OFFSHORE 2020

An Asian Perspective

Insights into the evolution of offshore financial services in the region and what is driving it

OIL Offshore Incorporations

CONTENTS

FOREWORD

It is easy in any business to become pre-occupied with **today**, and not pay enough attention to **tomorrow and beyond.**

In our business – the formation and ongoing management of offshore companies for cross-border investment and trade – the market has been robust for many years. However, we felt that the time was right to step off the dance floor temporarily, take a look down from the gallery, and ask why, how fast and to what music people are dancing.

This desire to examine the bigger picture was the core idea behind our "Offshore 2020" market research study. We wanted to look into the crystal ball and understand the longer term trends that we face as an industry, the reasons why clients will use offshore jurisdictions in the future, and the way in which their structures will develop over time.

This is the first of what we hope will become a regular "temperature check" on our industry. We hope you enjoy reading this report and trust that it reflects your views on the industry accurately.

OIL will be using the results of this research to develop the products and services we provide to clients. We look forward to receiving any comments and feedback so we can further enhance our services and add value to your business.

Martin Crawford
Chief Executive Officer

INTRODUCTION TO THE MARKET

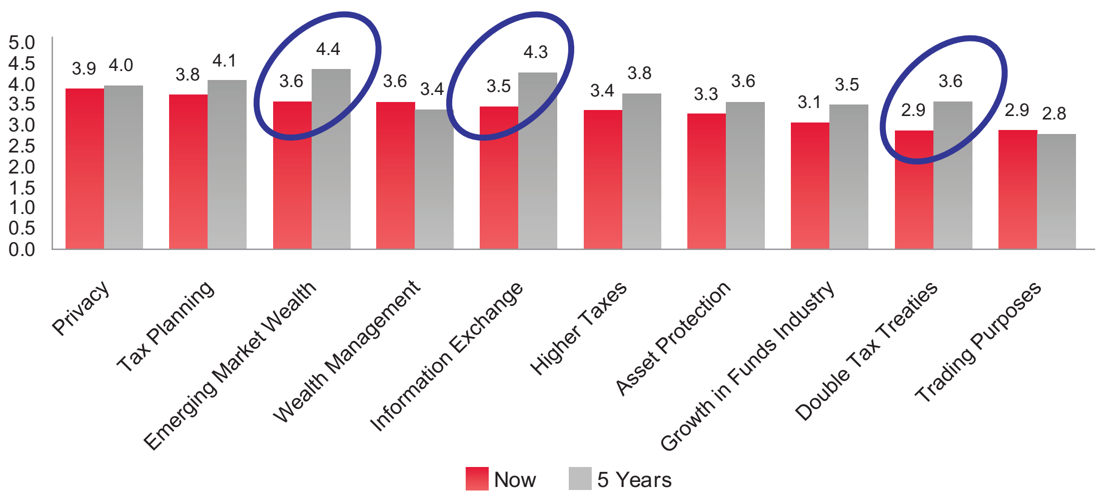
At various points in the last decade, the offshore industry has come under regulatory scrutiny from a combination of international agencies and individual governments. But in terms of scope and success, few previous efforts can match the Organisation for Economic Co-operation and Development's (OECD) drive for greater tax transparency, which peaked in early 2009 with backing from the G20 nations.

Although there is some concern as to how far the OECD will go in enforcing tax information exchange, the general hope is that the industry will emerge better managed and better regulated. Operating in a more even and transparent commercial environment, larger service providers should be able to capitalise on their geographical and product scope while smaller operators reap the rewards of high-end specialisation.

However, the criteria upon which clients devise investment strategies is changing and this will in turn alter the roles that onshore and offshore services play in the financial sector from a corporate and an individual point of view.

The survey confirms as much. Asked to rank a selection of factors by the level of influence on offshore activity, respondents placed privacy and tax planning in the top two spots (see Figure 1). However, in five years time, they expect both of these factors to be supplanted by information exchange, a direct result of the OECD's initiative. Double tax treaties (DTTs), a primary means of ensuring tax efficiency in a transparent regulatory environment, will also see a sharp jump in significance.

