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TRUSTS • by Caitlin Randall

Moves to tame the tiger

Offshore trusts are surging but legislators are waking up to the risks

The day Interpol burst into one private banker's office, charging he was fronting a brothel, taught him an important lesson about trust funds.

"You're getting a tiger by the tail with trusts. Because you legally own the assets, the risk for the trustee is incalculable," he said, recalling that day in the Bahamas when one offshore account went sour.

Despite such risks, the offshore trust business is surging ahead. The strong US and UK economies; instability in the Middle East, and the increased sophistication of personal investors have all contributed to the surge.

A growing number of very liquid international high fliers are also putting their money in offshore trusts. But legislators have recognised the risks: the US and Canada have moved to regulate offshore trusts, and European Union governments are keeping a sharp eye on developments.

In recent years, several old names in private banking have merged with bigger brethren – Cater Allen with Abbey National, Adam & Co with Royal Bank of Scotland and Morgan Grenfell with Deutsche Bank, among others.

Bankers say this once staid and traditional business is changing fast. New entrants are trying to cash in on what they view as a lucrative income stream while old hands are scrambling to attract an increasingly international client base.

"It's become a very competitive business," said David Way, a partner with Morgan, Lewis & Bockius who specialises in creating offshore trust accounts.

"Big participants such as Coutts, RBS and Credit Suisse are putting huge resources into the offshore trust business. At the same time a growing number of small companies are setting up operations," he said.

In the closed world of trusts, financial information is scarce and even banking regulators in offshore centres are unable to put a figure on the number of new offshore trusts established this year, or even the number of new trust services.

But as a sign of buoyant times, Coutts & Co, the leading name in UK private bankings, says its trust business in the Channel Islands and Isle of Man jumped 50 per cent in the year to October 1997, with foreign nationals accounting for the lion's share of new accounts.

Outside these areas, Coutts's trust business increased only 5 per cent over the same period, but this followed a 33 per cent jump the previous year. Other banks also report hefty increases in offshore trust business. But none will divulge their total trust holdings.

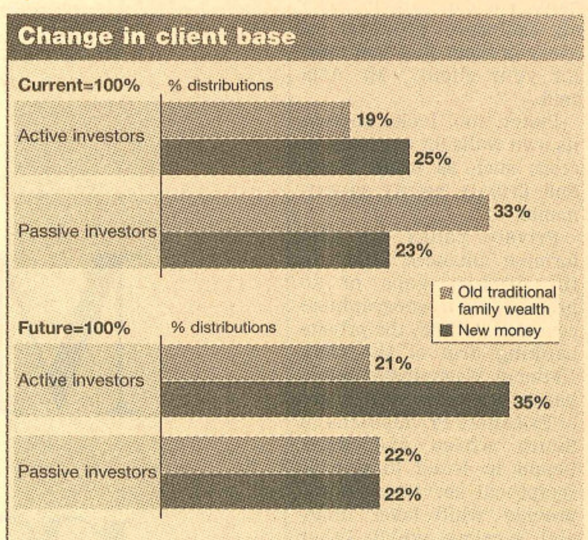
"There's an increasing interest in trust services generally, with the business seen growing between 10-20 per cent a year over the next five years," added David Sykes, executive director of private banking at London-based EFG Private Bank.

In October 1996, EFG acquired Reeds Trust, an independent Jersey trust service. Mr Sykes says the number of independent trust services in the Channel Islands is declining as new operators seek to gain a foothold.

The 1984 Trusts (Jersey) Law says newcomers to the island must be, or be in partnership with, "institutions . . . .of an established reputation and track record." But Jersey has many one-man operations profiting from fixed fees, priced to undercut larger participants.

"The big players market themselves as safe," said Roger Leonard, one of two partners in the newly formed Premier Asset Management of Jersey. "But the bigger firms sell a fairly standardised package...the complete freedom of choice for the individual is getting squeezed." Premier claims to offer a more personalised service to clients.

But the risks for trustees, particularly small ones, are considerable, bankers say.



Source: Price Waterhouse, European Private Banking Survey 1996/97

For Martin McLellan, a partner with Coutts & Co: "These Johnny-come-latelys have yet to be in a position where the full rigour of the law has spotlighted one of their trust accounts. They simply don't appreciate the risks involved."

"This is not easy money," said tax solicitor Mr Way, citing a myriad of potential problems. These include creditors seeking redress; disaffected beneficiaries demanding a slice of the trust; tax troubles; and intervention from foreign governments when they suspect money laundering or other illicit activities.

Bigger operators, meanwhile, are seeking to increase their share of the business by attracting a new breed of client. The Royal Bank of Scotland is targeting potential high net worth clients in Spain, the Middle East and South Africa as never before, says Simon Hayward, a private banking manager at RBS in Jersey.

"In the early days the offshore industry was geared to UK business. That has shifted totally," added Barry Mildon, managing director of Adam & Co in Guernsey, where 70 per cent of cash deposits are non-sterling.

New money, particularly funds set up from "new-rich" individuals, is stirring the offshore trust pot. At least one client recently set up an individual trust valued at more than $1bn. Such activities brought calls for offshore trusts to be monitored: some authorities claim they are legal tax evasion.

In August 1996, the US tightened its laws governing American citizens' setting up foreign trust accounts. They are now required to notify US tax authorities of a new account within 90 days. Canada followed with similar rules. Few expect Britain to imitate the US and Canada, but stricter scrutiny of trust funds is likely as EU regulators share information on financial markets.