1.1 The Hague Convention on the Law Applicable to Trusts and on their recognition

The Hague Trust Convention is a multilateral treaty developed by the Hague Conference on Private International Law on the Law Applicable to Trusts which came into force on 1 January 1992, and as of March 2011 was ratified by 12 countries. The Convention aims to harmonise not only the municipal law definitions of a trust, but also the conflict rules for resolving problems in the choice of the *lex causae* (the law applicable to the problem/dispute). The key provisions of the Convention are:

- Each signatory recognises the existence and validity of trusts. However, the Convention only relates to trusts with a written trust instrument. It would not apply trusts which arise (usually in common law jurisdictions) without a written trust instrument.
- The Convention sets out the characteristics of a trust (even jurisdictions with considerable legal history relating to trusts find this difficult).
- The Convention sets out clear rules for determining the governing law of trusts with a cross border element.

Trust laws dispel the legal uncertainty and are needed to enhance trusts as potential vehicles for the holding and management of assets and to facilitate the administration of existing trusts. The majority of offshore jurisdictions that offer fiduciary (trust) business will have established such a law.

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2. Trust law

There are various laws governing trusts in England. Relevant statute law includes but is not limited to the Trustee Act 2000 (TA2000) and the Trustee Act 1925 (TA1925). The provisions of the TA2000 are referred to throughout this book.

In addition to the statute law, law has also developed as a result of **judicial precedent** (earlier court decisions) which means that some trust law is found in case law. It can therefore be difficult to easily access all of the relevant rules of law and trust law considerations. Over time, the more established principles have become well known to offshore trust practitioners.

judicial precedent
A ruling by a judge in a civil law case.

2.1 Offshore trust law

Trust law in the majority of offshore jurisdictions have developed by following UK trust law and are slowly adapting and applying their own laws in recognition of the TA2000.

However, as offshore jurisdictions introduce different and diverse products into the trust marketplace, they must also ensure that their trust laws also develop accordingly.

Good offshore practitioners will seek to keep up to date with developments to the laws in both the UK and in other offshore centers. The relevance of the outcome of UK cases to some offshore practitioners is that the statutory provisions in

offshore jurisdictions are often modelled on English Acts of Parliament and where this is the case, English cases are frequently referenced by courts.

Since the introduction of trust laws in offshore jurisdictions, where there is an absence of specific express powers in the trust deed, there are now statutory powers that trustees can rely on.

Statutory powers usually include the power for trustees to:

- rely on the powers as a beneficial owner of the trust assets;
- sue and be sued as trustee;
- consult professional persons in relation to the administration and affairs of the trust assets;
- delegate the management of the trust assets;
- appoint professional persons in relation to the administration and affairs of the trust assets; and
- appoint investment managers whom the trustee reasonably consider being competent and qualified to manage the investment of the trust assets.

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Before the introduction of specific trust laws in offshore jurisdictions, there were no regulations in respect of the powers and duties of trustees relating to the investment of trust assets. Trustees only had the necessary power to invest the trust assets in those investments actually specified in the trust deed.

However, the majority of offshore jurisdictions have subsequently encouraged and introduced the basic statutory duty that trustees should preserve and enhance the value of the trust assets.

The TA2000 states that a trustee may make any kind of investment as long as certain standard investment criteria are followed.

As well as providing additional powers of investment for trustees in trust law, some jurisdictions have also adopted prudent investment rules, which can include that the trustee should:

- look at the objectives of the trust and construct a portfolio specifically incorporating risks as well as return objectives;
- diversify the assets of the trust, unless there is a prudent reason not to do so;
- take into account inflation, so as to preserve the real value of the assets of the trust and income payments;
- maintain and enhance the real value of trust assets;
- pursue real growth in the trust assets; and
- balance the needs of the income and capital beneficiaries if different individuals.

However, it is the duty of the trustee to take reasonable care and where the trustee is a professional and/or licensed trustee, the standard of care imposed will be higher than, say, that required or demanded from a non-professional and non-licensed trustee.

2.2 The proper law of a trust

The rules governing the administration of a trust are largely determined by its 'proper law'.

The proper law of the trust is the law that governs the administration of the trust assets.

It is the law that would be used to determine the answers to questions relating to the validity or interpretation of a trust and other important matters such as the duties and powers of the trustee.

The proper law is normally stated in the trust deed.

Test yourself 1.1

What are the risks for a Cayman Islands based trustee company if it is appointed as trustee of a trust, the proper law of which is stated to be the laws of the Isle of Man?

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In addition to the proper law of a trust, other legislation may apply as the trust legislation of some offshore jurisdictions provides that their courts have jurisdiction in circumstances where:

- the proper law of the trust is that of the offshore jurisdiction;
- the trustee of a foreign trust is resident in that offshore jurisdiction;
- any **trust property** of a foreign trust is situated in that offshore jurisdiction; or
- the administration of any trust property of a foreign trust is carried on in that offshore jurisdiction.

trust property
Any assets submitted to be held in trust.

Making it work 1.1

In the matter of the M Trust and Other Trusts

This case from 2011 is a good example of a court choosing to exercise or use what is referred to as its inherent jurisdiction. The Royal Court of Jersey (JRC) gave directions to the trustee of the M, R, T and O Trusts. This action of the JRC was despite the fact the four trusts were governed by the law of the British Virgin Islands.

In each case the trustee was a Jersey company resident in Jersey and the administration was carried out in Jersey. The JRC had decided it had jurisdiction to hear the matter under article 5(b) and (d) of the Trusts (Jersey) Law 1984. These articles stated that the court has jurisdiction where a trustee of a foreign trust is resident in Jersey and where the administration of any trust property of a foreign trust is carried on in Jersey.

If you think back to Test yourself 1.1, the Cayman Island based trustee would need to have been expert in the laws of the Isle of Man and indeed of any jurisdiction where a court case concerning the trust might be heard.

3. Trust creation

A trust can usually be created by one of four separate and distinct methods. The favoured or usual method is by an express trust whereby the settlor transfers legal assets to a trustee for the benefit of named beneficiaries. A trust deed will be completed by the settlor and the trustee setting out the terms of the trust.

Although it could be said that a trust could be formed by an oral statement and that a trust deed is not necessary to constitute a trust, it is normal practice, especially in offshore jurisdictions, to ensure that one is in place.

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3.1 Classification of trusts

Trusts may be classified by the way in which they are created and/or constituted. It is widely acknowledged that there are four modes of creation:

- Express trusts;
- Implied trusts;
- Resulting trusts – presumed; and
- Resulting trusts – automatic (constructive trusts).

Express trusts

inter-vivos
Latin term, literally translated as 'between the living'.

A trust that is created intentionally by the settlor during their lifetime (***inter-vivos***) or a trust that comes into existence upon the death of the settlor as result of their will may be referred to as an express trust.

The majority of trusts in offshore jurisdictions are express trusts created when a deed of settlement made between the settlor and the trustee is executed or when the settlor transfers assets to the trustee who then executes a Declaration of Trust.

