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STRUCTURING TRENDS IN GUERNSEY FOR MIDDLE EASTERN CLIENTS

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Last year was another busy one for Guernsey, with fiduciary work derived from the Middle East reaching an all-time peak. In this article, Angela Calnan, Group Partner at international law firm of [Collas Crill](#), reflects on trends in the structuring of financial deals in Guernsey and their future implications for people who work in the trust and foundations sector. Angela, who manages Collas Crill's Middle Eastern Practice, lived and worked in the region for several years before relocating to Guernsey.

Different instructing partners

The first major change to note is in the new direction from which our instructions are coming. Approximately 80% of our Middle Eastern instructions for trusts and foundations used to come from trustees. Approximately 5% came from private bankers/accountants and 15% from the Middle Eastern families directly or from their gatekeepers/family offices.

Over the last 12-18 months, however, we have seen a very definite shift towards direct instructions from the families. Now, approximately 30% of our private client work in the Middle East and North Africa (MENA) comes directly from them and, of the remaining 70%, approximately 60% comes from trustees and 10% from financial intermediaries.

Why is this happening? I believe that the shift is due to three main factors.

- **Word of mouth.** During the last five-10 years, Western private client lawyers, wealth planners and intermediaries have lavished a great deal of their energy on emerging markets such as the United Arab Emirates, Russia and Africa by travelling or relocating to those markets and also by having valuable, in-depth conversations with families about estate planning. It can take five, 10 or even 20 meetings with MENA families to earn enough trust to move ahead with the structuring. We have reached a stage now where our original clients have shared their experiences and ideas with their peers and those new families are now coming to us directly.
- **Guernsey Finance.** This staunch promoter of Guernsey's financial sector abroad has invested significantly in visits to emerging markets such as the Middle East over the last five years. This has been very reassuring for our clients and prospects. These days, I very rarely need to get the map out and show the families where Guernsey is and I can spend my time instead talking about structures rather than trying to persuade the clients that Guernsey is a credible, reputable international financial centre.
- **Transmission to Generation Two.** Rather than trying to persuade an octogenarian patriarch/matriarch that estate planning is a good idea, I am now often dealing with "Generation 2" directly. These are the offspring of the people who set up the original trusts/structures and they are familiar with the way they work. Instead of being strangers to estate planning, they have already taken part in it.

Historically, we have often dealt with elderly Middle Easterners who come from a culture where it is shameful to appear to be ignorant about things. Such is their aversion to this that when we talk to them about a complicated structure or financial arrangement, they pretend to understand us even if they do not. They then sometimes murmur their approval for our plans but, having failed to understand them, they escape and stay away for fear of asking for further details (or the same details all over again) and thereby losing face. If and when they do come back, it often takes us 10-15 meetings to explain our recommendations to them and lead them to the point at which they understand them. This was very common ten or 15 years ago, although it is less so now.

The next generation, "Generation 2," are very different. They are usually Western-educated people for whom there is no humiliation in asking questions over and over again if needs be. Their education has trained them to

be rational and inquisitive about problems and if they fail to understand an explanation, they will ask to hear it again. Some times their parents are still alive, sometimes not.

The control structure of choice

Clients from the Middle East still often have “retaining control” as their primary aim, especially when the primary asset is a family business. In the past, our clients opted for “reserved power trusts” (whose settlors can retain powers in respect of them, or can employ others to hold them, without affecting the validity of their structures) or trusts with protectors or a protector committee/family council in order to achieve a comfortable level of control.

Over the last five years, however, our MENA clients have moved away from these simple structures, now preferring to exercise control at the trustee level through a Private Trust Company (PTC).

A PTC is a Guernsey company set up by the family in question with our help. It is essentially the client’s own trust company. Its board is often identical to the board of the client’s underlying operating business. We usually suggest that a Guernsey licensed fiduciary should occupy a “minority seat” on the PTC’s board in order to ensure good information flow for compliance purposes.

