Deal or no deal?

As Britain stands on the precipice of a disorderly Brexit, we assess the impact on the offshore markets in the UK Crown Dependencies and Overseas Territories

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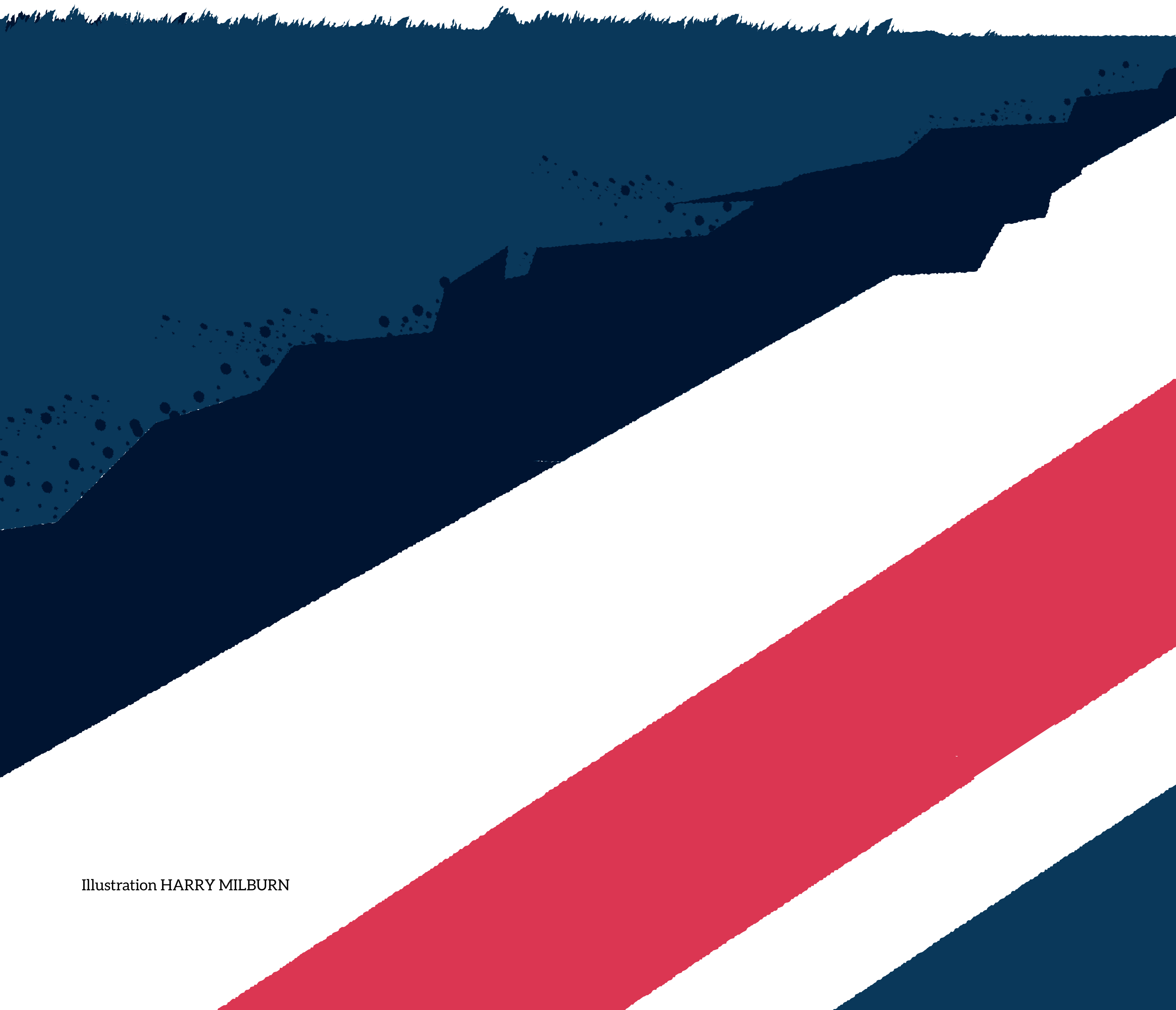

Illustration HARRY MILBURN

Protracted arguments over Brexit have led a divided Britain to the point of exhaustion. In the months leading up to the June 2016 referendum, offshore firms were concerned about the potential impact of a 'Yes' vote – although perhaps less so than some of their onshore counterparts. Even before the financial crisis, there had been a continued diversification by larger firms in the major offshore jurisdictions away from a reliance on the UK economy.

Since the referendum, offshore firms in the British Crown Dependencies and Overseas Territories have been dealing with the problems of continued uncertainty that Brexit has created for their clients and advising them in relation to investment opportunities that may arise once it is eventually resolved.

