OIL’s recommendation

26 Summary

27 Methodology

29 Acknowledgements
Nothing much can change in a year, right?

If only things were so simple. Since the last edition of OIL’s “Offshore 2020” survey we have seen yet more storm clouds gather over the offshore industry.

Investigative journalists published “leaked” (or was it stolen?) information pertaining to more than 100,000 offshore companies, trusts and funds in the hope of naming and shaming high profile politicians and business people. Successful global and highly entrepreneurial businesses have been hauled in front of senate and parliamentary committee hearings to explain their tax strategies. And tax transparency has shared top billing on the G8 meeting alongside the conflict in Syria.

Over the past 12 months we have witnessed a debate that began with tax at the core, shifting to a political points-scoring exercise and now a moral enquiry about paying “a fair share”, regardless of the legal soundness of the approach. Our question for governments and regulators is at what point do you stop pointing the finger at successful multinational corporations utilising bilateral agreements and look closer to home in terms of fixing government debt?

Now in its 4th year, the “Offshore 2020” market research into the key trends and future developments within the industry continues to go from strength to strength. We have expanded this year’s edition in terms of number of participants (228, up from 155), geographical spread (over 30 locations are now represented) and range of topics.

For the first time since launching the survey, the two jurisdictions that have consistently ranked highest (the British Virgin Islands and the Cayman Islands) have reason to query whether their popularity can be sustained. Is this a temporary “blip” or does it represent the start of a fundamental evolution in jurisdictional usage? Time will tell.

We also make some recommendations as to what the industry should be doing to counter the negative perception and provide a balanced view in the public debate.

Despite these assorted concerns and pressures, the industry remains in good shape as evidenced by increased demand for offshore structures. They remain essential tools in everything from cross-border investment to sound wealth planning.

We are not sure exactly how the next 12 months will unfold, but it is unlikely to be boring.

OIL will continue to provide this annual barometer and we would welcome any feedback on how it can be improved.
Introduction

No one can plan for all contingencies, can they? Twelve months ago, the “Offshore 2020” survey offered a sense of optimism after several years of uncertainty. The industry was not wholly comfortable with the changes brought about by the drive for greater tax transparency, led by the Organisation for Economic Cooperation and Development (OECD), but it was getting used to them. Double tax treaties (DTTs) and tax information exchange agreements (TIEAs) were increasingly seen as an opportunity rather than a threat.

However, expectations of steady progression have been thrown asunder by unforeseen headwinds. The damage caused by the International Consortium of Investigative Journalists getting its hands on a cache of 2.5 million records detailing the offshore assets of people should not be underestimated. From the vaults of two service providers alone, the investigators extracted the identities of individuals and groups, from more than 170 jurisdictions and countries, behind 100,000 companies and trusts.

Though contained – so far only two service providers have been compromised, out of the hundreds of fiduciaries operating globally – the scandal has created a crisis of confidence in the industry, forcing many investors to re-evaluate the ability of certain jurisdictions to preserve client confidentiality.

On top of this, the political debate on offshore financial services has become an unseemly morality war. Several multinational corporations have been questioned by politicians in the United States (US) and United Kingdom (UK) over accusations that they use offshore jurisdictions to evade domestic tax. Regardless of the role DTTs play in facilitating cross-border trade and efficient business practice – or the lack of conclusive evidence that laws have been broken – those that use them have been tainted by association with companies that are allegedly short-changing governments and squeezing out competition from smaller players that don’t have the resources to engage in complex tax planning.

What the industry faces is not so much a material challenge based on quality of service as a public relations problem. If not addressed properly, it could add to the pressure still being imposed by the OECD, potentially resulting in the imposition of punitive regulations. For the British Overseas Territories (BOTs) in the Caribbean, there are immediate threats, as a result of measures raised by the UK Government.

There is merit in efforts to clean up the system. The more nefarious elements of offshore financial services should be curtailed, whether that means taking a closer look at transfer pricing techniques, allowing regulators to have greater visibility on the ultimate beneficiaries of structures, or ensuring that companies have adequate “substance” in a jurisdiction when it is being used to derive tax benefits.

There are, however, two caveats. First, cleaning up the system means Western governments must address weaknesses in their own economies – such as putting in place mechanisms to collect client information – as well as calling on jurisdictions to introduce reforms. Second, beware a kneejerk response. The data leaks and G20 agenda risk over-politicising the debate, potentially resulting in actions that stymie the benefits offshore structures undoubtedly bring.
1. BIG PICTURE: A PUBLIC RELATIONS PROBLEM

The primary challenge currently facing the industry concerns its public image – the leak of 2.5 million records identifying the owners of assets held offshore plus renewed pressure from the G20 group of nations on the cross-border activities of multinationals have made sure of that.