Figure 1: Factors driving usage of offshore vehicles



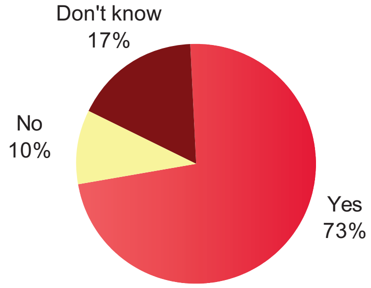
Neither of these factors ranked number one, though. Emerging market wealth, currently the third most important consideration, is expected to head the list in five years time, ahead of information exchange, privacy and tax planning. This is strong confirmation that, despite the upheavals in the industry, enormous opportunities remain, particularly in Asia's emerging economies.

The survey also established – overwhelmingly – that clients are becoming more sophisticated (see Figure 2) in their knowledge and requirements: institutions and fund managers now have in-house counsel and other expert advisors familiar with offshore structures; the proliferation of professional advisors, including accountants, lawyers and private bankers, mean that companies and individuals come to the table better informed than ever before; and of course the OECD's agenda has focused attention on the offshore industry.

What this means is that service providers are faced with a much larger target market but must go through a much tougher sell to secure their part of it. More than 90% of survey respondents said that the industry's first and most important response to the dynamic and increasingly regulated offshore environment is to promote education and awareness.

Operating in a more even and transparent commercial environment, larger service providers should be able to capitalise on their geographical and product scope while smaller operators reap the rewards of high-end specialisation.

Figure 2: Has clients' relative level of sophistication increased?



"Yes clients are getting more informed in part because they have to avoid exposure and in part because the advice is getting better."

Singapore Lawyer

KEY TRENDS

THE CLIENTS: A CHINA-DRIVEN, BUT NOT A CHINA-DOMINATED MARKET

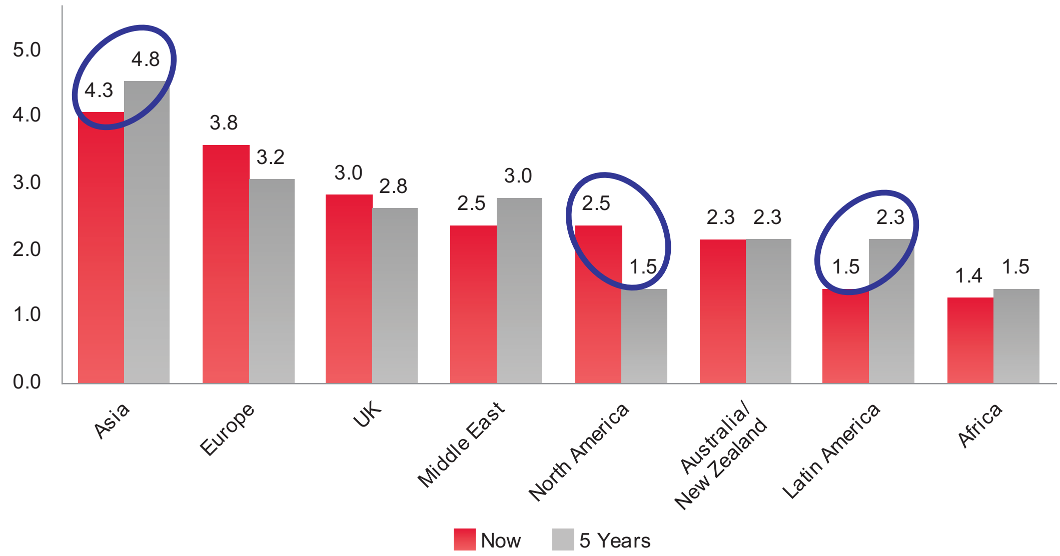
China looms large over Asia's offshore industry today, it's a "now" market, not a "next year" opportunity. Although this is unlikely to change, there are other nations poised to emerge as key target markets.

While survey respondents rated privacy and tax planning the most important factors in offshore financial planning today, emerging market wealth is expected to rise from third to top spot over the next five years. This broadly corresponds to anticipated changes in client origination. Asia, Europe, the UK, the Middle East and North America are currently seen as the leading sources of clientele (see Figure 3). Respondents said Asia should consolidate its position over the next five years – hardly surprising, given the respondents' profile – with Europe, the UK and North America all falling in importance. The North American decline is so steep that the region will cede two places to Australia/New Zealand and Latin America, ending up joint last with Africa.

