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The Dutch Trust Industry

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Summary

The Netherlands has a long tradition in international trade. There is an internationally oriented regulatory environment, and a sophisticated network of trade supporting industries. From a fiscal point of view, the Netherlands is an attractive place for multinational operating corporations (MNCs), thanks to an extensive network of bilateral tax agreements, the participation exemption and, most important, a stable and reliable fiscal climate with adequate supervision. The feasibility of advanced tax rulings between MNCs and the tax authority reduces uncertainty about the fiscal consequences of the international corporate and tax planning of MNCs.

Taxes, like all transaction costs, have a distortional effect on production. The decision where to locate their financial and administrative headquarters has a large financial impact on MNCs. These enterprises use legal entities in the Netherlands for reducing international tax liabilities, especially preventing duplication of fiscal liabilities, and for structuring financial transactions. In this way, they try to minimize total transaction costs associated with tax payments and the consequent financial transactions. These costs do not only consist of taxes to be paid, but also of reporting costs, information costs and the costs of compliance to (local) rules and regulations. Trust offices (also known as fiduciary offices) act as local representatives on behalf of foreign clients. In terms of economic theory, trust firms play an important role in reducing transactions costs for their clients. They provide administrative and management services, and coordinate advisory services in the field of corporate financial planning. Since the services and activities of trust firms are hardly visible in the public domain, the trust industry is often accused of a lack of transparency.

In 2004 industry was brought under a regulatory regime, in the Act on the Supervision of Trust Offices (ASTO). In 2006, *De Nederlandsche Bank* had granted a license to 141 trust offices. Together, these firms employ about 1.700 employees. Annual turnover (in 2006) of the trust offices totals € 242 million, derived from about 20 000 legal entities, represented by 16 000 clients. The Dutch trust industry mainly focuses on delivering services to corporate clients. About 80 percent of turnover is derived from business-like clients. Europe is the most important region for trust offices: about half of the turnover is accounted for by ultimate beneficiary owners located in the EU. Another 11% is derived from European countries outside the EU. The USA and Canada account for 18% of turnover. Asia, the Pacific and Australia account for another 12%.

Trust offices frequently call in other, specialized, advisors on behalf of their clients. Most important in this respect are financial and legal firms, delivering services in designing transactions. Notary firms take care of the incorporation of legal entities for clients. The total value of additional professional services rendered to the clients of trust offices amounts to € 320 million. Over three quarters of these services (€ 245 million) is provided by suppliers located in the Netherlands. Employment involved with these services amounts to 1 300 jobs. We estimate the total annual financial benefits of the trust industry for the Netherlands to be 1.8 billion euro, 73 percent of which consists of taxes, and 27 percent of turnover of the trust firms and other advisors. With 3 000 highly qualified jobs and 16 000 international clients, many of them multinational corporations, the trust industry plays a vital role in shaping the Netherlands as an international center for high quality financial services.

Preface

This report describes the main results of a study commissioned by the *International Management Services Association* (VIMS), supported by the *Dutch Fiduciary Association* (DFA) and carried out by *SEO Economic Research*. Interviews with stakeholders and a questionnaire among trust offices and extensive desk research are the main pillars of this study. The aim of this inquiry is answering the following questions:

- *What services does the Dutch trust industry provide?*
- *How and to whom are services provided?*
- *What is the economic impact of the Dutch trust industry on the Dutch economy?*
- *What is the (competitive) position of the Dutch trust industry in an international perspective?*

In order to answer these questions, SEO Economic Research carried out interviews with trust offices, industry organizations, regulators and providers of related professional services. In addition, SEO Economic Research set out a questionnaire among all trust offices in the Netherlands in possession of an ASTO-license and reviewed existing literature.

In this report we present our findings. Chapter 2 explains the role of the trust industry in the international financial system, from a transaction costs point of view. Chapter 3 provides an overview of the Dutch trust industry: firms and clients, services rendered, and value created. Chapter 4 presents a quantitative analysis of the economic impact of the Dutch trust industry on the Dutch economy in terms of value added, employment and tax payments. Chapter 5 puts the Dutch trust industry and the Netherlands as a jurisdiction in a competitive position vis-à-vis other jurisdictions.

We first would like to thank all interview partners for their time and effort put into the interviews and the useful information they provided to us. A list of all interview partners is given in appendix B to this report. The picture we are able to draw on the economic impact of the sector was not feasible without the valuable information that trust offices provided through the questionnaire. We are aware that the requested information was not easy to provide because of both its complex and confidential nature. The time and effort that the trust offices put into the questionnaire was worth it: it provided us with the possibility to sketch a clear and robust picture of the impact of the trust industry on the Dutch economy.

This study is carried out under the supervision of an advisory committee, whose members provided us with a lot of insights, and the necessary checks and balances. Finally we would like to thank André Nagelmaker for his continuous support and open communication over the course of the project and for his practical solutions to the various problems we were confronted with.

1 Introduction

No matter how efficient governments raise them, and no matter how effective governments spend their money, taxes –like all transaction costs– have a distortional effect on production. Businesses in a competing environment naturally strive for cost minimization. Multinational operating firms (MNCs) work under different fiscal and legal regimes. The decision where to locate their financial and administrative headquarters, which may be separated from physical operations, has a large financial impact. Fiscal considerations play an important role, but also trade regulations and political stability. So called offshore financial centers (OFCs) offer a combination of tax rates, regulation and trading facilities (e.g., bilateral treaties) making them attractive for businesses as a domicile. Multinational corporations use OFCs for reducing international tax liabilities, and for structuring financial transactions in an efficient way (*The Economist*, 2007). Trust offices (also known as fiduciary offices) make OFCs work. They act as local representatives on behalf of foreign clients. For corporate clients they provide advisory services in the field of corporate (i.e., financial and tax) planning, and add local managerial services. For private clients, e.g. wealthy families choosing domicile for their corporate structures in an OFC, trust offices provide advisory, administrative and management services.