Such is the significance of this particular theme that is permeates all others, influencing the perception of different jurisdictions and the weight of regulatory burdens. However, it is worth examining the impact of the public relations issue in isolation, if nothing else than to get a sense of how much of an obstacle it is proving for industry participants and how they would like to see it addressed.

It is important to note that the data leaks issue cannot be examined in isolation – the unfortunate incident forms part of the package of pressures on the industry, ranging from established phenomena like the OECD-led transparency drive to the relatively new scrutiny of multinationals by the G20. So when more than one third of survey respondents said the data leaks will result in a drop in demand for offshore vehicles, while 46% expect no change in underlying demand but a rebalancing in jurisdiction preferences, it should be seen in this wider context (Figure 1).
Indeed, banks have already responded by treating certain jurisdictions with increased scrutiny, as nearly one in 10 respondents attest (Figure 2). Given this is a public relations problem, the offshore centres that are suffering are those with the highest profiles – 38% of respondents said the British Virgin Islands (BVI) was attracting more attention from banks; 22% said the same of the Cayman Islands; only 7% noted this trend in the US. Anecdotal evidence suggests that several international banks have introduced additional procedures when opening bank accounts with offshore companies. Does this represent a temporary setback or an industry choke point?

**Figure 2.** Are banks viewing certain jurisdictions with increased scrutiny?

![Pie chart showing responses to banks viewing certain jurisdictions with increased scrutiny.]

- No change in underlying demand for offshore company: 16%
- No change in underlying demand for offshore vehicles: 46%
- Will cause a drop in demand for offshore vehicles: 38%

Source: OIL

“**Banks are viewing the Cayman Islands and the British Virgin Islands with increased scrutiny**”

Partner at a law firm, US

Asking how these perception issues could be dealt with, there were calls for concerted lobbying efforts, better public relations, more transparency and education and outreach initiatives so as to better explain the benefits of offshore services (Figure 3). They acknowledge that mainstream press coverage has been both poor and poorly informed.

Reassuringly, only 42% believe the battle for public opinion has already been lost. Industry participants appear to be reasonably sanguine on the issue, seeing it a broader context: first, in times of austerity, when many households are struggling with lower disposable incomes, the notion that others are evading tax – not paying their share – inevitably generates public discontent; second, politicians adopt populist measures for particular short-term ends, such as election victories.
Figure 3. How can the industry enhance its public image?

Furthermore, the vast majority of jurisdictions are still commercially healthy. There remains a fundamental demand for offshore solutions to underpin cross-border transactions and clients, responding to changing regulatory circumstances, are becoming more sophisticated in terms of how they employ these solutions (Figure 4).

Figure 4. "Aggregated" jurisdictional new incorporation volume 2009 – 2013

As such, the offshore financial services industry is not under pressure to prove its worth to the ultimate end users, or to the professional intermediaries who advise them; they clearly still recognise its merits. Rather, the battle is one for wider public opinion, which in turn helps shape political and regulatory agendas. Better practices and better engagement is the key: the industry must not just be transparent; it must ensure that it is seen as being transparent.
The crisis of confidence that emerged in the last 12 months has affected all offshore jurisdictions – but some more than others. While the likes of the Cayman Islands and the BVI have clearly suffered by virtue of their high profiles, financial centres that do not make newspaper headlines could actually benefit from the fallout as investors reconsider where their assets – and privacy – are best maintained.

Unlike previous years, to aid comparison, the jurisdictional landscape has been divided into three segments, based largely on the results of previous surveys: the market leaders established in previous surveys (the BVI, the Cayman Islands, Hong Kong and Singapore); the longer standing European players (Luxembourg, Ireland, Jersey and Guernsey); and “the rest”, a mixture of old school jurisdictions (Bermuda and Delaware) and up and comers (Mauritius, Malta, Seychelles and Samoa) (Figure 5).

The very first "Offshore 2020" survey in 2010 found that the BVI and the Cayman Islands are seen as the dominant jurisdictions, with Hong Kong and Singapore nipping at their heels, generally expected to become preeminent in due course.

Asked to rate these centres’ importance on scale of 1-5, in 2010 Hong Kong received 3.2 and Singapore 2.9, trailing the BVI and the Cayman Islands on 4.0 and 3.4, respectively. Fast forward to last year and Hong Kong had moved to 4.1, inching ahead of the Cayman Islands and within touching distance of the BVI. Singapore also registered a significant gain, moving to 3.8. The two Asian jurisdictions had closed the gap, but not at the expense of their Caribbean counterparts. This was evidence of the trend that has seen pure offshore and quasi-onshore – mid-shore – locations included in more complex, multi-layered corporate structures.
In 2013, all the leaders were judged to have fallen in importance compared to a year ago. This is likely a response to perception problems arising from data leaks, intensifying regulatory pressure through the G8 group of nations and the OECD, and heightened political scrutiny in the developed markets of the use of offshore structures.