At Appleby, global managing partner Michael O'Connell offers the familiar response that no one knows yet what will happen and firms will have to just react accordingly, although he does note that a great deal of preparation has been made in the Crown Dependencies to prepare for no deal. Jason Romer, group managing partner of Collas Crill, adds: 'Because we have always sat outside of the EU, we have been very used to dealing with the EU in terms of third-party passporting arrangements. That, in very broad terms, will carry on in a similar way as it has done prior to Brexit.'

At Mourant, the largest firm in the Channel Islands, global managing partner Jonathan Rigby echoes the point that for the global offshore firms, the majority of their operations are outside the EU. 'Our Channel Islands offices have benefited to a degree from clients looking for structures and jurisdictions that will provide continuity pre and post-Brexit. With an extensive range of co-operation agreements, Jersey and Guernsey continue to be well placed to support investment into both Britain and the EU 27.'

Edward Mackereth, global managing partner at Ogier, acknowledges the knock-on effect of Brexit uncertainty in London, which is causing a slowdown in the London market. But he too says that his firm like others has benefited from diversifying their geographical coverage over the last few years, meaning 'the impact is not what it once would have been'.

'It's hard to believe that people are tightening as much as they might be if they thought there was going to be a serious downturn anytime soon.' Ingrid Pierce, Walkers

FEELING THE PINCH

Where there is deal uncertainty, a slump in financing inevitably follows. For those offshore firms which are heavily borrower focused, this can be problematic. According to one managing partner: 'Some offshore firms have a very good borrower-led practice and would have been on all the major bank panels historically. If you have a slowdown in the financing practice and bank debt, then that would hit them particularly hard.'

At Walkers, global managing partner Ingrid Pierce suggests that clients are 'reasonably bullish'. She comments: 'People are talking in terms of a downturn, but not a severe one. If their activity is anything to go by, in terms of work on the debt side and what we're seeing in terms of flows coming in through the offshore jurisdictions, it's hard to believe that people are really tightening as much as they otherwise might be if they thought that there was going to be a serious downturn anytime soon.'

As a Caribbean-based firm, Conyers might seem to have less direct interest in Brexit than many of its peers, especially since it has no Channel Islands presence. But chair Christian Luthi has 'noticed an increased interest by high-net-worth individuals looking at their options offshore through trusts, private trust companies and other family wealth vehicles. This clearly is positive for our jurisdictions'. There has been significant concern about Brexit among UK-based clients while deal flow originating from the UK has declined somewhat, he notes.

As the only other large offshore firm not to have a local presence in Jersey or Guernsey, Harneys does not plan to open there. 'We have never seriously considered either of those markets,' says chair Peter Tarn. 'They are quite European by comparison with us, and Europe facing. We don't see that as the future – it's not on our strategic radar and hasn't been in the last 20 years.' As for Brexit, he adds: 'In terms of impact on deal flow or work, I don't see any for us.'

Nevertheless, he does see a future in Europe. In April, it was announced that Luxembourg-based law firm M Partners had joined the Harneys group. 'It was very definitely a funds-driven decision,' he says. 'There is an increasing difficulty of using Caribbean funds in Europe and the signals are that is not about to change. There is also a lot of cross-fertilisation between Cayman and Luxembourg. But it's very much high-end and product-driven – nothing to do with Brexit.'

In contrast, the biggest global offshore law firm, Maples, takes an opposing view: last September, it opened in Jersey. Local managing partner Chris Byrne concedes that with Brexit, most of the offshore firms would now admit that UK real estate investment has been curtailed – the market is far softer than people would have hoped, or perhaps expected, when this began. Even a weak pound – which most people would regard as a good buying opportunity – has not translated into real estate investment. However, he adds: 'Where we have seen significant deal flow is in downstream private equity transactions – those continue to use Jersey entities and often combine them with entities in a number of Maples Group jurisdictions.'

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Peter Tarn, Harneys

CONFIDENCE PERSISTS

Financial markets have weathered Brexit with a resilience that some find surprising. Since the referendum, they have generally stabilised while volatility has diminished. But for investor caution to subside, one ingredient is still missing: certainty. Once that returns in a post-Brexit world, whether that be with an agreed deal or not, several offshore firms anticipate significant opportunities for their clients, most especially in real estate.

Alex Ohlsson, Carey Olsen's managing partner, sees clients ready to invest as, from an external investor viewpoint, assets are beginning to look cheap. But he suggests other clients are waiting for greater certainty and senses that private equity is keeping its powder dry for now. 'The UK remains an attractive market, if it can sort out its own internal wrangling.'

Maples has a very strong Middle Eastern and Asia workload, according to Byrne. This results from being one of the largest firms in Dubai and having a very strong Hong Kong office. He says the firm has ongoing instructions from Middle Eastern and Asian investors looking to invest into the UK but they are waiting 'because no one wants to be the person who powers in now and then finds out there is another pricing shock that they had not contemplated. But at some point, the money will flow'.

The point is developed by Tim Pearce, global managing partner of Bedell. 'None of us know what is going to happen after Brexit nor what it will look like,' he says. 'You will always get speculators, private equity and other funds, who are looking to make a return based on currency arbitrage or some other mismatch in pricing. But you will also start seeing the longer-term investors come back into the market once they have normalised after Brexit.'

