

Peter Tarn: Offshore firms must be prepared for the post-Lehman age

Author: Peter Tarn

14 Jul 2009 | 10:07

Even in the turbulent days of last autumn when the financial pages of the newspapers seemed out of date by mid-morning the big issue was not how offshore firms would survive the immediate economic crisis, but what shape the equally inevitable regulatory backlash would take and how that would impact them in the medium term.

Of course, you have to get to the medium term first, but an offshore law firm with a reasonable degree of financial hygiene can do that, and so far all have. Their corporate services arms give a degree of recurring revenue and cash-flow that many professional services firms lack, and the counter-cyclical kickers really exist.

I imagine many were slightly surprised at the strength of the investment fund restructuring workflow as compared to the straight debt restructuring, but in a sense, it is merely a detail, and financial services-related and asset recovery litigation continues to power ahead. However, the medium term very quickly becomes the short term, and the regulatory backlash has well and truly arrived.

The assaults on the offshore sector from 2000 onwards had been supposedly based on combating tax evasion, money laundering and terrorist financing, and despite the administrative burden being unwelcome, the bottom line was always that these targets were, in the context of the major offshore law firms, irrelevant. Whatever the press might say and whatever OECD countries might choose to say they believed, this was not how we earned our money. Post-Lehman, the thrust of the attack changed and became more challenging.

Obviously, initial instincts were to point out that the financial crisis had its genesis in the regulated onshore financial centre. But frankly, doing so was a mug's game. As was the defence that the low-tax jurisdictions have essentially done exactly what the Western world has asked of them over the last decade and the fact that this compliance has been verified by the relevant global institutions. The position now is simple: the size of developed countries' budget deficits mean that the hunt to extract tax wherever and whenever is not going away. If regulation of the financial services sector provides cover for that, it will be used.

We need to get used to a world in which those who lead developed countries believe that the profit generated by private enterprise is primarily a resource owned by governments. The fundamental position that everyone is perfectly entitled to order their affairs so as to minimise tax seems precarious, and any argument that the amount the individual keeps should be preserved or increased will only be heard on the basis of contribution to a common good.

Like it or not, offshore law firms have to make the case that they do contribute to the common good. First, there is a very real argument that the offshore centres and the shadow banks are actually functioning as they ought to with failures, losses, reallocation of resources and no systemic threat. Second, the world's prime problem right now is that capital flows are gummed up. The offshore world facilitates those capital flows with its legal systems, regulatory systems and by providing tax neutrality.

In a fragile environment, every marginal cost of doing international business reduces capital flows. Taxes are paid at the beginning and at the end of the every piece of business, insisting that they are also paid in the middle may just prevent the journey and removing the taxation saving element of offshore centres is not the 'no cost' option that is presented to the media and electorates.

Those arguments will prevail eventually. It will not be business as usual, but a role for those who have real ability to assist in structuring cross border capital flows will continue. Offshore law firms have changed beyond all recognition to facilitate the major capital flows of the last decade. The nature, the source, the destination and the structure of those flows will change, and the good offshore law firms are already changing with them.

Peter Tarn is global head of banking and finance at Harneys.