The leaders bore the brunt of the impact because of their status as leaders. When asked about the prospects for the leading jurisdictions five years from now, Hong Kong and Singapore are both expected to rebound. The BVI and the Cayman Islands, meanwhile, will see their positions continue to deteriorate, a notion that is likely to give further impetus to these jurisdictions’ efforts to broaden their product scope and compliance with global transparency standards. It should be noted that, as BOTs, they are subject to greater Western regulatory influence than mid-shore and onshore centres.

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Feedback on jurisdictions in the other two categories is also instructive, albeit for different reasons. Sentiment on the European players is largely unchanged from 2012. They have not gained from the crisis of confidence in the BVI and the Cayman Islands, and neither are they expected to. Only Ireland is expected to be more important in five years time than it is now, perhaps a response to the government’s fierce protection of low corporation tax levels. For the Channel Islands Crown Dependencies – which face similar pressures to the BOTs, it is a trade off: regulatory reforms mean they are more important in terms of accessing the EU, but at the same time they are being forced to compromise on confidentiality.

As for the others, with the exception of Samoa, which has seen a sharp drop in support against 2012, the prevailing view is plain to middling. Five years from now, Delaware is likely to be as important as it is today, tighter US tax policies notwithstanding, while Seychelles looks set to gain and Mauritius to lose.

The problems in Mauritius can be linked to continued uncertainty over its DTT with India – traditionally the source of much of the jurisdiction’s offshore business – and there are already signs that Singapore in particular is benefiting from this situation. Meanwhile, anecdotal evidence suggests that Seychelles is winning the international business company (IBC) clients at the expense of the BVI.

Interestingly, this appears to be an issue of perception rather than quality. In the assessment of jurisdictions by particular service criteria, the BVI outscores Seychelles on every level: set up and maintenance costs (1st vs. 3rd); ease of use (4th vs. 5th); robust regulatory environment (6th vs. 7th); professional infrastructure (5th vs. 8th); commercial mindset (4th vs. 7th) (Figure 6). However, if reports that opening bank accounts for the BVI-domiciled companies has become more difficult are true, Seychelles might be seen as a useful alternative.

**Figure 6.** Ranking of performance on major jurisdictions against service criteria

<table>
<thead>
<tr>
<th></th>
<th>The BVI</th>
<th>The Cayman Islands</th>
<th>Cyprus</th>
<th>Guernsey</th>
<th>Jersey</th>
<th>Hong Kong</th>
<th>Seychelles</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost (set up and outgoing maintenance)</td>
<td>1</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>8</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Robust regulatory environment</td>
<td>6</td>
<td>3</td>
<td>8</td>
<td>5</td>
<td>4</td>
<td>2</td>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td>Professional infrastructure</td>
<td>5</td>
<td>3</td>
<td>7</td>
<td>6</td>
<td>4</td>
<td>1</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>Ease of use (e.g. opening a bank account)</td>
<td>4</td>
<td>3</td>
<td>8</td>
<td>7</td>
<td>6</td>
<td>1</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Commercial mindset (willingness to work with stakeholders)</td>
<td>4</td>
<td>2</td>
<td>8</td>
<td>6</td>
<td>5</td>
<td>1</td>
<td>7</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: OIL

When Hong Kong-based respondents, who dominate OIL’s sample, are stripped out from the results the picture changes somewhat: Seychelles climbs into the top three in four out of the five categories, bettering the BVI in everything apart from set up and maintenance costs and ease of use (Figure 7).
Unsurprisingly, Hong Kong and Singapore score highly across all these parameters. Even without Hong Kong-based respondents, the two jurisdictions rank in the top four for each category bar commercial mindset, which is perhaps the most subjective of the measures.

The mid-shore credentials that underpin Hong Kong and Singapore’s offerings are expected to benefit these jurisdictions in the fall-out from Cyprus’ banking crisis.

With the economy in dire straits and the Cypriot government responding by announcing a one-off 9.9% tax levy on all bank accounts with in excess of EUR100,000, three quarters of survey respondents expect the country’s trust and fiduciary market to be negatively affected. Such action is a blow to investors’ confidence in the system, making new business harder to come by while existing clients consider re-domiciling of assets in larger and more stable jurisdictions (Figure 8).

Ironically, the banking system aside, Cyprus remains one of the most attractive jurisdictions in the European Union (EU) from a tax rate and DTT’s perspective.