Nowadays, instead of employing its favourite trustee/relationship manager (who himself is the employee of a major trustee company) as trustee, a family is more likely to set up its own mini-version of that large company with a relative on the board. The trouble with this arrangement is that the client’s own trust company must legally have an external shareholder, whereas a foundation need not. A PTC, in other words, needs a “third-party” shareholder and this is a problem because in this arrangement a stranger has to sit at the top of the company rather than the client.

Forward the foundation

With a PTC, therefore, the family in question is not in the driving seat with its own people at the top of its structure. This problem was laid to rest four years ago in Guernsey when the Foundation Law came in. By using a foundation as a PTF, a family does not need an external shareholder. The entrepreneur can therefore remain at the top of the structure, in the driving seat. There are also administrative costs to be saved when one does away with the purpose-trust level of a PTC. The PTF is now a widely accepted structure in Guernsey and is proving very popular with our Middle Eastern and North African clients. Foundations are on the rise in general.

The PTC usually acts as a trustee for several family trusts, with each one benefiting a particular branch of the family or holding a particular asset class. We usually have a separate trust for the family business in order to protect the rest of the family’s wealth from business creditors.

Whom to trust?

When clients are setting up new structures or changing trustees, they often ask us to recommend new trustees. Over the last year, their conversations with us about this have taken on another dimension. Clients used to look at large trust companies and think that they were bound to be good because they had large offices. The problem with such companies is that they have a high turnover of staff, not to mention the fact that their structures are often disrupted by amalgamations and takeovers. The workforce is also more mobile than it was 15 years ago. For all these reasons, size is no longer the selling-point it once was for a large trustee company.

Whereas a client might once have thought that Mr X was a relationship manager in whom he could have faith, he is now likely to see Mr X moving to a totally different firm, or even setting up his own boutique firm. He might then employ Mr X’s new company instead of the large firm. He might even go farther in his search for a reliable relationship by employing a family business whose staff are related to one another and are never going to leave.

He might, alternatively, employ a big bank that is very conservative in terms of the assets it is prepared to handle. There are two types of company in the offshore world – a ‘holdco,’ used in planning structures, which is merely a basket that holds shares, such as a company set up to sit between a trust and a piece of London real estate; and, alternatively, a true business, i.e. an ‘operating company’ such as Volkswagen. Some big, conservative banks prefer bankable assets to these operating companies and many clients find that comforting. They also eschew ‘risky’ investments beloved of Middle Eastern and North African families such as aeroplanes, boats or flashy cars (or ‘toys’ as they are known in the trade) and artwork. Such products are especially risky because in many cases the end family will regard those assets as theirs even though they are actually owned by the trustee. Members of the family will have the keys to them and use them freely without recourse to him. When there is an accident, it will be his name on the insurance policy and not theirs. An accident will also represent a loss to the trust fund for which the trustee is liable.

Why the shift?

Middle Eastern and North African clients do not tend to be as bothered by fees as our other clients and are willing to pay for the traditional “trustee for life/relationship manager” model. Because of this, the boutiques are doing

very well. Most of the small trust companies (which call themselves 'independent' because banks do not own them) on both Jersey and Guernsey have disappeared in the last 15 years or so, and especially in the last couple of years, by merging with each other or being acquired.

Solid foundations

It is too easy and naive to say that Middle Eastern and North African clients do not understand trusts. Many of the families that we look after have had trusts for decades. That said, Middle Eastern and North African families who are new to estate planning do like the corporate feel of foundations. Our Foundations Law in Guernsey was a little slow to gain traction but we have seen a real uptick in the use of foundations in the last two years, both as private trustee vehicles and in philanthropic structures. This is because HM Revenue & Customs was rather inconsistent in the way it taxed foundations in the early days. The problem ended with the advent of the British Government's Liechtenstein Disclosure Facility, after which time we could predict the tax that any given foundation would have to pay. In the Middle East, the word 'foundation' has long been synonymous with philanthropy, charity and zakat (the compulsory giving of a set proportion of a good Muslim's wealth to charity). Middle Eastern and North African clients like to leave "public legacies" to history, sometimes giving their names to charitable foundations for the welfare of children or some other worthy cause.