The Netherlands claims to be a good place for doing international business, and with reason. Based on a long tradition of international trade (see WRR, 2003), there is an internationally oriented regulatory environment, and a sophisticated network of trade supporting industries, like logistics and the financial sector, providing a first class infrastructure for international business. This infrastructure, and a good maintenance of the skills in trade and financial intermediation, gives the Netherlands a comparative advantage in keeping transaction costs low. For many American and Asian firms, the Netherlands is the gateway to Europe. That is one reason foreign companies choose the Netherlands as their financial and administrative headquarters. From a fiscal point of view, the Netherlands is attractive for MNCs because of an extensive network of bilateral tax agreements, and the participation exemption and, most important, a stable and reliable fiscal climate. The feasibility of advanced tax rulings between MNCs and the tax authority reduces uncertainty about the fiscal consequences of the international corporate and tax planning of MNCs.

The Netherlands has a thriving, although to outsiders virtually unknown, trust industry. The strong position of the Netherlands as trust service cluster is to a large extent historically determined. Operating from a small and open economy, Dutch MNCs such as Shell and Philips were confronted with double taxation of the income of their subsidiaries in other countries, and of income (dividend payments of subsidiaries) of the parent company located in the Netherlands. To solve this issue of double taxation, the Dutch government entered into tax treaties with foreign governments (Lugard, 2005). The internationally oriented fiscal legislation has helped the Netherlands in developing a large and sophisticated financial services industry.

The economic benefits of the trust industry have received remarkably little attention. The way MNCs structure their international fiscal liabilities is perfectly legal, and even necessary given the toughness of competition in many international markets. Yet, with the general public offshore finance is often seen as an undesirable consequence of international capitalism. Van Dijk *et al.* (2006) appear to take this view as a starting point. Their report received attention from Dutch (*NRC Handelsblad*, *Het Financieele Dagblad*) and international newspapers (*The New York Times*, *The Financial Times*), paying attention to the role of the Netherlands as an offshore financial centre. Offshore finance and the trust industry are commonly mentioned in a context of money-laundering and tax evasion. Such allegations often lack proof. In a recent study on money-laundering in the Netherlands, Unger *et al.* (2006, p. 162) argue that «trust companies pose a risk in money laundering because of their capacity to conceal the beneficial ownership of the legal persons behind the entities they manage.» The authors mention that the Dutch trust sector has been regulated in 2003¹, and that «it would make a valuable contribution to policy formulation to determine how successful these new regulations have been in combating and reducing money laundering». They state this without proof about the scale or even the existence of money laundering facilitated by trust companies before regulation was introduced.² The trust industry is accused of a lack of transparency, and some (like Van Dijk *et al.*) consider trust activities to be harmful for the international reputation of the Netherlands. This opinion is even reflected by policy makers. In 2005, the current State Secretary of Economic Affairs, Mr. Frank Heemskerk, stressed the need to «balance the costs of reputational damage caused by the trust sector with the benefits of the tax income it generates» (Carp, 2005).

Inspired by its somewhat dim image, some have argued to dismiss the trust industry as a whole. Before taking such action, it might be wise to find out what the trust industry actually stands for. The two associations of trust offices in the Netherlands (The International Management Services Association VIMS, and the Dutch Fiduciary Association DFA) acknowledge that a perceived lack of transparency is mainly caused by the closed character of the industry. That is why VIMS and DFA commissioned SEO Economic Research to do this inquiry. This report concerns the economics of the trust industry: its reasons for being and the way the firms in the industry operate. In fact, the report concludes that an essential aspect of the niche market for the trust industry in the Netherlands is that it has built a reputation of trustworthy behavior. This reputation is to be maintained through commitment that no illegal transactions will be conducted, possibly at some additional transaction costs in the short run. However, such a credible commitment prevents huge transaction costs from reputation losses on the long run, if clients of trust offices would be associated with illegal activities. For that reason the Dutch Central Bank emphasizes in its recent annual report (DNB, 2008a, p. 83) the importance of good supervision, with trust offices being required to have complete knowledge of the origin and character of the transactions they administer. This credible commitment through adequate supervision is, combined with a stable fiscal climate, network externalities and specific expertise, a major reason for prospects of growth for the trust industry in the Netherlands.

¹ In fact, regulation was introduced in 2004.

² We are aware that absence of proof is no proof of absence; see OECD (2001) for an extensive study how corporate vehicles can be used for illicit purposes in a multitude of ways.

2 The trust industry in the international financial system[♦]

This chapter discusses the role of trust offices from the perspective of transaction cost economics. It shows how trust offices may exploit comparative advantages in keeping transaction costs low and, in this way, profit from the international trend of globalization and fragmentation of production. The ability of good transaction management by the trust industry can enhance its market share when multinational enterprises (including large commercial banks) decide to outsource these activities.