"Singapore will benefit from the Cypriot banking crisis"
Government policy analyst, the BVI

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Ironically, the banking system aside, Cyprus remains one of the most attractive jurisdictions in the European Union (EU) from a tax rate and DTT’s perspective.
Singapore and Hong Kong are identified as the offshore centres most likely to claim business from Cyprus – they are seen as “far away”. Malta ranks third, and for the opposite reason (Figure 9). It is an EU member state so offers the same level of customer access as Cyprus, but boasts the region’s lowest effective tax rate and shown little sign of needing financial assistance from the EU. Furthermore, Malta has been savvy in assembling its DTT network, which now stands at 63 to Cyprus’ 50. In the last year, Malta has signed treaties with both Russia and Ukraine, both of which have traditionally relied on Cyprus as an offshore centre.

**Figure 9.** Jurisdictions benefiting from the “Cypriot banking crisis”
The sample size for the “Offshore 2020” survey has grown nearly five-fold since its first incarnation in 2010. Respondents also hail from a more diverse selection of geographies. Although there is a conscious effort to tap into trends in Asia’s growth markets – more than 60% of respondents are based in the region – it has never been clear how exposed these people are to the traditional sources of wealth, Europe and the US. Indeed, given the increasing complexity of offshore networks, we will probably never really know.

It is in this context that the survey addressed the regulatory issues facing the offshore community. When asked to name the most pressing new and existing rules under which they must conduct business over the next five years, the US Foreign Account Tax Compliance Act (FATCA) emerged as leader by a considerable margin. The EU’s own landmark piece of legislation – the Alternative Investment Fund Managers’ Directive (AIFMD) – came in second (Figure 10).
Figure 10. Regulations, new or existing, which are likely to be an impact on the offshore market in the next 5 years

Why the disparity between the two? While elements of FATCA have been repeatedly postponed, the first stage of AIFMD came into effect in July 2013. The answer lies in who is impacted by these regulations and how.

AIFMD, although tamer than the initial drafts, is indeed draconian – but predominantly for managers of private equity, real estate, infrastructure and hedge funds. Each EU member nation is scrutinising its domestic managers more closely, and now if managers from outside the EU (the vast majority of funds are domiciled in the Cayman Islands) want to target investors within it they must meet certain transparency requirements.

It is not only the requirements themselves that present a challenge – publishing annual reports, making certain information, such as fees, known to investors before they commit, registering and the reporting to relevant local authorities – as the fact that each jurisdiction could come out with its own sub-set of rules. Non-EU managers will ultimately get access to the passport scheme open to EU-based managers, whereby once they are approved in one territory they can operate in them all, but it is likely to remain easier to target the region from within than outside, and this has consequences for offshore structuring.

FATCA, meanwhile, potentially has consequences for anyone managing money offshore and with exposure to the US. The regulation instructs foreign financial institutions to disclose all the US clients to the Internal Revenue Service (IRS). Failure to do so results in severe financial penalties. The risk has prompted some banks to give up on the US market entirely, while certain countries have come under pressure to revise secrecy laws so that local firms can be compelled to comply with the IRS requirements.
It is therefore understandable that four of every five survey respondents expect FATCA to impact their business. While the legislation could in theory open up new lines of business – just like AIFMD, it means less experienced trust and fiduciary services providers will seek external consultation and support – the general expectation is that costs rise and margins fall. There is also likely to be a preference for dealing with more regulated jurisdictions.

When asked whether FATCA would be adopted as a universal model by 2020, driven by the OECD, just over 60% of participants responded in the affirmative. This is interesting because it throws up the possibility of individual regulatory initiatives coming together as a global platform. Forecasting the emergence of an “OECD tax police”, is alarmist but for some industry participants it is a genuine concern.

FATCA and AIFMD were not the only concerns raised; disclosure of beneficial ownership also featured prominently (Figure 11). The issue was discussed by the G8 group of nations while the survey was being conducted, with several governments calling for public registers detailing the ultimate owners of offshore structures in order to facilitate transparent business practices. This would make it easier for banks to conduct anti-money laundering (AML) and know-your-customer (KYC) due diligence, as well as assisting government agencies in tracking tax evasion.

The irony, of course, is that two of the countries calling for beneficial ownership disclosure – the US and the UK – presently have no mechanisms in place for collecting this information themselves.

**Figure 11. Jurisdictional beneficial ownership disclosure comparison**

<table>
<thead>
<tr>
<th>Beneficial ownership always recorded</th>
<th>Legal ownership recorded (some or all type of corporate vehicles)</th>
<th>No beneficial owner information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anguilla</td>
<td>The UK</td>
<td>The BVI</td>
</tr>
<tr>
<td>Bermuda</td>
<td>Germany</td>
<td>The Cayman Islands</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>Panama</td>
<td>Austria</td>
</tr>
<tr>
<td>India</td>
<td>Singapore</td>
<td>Seychelles</td>
</tr>
<tr>
<td>Jersey</td>
<td>Switzerland</td>
<td>The US</td>
</tr>
<tr>
<td>Monaco</td>
<td>Isle of Man</td>
<td></td>
</tr>
</tbody>
</table>

Source: OIL

“**Significant business opportunity will be created due to the introduction of FATCA**”

Director of a consulting firm, Hong Kong
Other issues, such as exchange of information, tax transparency and AML measures, are all stalwarts of previous surveys, concerns crystallised by the OECD-led push for improved international tax transparency that is now several years old.