Another way of explanation is that an express trust has been constituted when all the **three certainties** are in place, when all the trust documentation has been completed by all the necessary parties and the trustee has received the initial assets of the trust.

three certainties
The three conditions that are usually required in order to create a legally valid trust: certainty of intent, certainty of object and certainty of subject.

Implied trusts

An implied trust is a trust that arises from the un-expressed and presumed intentions, or is enforced by a court as a result of surrounding circumstances. For example, if an individual purchases an asset in the name of another individual, there is a presumed intention that the purchaser holds that asset in trust for the other.

There are two categories of implied trusts to consider.

Resulting trusts – presumed

A resulting trust is the creation of an implied trust by operation of law, as where property gets transferred to one who pays nothing for it, and then is implied to have held the property for benefit of another person, the trust property is said to 'result' back to the transferor (implied settlor).

If the trust that was intended fails, for example, or a trust fails for a lack of objects (**beneficiary**), a resulting trust occurs as the trustee finds themselves holding the trust assets upon trust for the settlor as a result of the failure.

beneficiary
The entity which enjoys the benefits of ownership of an asset held by a trustee.

This is implied by law to sort out all of the presumed intentions involved. This does not take into consideration the expressed intent. It is a matter that is dealt with legally, weighing up all of the evidence.

Presumed resulting trusts are based upon intention, being that the parties have implied intention. They have a general intention, but have not yet properly formalised the situation.

For example, when all the parties have contributed to the purchase price of a house there would be an implied understanding that all parties have a share in the equitable interest in the house.

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Resulting trusts – automatic (constructive trusts)

The final category, also known as constructive trusts arise by operation of law and are based on actions irrespective of any intention of the parties for the purpose of being fair to each party. This trust does not consider the intentions involved, only that justice is worked into the situation or outcome.

For example, if one party transfers assets to another for a specific purpose, then this will create a trust relationship between them.

The person receiving the assets (the trustee) will be obligated to carry out this specific purpose. As shown in *Barclays Bank Ltd v Quistclose Investments Ltd* (1970) it was decided that there could be an express trust to carry out a purpose.

This could result in the beneficial ownership of the assets remaining with the settlor, with the trustee holding the legal title upon a resulting trust (see Section 3.1 above).

A settlor can usually transfer some of their legal assets to the trustee by the following methods:

- **Property (land)** – The conveyance of the property by transferring title of the land into the name of the trustee, in accordance with the law of the jurisdiction in which the property is situated.
- **Stocks and shares** – The completion of a stock transfer form and delivery of the actual share certificates, if any, to the registrar of those companies to arrange for them to be registered into the name of the trustee.
- **Chattels (moveable possession – i.e. works of art)** – Physical delivery of the asset to the trustee may be all that is needed to confer title and act as proof of title that the item is now part of trust assets.
- **Debts** – The settlor would assign the debt into the name of the trustee.

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Incomplete constituted trusts

If the settlor fails to transfer the intended assets to the trustee, they cannot be compelled to do so by the intended trustee and/or the intended beneficiaries.

There are a number of cases, which confirm and support this approach. These include:

- *Milroy v Lord* (1862)
- *Jones v Lock* (1865)
- *Paul v Paul* (1882)

Like all types of trusts the main disadvantage is, although it is clear that an intention to create a trust is proven, the trust may still be void if the assets are not transferred from the control of the settlor to that of the trustee.

This situation will be regarded by equity as an imperfect gift and the trustee as the volunteer cannot compel the settlor to perfect the gift. Recourse to equity will also not be favourable due to its maxim that states that equity will not perfect an imperfect gift.

A possible solution, to enable volunteer beneficiaries to sue a settlor, is when a promise is made by a purported settlor to potential beneficiaries. The decision in *Fletcher v Fletcher* (1844) stated that there was a **completely constituted** trust not in respect of the proposed assets, but because of the promise, and the beneficiaries were able to enforce the trust.

completely constituted
For a trust to be completely constituted it must have completed all matters. Usually the three certainties will be in place including transferring the legal assets into the name of the trustee and completing all trust documentation.

An alternative solution has also come about because of the decision of *Tinsley v Milligan* (1994) whereby equity could now follow the rule at common law. This would allow beneficiaries, who brought their claim to equity, to enforce the promise of a purported settlor who failed to transfer some of their assets to the trustee.

Certainty of words or intention is evidenced as seen in *Re Adams and the Kensington Vestry* (1884) case, where it is unlikely that precatory words are sufficient to establish this intention. The words used to create a trust must make it plain that a trust is intended.

Case law 1.2

***Re Adams and the Kensington Vestry* (1884)**

The estate of the testator was left to his widow for her absolute use. The words used in his will included the phrase 'in full confidence that she will do what is right as to the disposal thereof between my children, either in her lifetime or by will after her decease'.

It was held that these were merely words of aspiration (as they were merely his wish) and did not impose a legal obligation on his widow.

She was therefore granted an absolute interest in the assets. Although this case was decided on many years ago, it continues to be considered the source of the modern view that there must be clear intention in the words that a trust is to be constituted.

However, as in *Re Kayford* (1975), although there may be no written documentation, it could be argued that the word trust is sufficient to confirm that a trust was intended.

Finally, a trust will not be formed if it is clear that some other intention was there, such as the intention to make a pure gift, as in *Jones v Lock*.

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Certainty of object

This establishes who could benefit from the assets of the trusts, in other words, the beneficiaries of the trust.

In *Re Endacott* (1960) the certainty of objects (the beneficiaries of the trust), under a trust should be clearly defined by class or by name.

Within express trusts this is a particularly complex area, because the test used to determine certainty varies between fixed trusts, mere powers and discretionary trusts.

Fixed trusts are trusts that are constituted for a specific and identifiable person or class of beneficiaries for example: '£10,000 to be held upon trust equally for the complete team of 11 Sunderland Football Club players who started the 1992 Cup Final at Wembley'.

The test for fixed trusts is that the trustees must be able to give a complete list of the beneficiaries, as laid down in *IRC v Broadway Cottages*. If there are any potential beneficiaries of whom the trustees are not certain, or the trustees cannot compile a complete list, the trust is void for uncertainty.

Very often the 'objects' (beneficiaries) of the trust, despite having been established with certainty, are not obvious from the trust deed. The fact that it is

the life of the trust, the Cy-pres doctrine (as near as) may apply and the court will choose the charity purpose and the gift may thus be applied to a charitable purpose similar to the one specified in the trust deed or will.

Cy-pres doctrine
If a charitable purpose does not exist or has never existed, the courts can make an order that the trust assets can be applied to a similar charitable purpose(s).

Certainty of subject – Certainty of subject relates to the assets of the trust. The assets of the trust must have value and they must be identifiable. They must be described in such a way that it becomes certain and ascertainable. This reasoning, although appearing straightforward, can bring its own difficulties even if a trustee can perform its duties when knowing exactly what those assets are.

The language used by a settlor may be too vague or uncertainty might arise from the settlor's failure to segregate the trust assets from their own.

There are a number of cases which confirm and support this approach.

In *Palmer v Simmond* (1854) the trust failed because the settlor declared a trust for the bulk of his Estate and the trustee was unable to determine what assets this related to.