2.1 Trade, transaction costs and trust companies

Trust offices play an important role as intermediates in international financial transactions. The main value creation of these trust offices is that, by using their expert knowledge and networks, and by economics of scale, they reduce transaction costs for their clients. There exists a trade off for the clients in the Coasian sense, namely whether to conduct the administrative, legal and reporting activities associated with these financial transactions themselves within the (hierarchy of) the company, or to outsource and delegate them to trust offices. According to Coase's (1937) seminal description of the nature of the firm, a firm has its optimal size when marginal transaction costs that are a result of vertical coordination via the hierarchy are equal to marginal transaction costs that are a result of horizontal coordination via the market. So if transaction costs with respect to the services that trust offices offer to companies are lower than when these services are carried out by the companies themselves, the strategic decision of the companies will be to outsource to the trust offices. It implies that it is essential for trust offices to be able to perform their services at lower (transaction) costs than the client companies would have been able to do it themselves. Therefore, in order to obtain a better view on the role of trust offices in the (Dutch) economy, it is important to assess the various types of transaction costs that are relevant in this respect. For that reason, this section first discusses the ongoing trend of world wide fragmentation of production which goes along with globalization. This trend enhances the role of transaction costs. From that perspective the following subsection shortly reviews the main topics of transaction costs economics and its relevance for understanding recent developments in international trade. The last subsection focuses on the implications of globalization and transaction cost economics for trust offices and for the regulatory framework within which trust offices have to operate.

2.2 Globalization, fragmentation of production and international trade

Although today globalization is very much in the spotlight of the economic debate, in fact it represents a trend which characterizes world wide economic development for decades, and, with ups and downs, even for centuries. Industrialized economies witnessed already for a long period a steady decrease of employment in agriculture and industry, whereas employment in services and

[♦] Chapter 2 was written by Prof. Dr. F.A.G. den Butter, Amsterdam Trade University (AmTU).

trade has increased. It is especially true for a trading nation like the Netherlands, which, moreover, plays an important role in the financial world (see WRR, 2003). This development is much connected with the increasing division of labor and specialization, both within the national economies and in the world. Specialization means exploitation of economies of scale and using differences in competences and in availability of resources when producing goods and services. Due to specialization and the resulting (international) trade, production will take place where relative costs are lowest. Availability of raw materials and presence of capital, both physical capital goods and human capital, determines the types of products and services that are made and traded in a country. These are the factor endowments of a country (or a company) which are the sources of comparative advantages. In his famous example of the pin factory Adam Smith already noted that division of labor and specialization are the main sources of wealth. Specialization becomes profitable when persons or nations have different endowments and skills in producing different commodities. That is why the comparative advantages have been central to international trade theory ever since Ricardo came up with the concept. In various ways trade theory has tried to explain actual trade flows from the principle of comparative advantages.

However, most of the traditional trade theories do not account for the fact that trade is not for free: the effective exchange of goods and services is costly. In essence all trade transactions relate to exchanges of property rights. So trade and specialization bring about transaction costs. Traditional trade theory does not reckon with these transaction costs and calculations show that international trade would be much larger indeed, when there were no such transaction costs. As Trefler (1995) notes: «Factor endowments correctly predict the direction or the service trade about 50 percent of the time, a success rate that are matched by a coin toss». In short, in a modern economy, the traditional way of looking at comparative advantages does not explain much of the trade flows and of international operations of large (and nowadays also medium sized) companies. Therefore taking transaction costs into consideration is essential to get a better understanding of these trade flows and international operations. These transaction costs can also be regarded as frictions in (international) trade which are the cause that the optimal trade equilibrium from a purely neoclassical perspective is not reached in practice. In fact there is much less trade than in a frictionless economy.

Transaction costs which bring about trade frictions and specialization in production are much intertwined. On the one hand, division of labor and specialization enable a more efficient production of goods and services. This applies both to division of labor and specialization within companies and between companies and countries. On the other hand division of labor and specialization also imply that the different activities must be coordinated. The coordination is a major source of transaction costs. This coordination can take place either through the market mechanism between firms – horizontal coordination – or through the hierarchy within a firm. In case of coordination via the market a trade transaction implies an exchange of property rights. Both coordination mechanisms bring about different types of transaction costs (see next subsection). The introduction of this section already refers to the theory of the firm of Coase (1937) which describes how the decision to split up the production chain and to outsource is determined by these transaction costs. In equilibrium marginal transaction costs through coordination via the market are equal to marginal transaction costs with hierarchical coordination. In case transaction costs via the market mechanism become smaller – e.g. specialized trust offices offer services at lower price and transaction costs – more outsourcing and market transactions will take place. This economic mechanism can, by the way, also put the recent debate on corporate governance

in perspective. Relative differences in transaction costs are relevant in the judgment of active shareholders (hedge funds) on optimal firm strategy. A merger between two firms (e.g. banks) may be profitable in case of economies of scale or scope, where parts of transaction costs are consolidated and netted out. On the other hand mergers may become costly, and less profitable than originally expected, when the linkage of different cultures of the merging firms brings about additional transaction costs through coordination problems.

Transaction costs can be too high for a trade transaction to take place. In that case the advantages of division of labor and specialization do not outweigh the disadvantages. Then, a reduction of transaction costs will imply that more specialization becomes profitable and that the amount of trade transactions increases. It means also that existing trade becomes cheaper. In both cases such reduction of transaction costs will enhance welfare. One of the major driving forces of globalization is a worldwide reduction of transaction costs. The resulting upsurge of specialization and division of labor has led to a fragmentation of production, where the production chain is split up further and further. Those parts of the chain, which could be produced at lower costs elsewhere, and where the lower costs of production outweighed the transaction costs, were outsourced, either to foreign producers or to subcontractors at home. This fragmentation of production has changed the character of the trade in such a way that a new kind of trade theory is in order. Grossman and Rossi-Hansberg (2007) argue that no longer trade in products and services should be the focus of the theory, but rather the trade in tasks.