In addition to Asia, the emerging markets of the Middle East and Latin America are expected to go from strength to strength in terms of client origination.

Within Asia, survey respondents already rate China the third most important client location in the region (see Figure 4), trailing Hong Kong and Singapore. These three locations, plus Indonesia and Taiwan, have a clear lead over Malaysia, India, Thailand, Vietnam, Japan (always an anomaly), Philippines and South Korea. The expected shift over the next five years towards the region's strongest emerging economies is remarkable.

Figure 3: Client origination by region



Respondents tipped China to surpass Hong Kong and Singapore and take top spot, while India moves from seventh to fourth most important and Vietnam climbs from ninth to seventh, closing in on eighth place and with a sizeable lead over tenth.

Even though Hong Kong and Singapore are also set to gain in importance, respondents highlighted the role that emerging markets will play in this process. These two financial hubs will be the conduits for investments emanating from all over the region, although service providers are likely to spend more time engaging directly with clients in the source markets. The expansion of wealth management providers into mainland China in recent years – setting up offices that are contact points for clients with much of the administration and management functions performed in Hong Kong and Singapore – stands as testament to this.

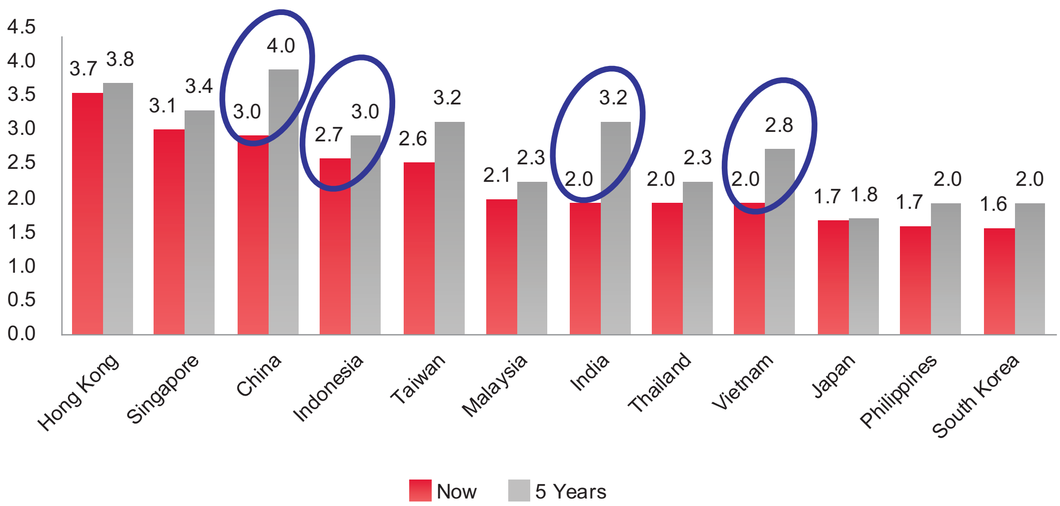
Taiwan, which is also expected to grow significantly in importance, perhaps owes its elevated status to a somewhat different dynamic. It is widely believed that closer economic ties with mainland China will inject new momentum into the Taiwan economy, both through direct cross-strait exchanges and the forging of stronger links throughout the region. This would in turn deliver a more prosperous and outward-looking client base.

A natural reference point for these trends are separate surveys tracking the growth and geographical spread of high-net worth individuals (HNWIs) in the region. The 2010 installment of

"It's not just about China but about the emergency of other locations like India, Indonesia and Vietnam."