In *Boyce v Boyce* (1849) the trust failed because of uncertainty as to the beneficial interest of the houses left on trust for his wife.

The settlor must identify the assets which they intend to be the subject matter of the trust. The assets can include but are not limited to; cash, stocks and shares, property or land, chattels, planes, boats and cars.

If the settlor has expressed an interest in clear terms in writing (either in a will or trust deed) and has satisfied the other requirements for its formation (all the three certainties are in place) an express trust is created.

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3.4 Void and voidable trusts

A trust will usually be void if any of the three certainties are missing:

- words or intentions
- subject matter
- objects.

It would also be void if the perpetuity period was exceeded. This can be overcome by changing the date of distribution of the final assets on the trust deed or start all over again by executing a new trust deed.

A void trust is a trust that is not legally valid and therefore unenforceable. A trust will usually be void if:

- it was set up contrary to the proper law of that jurisdiction;
- it was established under duress or undue influence;
- the terms were uncertain;
- it is immoral or contrary to the public good;
- it was set up for fraudulent purposes; or
- the assets transferred into the trust were derived from illegal sources.

- centralising ownership of worldwide assets;
- protecting assets held against the imposition of exchange controls;
- holding shares for employees (ESOPS); and
- providing asset protection.

4.3 Other reasons

This may be linked to a business or other needs, and a trust arrangement can also be used to administer the trust assets when the settlor is:

- seeking the protection of a stable political and social environment for the ownership and management of assets;
- seeking safe hands in a safe jurisdiction when emigrating or temporarily working abroad;
- for philanthropic or charitable foundations;
- to provide flexibility regarding future needs or contingencies;
- to facilitate indirect stock market investment by the public through unit trusts; and
- to hold funds for charitable purposes, or for pensions, or for historic buildings.

4.4 Advantages of setting up a trust in an offshore jurisdiction

Offshore jurisdictions have an established and highly reputable and experienced range of trustee **services providers** (TSPs) who can create bespoke trust **structures**.

Reputable offshore jurisdictions have implemented robust trust and regulatory laws and processes which are updated on a regular basis to uphold their own high standards. They have also enhanced their standing by the completion of co-operation agreements, with other offshore jurisdictions.

In addition, supporting the TSPs is an established infrastructure including banking expertise, accounting and legal services. This enables them to also offer a variety of financial services, a high level of expertise which means that all of the settlor's financial needs can be addressed from within a single offshore jurisdiction. Such services include, but are not limited to, trust and company administration services, funds administration services, banking services, investment business, captive insurance companies, employee benefits and ship registration and management services.

It is likely that the offshore jurisdiction will have a favourable tax regime for non-residents and do not usually have exchange control regulations in place that restrict the movement of funds in and out of the jurisdiction.

service provider
Organisations or individuals that provide financial services business offshore may simply be referred to as service providers.

structures
Collectively, all of the entities that are aimed at meeting the needs of a particular client or group of clients and that are connected by virtue of their ownership or their assets.

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This concept of separate legal entity was fully examined by the English court in the well-known case of *Salomon v Salomon & Co Ltd* (1897), see below for details of the case.

Case law 3.1

***Salomon v Salomon & Co Ltd* (1897)**

Mr Salomon ran a business as a sole trader and decided to incorporate a limited liability company and sell his business to the company. Instead of paying Mr Salomon in cash for the business, the company paid by issuing a debenture (an instrument acknowledging the debt). The debenture was secured by a floating charge over the company's assets, meaning that if the company did not honour its debt, Mr Salomon could recover the money owed to him from the sale of the company's assets. Salomon was appointed as a director to the company and continued to run the business.

The company eventually could not pay its debts and went into liquidation owing money to trade creditors and a debt to Mr Salomon due to the debenture.

As secured creditors take priority over non-secured creditors in the course of a winding up, Mr Salomon was entitled to be paid before the other creditors.

The business did not have sufficient assets to pay all of its creditors. The unsecured creditors argued that Salomon should not have priority over the company's assets as the business really 'belonged to Mr Salomon' and that in effect Mr Salomon and the company were the same.

The court held that the legal personality of a limited liability company is separate from that of its owners and directors. Salomon, as a secured creditor was therefore entitled to the assets of the company.

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The implications of separate legal personality on the parties to a company require that:

- The members of a company may change.
- Their participation in management decision making would be variable.
- Their liability for corporate debts is with the company.

The effects of separate legal personality can be considered as follows:

- The property (assets) belongs to the company and not to any particular shareholders.
- The right to pursue legal actions. It is the company that must sue to redress any wrongs done to it, not the individual shareholders or directors.

forms the cornerstone of company law. The authority in these cases are, so it would seem, unshakeable, and yet exceptionally in some instances the law is prepared to disregard or look behind the corporate personality.

Many of the statutory directions to 'lift the veil' have occurred in revenue cases, or in relation to the effects of the Trading with the Enemy Act 1939.

In *Re Darby, ex p Brougham* (1911) it was held that the corporate veil may be disregarded if the company is used as a means to perpetuate fraud.

In *Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd* (1916) it was held that the court may go behind the veil of incorporation in order to determine whether a company is to be characterised as an 'enemy' in time of war.

CA2006 does not provide for lifting the veil. Instead it focuses on making the directors and other officers liable for company wrongs, rather than allowing the 'veil' to be penetrated to make members liable.

The possible doctrine of lifting the veil however seems to have little potential going for it. The continuing trend is almost entirely towards reasserting the Salomon principle not only in the UK but also in Australia, Canada, New Zealand and South Africa.

1.3 Perpetual succession

In company law, perpetual succession is the continuance of a company's existence despite the death, insanity or bankruptcy of a director, member/shareholder, company secretary or of the beneficial owner. None of these events affect the continuity of the company, as the life of the company does not depend on the life of any of their officers.

The company will continue to exist and does not need to be liquidated even if a director, resigns or is removed from office; the company can continue as an alternative can be appointed or co-opted onto the board. Alternatively, if a member transfers their shareholding to another, as any change in membership of a company, it does not affect the status of the company.

1.4 Transferrable ownership

A shareholder of a company has shares in the company which entitles them to participate in the company. This could include rights to information, attendance and voting at meetings and receiving a dividend if one is being paid.

If there is a ready market for shares (for example where shares are listed on a recognised stock exchange) then a value can easily be attributed to the rights attached to shares in a company.

However, the vast majority of companies in the UK and offshore are private companies. Private companies commonly restrict the right of members to transfer shares. As a result, the right to sell their shares in a private company is not even a common feature of the rights that are attached to a share.

The most common provision are the articles of association giving the directors discretion to refuse to register any transfer. If the directors are given absolute

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- **Issued shares** – The amount or number of shares that the company has actually issued.

CA2006 has removed the requirement for a company to have an authorised share capital.

2.2 Called-up share capital

This is the portion of issued share capital obtained by a company in exchange for capital stock that has not been fully paid for by the shareholders and is called for full payment.

Section 547 of CA2006 states that 'called-up share capital', means so much of its share capital as equals the aggregate amount of the calls made on its shares (whether or not those calls have been paid), together with:

- any share capital paid up without being called; and
- any share capital to be paid on a specified future date under the articles, the terms of allotment of the relevant shares or any other arrangements for payment of those shares.