Fears remain of being left off the “white list” of jurisdictions deemed proactive on this front, and there is still uncertainty as to where the OECD will go next. Over two thirds of respondents said they have yet to receive a request under the TIEAs signed in the wake of initial white list’s release. But with talk of automatic information exchange, where an investigation might be based on little more than speculation and its target has no recourse, threats to normal business practice are real.

Bringing these various efforts together would afford the OECD much more momentum. With this in mind, developments in the BOTs and Channel Islands Crown Dependencies will be followed closely. Nine in 10 respondents expect that the UK government, under pressure from the G20, will demand that BOTs in the Caribbean adopt more stringent regulatory systems along the lines of those being introduced by their Channel Islands counterparts.

As this report was going to print, the Cayman Islands and the BVI appeared to have “signed up” to the FATCA framework, following Jersey and Guernsey’s lead (although the Cayman Islands and Guernsey actually signed the intergovernmental agreement that allows the UK financial institutions to comply with FATCA obligations without breaching domestic data protection laws).

There is an argument that the BVI and the Cayman Islands already have frameworks equal to those of Jersey and Guernsey, and that the move towards closer scrutiny is merely another aspect of the misperception issue from which these jurisdictions suffer.
4. CUSTOMERS: A BROADER BASE, BUT STILL A CHINA STORY

Asia remains, by some distance, the principal source of business growth for the offshore financial services industry. Looking at the survey results more closely, though, two other, more nuanced trends emerge: there appears to be robust demand across all major markets, which points to an industry that is more globalised; and the nature of China-related demand, the most significant driver within Asia, is shifting from inbound to outbound at a faster pace than anyone expected.

Fluctuations in demand from particular markets reflect broader macroeconomic movements. For the last four years, survey respondents have been asked to rate regions on a scale of 1-5 in terms of importance for client origination. Europe (excluding the UK) has seen a steady decline over this period, from 3.8 in 2010 to 2.9 in 2013, and it is the only market not to see an uptick in demand this year compared to 12 months ago. By contrast, North America, which saw its rating sink from 2.9 in 2011 to 2.6 in 2012, rebounded to 2.9 (Figure 12).

This dynamic can be explained by the two markets’ divergent economic performance in the last year. Europe has been dragged from crisis to crisis, with various EU member states calling for central assistance as they risk default on their debt, thereby fuelling further speculation about the future of the euro. The US, meanwhile, appears to be experiencing an economic revival, although it is protracted and areas of weakness – notably political intransigency – remain.

The positive takeaway is that neither market is expected to see a drop in demand for offshore services in the next five years, despite the various regulatory concerns. Indeed, Europe’s ranking is tipped to reach 3.1 by 2018, which suggests an optimism within the industry that current economic storms can be weathered and the region will see a bump in demand, much like North America.
Client origination expectations in emerging markets are, of course, tied to their respective growth trajectories. The impact of rising individual and corporate incomes, plus more interaction with the global economy, translates into stronger demand for offshore structures. Asia’s ranking is expected to be 4.4 in five years time, up from 4.1 today, while the Middle East will jump from 2.4 to 2.9.

However, respondents identified Latin America and Africa as the most dramatic growth centres between now and 2018. This is not unusual – similar sentiments have been expressed in previous surveys – and it reflects the aspirational nature of these markets. Only time will tell if these hopes are fulfilled.

As for China, expectations for more outbound business are already being realised. In 2012, 55% of respondents said most of their China business was inbound; this year the proportion fell to 44% as an increasing number of domestic investors began to look overseas (Figure 13). Between 2005 and 2011, annual Chinese outbound M&A jumped more than fivefold to $63 billion. Last year, total deal value topped $64 billion and it will likely continue to increase, supported by government policies to secure natural resources, technologies and expertise required to sustain long-term economic growth.
The standout deals of 2013 reflect the breadth of Chinese interests: China National Offshore Oil Corp’s (CNOOC) $15.1 billion purchase of Nexen, a Canadian oil and gas company, and Shuanghui International announced $7 billion acquisition of Smithfield Foods, a leading US pork producer. Nexen is emblematic of the natural resources deals that continue to dominate but Shuanghui represents what is to come as China follows the pattern already seen in other emerging economies and the focus of M&A moves from resources through manufacturing to services.