However, a disorderly Brexit could produce unforeseen consequences. Most notable from an offshore perspective is litigation that could spill over into offshore jurisdictions, according to Stephen Baker, senior partner of Jersey-based disputes firm Baker & Partners. 'A huge amount of English real estate has traditionally been held through Jersey structures, so that there has always been great potential for associated disputes to be litigated in the Jersey courts,' he says. 'This may intensify. Brexit continues to breed imponderables.'

Mackereth speaks for many of his counterparts when he concludes: 'Whatever type of Brexit takes place, the market will eventually adapt and return to the UK (albeit perhaps at a different level). Through our strong presence in the UK and Luxembourg markets, we are well placed to deal with the immediate impact and then the reinvestment/restructuring opportunities further down the line.'

UNDER ATTACK

At some point, Britain will eventually move on from the Brexit maelstrom. Two competing visions of the nation's future will be set out by the largest political parties in a general election, both of which may affect offshore centres. The Labour Party has already had much to say on the subject. Shortly after he became Labour leader in 2016, Jeremy Corbyn suggested that the government should consider imposing direct orders on offshore centres to stop them 'acting as tax havens'.

Shadow Chancellor John McDonnell has also talked tough. In June, he said: 'In the last general election, people accused me of having a magic money tree. Well, I've found it – it's in the Cayman Islands. We're going to dig it up and bring it here.' He followed this up in September, telling *The Sunday Times* that he is drawing up plans for Labour's manifesto against the 'enablers' of tax avoidance, 'like the big accountancy firms'. McDonnell has also announced plans to introduce an offshore company property levy and his policy advisers have recently visited offshore centres on a fact-finding mission.

History shows that extravagant political rhetoric is often tempered by the harsh realities of public office. But were Labour to win the election outright, what do offshore firms anticipate from a Corbyn-led government and how would they respond? 'If it is a Labour government, I expect tax rates will shoot up, there will be a flight of capital, wealth and individuals out of the UK, and that will probably be very, very good for the offshore markets generally,' says Romer.

Mackereth says were that scenario to occur, there would be an element of disruption but also restructuring. 'How the anti-business rhetoric would play out in practice when faced with the value that the Crown Dependencies provide to the UK's capital flows is anyone's guess, but would likely involve a different routing of capital flows and entrepreneurial talent, all to the UK's detriment.'

According to Luthi, statements by leading figures within the Labour Party regarding offshore centres exhibit a lack of awareness of the role that these jurisdictions play in western financial markets generally. 'If Labour is elected and if the reported plans that Labour has come to fruition, it will be necessary to increase our efforts to educate onshore lawmakers of the important role that offshore jurisdictions play.'

Ohlsson says that education would entail communicating that there is a need for a tax-transparent structure, which enables capital to flow freely, with taxation being levelled at the underlying investment and where applicable on the overlying investor, without multiple layers in between. 'It is clear that there are some members of various political parties who have not fully appreciated it.'

In practice, according to O'Connell, a Corbyn-led government means an increasing focus on the wealth and assets of the top 5%, certainly the top 1%, and asking them to make a bigger contribution to UK taxes, alongside a continuing erosion of privacy and their ability to transfer significant wealth down the generations. 'Offshore centres continue to see interest from UK-resident ultra-high-net-worth individuals in both the possibility of taking up residence there, or structuring their wealth using wealth-planning structures where appropriate, or a combination of both.'

Without much by way of detail, an alternative vision of sorts has been floated by the Conservatives – that the UK develops some offshore characteristics. This too raises objections. In September, German Chancellor Angela Merkel highlighted the economic danger posed by Britain 'if it becomes a Singapore-on-Thames'. Boris Johnson's recently-stated desire to build a 'buccaneering' Britain has been perceived by EU officials as a signal of his plan to reshape the UK as a low-tax, low-regulation state, according to the *Financial Times*. Separately, French President Emmanuel Macron has said that leaving the EU would mean the 'Guernseyfication of the UK.'

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Edward Mackereth, Ogier

One government plan already put forward is the creation of up to ten free ports in the UK after Brexit: goods would be brought in customs-free, stored, processed or manufactured and then re-exported with no UK tariffs or taxes payable. This may be supplemented by a continued lowering of corporate tax rates.

'If you have a Conservative government in power that follows that sort of philosophy, then there's a very realistic possibility that London will become a mid-shore jurisdiction, rather than a genuine onshore jurisdiction,' says Romer. 'It depends on which direction the UK goes in,' adds Tarn. Taking a longer-term view, he adds: 'Perhaps there will be an increase in line with the Crown Dependencies as the UK itself struggles with being a relatively small country – essentially reverting to slightly offshore routes if, in 10-15 years, there is a world that creates a greater alignment of interest.' LB