Big Four Hong Kong Tax Accountant

Figure 4: Client origination by Asia countries



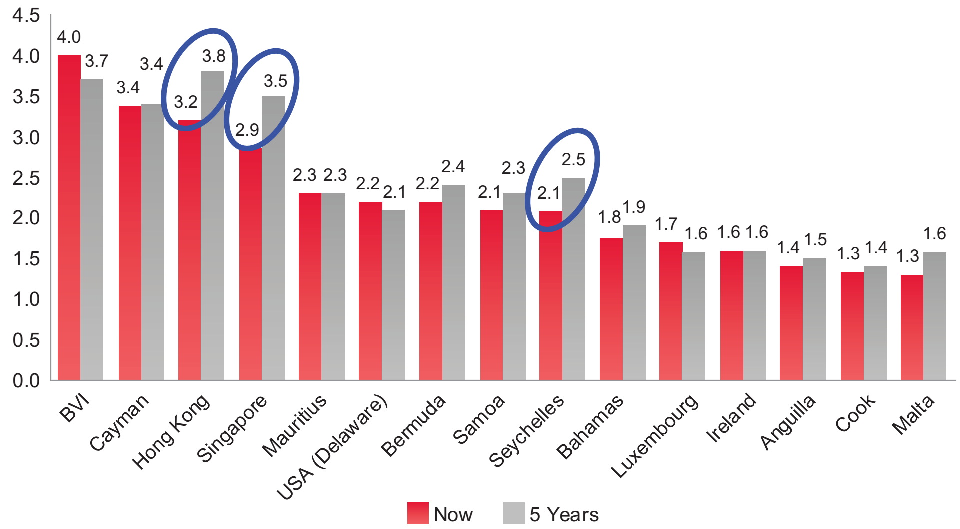
Hong Kong and Singapore will be the conduits for investments emanating from all over the region, although service providers are likely to spend more time engaging directly with clients in the source markets.

the Capgemini and Merrill Lynch Global Wealth Management's world wealth report found that for the first time ever the HNWI population of Asia Pacific was equal to that of Europe. Three million people in the region qualify as HNWIs – by having non-property investible assets of US$1 million or more – with a total wealth of US$9.7 trillion at the end of 2009.

China alone has the fourth largest number of HNWIs in the world with 477,000 in 2009, up 31% year-on-year. India has just 126,700 HNWIs but this was 59.9% more than in 2008, the fastest growth of any of the major economies. In both countries, the HNWI population is projected to triple by 2018 from 2008 levels.

Recent research by Matrix Services Limited (a research company that specialises in Asian wealth management) suggests these HNWIs are predominantly male, relatively young (in their 40s and 50s), and their fortunes are self-made, which feeds through to a more aggressive investment style, focusing on wealth creation rather than preservation. Research shows that a minority of Chinese HNWIs have a private banking or advisory relationship, largely due to a lack of trust or a lack of awareness. Their primary considerations are, in order of precedence, expertise, customer service, reputation and brand, privacy, and product variety.

Figure 5: Jurisdictions of importance



THE JURISDICTIONS: THE EMERGENCE OF 'MID-SHORE' IN ASIA

The regulatory reforms taking place within the industry, combined with the growing sophistication of the clientele, is changing the way in which jurisdictions fit into investment structures. This transition – from "tax naive" to "tax aware" – is likely to give rise to a phenomenon best described as "mid-shore."

Asked to score jurisdictions in terms of importance, respondents came back with a fairly predictable set of rankings (see Figure 5). The British Virgin Islands (BVI) and the Cayman Islands sit atop the list, followed by Hong Kong and Singapore. There is little to choose between the remaining locations, which broadly divide into two groups: Mauritius, Bermuda, US (Delaware), Samoa and Seychelles; and Bahamas, Luxembourg, Ireland, Anguilla, the Cook Islands and Malta.

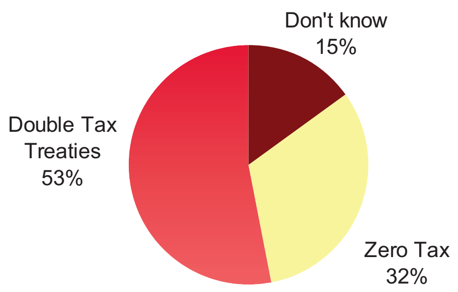
Respondents were then asked to score the jurisdictions based upon their expectations for the industry in five years time. The most startling gains are made by Hong Kong (3.2 to 3.8) and Singapore (2.9 to 3.5), but these gains don't necessarily come at the expense of other locations. Indeed, respondents thought only BVI, Bermuda and Luxembourg would fall in importance, and the deficits for the latter two are negligible.

There are two forces at work here. First, the OECD efforts to ensure tax transparency are changing the balance of priorities. Secrecy and zero-tax are becoming less crucial considerations as far as Asian investors are concerned, while service quality and proximity are increasingly important.