2.3 Paid-up share capital

This is the amount of a company's capital that has been funded by shareholders. Paid-up capital can be less than a company's total capital because a company may not issue all of the shares that it has been authorised to allot. Paid-up capital can also reflect how a company depends on equity financing.

Issued share capital and paid-up capital are the total amount of capital funded by a company's shareholders.

Authorised share capital versus paid-up capital

Before a public company can sell stock, it must specify a certain limit to the amount of share capital that it is authorised to raise. This limit is set forth in its constitutional documents and can only be changed with the approval of the shareholders. This is sometimes known as the authorised share capital.

A company does not usually issue the full amount of its authorised share capital. Instead, some will be held in reserve by the company for possible future use. The amount that is issued is called the paid-up capital.

Paid-up capital can never exceed authorised share capital. In other words, the authorised share capital represents the upward bound on possible paid-up capital. In terms of investing or immediate business finance decisions, paid-up capital is generally more important.

2.4 Par value companies

Par value is the minimum price per share that shares must be issued for in order to be fully paid.

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Administrators in many offshore jurisdictions are unlikely to administer large numbers of companies incorporated in England and are more likely to administer companies incorporated under the laws of their own jurisdiction or other offshore jurisdictions. In these jurisdictions, the memorandum is still an important part of a company's constitution and therefore, when considering the requirements from an offshore perspective, any references to the company's constitution in this book should be read to include the memorandum within the meaning.

3.1 Articles of association

Section 18 of CA2006 states that:

1. A company must have articles of association prescribing regulations for the company.
2. Unless it is a company to which model articles apply, it must register those articles.
3. Articles of association registered by a company must be contained in a single document, and must be divided into paragraphs numbered consecutively.

A company's articles of association are concerned with the internal regulation of the company and in the UK must be registered under the authority of an Act of Court in the Register of Companies.

If the company's articles are annexed to the instrument of incorporation, as is the usual practice, when the application is made to the court for permission to register the instrument of incorporation, the articles may be registered with the instrument of incorporation under the authority of the same Act of Court.

The Court/Registrar of Companies (or equivalent body) shall not authorise the registration of the company's articles unless there has been an application to the Court/Registrar made in the name of all the company's founder members and the articles are signed by the founder members with a statement of their names and addresses, the signatures being made in the presence of and attested by a witness, usually a solicitor, whose name and address shall also be stated.

It is only after this process has been completed that the company can be incorporated under its name and for the objects set out in the instrument of incorporation.

Key clauses in the articles

The articles may include the following topics:

- Issue and transfer of shares and any restrictions of share transfers.
- Alteration of share capital.
- Procedures at directors' meetings.
- Appointment of directors.
- Removal of directors.
- Number of directors.

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The division of powers between the members in general meetings and the board of directors is discretionary, and determined by the company's articles (subject, of course, to any mandatory provisions of CA2006).

3.3 Memorandum of association

This document sets out the basic constitution of the company, defines the characteristics of the company's personality, and is sometimes termed the external document of the company or the powers of the company.

A memorandum of association is now a short document (usually only a page).

Section 8 of CA2006 states that it is a memorandum that the subscribers wish to form a company under the Act, and agree to become members of the company, and, in the case of a company that is to have a share capital, to take at least one share each.

The memorandum for many companies formed prior to CA2006 in the UK and companies formed today in offshore jurisdictions is likely to contain the:

- **Name clause** – A private company, whether limited by shares or guarantee must end its name with the word Limited or Ltd.
- **Registered office clause** – The actual address is not usually listed (exceptions include a BVI company), because the company has not yet been incorporated. There will be a statement evidencing where the registered office is situated. This determines the domicile of the company and determines the law that applies to the company.
- **Objects clause** – Sets out the aims and purposes of the company. Nowadays the clause will usually state 'the objects and powers of the company are not restricted'.
- **Capital clause** – States the amount of the company's authorised share capital and its divisions into specific classes or shares. For example, the authorised share capital is £20,000, divided into 10,000 ordinary £1 shares and 10,000 £1 preference shares.
- **Limited liability clause** – Will state that shareholders are only liable for the amount of their unpaid shares.
- **The common signature of the company** – Will usually include the seal of the company or the authorised signatory list of the company, as changed from time to time.

The subscribers, each of whom should subscribe for at least one share, must sign the memorandum of association.

4. Registered office

A company must have a registered office which will be the address at which the company can be contacted by the Registrar or any other parties who need or want to correspond with a particular company. Section 86 of CA2006 and the

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A company may at any time change the situation of its registered office, however, depending upon the jurisdiction, the change may not be effective until notice, and where applicable, the appropriate fee has been paid to the Registrar (or equivalent body). This notice should be forwarded to the Registrar after an ordinary resolution has been passed at a directors' meeting of the company.

4.1 Information and documentation to be held at the registered office address

Statutory records of the company are usually required to be held at its registered office. Section 1136 of CA2006 states where certain company records are to be kept available for inspection. It therefore follows that there is a requirement that every company maintain the following company records, the:

- minute book of the proceedings of meetings of the directors and members of the company;
- register of members;
- register of secretaries;
- register of directors;
- register of charges;
- register of transfers; and
- accounting records.

If the registered office of the company is also the administrative office of the company, then the following items are also likely to be held at that address:

- the original certificate of incorporation;
- the original Constitution documentation;
- the company seal, if appropriate; and
- all the remaining records of the company.

4.2 Changing the registered office

As the constitutional documentation of most offshore private limited companies do not include the first registered office address of the company, it is usual for a directors' meeting to be held to change the registered office by the passing of an ordinary resolution, unless otherwise stated. There are exceptions to this rule, for example, the constitutional documentation of British Virgin Island (BVI) companies always includes the first registered office address and the name of the first registered agent of the company. In these cases it is usual that a general meeting is held to change the registered office address of a BVI company.

There is usually a requirement to inform the Registrar of Companies of any change in the registered office within a set time period. In addition, the secretary would usually inform the beneficial owner and also any third party agents to the company (for example, bankers and investment managers) of the change of the registered office address of the company.

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Directors should strive to minimise the amount of vulnerable capital invested within the company. They can accomplish this goal when starting their business in several different ways, including the following:

- initially investing a minimum amount in the entity;
- capitalising the entity with debt (for example: loans and leases); and
- obtaining extensions of credit (for example: loans and unpaid salary) from the owner to the entity.

However, to be effective long-term, the initial strategy of minimising the amount of capital invested within the company must be combined with a strategy calling for regular withdrawals of money from the company as income is generated. Funds generated by the company, but left within it, are in essence invested in the company, as if they were invested from an outside source, but in a way that leaves the company vulnerable to the claims of its creditors. A continual withdrawal of funds, as they are generated, guarantees that vulnerable funds will not accumulate within the company.

To efficiently accomplish this goal, directors need an understanding of the restrictions on withdrawals before they review the withdrawal methods available to them. Once the plan to minimise vulnerable capital is in place, the directors will need proper authorisation and documentation to secure the withdrawals from a creditor's challenge.