Globalization and fragmentation of production imply that the share of the transaction costs in the total costs increases. It opens up the possibility for companies, and more in general for a country, to specialize not so much in making the own production more efficient and obtain, or retain, comparative advantages in the production process in a narrow sense, but to specialize in being a more efficient coordinator of the production process. In that case the company, or the country, obtains a comparative advantage in coordinating the production, and hence in orchestrating the value chain. These are the type of activities that characterize a trading nation such as the Netherlands (see WRR, 2003). Obviously the role of trust offices can be seen in this perspective. More in general, in a trading nation, the ability to reduce transaction costs and to create value by efficient coordination can be labeled good transaction management. In this respect the trust industry can be regarded as an important niche in the financial services network, giving the Netherlands a comparative advantage in transaction management.

2.3 Transaction cost economics

The previous subsection illustrates the vital role of transaction costs in the coordination of production in a globalizing world. A major and somewhat unresolved aspect, however, is the definition and measurement of transaction costs. Here it is warranted to come to a clear classification and taxonomy of the different types of transaction costs. Trade transactions can take place as exchange of property rights between legal bodies in market transactions, but also in a more informal manner within the hierarchical organization of a (large) company, or within a network of traders or even within a family. The literature (see, e.g., North and Wallis, 1994; North, 1994) provides a first step to a classification of various types of transaction costs, but in practice the demarcation between various types of transaction costs, and between direct production costs and transaction costs is fuzzy. Such split up of total costs (at market prices) in direct production costs and transaction costs would provide insight in the relative importance of transaction costs as part

of total costs. Our hypothesis is that the share of transaction costs in total costs increases in a globalizing world, and that therefore the ability to keep transaction costs low, and to obtain comparative advantages in transaction management, becomes more and more important. If the hypothesis is true, it is implied that the role of trust offices in the globalizing world will increase, provided that they are able to retain their comparative advantages in keeping transaction costs low. In that case, further 'deglomeration' implies more outsourcing of financial services. Trust offices, especially in the niche market in the Netherlands with its reputation of trustworthiness, can benefit from this world wide trend of outsourcing.

A key question is: *what are transaction costs?* Transaction costs can be defined as all costs made in trade transactions, either as an exchange of property rights in a market transaction, or as an exchange of responsibilities in a hierarchical situation. In other words transaction costs can be associated with the fuss and ado that occurs when purchasing or selling goods and services, when changing the location of production and splitting up the supply chain. A firm that is able to keep its transaction costs low, will be more successful in offering attractive products to the market, as this type of costs plays a considerable role in international trade. In principle two types of transaction costs can be distinguished: 'hard' and 'soft' transaction costs. Hard transaction costs relate to costs that are readily perceptible and quantifiable, such as transport charges, import levies and customs authorities tariffs. Soft transaction costs are much more difficult to observe and measure. One can think of all kinds of costs of making and checking contracts, information costs, costs because of cultural differences and communication failures, tacit knowledge on legal procedures, formation of trust and reputation, network building, costs associated with risks and with rules and regulation in order to reduce risks, security requirements etc. Now that the hard costs decrease because of trade liberalization and lowering of transport charges, the soft costs become more important. Good entrepreneurship in trade is needed to value these soft transaction costs. Part of these soft transaction costs can be regarded as informal trade barriers. They are the consequence of differences in language and culture, lack of knowledge and insufficient trust (see e.g. Den Butter and Mosch, 2003, Linders, 2006). Probably the calculation of all of these transaction costs at macro level will show a further increase of these costs. Such rise in costs at the macro level seems paradoxically when keeping transaction costs low and reducing these costs further is seen as the strength of a trading nation (or *transaction economy*: see Den Butter, 2007). However, such an outcome would imply that lower transaction costs provoke more than proportionally additional trade transactions. So the reduction of transaction costs creates additional value, which translates into a higher value added in the transaction economy. This may also apply to the trust industry: the more trust offices are successful in reducing transaction costs for their clients, with respect to both paying low taxes and reducing all kinds of administrative costs (which partly can be regarded as 'soft' transaction costs), the more turnover through increased demand the trust offices may generate.

In spite of the problems of defining and measuring transaction costs, some attempts have been made to quantify transaction costs at the macro-level. Following the methodology of North and Wallis (1986), De Vor (1994) asserted that in 1990 total transaction costs in the Netherlands economy amounted to almost 53% of GNP. It implies that more than half of value added in production in the Netherlands relates to conducting transactions. In the period 1960-1990 total transaction costs increased with about 9 %-points. This can be ascribed completely to an increase in the private sector. According to De Vor's measurement transaction costs in the private sector are (in 1990) over five times higher than in the public sector. Van Dalen & Van Vuuren (2005)

measure by means of occupational data that in the Netherlands approximately 25% of workers is employed in transaction jobs, and 29% if one includes transport tasks. However, these occupational data do not take into account time spent on coordination by production workers. Klammer and McCloskey (1995) note that one quarter of the GDP is related to persuasion, i.e. talks to make 'real production' possible. In their survey on 'trade costs', Anderson and Van Wincoop (2004) illustrate the size of these trade costs by means of the tax equivalent of these costs: what would be the tax tariff on direct production costs if all trade costs were regarded as taxes – from a theoretical point of view trade costs have the same distortional effects on production as taxes. Anderson and Van Wincoop have a rather broad definition of trade costs so that it comprises most of the transaction costs discussed earlier in this section. Their main finding is that trade costs are large and variable. The example of the Barbie doll, as discussed in Feenstra (1998), illustrates these large costs. The direct production costs of the doll are \$1, but they are sold in the US for about 10\$. So the costs of transportation, marketing, wholesaling and retailing have an ad valorem tax equivalent of 900%. In their own (rough) calculations Anderson and Van Wincoop arrive at an estimate of the tax equivalent of 'representative' trade costs for industrialized countries of 170%. The number breaks down as follows: 21% transportation costs, 44% border related trade barriers and 55% retail and wholesale distribution costs ($2.7 = 1.21 \times 1.44 \times 1.55$). Anderson and Van Wincoop argue that further evidence on the importance of trade costs should be obtained by using microeconomic founded gravity equations.