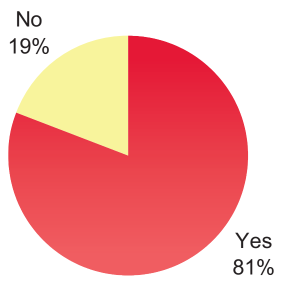
Second, as offshore structures become more sophisticated – particularly in wealth management, a key growth area in Asia – a higher standard of delivery is required across offshore and onshore financial services.

Figure 6: Double tax treaties & regulatory cooperation

Zero tax or Double Tax Treaties?



Increased cooperation and information exchange – A key factor in the medium to long term?



Hong Kong and Singapore are the natural beneficiaries of these trends. Neither place is a typical offshore financial center; aside from being low-tax rather than zero-tax, they have well established and high performing onshore financial sectors. Investors are attracted by their strong legal systems, high levels of service, relatively painless bureaucracy, extensive international trade links, and – a more recent development – their expanding DTT networks.

This is unlikely to cost other jurisdictions much business. Hong Kong and Singapore are "mid-shore" locations in that they offer elements of the onshore and offshore worlds, not the whole package. As the industry develops, Hong Kong and Singapore are likely to consolidate their position as staging posts for investment going into or coming out of Asia, with other jurisdictions playing a role further down the chain. For example, a private equity fund would still register in Cayman and use the location as its primary base, but all Asian operations might be channeled through Hong Kong. Similarly, a financial institution looking to tap high-net worth individuals in Vietnam may use Singapore as its administrative headquarters to manage investments in a variety of onshore and offshore locations.

As for the prospects for other jurisdictions, it is worth noting that respondents identified numerous locations not among the 15 featured in the survey. The industry is geographically fragmented and looks set to remain so – although this would be less of a concern to an Asian investor using Hong Kong or Singapore as his base of operations.

However, the survey does point to changes in the way that jurisdictions are perceived by investors. Participants were asked whether zero tax or the existence of a broad range of DTTs would become more important in the medium to long term; DTTs collected 53% of the vote compared to 32% for zero-tax (see Figure 6).

In this respect, jurisdictions with a particular niche offering – such as a DTT network or easy access to an attractive target market for investment – can expect to do well. Hong Kong and Singapore aside, Seychelles was rated the jurisdiction likely to see the biggest jump in importance over the next five years. In addition to a DTT with China that is in some respects seen as superior to those that Hong Kong and Singapore negotiated with Beijing, Seychelles is geographically well placed to serve as a strategic platform for investments in Africa.

The survey found that BVI is expected to see the biggest drop in importance, although alongside Cayman, Hong Kong and Singapore, it will remain by some margin one of the four key jurisdictions for Asian investors. It could be argued that BVI has prospered in the region as a function of habit as much as a result of its strong services. Habits are now changing and BVI – which can't offer a DTT network, for example – must find new ways to recommend itself to investors. BVI's push into investment funds, an area long dominated by Cayman, is one such example.

"People are looking to not stand out."

Private Banker in Singapore

THE SERVICE PROVIDERS: LARGE-SCALE CONSOLIDATORS OR HIGH-END SPECIALISTS

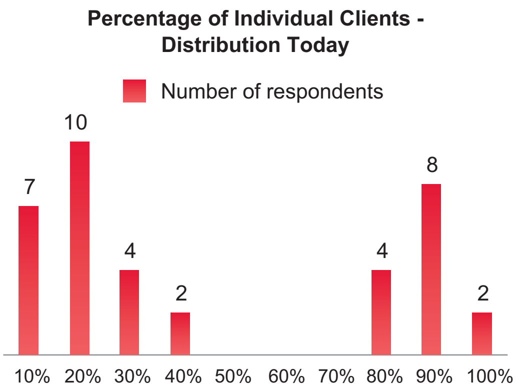
A longstanding feature of offshore financial services is the divide between institutional and individual business: the two strands require different skills sets and therefore different practitioners have emerged in each area. In the next five years this is likely to change, albeit in small increments.