Any company planning a major expansion, requiring a significant amount of capital, will probably agree that the best way forward would be to accumulate the funds in the company.

Alternatively, these funds may be withdrawn, in accordance with a regular withdrawal policy, and then re-invested when necessary.

The withdrawal of funds often interlinks with the manner in which monies were originally raised:

- Repayment of capital Is usually undertaken as redeemable share (if this type of share has been issued), as a dividend payment; and on liquidation of the company as surplus monies depending on priority.
- Repayment of debt Is usually by way of the repayment of capital and interest if this is chargeable.
- Distributions to the beneficial owner or payments to other associated parties Is by way of: the provision of a loan receivable, a capital distribution (sale of assets) or the payment of expenses.

Offshore structures often involve loans between trustees and the underlying company(s) of the trust and these loans are usually interest free and repayable on demand.

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Making it work 6.1

Client profiles

> 'A retired businessperson who settled their trust with the bulk of their assets. Their only income is their pension, which is sufficient for them to live comfortably.
>
> It is not expected that further funds will be settled into the trust.
>
> No withdrawals are anticipated until their grandchild reaches the age of 18 at such time the trust will be wound up and the entire fund paid to their grandchild'.

In the event that the trustee received an amount of £500,000 from the businessperson, the administrator's actions would be expected to include, but not be limited to the following:

- Refer to the client profile.
- Note that no further additions to the trust were expected.
- Note that this activity therefore falls outside of the service provider's expectations.
- Note that the client had settled the bulk of their assets into the trust and therefore would not necessarily have had means to settle such an additional sum.
- Note that the client's only income is that arising from their pension which they live on.
- Contact the client and find out the nature of the receipt (for example, are they intending to settle the funds into the trust?), the source of the funds (for example, how have they arisen?) and the reason that they wish to transfer the funds into the trust (are these funds also to be made available to their grandchild or have circumstances changed?)
- Assess the information provided by the client to establish whether or not there is a reasonable explanation (the funds could have been an inheritance, for example).
- Consider whether there is a need to make further enquiries or request documentation following the receipt of the explanation.
- If the explanation is inadequate and/or gives rise to suspicion, the administrator must make a suspicious activity report to their money laundering reporting officer (discussed further in Chapter 10).
- Hold a trustee meeting if required (e.g. to resolve to accept the funds as an addition to the trust fund).
- Consider whether there are formalities that need to be undertaken, for example, if the funds were to be settled, a deed of addition of funds may be required.

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knows how this can be decided, they know what they need to do to get that right (and be able to evidence it to).

The dispute concerned a Netherlands incorporated company owned by a single individual. It was not necessary for the tribunal to conclude that the owner was UK tax-resident but it seems to have been accepted that the owner was UK resident. The owner served for a while as a formal director of the taxpayer company alongside one other director but the owner later resigned, leaving the other director as the only formally appointed senior officer of the company.

The company acquired a stake in a major UK company and later sold that stake at a multi-million pound profit. The UK tax authorities sought to tax the gain realised by the company. This was on the basis that the company had been tax-resident in the UK during the relevant period by virtue of its central management and control having been exercised from the UK.

The company in trying to avoid the tax pointed:

- to the significant number of formal managerial meetings that had been held in the Netherlands and various other locations outside the UK; and
- many of which were not actually attended by the owner so that the company's other officer appeared to be acting alone.

The Tribunal, however, refused to look simply at where resolutions had been signed. They looked at all the activities of the owner (whether the owner was a shareholder or director) in the UK. This included attending meetings with lawyers and other advisers of the company relating to its activities.

The Tribunal considered whether the activities carried on inside and outside the UK were concerned:

- only with ministerial matters and matters of good housekeeping; or
- with policy, strategic or management matters relating to the conduct of the business of the company.

The Tribunal thought that the activities of the owner (shareholder/director) in the UK were related to policy, strategic or management matters rather than ministerial matters and matters of good housekeeping and that these activities included decision making in relation to the company's business, as such it supported the claim from HMRC that the company was liable to be taxed.

Expertise in the line of offshore services provided is an essential factor as anyone going offshore would want to be confident of the legal and financial advice obtained. The best OSPs are equipped with lawyers, as well as financial and corporate secretarial professionals, that are capable of delivering updated information, reliable advice and sound offshore tax planning strategies to their customers.

The case of *Wood v Holden* (2006) is important as it illustrates the fact that all situations must be looked at in a realistic way. It is unrealistic to say that a tax scheme created by a UK adviser will necessarily affect the residence of all the

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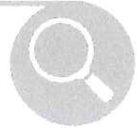
Case law 6.1



***Rahman v Chase Bank Trust Company (Jersey) Ltd* (1990)**

This famous (perhaps infamous) case concerned a discretionary trust set up by Mr Rahman in favour of a class of named beneficiaries. The claimant was Mr Rahman's widow who was not one of the beneficiaries.

After his death she sought to set aside the trust (so as to be able to have the trust assets considered part of his estate from which she would benefit). This was on grounds that it was a sham.

She relied in support of her claim on the following provisions in the trust instrument which enabled the settlor to direct the trustees to make investment and administrative decisions:

- the settlor had power in his lifetime, with the trustee's consent, to appoint capital as he saw fit and, without the trustee's consent, to appoint one third of the capital in any 12-month period;
- the trustee had an independent dispositive power to transfer the capital to the settlor and in doing so had to have regard exclusively to the settlor's interests;
- all of the trustee's significant administrative powers, including powers of investment and delegation, required the settlor's prior written consent for their exercise; and
- the settlor had the power to appoint an investment adviser and if the trustee followed the investment advice given it would not be liable for the success or failure of the investment policy.

The Royal Court of Jersey recorded its decision as follows:

We were unanimously satisfied that the oral evidence, together with the documentation placed before us, established clearly that from the date on which [Mr Rahman] purported to constitute the settlement he exercised dominion and control over the trustee in the management and administration of the settlement, including distributions of capital to himself, to others as gifts or loans, and the making and disposal of investments.

He treated the assets comprised in the trust fund as his own and the trustee as though it were his mere agent or nominee.

We are unanimously of the opinion that the settlement was a sham on the facts, in the sense that it was made to appear a genuine gift when it was not.'

It was held that Mr Rahman's advisers and trustees 'lent their services to the attainment of his wishes'. It is not clear what the Court had meant by this.

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services. Any activity that suggests that this is not the case should be addressed immediately and not simply accepted by the service provider.

Examples of instances which may need to be addressed with the client or third parties include:

- receipt of an 'instruction' rather than a request from a beneficiary for the trustee to pay funds to them;
- the settlor referring to trust assets as 'their' money; and
- the client requesting a broker directly to buy or sell shares that are owned by the trust or company.

4. Administration of trust and company assets

Trustees have a statutory duty to ensure that they have legal ownership and control over any assets settled or to be settled by the settlor into the trust.

The trustee must therefore ensure that the assets are properly vested (transferred) into the name of the trustee and that the assets and liabilities can be properly ascertained at any point. This is one reason why, whenever funds are deposited into or withdrawn from a trust or a company, the bookkeeping records and any registers maintained by the OSP in relation to its assets are properly maintained.