The theory of transaction costs economics (see e.g. Williamson, 1998) provides more insights in the role of transaction costs for the working of the economy. It illustrates the relevance of transaction costs for understanding several of the empirical phenomena that are impossible to understand without relying on such costs. Institutions play a major role in transaction costs economics. Different institutions may bring about different types of transaction costs. A major example is whether transactions take place according to formal or informal contracts. Although globalization brings about some convergence of institutions, or more specifically some dominance in Anglo-Saxon trade institutions, cultural, legal and social differences between the various countries and regions of the world will remain. Knowledge of, and feeling for these differences is of utmost importance for keeping transaction costs low in international trade relationships. The traditional position of the Netherlands as a trading nation is that of a meeting place for these different ways of trading. Therefore openness to these differences, and the possibility to establish links between the various institutions of trading, should be a major focus of research on transaction costs economics in the Netherlands. It will help to confirm the position of the Netherlands, and more particularly Amsterdam as a focal point between the Anglo-Saxon, the European continental, the Middle Eastern and the Asian ways of trading. This functioning as a bridge between various cultures of conducting trade can be a reason for the location choice of trust offices in Amsterdam. Knowledge of tax rules in various parts of the world, and knowledge of application of these tax rules by the authorities, which is partly *tacit* (=non codifiable) knowledge, can be an additional argument for such location choice; see figure 3.4 for the regional distribution of the turnover of Dutch trust offices.

Transaction cost economics provides us with further insights into the welfare enhancing effects of specialization, but also to the limits of the extent of specialization (Williamson, 1998). The way in which transactions are organized is endogenous according to the transaction costs theory. Alternative modes of organization imply different transaction costs. Transaction cost economics sees a trade off between transaction costs and efficiency of production. If a transaction is simple

and transparent, the market is well-equipped to facilitate the transaction. But when transactions get more complicated and other issues become more important (e.g. because of sunk costs or intellectual property rights), more complex contracts have to be designed and enforced.

Consequently, the transaction costs will rise. At a certain moment, transaction costs will be so high that it will be more efficient to internalize different production stages in a single firm. This will reduce transaction costs because there no longer is a need to formulate and enforce complicated contracts. But, meanwhile, internalizing production will lead to less efficiency, because hierarchical structures provide less powerful incentives than markets. The choice for a certain mode of organization thus depends on the characteristics of the transaction and the institutional environment. In the extreme case, when public interests enter the arena, transaction costs can lead to regulation or even a public bureau (Williamson, 1998, p. 47).

The influence of transaction costs on the organization of firms also relates to the way innovations enhance firm productivity, and hence to innovation policy. As argued above, the production costs of goods and services in a production chain can be split up between direct production costs and transaction costs. Direct production costs relate to production within parts of the production chain, whereas transaction costs relate to costs involved in linking the various parts of the chain. In the traditional organization of a firm from the industrial sector, the production chain consists of relatively few parts so that transaction costs are relatively moderate. In that case it is most profitable to enhance the efficiency of production by a reduction of direct production costs within the parts of the production chain. In such situation innovations (e.g. through R&D) should be directed at making the production process itself more efficient. However, in the situation of a firm with global activities the production chain is split-up in many parts. Here the transaction costs of linking the various parts, either through outsourcing and subcontracting production tasks or through dividing production tasks over various plants on different locations in the world, transaction costs become relatively important. Now efficiency of production can be enhanced by focusing innovations (and R&D) on a reduction of transaction costs. It illustrates how innovations in trade can contribute to productivity increases and to preserve comparative advantages in transaction management. It also indicates that good skills of trust offices, and making administrative and reporting services more efficient, can be regarded as innovations which will have beneficial spill-over effects for the working of the economy.

2.4 Trust offices and transaction costs

This transaction costs perspective on globalization provides some insights into two major questions with respect to the position of trust offices, namely (i) what factors can be determinant for the location choice of trust offices in the Netherlands, and more particularly in Amsterdam?, and (ii) what role do these trust offices play in the Dutch economy?

Regarding the first question, the location choice, it is obvious that the decision to locate the offices in Amsterdam is dictated by the fact that transaction costs are relatively low at that location. Here, as indicated above, various types of transaction costs can be distinguished. A major activity of trust offices is the management of companies, of which the special financial institutions (SFIs) form an important part (see De Nederlandsche Bank, 2007). It usually means that a trust office acts as the managing director, providing the SFIs with a registered office, and with administrative and legal services. SFIs are finance, royalty and holding companies established in the Nether-

lands, but controlled by foreign owners. They receive and lend financial assets across international borders, and consequently constitute important links in the financing chains of large multinational groups of companies, but also play a role in the context of mergers, takeovers, restructuring and refinancing. Total transactions by these SFIs amount to over 4,500 billion Euros a year, which is over nine times the Dutch Gross domestic product.

As one of the main tasks of the trust offices is to help clients to structure their corporate holdings in order to optimize their tax situation, favorable tax arrangements for these financial institutions in the Netherlands will be a main determinant of the ability to keep transaction costs low – as tax payments are part of the ‘hard’ transaction costs described above. Therefore the prevailing tax regime is an important criterion for the location choice.