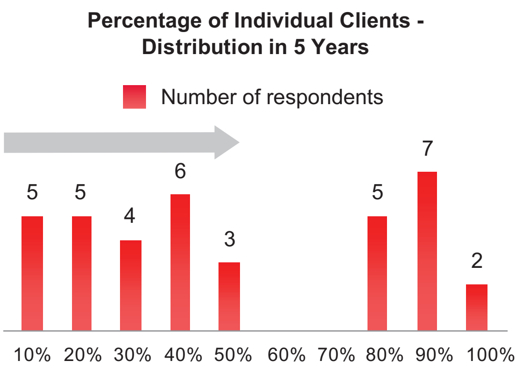
There was a clear division among survey participants in terms of their current operations (see Figure 7). 23 of the 37 respondents were institution-focused, with individual clients accounting for 10-40% of existing business; for 17 of these 23, the figure was 20% or below. The remaining 14 of the 37 respondents fall at the far end of the spectrum, 80-100% of business coming from individual clients. There are no half-measures, it appears.

Jurisdictions with a particular niche offering – such as a DTT network or easy access to an attractive target market for investment – can expect to do well.

Figure 7: Institutional vs. individual

Timeline	Percentage of Institutional Clients
Now	51%
Five Years Hence	52%





Asked how client breakdowns are likely to change in the next five years, the responses point to a very different scenario. The same group of 14 that currently deal predominantly with individual clients anticipate little change. However, the institution-focused operators expect to cater more to the needs of high-net worth individuals. Thirteen of the original 23 suggested that individuals will account for 30-50% of their business in five years time, leaving just 10 in the 10-20% range.

The difficulty, particularly in Asia, is where to draw the line between institutional and individual business: institutional wealth and family wealth are very much intertwined.

At the same time, this kind of transition corresponds to patterns common in emerging markets – and, as already established, the survey identified China, India and Vietnam as the principal risers in terms of importance as client locations. As personal disposable incomes rise, individuals accumulate sufficient assets to warrant professional wealth management services. It is

It is not inconceivable that large-scale service providers will evolve into one-stop-shops for all kinds of foreign investment services, from setting up wholly foreign-owned enterprises to administering trusts.

therefore only natural that service providers would respond to changes in regional demand.

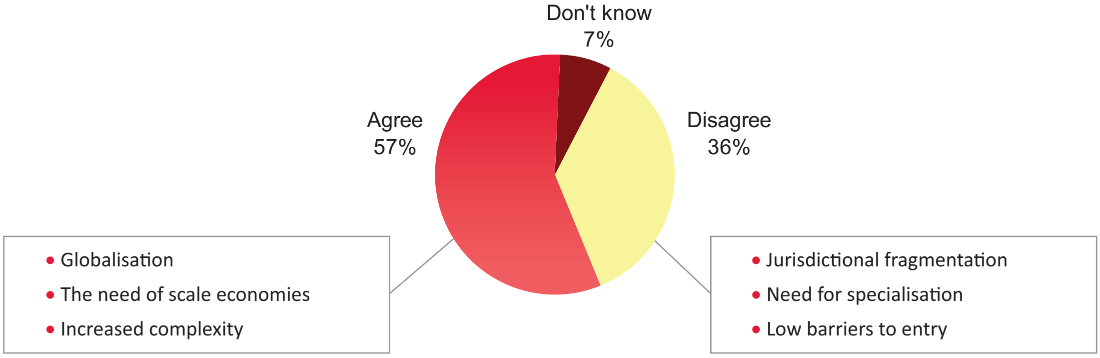
With companies looking to broaden their product portfolios, a degree of industry consolidation might appear inevitable. On this issue, however, survey participants were split. Asked whether globalisation and the need for economies of scale mean that the industry – and the company formation segment in particular – is likely to consolidate in the medium to long term, 57% of respondents agreed while 36% disagreed (see Figure 8).

In addition to globalisation and economies of scale, increased complexity and regulation and licensing issues are seen as drivers for consolidation. The counter-argument is underpinned by tendencies towards jurisdictional fragmentation, the need for specialisation and low barriers to entry.

The likely outcome is a polarisation of the industry, with small, specialised operators at one end and large-scale, full-service providers at the other. Both positions are commercially defensible. The specialised operators survive by virtue of their low-volume but high-value business model that focuses on a particular product category and perhaps even a particular jurisdiction. Most rivals are unable to emulate this approach due to the skill and sophistication involved.