From an offshore perspective, Shuanghui International is the Cayman Islands-incorporated arm of China-based Shuanghui, the country’s largest meat processor, which counts a consortium of private equity investors as its major shareholder. These investors are ultimately expected to exit the merged and restructured company via a Hong Kong IPO. Meanwhile, CNOOC, like most oil majors, conducts business through a network of offshore entities based on its particular needs.

In 1995, Chinese outbound investment spanned just four industries globally; nine years later it had grown to 20 and reached 26 in 2012. One-off large-scale acquisitions can skew the numbers but average deal size has generally fallen over the years, which reflects growing M&A activity in the private sector. While state-owned giants have traditionally focused on energy and financial services, private players are likely to target intellectual property and expertise in areas such as high-end manufacturing, renewable energy and food.

Needless to say, the more private enterprises seeking global exposure, the greater the demand for offshore wealth management solutions from the entrepreneurs behind these businesses.

Nearly two thirds of respondents expect the balance of China demand to swing further towards outbound in the next five years (Figure 14). China and Hong Kong are already the top two locations for client origination, with the US and the UK sharing third place. Interestingly, by 2018, Hong Kong is expected to lose ground to mainland China – suggesting more direct business rather than routed through an intermediate jurisdiction.

“China is the most important location for client origination for business in the next five years”

CEO of a Trust company, the BVI
It is difficult to reconcile this expectation with the situation on the ground. Even factoring in full renminbi convertibility – China has taken steps to internationalise its currency but there is no formal timeline for opening up the capital account – the robust support systems and reliable financial and legal networks of Hong Kong will be difficult to replicate.
5. MARKET DRIVERS: LESS ABOUT TAX PLANNING

While the position and perception of offshore services as part of the wider financial system are changing, many of the market drivers and constraints, as well as the trends marking the evolution of clients and service providers, are exactly the same as in previous years.

There is, however, one telling exception. When asked what accounted for the bulk of their business, 10.3% of survey respondents cited individual tax planning, down from 15.9% in 2012 (Figure 15). No other category saw a decline of similar magnitude. It is indeed ironic that, as the industry deals with a deteriorating public profile and increasing regulatory pressure, the principal cause of this discord – a perception that individuals and companies are using offshore structures to evade tax – is actually becoming a smaller part of the business.

Asset management and wealth protection remain the primary industry driver and the largest source of end users: 29% of respondents said asset management was responsible for most of their business, up from 23.9% in 2012; funds management was up to 20.2%, from 14% the previous year. These two categories accounted for nearly half the total response, with other purposes – investment holdings for corporate, trading for corporate, special purpose vehicles, and listing vehicles for IPO – all falling compared to 2012.
More than one third of respondents said their leading source of business growth in the last two years had been high net worth individuals, followed by hedge funds and private equity (Figure 16). Small and medium-sized enterprises and multinationals ranked a distant third and fourth, respectively.

At the same time, over the last four years there has been a gradual shift in the market from private business (driven by individuals) towards institutional business (driven by companies). The institutional share stood at 51% in 2010 and it is now 55%, down slightly on 2011 and 2012, but the long-term trend is clear: By 2018, survey respondents expect 59% of their business to come from institutions (Figure 17).
In this context, it is no surprise that the industry is becoming less polarised. In 2010, more than half of respondents said private clients accounted for at least 80% of their business, over one third relied on institutions for at least 80%, and there was very little in between. Now business distribution is much more even. Nearly two thirds of respondents generate 50% or more of their revenues from institutional clients.

This might appear to be at odds with the emergence of high net worth individuals as the primary source of business growth, but it is not. Certainly from an Asian perspective, the high net worth individuals themselves are becoming more sophisticated and operating as family offices with dedicated investment professionals in their employment.

In many respects, this is a function of the constraints the industry now face. The key points identified by survey respondents are the same as last year – DTTs and information exchange and AML and KYC processes (Figure 18). These are closely tied to the OECD-led initiative on tax transparency, and as the industry gradually moves towards automatic information exchange, they will become increasingly important.
Meanwhile, new additions to the list of constraints include the US FATCA – and similar legislative efforts in other countries, should they materialise – and issues relating to the industry’s public relations problem, namely opening bank accounts for offshore companies and information leaks eroding client confidence. Two previous bugbears, the lack of qualified staff and the euro crisis, appear to have eased over the last 12 months.

What it all amounts to is a much more complicated operating environment. The use of pure offshore structures has declined significantly over the last three years. In 2010, 32% of respondents thought that zero-tax jurisdictions would be the most important factor in driving future demand for offshore structures. As of 2013, the figure has dropped to 6%, with 24% opting for mid-shore jurisdictions with a broad range of DTTs and the remainder saying it would be a combination of the two (Figure 19).
The trend towards using mid-shore jurisdictions, such as Hong Kong and Singapore, that boast broad-based financial services industries, is fully ingrained, but it is only one part of the puzzle.