However, there are other reasons from the perspective of transaction costs for such location choice. These refer to what has been characterized as ‘soft’ transaction costs. The services of trust offices require very skilled and specialized personnel. They should be able to guide the clients of the trust offices through all kinds of necessary procedures. Therefore excellent contacts with local authorities and solid knowledge of rules and regulations are needed. Trust offices take care of registration with the local chamber of commerce, the central bank, the social security and the tax authorities. It implies that there is much ‘relationship specificity’ in the services of the trust offices. It means that the services do not have a routine character but that each service should be much tailored to the special situation and wishes of the client (see Nunn, 2005). Such relationship specificity makes the services very knowledge intensive, which can be a rationale to outsource these services to specialized offices. For that reason the multinational commercial banks, who have their head offices in Amsterdam, may have decided not to provide these services themselves to their clients – some did and some still do – but to delegate them to trust offices. Obviously the clustering of these headquarters and trust offices reduces transaction costs through the good network facilities. Moreover trained personnel is (and should remain!) available in Amsterdam. Another ‘reason’ for location choice has to do with path dependency. The Netherlands pioneered in offering trust services.

A final argument is that the trust offices in the Netherlands have strict codes of conducts and are supervised by the Dutch central bank. Trust offices must have a license under the Act on the Supervision of Trust Offices (*Wet Toezicht Trustkantoren*) of 2004. The licensing process includes a trustworthy test of managers of the Managing and Supervisory Boards, and their shareholders. Furthermore, a trust office’s administrative organization and system of internal control measures must meet certain requirements so as to safeguard adequate control of potential integrity risks attached to their services.³ By preventing integrity accidents and fraud, the risk of reputation losses for trust offices and their bona fide clients, and for the Dutch financial sector as a whole, is minimized. So the ‘trust’ that can be given to trust offices through these codes of conduct and strict supervision may considerably contribute to the relatively low transaction costs of trust offices in Amsterdam. Obviously supervision can never be so strict (it would enhance transaction costs too much) so as to prevent misuse or fraud, and the consequent loss of reputation completely.

³ http://www.dnb.nl/dnb/home/toezicht/toezicht_op_andere_instellingen/toezicht_op_trustkantoren/markttoetreding/algemeen/nl/46-147907.html

The arguments with respect to path dependency and network facilities also provide a clue for the answer to the second question, namely on the role of trust offices in the Dutch economy. Obviously on the one hand the clustering of international financial and legal offices and headquarters in Amsterdam facilitates network formation and knowledge transfers which reduces transaction costs for the trust offices. On the other hand the presence of trust offices and short communication lines will also reduce the transaction costs for the clients of the trust offices. Therefore the presence of well equipped and trustworthy trust offices makes Amsterdam more attractive for establishment of internationally operating financial and legal institutions. This is beneficial to economic activity and employment. An inclusive quantification of these spillovers is beyond the scope of this study. Our estimate of the possible benefits of the trust industry for the Netherlands' economy in chapter 4 is confined to tax revenues and direct earnings of the trust offices and their co-suppliers.

3 The trust industry

This chapter provides a general overview of the trust industry in the Netherlands. We discuss the regulatory setting, in which the Dutch trust industry operates, we introduce the trust service value chain, and briefly discuss the various stakeholders and their role in the value chain. We elaborate on the Dutch trust industry: the firms, the services they provide and their clients.⁴

3.1 Regulatory setting

The previous chapter emphasized the importance of trustworthiness of the trust offices in order to reduce (long run) transaction costs for their clients. As of March 2004, the Act on the Supervision of Trust Offices (ASTO) is effective.⁵ The primary objective of the ASTO is to promote the integrity of the Dutch financial system in general, and the trust service industry in particular. It does so by imposing minimum requirements on the operational and organizational structures of trust offices. Policymakers of trust offices are assessed for their trustworthiness and know how.⁶

ASTO was mostly inspired by OECD (2001), and the recommendations of the Financial Action Task Force on Money Laundering (FATF, 2003). ASTO gave legal status to several elements of the set of self regulatory measures of VIMS (one of the two industry associations). See also Text box 5.1 for the role of the trust industry in Curacao in the development and the incorporation of regulation in the Netherlands. Next to the ASTO, the activities of trust offices are affected by a set of additional legislative measures:

- Regulation on Sound Operational Management under the ASTO (Rsom);⁷
- Disclosure of Unusual Transactions (Financial Services) Act (DUTA);⁸
- Identification (Provision of Services) Act (IPSA);⁹
- Sanctions Act.¹⁰

In addition to this legislation, there is a broad range of legislation that affects the trust business, but that is not designed particularly to supervise the activities of trust offices as such, e.g. the entire fiscal legislation, the Act on Financial Supervision (AFS) and Book 2 and Book 9 of the Civil Code.

⁴ The information presented in this and next chapters, was gathered by interviewing a broad group of stakeholders in the trust industry. We interviewed representatives of a broad range of players: Dutch and foreign trust offices, financial and legal service providers, policymakers and regulators. Next to that, we sent out a questionnaire to all ASTO-licensed trust offices. 44% of these, covering approximately 70% of the licensed Dutch trust market, responded.

⁵ In Dutch: *Wet toezicht trustkantoren (Wtt)*.

⁶ http://www.dnb.nl/dnb/home/toezicht/toezicht_op_andere_instellingen/toezicht_op_trustkantoren/markttoetreding/algemeen/nl/46-147907.html

⁷ In Dutch: *Regeling Integere Bedrijfsvoering Wtt (Rib)*.

⁸ In Dutch: *Wet Melding Ongebruikelijke Transacties (Wet MOT)*.