Pensions

Another interesting trend concerns pensions and benefits for employees based in the Middle East. In Dubai, employees of businesses are not entitled to pensions; instead, they receive generous severance pay when they leave their jobs. In 2008-9 we had a lot of property development companies in Dubai that wanted to fire staff in large numbers because they could not afford to keep them. They had a problem, however: they also could not afford the mountain of end-of-service maturity payments (regulated by government statute) that they would have to make. Many of them then began to debate openly about whether to put money aside every month to defray severance costs in the event of a future crash. This very high-profile debate raged for a while but dissipated when the world's economy improved. Many companies failed to pay enough into their severance funds during this upturn. Now, however, the property market is once again in trouble and the debate has re-ignited.

I recently drafted a scheme for a MENA airline that is administered in Guernsey. That scheme, as well as providing for end-of-service gratuity payments, also doubled as an employee savings scheme used to both manage the employer's liability and also to attract and retain talent. In the last year, we have seen Dubai-based companies (and, to a lesser extent, companies from elsewhere) start to establish new schemes again. The advantages of having these schemes in an offshore location include expert administrators, modern legislation and 'firewall provisions.' These provisions are vital because they immunise structures from the Islamic/Sharia law that dominates jurisdictions all over the Middle East. If a man in Dubai wants to use Dubai law to change a structure located in Guernsey, he cannot because there is a 'force field' around it. Guernsey's legislation says that only Guernsey law can apply to a trust.

The influence of the UK

Finally, I would like to devote a quick word to the way in which the UK has influenced our work for Middle Eastern families recently.

- The weak pound has generated significant interest in real estate in the UK – particularly from Saudi Arabia, Kuwait and Lebanon and particularly for commercial real estate.
- The way in which the relevant acquisitions are structured is changing and we are also seeing existing UK residential property holding structures being unwound due to the changes in the UK's tax landscape.
- Even though Guernsey is already outside the European Union, the 'Brexit' vote in the UK has had an effect on our work and on the structures that are being set up and unwound.
- We expect to see a rush to 'de-envelope' between now and 5 April 2017. If you have a residential property in the UK, it is often owned by a company (perhaps in Guernsey or the British Virgin Islands) that is, in turn, owned by a trust. If one thinks of the company as the 'envelope' into which the house is put, one can imagine it as something that the trustee keeps on the shelf in his office. The tax structure that surrounds such arrangements in the UK is changing - indeed, tax benefits are giving way to tax penalties - and we are therefore frantically trying to help trustees take assets such as houses out of their 'envelopes.'
- We also expect to see the establishment of protected trusts for those UK-resident Middle Eastern and North African clients who are approaching the status of 'deemed domicile' under the '15/20' rule (once they have remained in the UK for 15 out of a total of 20 years, they are 'deemed domicile'). There is always the risk that clients can contaminate those protected trusts – perhaps by inadvertently adding money to them, thereby

breaking trust rules and losing tax benefits. We often deal with this problem by setting up many trusts for each client so that if he contaminates one, the consequences will not be as serious because others exist. A lot of trusts used to exist for British HNW families but the tax advantages have evaporated, so now Middle Eastern and North African families predominate in this market.

Are trusts dead?

I am often asked – usually around the time of the Budget – whether trusts are ‘dead’. It is certainly true that a lot of the tax-driven structuring has fallen away but, for clients from no-tax or low-tax jurisdictions in the Middle East who have exposure to forced heirship rules and who have genuine estate planning needs, trusts and foundations are still hugely relevant, effective and popular.

We have also seen a ‘flight to quality’ in Guernsey since the publication of the Panama Papers.

A lot of people have been launching foundation structures and pension structures in the last 12-18 months with gusto, where previously they had shown some trepidation.

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