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4.1 Cash and bank deposits

The trustee has a fundamental duty to protect and preserve and, as far as possible, enhance the trust fund. It is not, therefore, acceptable to simply place funds in a bank account without having given proper consideration as to the impact that inflation may have on the value of the cash in real terms and whether or not the interest rate is the best that the trustee could obtain in relation to the cash or whether the cash should be invested, for example, in an investment portfolio.

The trustee should ensure that capital (for example, funds settled into the trust) and income (for example, bank interest or dividends received) is kept separately in order to ensure that both income and capital is taxed appropriately and in the most efficient manner when it is distributed to the beneficiaries and to ensure that beneficiaries with specific entitlements receive only what they are entitled to. For example, the life tenant of a life interest trust is entitled to the income only.

The trustee should ensure that they manage any cash balances effectively and that:

- the bank mandate is completed and in accordance with the authorised signatory list of the trustee;
- the type of account(s) to be opened is appropriate, e.g. should it be interest-bearing, be a fixed-term deposit to accrue more beneficial interest;

- a regular professional valuation, which may be costly;
- the title deeds or other satisfactory proof of ownership to be held in safe custody;
- if the title documents are held elsewhere, a certified copy should be obtained and held;
- confirmation from the external depository (who is holding the title documents) should be obtained;
- suitable and adequate insurance arrangements should be made to cover loss, damage, and where appropriate, public liability; and
- the retention and use of the special asset may usually be subject to periodic reviews to consider any amendments needed with regard to insurance and value.

4.5 Unquoted investments and/or non-managed assets holding companies

Most trustees have significant procedures in place in respect of holding unquoted investments or non-managed asset holding companies in trust structures.

A trustee should carry out due diligence and sufficient monitoring on these types of assets and ensure that they are appropriately reviewed and sufficient information is obtained from the directors of these companies about underlying assets.

There is a risk of failure to oversee these types of companies, where the trustee does not provide the directors.

The usual requirements of a trustee before accepting these types of investments include:

- obtaining certified copies of the certificate of incorporation and the constitution documentation of the company;
- obtaining copies of register of directors, shareholders and secretary, and updated if any changes are made in the future;
- obtaining copies of the financial statements of the companies;
- ascertaining whether there are any requirements for regulatory approval for the activities being undertaken by the companies;
- obtaining full due diligence on all the directors (and maybe the beneficial owners of the companies if different); and
- ascertaining whether or not there are any tax-related issues.

Arrangements should also be made to ensure that the trustee is informed as to the company's progress, results and prospects, and it may be appropriate that a director of the trustee should regularly meet with the directors of these types of companies.

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- whether sufficient, up-to-date customer due diligence is held;
- whether there are sufficient liquid funds to make the payment;
- whether minutes of a meeting or a resolution will be required; and
- whether the remitting jurisdiction is subject to financial sanction or otherwise considered as a 'high risk' jurisdiction.

Test yourself 6.3

What considerations should an offshore service provider address whenever funds are received or paid from an entity to which they have been appointed? Name at least three.

OSPs will usually have procedures and checklists that will assist administrators to consider all of the relevant matters when undertaking a transaction. Checklists may include:

- receipt of funds checklist;
- loan checklist;
- dividend checklist;
- distribution checklist; and
- payments checklist.

5.1 Loans

In addition to the basic considerations described in Section 5 above, the following matters may also be included within the internal procedures of the OSP and may include:

- the completion of a loan checklist;
- the preparation of minutes;
- the creation of any diary notes in respect of repayments or expiry dates;
- the repayment terms and the interest rate and its calculation;
- agreement of any arrangement fee;
- obtaining full details and due diligence in respect of the borrower/lender;
- the amount and purpose of the loan;
- identifying the proper law under which the loan is governed;
- which assets will be offered as security, where applicable; and
- whether the security for the loan will need to be registered.

It is common for funds to be transferred between overlying trusts and their underlying companies by way of unsecured, interest free and repayable on demand loans.

It is a common mistake that administrators bookkeep the receipt/payment of a loan in one entity and fail to remember to bookkeep it in the other.

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A result of such an order is that it avoids undue delay in the further administration of the trust or the estate in a will. The order could allow the trustee to ignore the potentially dead beneficiary and distribute the assets, and the trustee would be protected by the court order if the beneficiary or their descendants ever appeared to claim.

Although the trustee would be protected against any subsequent claims, the claimants may seek their share from the assets distributed to the other beneficiaries.

Regular reviews to ensure that any distribution plans reflect the needs of beneficiaries and is aligned with the terms of the trust deed is essential.

In the case of younger beneficiaries, the trustee may make distributions directly to (say) their parents, guardians, schools or universities. Trustees may also be obliged to provide information to the beneficiaries when appropriate.

Checklist – Trust fund distributions

Before making a distribution from the trust fund, the TSP should check certain points.

- That the request has been received from a beneficiary or an authorised person.
- That a facsimile or email indemnity is held for the beneficiary, if a request is made in this way.
- That the position of the other beneficiaries is considered (given the trustee's duty to act with impartiality).
- That the trust deed affords the trustee the power to make the distribution.
- That any supplemental deeds have been checked to ensure that the beneficiary has not been later excluded from the class of beneficiaries.
- That the content of the letter of wishes has been considered.
- That the protectors consent has been obtained, if required.
- That the reason for the distribution request is considered and appropriate given the trustee's duty to act as a prudent person would.
- That the nature of the distribution is clear (i.e. income or capital).
- That the trustee holds sufficient liquid assets of the correct nature (capital or income), whilst taking into account ongoing expenses.
- That sufficient and up-to-date customer due diligence is held.
- That the payee is the beneficiary or that special procedures are followed where the payment is to be made to a third party at the beneficiary's request.
- That there are no charges or liens against the assets of the trust.
- That the decision to make the distribution has been minuted.
- That a deed of appointment and indemnity of capital and indemnity has been received if required.
- That, where there are co-trustees, the trustees have acted together.

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6.3 Obtain investment advice

Under s.5 of TA2000, before exercising any power of investment a TSP, having regard to the standard investment criteria:

- should obtain and consider proper advice about the way in which the power should be exercised; and
- when reviewing the investments of the trust, a TSP should obtain and consider proper advice about whether the investments should be varied.

The exceptions to the above will be if a TSP need not obtain such advice they reasonably conclude that it is unnecessary or inappropriate to do so. This will be a harder decision to arrive at in view of court decisions such as in *AB v CD* referred to earlier.

Proper advice is the advice of a person reasonably believed by the TSP to be qualified to give it by his, her or its ability in, and practical experience of, financial and other matters relating to the proposed investment.

6.4 The appointment of an investment adviser

Unless the TSP has particular investment expertise, the TSP would normally appoint professional investment advisers to assist them with the administration of the trust assets.

The TSP would need to ensure that before they do this, they are certain that they are authorised to do so under the terms of the trust or under the laws of their jurisdiction.