⁹ In Dutch: *Wet Identificatie bij dienstverlening (WID)*.

¹⁰ In Dutch: *Sanctiewet 1977*.

According to representatives of the trust offices and their suppliers' firms, the way the regulatory regime is implemented is not yet optimal. The interviewees expect this to be a matter of time: effective regulation takes time to develop.¹¹ Nevertheless, the supervisory regime is generally perceived to have had a large impact on the industry, even though it has been effective for just four years. ASTO-licensed trust offices consider their license to be a warranty of quality. According to the experts, ASTO has raised the bar for providing trust services significantly. This has led to an increase in the level of integrity and professionalism in the industry. It is now common practice in the industry not to hire employees or to acquire clients who were dismissed by trust offices because of unacceptable behavior.

ASTO has partly led to a shake out, since DNB withheld a number of applicants a license (DNB, 2006a, 2006b).¹² On the other hand, the introduction of ASTO has contributed to the growth of the trust industry, measured in the number of firms and in turnover. The demand for services of the Dutch trust industry has benefitted from an increased reliability and trustworthiness of the industry.

3.2 The trust service value chain

Figure 3.1 depicts the players in the trust industry. We distinguish trust offices, holding companies, being the clients of trust offices (not necessarily the same as ultimate beneficiary owners, see section 3.4), regulators and professional service providers (the suppliers of additional services to clients).¹³ Trust offices provide a variety of services to their clients. These services can be categorized into four basic groups: domiciliation, management services, administrative services (frequently including bookkeeping and accounting services), and additional client specific services. Trust offices act as service coordinators: they hire specialized services within the core business from providers like legal and notary firms, accounting and auditing firms and banks.

The clients of trust offices are both (multinational) corporations and funds owned by wealthy families. The starting point of servicing a client by a trust office is usually the domiciliation of a holding company in the Netherlands. A holding company is owned by a parent company, usually located abroad. The holding company holds assets in subsidiaries located in third countries.

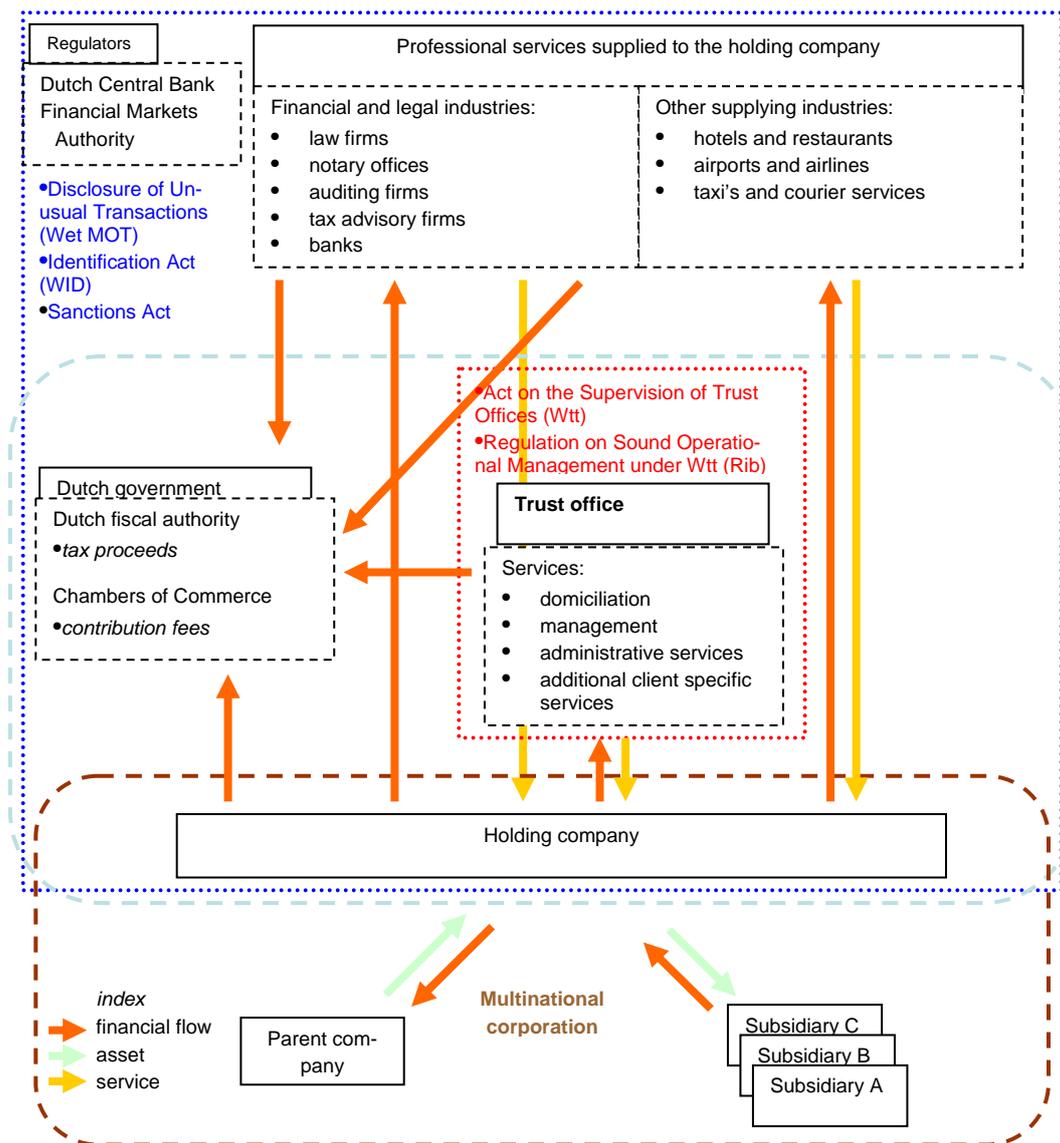
As legislative and regulatory powers, the Dutch government and Central Bank play an important role. The Dutch government also collects taxes related to the trust industry. VAT and profit taxes are raised on the activities of the trust industry and supplying industries and, more important, on financial flows channeled through the Netherlands by the clients of trust offices. All legal entities are registered with the Dutch Chamber of Commerce. The Chambers of Commerce also benefit from the presence of legal entities in the Netherlands in terms of collected contribution fees.