Large-scale providers, meanwhile, can leverage economies of scale to gain market share from mid-size peers. Price remains a big concern for Asian investors (see Figure 9) – and 63% of survey respondents said they didn't expect the "seek out the cheapest" mentality to change – and competition in this area will remain tough. But large-scale providers can also call upon a breadth in geographic and product coverage, which amount to significant barriers to entry. It is not inconceivable that these firms will evolve into one-stop-shops for all kinds of foreign investment services, from setting up wholly foreign-owned enterprises (WFOEs) to administering trusts.

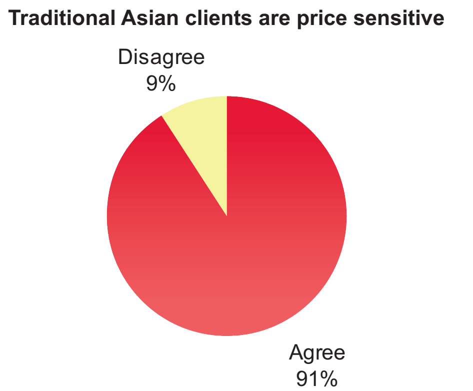
Figure 8: Is the industry likely to consolidate in the medium term?



Larger service providers are also likely to be jurisdiction agnostic. Despite the fragmentation in this area, a number of service providers already have networks that span most major locations, either through direct ownership or service agreements with local players. As a result, allegiances to particular jurisdictions should fade away, especially as investment structures become more complicated and use multiple locations.

This process would be accelerated should regulators in leading jurisdictions – notably Hong Kong and Singapore – introduce mandatory licensing for offshore service providers. Nearly two-thirds of survey participants said they expected licensing to be phased in, although not for around four years (see Figure 10). Based on the experiences of other locations, licenses are granted conditional on certain levels of industry expertise and passing a fit and proper person test. Should they become the norm throughout Asia, many of the smaller, less experienced service providers might be forced out of the industry by failing to meet the required standards.

Figure 9: Asian pricing



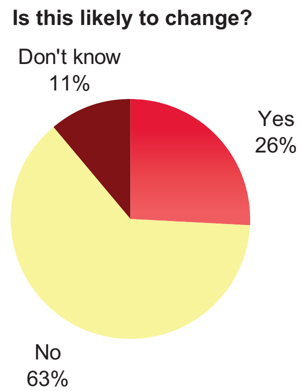
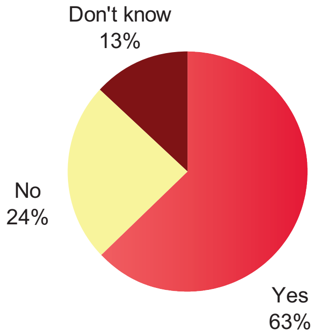


Figure 10: Will the corporate services providers be licensed in the future?



SUMMARY

The offshore market has always been a dynamic creature, buffeted by wider trends in the financial services industry. This is certainly the case today, with emerging market wealth and tighter regulation requiring new approaches to traditional issues such as tax and estate planning. It is certainly the case that a combination of the regulatory environment and better quality advice has made clients more sophisticated in terms of their understanding of the industry and, by extension, the requirements they make of service providers. In this respect, it is important that the industry rectifies its poor efforts so far in selling the legitimate role of offshore structures in today's globalised world.

Asia looms large in the industry's future – with India, Indonesia and Vietnam likely to emerge as key players alongside China – and meeting its needs will involve taking on challenges old and new. Anti-money laundering measures and KYC compliance continue to be constraints on the market while price remains a significant hurdle, especially for new Asian clients. To these issues can be added the full weight of the Organisation for Economic Cooperation and Development's agenda on tax transparency, and with it double tax treaty considerations and information exchange between regulators.

The offshore industry that is emerging is increasingly complex, and likely to become more so. "Mid-shore" locations like Hong Kong and Singapore will grow in importance as structures begin to incorporate a combination of onshore and offshore elements. However, this will not necessarily be at the expense of traditional jurisdictions, which should continue to play a role in geographically and legally diversified product portfolios.

This rising complexity may well bring about a polarisation within the industry, with a small number of large, universal service providers and a large number of smaller, specialist operators that target particular products or jurisdictions. As a result, the dividing line between those who service institutional clients and those focused on individuals is likely to blur, with the institutional players increasingly turning to individual client business.