A global private equity fund, for example, may continue to be domiciled in the Cayman Islands with some investors in the fund participating via the BVI international business companies and others – chiefly the European contingent – using a Luxembourg feeder vehicle. Below the fund level there are likely to be all kinds of different structures: a Hong Kong entity to take advantage of the tax breaks on passive income afforded under the territory’s DTT with China; a Singapore-based entity offering similar advantages in India; and an assortment of Ireland and Delaware companies for tax efficient investments in Europe and the US.

The burden this places on the service providers is also significant, putting pressure on those that have neither size nor a niche product offering. As such, the message of previous years is reiterated, albeit with a contemporary postscript.

The level of resources and expertise required to be competitive in the offshore sphere suggests an incremental shift towards consolidation as economies of scale deliver efficiency and better pricing while a broad geographic footprint facilitates the delivery of bespoke products. And the onus is on these larger players to lead the way – through a combination of lobbying outreach and education – as the industry seeks to turn around public opinion.

“....... jurisdictions with a broad range of DTTs will become more important”
Partner at a law firm, US
There is clear consensus as to what the offshore industry must do to address its perception problem: survey respondents called for concerted lobbying efforts, better public relations, more transparency and education and outreach initiatives so as to better explain the benefits of offshore services. But where does the responsibility lie for coordinating these activities?

OIL is already part of a consortium that is advising jurisdictional governments and lobbying G8 nations on their policy decisions. The consortium can take some credit for the UK’s decision to soften their demands, for the time being, in relation to the creation of public registers of beneficial owners of offshore structures. Insisting on this, while the US condones the formation of thousands of Delaware companies with virtually no client disclosure, would have been an own goal of significant proportions.

The next step is creating a single and strong association to represent the industry in discussions with international decision-making bodies such as the OECD. This association could also take the lead in establishing uniform standards for best practice and in devising outreach efforts intended to educate the media. Little is known about the steps already taken to tackle criminality by adopting anti-money laundering rules, the jobs created – directly or indirectly – by the industry, or the role it continues to play in facilitating foreign direct investment in developing countries. A single platform equates to a louder and clearer voice.

Similar groups are already making their presence felt elsewhere in financial services. The Alternative Investment Management Association (AIMA), for example, has become a figurehead for hedge funds, acting as a forum for the exchange of ideas between industry participants and interacting with stakeholders ranging from institutional investors to regulators to policy makers. AIMA also has specific programs designed to help managers respond to the US FATCA and the EU’s AIFMD.

Previous attempts to form a united lobby group by the jurisdictions themselves have been an exercise in “herding cats.” While they should be important stakeholders, it is the role of private industry to spearhead this. The IFC Forum stands the best chance of being the AIMA equivalent for our industry.

On a general level, much can be gained from increased cooperation between industry participants to promote the offshore financial services. This isn’t limited to the service providers themselves, but should include international banks, accounting and law firms, and the governments of mid-shore jurisdictions.

Collaboration is required to develop compliance benchmarks covering areas such as due diligence and quality control. Making it more difficult to acquire trust and fiduciary licenses would also help, and again, a critical mass of support is required if it is to be successful. But even then, a tightening of regulations and compliance at the jurisdiction end, without a parallel effort to regulate service providers in markets where they operate, would leave a fundamental weakness in the chain.
The primary challenge currently facing the industry concerns its public image – the leak of 2.5 million records identifying the owners of assets held offshore plus renewed pressure from the G20 group of nations on the cross-border activities of multinationals have made sure of that. Banks have responded by treating the higher profile jurisdictions with increased scrutiny. While the situation may not necessarily cause a drop in demand for offshore vehicles, those using them are likely to think twice about where they put their assets. The industry should respond through better public relations and lobbying efforts, as well as greater transparency.

The jurisdictions suffering most from these image problems are the Cayman Islands and the BVI, which are in many ways the face of the industry. They are expected to remain market leaders but at the same time will lose ground to mid-shore locations such as Hong Kong and Singapore. European players Luxembourg, Ireland, Jersey and Guernsey are not benefiting from this phenomenon, and neither are they likely to. For the British Overseas Territories, in particular, there are concerns that the UK-imposed reforms could compromise confidentiality. Of the up and coming jurisdictions, Seychelles is expected to gain the most.

Regulatory concerns vary, but the US FATCA and the EU AIFMD are the most prominent. While the legislation could in theory open up new lines of business – it means less experienced trust and fiduciary services providers will seek external consultation and support – the general expectation is that costs rise and margins fall. There is also likely to be a preference for dealing with more regulated jurisdictions. Other issues raised include the disclosure of beneficial ownership, exchange of information, tax transparency and AML measures.