In some instances, the client acts as the investment adviser. Where this is the case, the client should be formally appointed in the same way as any other adviser, remunerated if appropriate. The TSP should ensure that they are confident that the client has the necessary expertise to warrant such an appointment.

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Checklist – Appointing an investment adviser

Before appointing an investment adviser, the TSP may review the following items:

- name of the regulator of the investment adviser;
- reputation of the investment adviser and size of the firm – to include assets under management, number of clients and type of clients;
- ownership structure of the firm;
- expertise and services provided by the investment manager including details of staff experience and any areas of specialisation;
- performance of the investment manager against their peers and against the market;
- fees and charges of the services offered by the investment manager;
- reporting process (frequency and type of reporting);

Where the performance is not adequate, the trustee should consider whether it is appropriate to take action such as disposing of the investments, though this may be difficult if the investment is in a family company.

Of course you need to bear in mind the earlier observations relating to having the critical ability to assess the performance. An industry has grown up in some jurisdictions offering just such expertise.

6.6 Investment in family companies

Given that the TSP has a duty to protect and preserve the trust fund and to enhance it as far as is reasonably possible, it is usual for TSPs to invest in investment portfolios that are managed by investment professionals and for them to avoid higher risk investments.

Investments in private companies pose additional risks to TSPs as the trustee is required to actively monitor the investment and to take action where the investment is not performing well. Selling off such holding may be against the wishes of the settlor or beneficiaries. The TSP will need to manage their expectations while being sure to chart the 'correct path' to disposal or think carefully about the risks of retaining such assets. Some newer trust entities (Settlor Reserved Power Trusts in Jersey for example) are thought well suited to such instances.

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Case law 6.3

***Re Lucking's Will Trust* (1968)**

In the *Re Lucking's Will Trust* (1968) case, the sole trustee had appointed a manager to run a business. The manager was subsequently found to have withdrawn funds from the business without the approval and knowledge of the trustee. The trustee was held to be liable of breach of trust in respect of the withdrawn funds because of a failure to properly supervise the appointed manager.

During this case, the court considered the various methods by which a trustee, who had a controlling interest in a private company, could place themselves in a position in which to make informed decisions as to how to protect these assets of the trust.

These methods included:

- managing the business by appointing themselves as managing director;
- having the business managed by someone else that would be fit and proper to do so; and
- appointing a nominee to the board to report to them from time to time on the company's affairs (also see s.16 of TA2000);

- Establish procedures for external reporting to the regulatory body and law enforcement agencies as needed.
- Appoint a senior person within the organisation as the money laundering reporting officer (MLRO). The MLRO must report required suspicious events to the regulatory authorities.
- Establish regular and varied education and training programs.

It is likely that the Law would consider the agents of the OSP (if a corporate body), and therefore the relevant senior manager(s) and/or directors, to be guilty of the offence. Naturally, this would then call into question their ability to remain as directors and/or managers in the future as they would not have acted fit and proper.

If an OSP is convicted of money laundering, its reputation may be tarnished beyond repair, its clients would not wish to be associated with the organisation and the reputation of the jurisdiction where the OSP is established may also be severely damaged.

The regulator of the jurisdiction would probably enforce various sanctions including fines and possible prison sentences of the OSP and/or the employees of the OSP (through the court), the revoking of the license of the OSP and/or restrictions of services.

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Reporting requirements

If an OSP, or one of its employees, suspects that a client is laundering money or is involved in any other form of serious crime as determined by local law, both the OSP and the employee will usually have a duty to report their suspicions.

This may involve reporting the matter to the police, the local customs and excise department or to a particular regulatory authority (e.g. the jurisdiction's Financial Supervision Commission, Banking Supervisor or equivalent).

OSPs will usually have an internal reporting procedure and in most cases a senior officer will have the ultimate responsibility for reporting a suspicious transaction or a request which appears suspicious to the authorities.

However, in some cases, the duty to report to the authorities may rest with the employee who has the suspicion, and in those instances the employee's responsibility under the local law may not be fulfilled if they only reports the matter internally and not directly to the designated authority.

Any report which is made will usually be received and handled by the authority concerned in the strictest confidence and should not breach any of the confidentiality provisions which exist either under statute or under the terms of the contract with the client.

These are often referred to as safe harbour provisions.

Often, details of a report which is made will be passed to onshore law enforcement agencies and a combined effort made to try and achieve a conviction against those involved in the laundering process.

It is the UK's lead agency against organised crime; human, weapon and drug trafficking; cyber-crime; and economic crime that goes across regional and international borders, but can be tasked to investigate any crime. The NCA has a strategic role in which it looks at the bigger picture across the UK, analysing how criminals are operating and how they can be disrupted. To do this it works closely with regional organised crime units (ROCUs), the Serious Fraud Office, as well as individual police forces. It is the UK point of contact for foreign agencies such as Interpol, Europol and other international law enforcement agencies.

2.1 Primary legislation

PoCA2002 created a single set of money laundering offences applicable throughout the UK to the proceeds of all crimes. It also creates a disclosure regime, which makes it an offence not to disclose knowledge or suspicion of money laundering, but also permits persons to be given consent in certain circumstances to carry out activities which would otherwise constitute money laundering.

The five established offences that can be applied across the global offshore financial services industry are:

- **Concealing** – To conceal or disguise proceeds from criminal activities.
- **Arrangements** – Where a person knows or suspects, facilitates the acquisition, retention, use or control of criminal property for another person.
- **Acquisition, use and possession** – Acquiring, using or having possession of criminal property.
- **Failure to disclose** – If a person knows or suspects or should know or suspect.
- **Tipping off** – Giving another person information that they are under suspicion for money laundering.

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The first three offences are punishable by an unlimited fine and/or a prison term of up to 14 years.

The last two offences are punishable by an unlimited fine and/or a prison term of up to five years.

The concealing offence

Section 327 of PoCA2002 states that a person commits an offence if they conceal, disguise, convert, or transfer criminal property, or remove criminal property from England and Wales, Scotland or Northern Ireland.

Concealing or disguising criminal property includes concealing or disguising its nature, source, location, disposition, movement, ownership or any rights connected with it.

The arranging offence

Section 328 of PoCA2002 states that a person commits an offence if they enter into, or becomes concerned in an arrangement which they know or suspect

information on which their suspicion was based may assist in identifying the money launderer or the whereabouts of the laundered property.

The maximum penalty for the failure to disclose offence is five years' imprisonment, and/or an unlimited fine.

Suspicious activity reports

The primary legislation in many jurisdictions imposes a direct obligation on employees in financial services business to make a suspicious activity report (SAR) if they suspect that money laundering has taken place.

In financial regulation, a SAR is a report made by a financial institution about suspicious or potentially suspicious activity. The criteria to decide when a report must be made varies from jurisdiction to jurisdiction but generally is any financial transaction that does not make sense to the financial institution, and is unusual for that particular client or appears to be done only for the purpose of hiding a transaction. The report is filed with that jurisdiction's financial crime enforcement unit, which is typically a specialist agency designed to collect and analyse transactions and report these to relevant law enforcement units.