OIL will continue to track these trends over the coming year as a means of opening up the debate on where the industry could – and should – be headed.

METHODOLOGY

During the second quarter of 2010, OIL commissioned Matrix Services Limited to conduct interviews with a wide selection of offshore industry participants. Interviewees were based in locations including Hong Kong, Singapore, Taiwan, China, the Cayman Islands, the British Virgin Islands, Anguilla and Labuan.

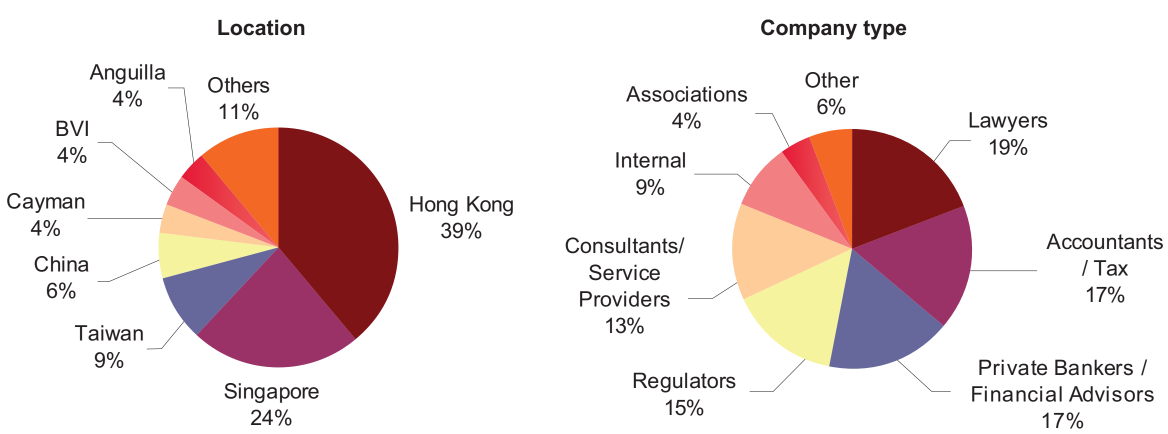
They represented the following industry segments (see Figure 11).

- Accounting
- Law
- Private banking/financial advisory
- Regulatory agencies
- Consultancies/service providers
- Industry associations

The aim was to assess - from an Asian perspective - how the offshore industry is likely to develop over the coming decade. Specific areas covered in the interviews included:

- Market structure: How is the structure of the industry likely to develop in the medium to long term?
- Motivations: Are the key motivations for the company likely to change?
- Emerging and new markets: Will the advent of emerging markets such as China and India have a significant impact on the industry?
- New wealth: How will the emergence of new pools of wealth in Asia change the market for company formations?
- Drivers: What key factors will drive and constrain the growth in the market, including attitudes to regulation, buying behavior and new product development?
- Size: How are the above factors likely to impact the size of the market over the medium to long term?

Figure 11: Sample by location and by company type



ACKNOWLEDGEMENTS

OIL wishes to express our appreciation for the input and support we received from clients and partners in our first market research study. Of the 50 participants who took part in the survey, the following companies have agreed to be listed in the report.

Anguilla Financial Services Commission, British Virgin Islands International Finance Centre, Samoa International Finance Centre, ANZ Private Bank, Azure Tax, BancAlliance, Boardroom Corporate Services, Campbells attorneys-at-law, Cayman Finance, Dacheng Law Offices, DLA, Family Capital Conservation Limited, Financial Partners International, Finova, Harney Westwood & Riegels, Hilda Loe Associates, Jersey Finance, Nexia TS, PricewaterhouseCoopers, Shanker Iyer & Co.

To have a deeper conversation about the key findings and how OIL may further enhance our services and add value to your business, please contact any of the following business unit head in our local office:

Hong Kong
Jonathon Clifton, Executive Director
jonathon.clifton@ofshore-inc.com

China
Ernest Zheng, Managing Director
ernest.zheng@offshore-inc.com

Singapore
Helen Soh, Executive Director
helen.soh@offshore-inc.com

Taiwan
Nadine Feng, Executive Director
nadine.feng@offshore-inc.com

If you wish to take part in next survey, please register your interest with marketing@offshore-inc.com.

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