Asia remains, by some distance, the principal source of business growth for the industry. Geographical fluctuations in demand tend to reflect broader macroeconomic movements – in the last 12 months Europe has seen a steady decline while the North America has rebounded, but the longer term prognosis for these and other major markets is positive. The sharpest growth in client origination over the next five years is expected to be in Latin America and Africa. In China specifically, the much touted jump in outbound business is already happening and it is likely to become even more pronounced.

Criticisms of offshore financial centres tend to focus on the notion that companies and individuals are using them to evade tax. However, tax planning is becoming less important as a driver of business growth. Asset management and wealth protection is the primary source of business, followed by funds management. Meanwhile, the fastest growing end user segment is high net worth individuals. The constraints these investors face are largely unchanged: double tax treaties, information exchange and AML, although FATCA is now also cited. Expectations remain that this more complex operating environment will prompt consolidation in the offshore service providers’ community.

OIL will continue to track these trends over the coming year as a means of opening up the debate on where the industry could – and should – be headed.
OIL’s first White Paper, “Offshore 2020”: An Asian Perspective, which was published in December 2010, was based on interviews with 47 offshore industry participants who conduct business in Asia. Interviewees were based in locations including Hong Kong, Singapore, Taiwan, China, the Cayman Islands, the British Virgin Islands, Anguilla and Labuan.

The following year’s offering had a wider geographical remit and larger sample size (92). More interviews were conducted and the likes of Switzerland, Jersey, Cyprus and Ireland added to the existing complement of jurisdictions covered.

The 2012 survey saw similar levels of geographical participation but there was a significant rise in the sample size, with 155 interviews. In 2013 this trend continued, with 228 interviews conducted. Asia, as the key driver of industry growth, remains the focal point of this report (Figure 20). This is reflected in the nature of the respondents, 61% of who are located in the region, with Hong Kong and Singapore accounting for 94 between them (Figure 21).

**Figure 20. Sample size by year**

<table>
<thead>
<tr>
<th>Year</th>
<th>Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>47</td>
</tr>
<tr>
<td>2011</td>
<td>92</td>
</tr>
<tr>
<td>2012</td>
<td>155</td>
</tr>
<tr>
<td>2013</td>
<td>228</td>
</tr>
</tbody>
</table>

**Figure 21. Sample size by country**

*a. Asia*

<table>
<thead>
<tr>
<th>Country</th>
<th>Interviews</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>73</td>
</tr>
<tr>
<td>Singapore</td>
<td>21</td>
</tr>
<tr>
<td>China</td>
<td>19</td>
</tr>
<tr>
<td>Taiwan</td>
<td>15</td>
</tr>
<tr>
<td>Mauritius</td>
<td>3</td>
</tr>
<tr>
<td>South Korea</td>
<td>2</td>
</tr>
<tr>
<td>Japan</td>
<td>2</td>
</tr>
<tr>
<td>Thailand</td>
<td>1</td>
</tr>
<tr>
<td>Labuan</td>
<td>1</td>
</tr>
<tr>
<td>India</td>
<td>1</td>
</tr>
</tbody>
</table>

*b. Ex-Asia*

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Interviews</th>
</tr>
</thead>
<tbody>
<tr>
<td>The BVI</td>
<td>9</td>
</tr>
<tr>
<td>The UK</td>
<td></td>
</tr>
<tr>
<td>Ireland (Republic)</td>
<td>8</td>
</tr>
<tr>
<td>Cyprus</td>
<td>6</td>
</tr>
<tr>
<td>Malta</td>
<td>5</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>5</td>
</tr>
<tr>
<td>The Cayman Islands</td>
<td>5</td>
</tr>
<tr>
<td>Australia</td>
<td>4</td>
</tr>
<tr>
<td>UAE</td>
<td>3</td>
</tr>
<tr>
<td>The US</td>
<td>3</td>
</tr>
<tr>
<td>Samoa</td>
<td>3</td>
</tr>
<tr>
<td>Switzerland</td>
<td>2</td>
</tr>
<tr>
<td>Jersey</td>
<td>2</td>
</tr>
<tr>
<td>Isle of Man</td>
<td>2</td>
</tr>
<tr>
<td>Guernsey</td>
<td>2</td>
</tr>
<tr>
<td>Others*</td>
<td>8</td>
</tr>
</tbody>
</table>

*Others include Anguilla, Belgium, Belize, France, Monaco, Netherlands, New Zealand, and Seychelles.

Source: OIL
Interviewees represented the following job roles:

- CEO/ Managing Director/ President
- Partner
- Director
- Head of department
- Lawyer/ Attorney
- General Manager/ Manager
- Vice President
- Founder
- Associate
- Company secretary

*Others include Anguilla, Belgium, Belize, France, Monaco, Netherlands, New Zealand, and Seychelles

Source: OIL
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