How offshore advisors can avoid (accidentally) committing a crime

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The offshore wealth management world can be a confusing place. Not to worry – our legal columnist Rebecca Leon of Baker McKenzie has a handy guide for avoiding common pitfalls.

Whether starting an offshore platform or expanding an existing one, US broker-dealers and wealth managers need to consider how to mitigate risks. Taking the right steps early on may help your firm avoid costly mistakes, including regulatory investigations and private litigation.

Importantly, it can also keep traveling advisors out of prison in jurisdictions where violation of local securities-related laws is a crime.

Risks particular to the offshore business fall into three main categories: US regulations, contractual obligations, and foreign regulations. These three areas often overlap and sometimes conflict.

In a post-pandemic world, advisors will resume traveling abroad to visit clients, which brings its own set of additional risks. Considerations need to go far beyond determining if a broker-dealer and advisor registration are required in each jurisdiction. Firms need to analyze all the areas they would consider for their US businesses.

To help navigate these waters, I've put together this guide to separate fact from fiction about doing business in the offshore world and dispel any common misconceptions.

Fact

> **Rules established by the Financial Industry Regulatory Authority (Finra) that impact offshore businesses are sometimes overlooked.**

Starting from the top, firms must consider whether there is a material change to their business by creating or expanding an offshore platform, and whether any proposed hiring is beyond Finra safe harbor limits. Any of these business expansions may require Finra approval. Of course, an offshore business typically requires compliance personnel and sales supervisors who understand the offshore model, are bilingual, have appropriate licensing, and who are familiar with complex offshore structures used by high net worth foreign clients for tax efficiency. Firms that allow private securities transactions and outside business activities in their offshore models have additional Finra considerations that require careful supervision.

> **Client outreach by brokers and sending US-required disclosures and correspondence may be considered solicitation of a prospective client that violates foreign regulations.**

Carefully scripted client communications can help mitigate this risk.

> **Certain investment products create additional legal risks.**

Offshore product distribution agreements often require representations by selling broker-dealers to avoid offering the security in a way that requires its registration in a new jurisdiction. Such agreements may provide broad protection for the issuer or fund manager by the selling broker-dealer for costs associated with a breach of such representation. To avoid such a breach, firms should design and implement procedures that may include: counting the number of offers of a particular security made to clients in a specific jurisdiction; qualifying clients under a foreign 'accredited investor' definition; including required legends in offering documents; and abstaining from offers to clients in a particular jurisdiction.

Fiction

> **Your clearing firm's willingness to accept accounts or make products and services available is a seal of approval that they can be offered to investors in a given jurisdiction.**

While there may be no violation of foreign law associated with the services provided by a clearing firm, the same jurisdiction may have laws limiting solicitation of local investors by US broker-dealers. Client-facing firms must think about risks and rules particular to their activities and consider what responsibilities and indemnification obligations are included in their agreements. Self-clearing firms, introducing broker-dealers, firms dually registered as investment advisors, and firms that have personnel located offshore bear distinct risks.

> **All agreements are under US law so foreign regulations are not applicable.**

Regulations generally seek to protect local residents regardless of the law governing the agreements. I previously commented on the application of Latin American privacy and consumer regulations to US firms. US broker-dealers also could incur liability for foreign taxes for following account beneficiary designations that are contrary to foreign heirship laws and for aiding and abetting client violations of foreign exchange controls, among other potential liabilities.

> **Risks can be eliminated.**

Where to start? Implement policies and procedures for brokers as well as their supervisors and compliance personnel that are specific to your firm's offshore business; implement travel policies and product offering policies that take foreign laws into consideration; supplement client agreements to provide disclosures and obtain representation and consent that address unique risks that arise with offshore clients; and review existing agreements to understand your firm's obligations. Consider addressing some of these topics in employment and independent contractor agreements with the brokers. And finally, AML, AML, AML. Are you ready?

Rebecca Leon is a partner at law firm Baker McKenzie, focusing on legal and compliance matters for US wealth management firms, broker-dealers, and banks that cater to offshore clients.

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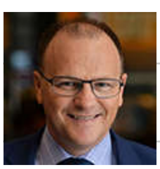

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