Front line staff in the financial institution have the responsibility to identify transactions that may be suspicious and these are reported to a designated person/nominated officer (usually the MLRO) that is responsible for the reporting of the transaction. The financial institution is not allowed to inform the client or the parties to the transaction that a SAR has been lodged.

In the UK the nominated officer, if they know or suspect there is such a link, must report it to the NCA. If they want to proceed with a transaction that they are suspicious of, they must ask the NCA for consent.

What is a suspicious transaction or activity?

There are many reasons why an employee might become suspicious about a transaction or activity. Often it's just because it's something unusual for their business – perhaps a customer/client has tried to make an exceptionally large cash payment. Maybe the customer/client behaved strangely, or made unusual requests that did not seem to make sense. Perhaps the transaction they wanted to make just didn't add up commercially.

All employees working for regulated entities must look carefully at all unusual transactions to see if there's anything suspicious about them. A SAR must include details of the persons involved and the reasons for the suspicion.

When to report suspicious activity

Anyone in the regulated financial sector must report any suspicious transaction or activity they become aware of to the 'nominated officer'. The nominated officer analyses the report and, taking all of the circumstances into consideration, decides whether or not in their opinion, the activity does give rise to a suspicion of money laundering.

It's the nominated officer's responsibility to decide whether they need to send a report or 'disclosure' about the incident to the NCA. They do this by making a SAR.

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2.2 Secondary legislation

The secondary legislation in the UK, the Money Laundering Regulations 2007, places three main requirements on firms:

- **Administrative** – Requiring them to carry out certain identification procedures, implement certain internal reporting procedures for suspicions and keep records in relation to AML activities.
- **Training** – Adequately training staff in the regulations and how to recognise and deal with suspicious transactions.
- **Preventative** – Ensuring the establishment of internal controls appropriate to identify and prevent money laundering.

It is a criminal offence, liable to a prison term and/or an unlimited fine, for firms and its employees to fail to comply with the money laundering regulations, although in deciding if an offence has been committed, the court must consider whether the firm followed the relevant guidance notes that were available at the time the offence was committed.

The Single European Market has also introduced several directives, which must be implemented and absorbed into member state laws by EU Member States.

These directives were threefold, to deter criminals from using financial institutions as conduits for money laundering purposes, to allow financial institutions and law enforcement agencies to co-operate and to establish customer identification procedures and record keeping to assist in the detection, tracing and prosecution of those involved in the money laundering process.

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Case law 10.1

Attorney General v Caversham Fiduciary Services Ltd and Caversham Trustees Ltd and Nicholas Bell (Caversham) **[2006] J.L.R. 61**

In 2002, Caversham, a Jersey trust company, was approached by a solicitor who explained that a solicitor who acted for a third party, Mr Lee, wished to set up a trust to hold the proceeds from the sale of a sauna business.

Caversham created the trust (with the attorney as the sole beneficiary) and received client due diligence documentation in relation to the identity of the solicitor, but not for the ultimate client.

Upon receipt of the trust fund (£850,000) from the solicitor's account, Caversham were asked (and agreed) to pay the vast bulk of the funds less their fees to four entities which were not connected to the trust. In Jersey, firms are required to maintain procedures to forestall and prevent money laundering. These procedures include measures to establish the identity of the person or persons (in this case Mr Lee) on whose behalf an applicant for business (the solicitor) acted.

Relationship information includes information such as the:

- source of wealth;
- source of funds;
- purpose and nature of the business relationship (rationale); and
- expected activity of the client including the volume and value of transactions.

3.4 Risk-based approach

International standards set by the Financial Action Task Force (FATF) and other international bodies (such as Moneyval with regard to Europe) advocate adopting a risk-based approach to CDD. This involves firms undertaking a risk assessment of its potential client and then deciding the appropriate level of CDD information and verification, to collect the appropriate level of transaction monitoring and reviewing to apply to the customer relationships on an ongoing basis.

A risk-based approach allows a focus of resources on areas where the risk of money laundering or terrorist financing is higher and therefore allows a proportionate and cost-effective approach to managing the risk.

Relationships involving politically exposed persons (PEPs), for example, are relationships that present a higher risk of money laundering. For these individuals, enhanced due diligence should be undertaken on a risk-sensitive basis.

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3.5 Enhanced due diligence (EDD)

EDD involves:

- obtaining further CDD information;
- taking additional steps to verify the CDD information;
- requiring higher levels of management approval for higher-risk new customers; and
- requiring more frequent reviews of the relationship.

4. Money laundering in offshore jurisdictions

The vulnerability to money laundering in any jurisdiction should, whether onshore or offshore, be considered in light of the effectiveness of the laws, the political will and resource available to enforce them. Many offshore jurisdictions are comparable to those of the onshore jurisdictions. That said, the features of offshore jurisdictions can prove useful to money laundering, as the following sets out.

Legal persons

Legal persons contract and transact business in their own name. The use of directors provided by a service provider or the use of corporate directors (usually a company owned by the service provider) means that transactions are undertaken on behalf of the company by these directors, thus negating the need for the client to be associated with the transaction.

The extent of information available from a company's registry varies significantly from one jurisdiction to another. Some, for example, require information on beneficial ownership at the time of incorporation but do not impose any obligation to update the registry where this changes. While it is often a requirement to inform the authorities of the identity of the shareholders (legal owners), this information is not useful in establishing beneficial ownership as the use of nominee shareholders is routinely provided by OSPs in offshore jurisdictions. With the use of nominee shareholders, a declaration is signed by the OSP admitting and declaring that they hold the shares as nominee for the customer absolutely and that they will do with the shares as they are instructed to do. A company must usually disclose the address of its registered office to the company's registry. This address is, however, usually that of an OSP and the company's physical presence (if it has one) is not necessarily located there.

Bearer shares are a feature of some companies that renders any CDD undertaken useless as soon as the shares change hands.

bearer shares
Shares which are considered to be owned by 'the bearer', i.e. whoever has them in their possession. Cash is an example of a bearer instrument.

The authorities in a well-regulated jurisdiction should have access to the files of the OSP; however, they may still have difficulty identifying the 'human face' behind a company, particularly if is owned by another company, registered in another jurisdiction, or if the shares are owned by a legal arrangement or have been issued in bearer form.

Legal arrangements

Most jurisdictions do not require trusts to be registered in the same way as companies and therefore the existence of a trust is not a matter of public record. The benefit of any register would only be as valuable as the information that is contained in the trust deed and this can be minimal.

In law, a trust is recognised without any written documentation (although it is unlikely that a well-regulated TSP would operate in this manner).

In the past, 'dummy settlors' have been named in trust documentation, so that the true provider of the funds is not evident from the documentation. While this practice is no longer prevalent in well-regulated jurisdictions, it is still acceptable for an instrument referred to as a 'Declaration of Trust' which does not contain the name of the settlor to document the terms of the trust.

Where a settlor's details are recorded on the trust deed, only the first provider of funds is recorded on the documentation. However, trusts are flexible in nature and would usually allow further funds to be added.

A person's ability to benefit can be hidden. It is not uncommon to find that trust documentation has been prepared with only a well-known charity as the named beneficiary (known as a blind trust). Again, this is an outdated practice.

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