¹¹ According to the interviewees DUTA and IPSA are much less effective. These Acts are generally perceived to bring too much paperwork, with too little result. Apparently here a further reduction of transaction costs in administration is feasible.

¹² In 2007 DNB tracked down 15 firms operating without an ASTO-license (De Nederlandsche Bank, 2007b). This is a considerable number, given the 141 trust offices working under the ASTO regime. Obviously, these illegal firms were not represented in our sample.

¹³ The word 'suppliers' is not entirely appropriate, because trust offices and the other advisors both deliver directly to clients. We call it suppliers, because this report focuses on the trust industry. See Text box 3.2 for the way trust offices and other advisors cooperate.

Figure 3.1 The trust service value chain



3.3 Trust offices

By 2006, 141 trust offices in the Netherlands had been permitted an ASTO-license by the Dutch Central Bank (DNB), and therefore were permitted to provide trust services.¹⁴ Together, these firms employ about 1.700 employees.¹⁵ Firm size in terms of employment varies from 1 to well over 200. The average trust office represents 12 jobs.

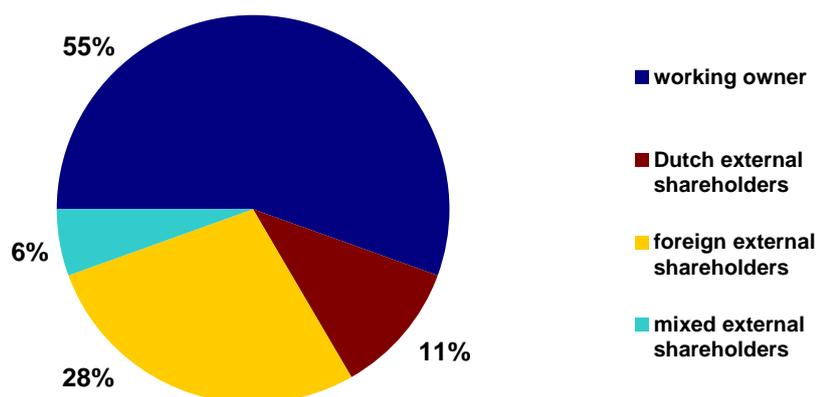
In the past, it was common for banks to have an in-house trust department. For several reasons, most banks recently have sold their trust activities, or put them at a distance. The common trend of outsourcing and specialization is one reason. It illustrates how the reduction of transaction

¹⁴ By December 2007, the number of ASTO-licensed firms had increased to 145.

¹⁵ Figures at industry level in this report are extrapolations of the results in our survey level. Extrapolations are corrected for non response and a weighing procedure was applied because of the overrepresentation of large trust offices in the sample. See appendix C for an elaboration on the applied extrapolation technique.

costs through increased trustworthiness promoted outsourcing of services to the trust offices. More important is an increasing notion with banks that holding directorships of legal entities and being a financier of the same entities may lead to governance problems. In case of bankruptcy of a legal entity, a bank holding a directorship ends up with subordinated loans. After the introduction of ASTO, nowadays only a handful of banks provide trust services in-house. Two thirds of the Dutch trust firms are 100 percent domestically owned, either by a working owner (most of the firms, see Figure 3.2), or by Dutch external shareholders. One third of the firms are foreign subsidiaries, most of them having 100 percent shareholders from abroad.

Figure 3.2 Ownership (% of number of firms)



Annual turnover (in 2006) of the trust offices totals € 242 million. This turnover is derived from about 20 000 legal entities, represented by 16 000 clients. The number of legal entities managed by trust offices varies between 1 and over 2 400.

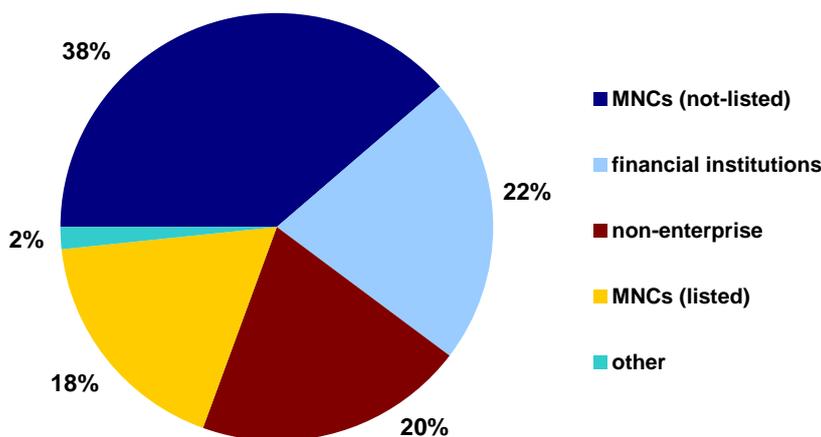
The meaning of trust

Trust is quintessential in the relationship between firms and clients. Relationships between trust offices and their clients tend to be long-lasting. Clients rarely change their trust service provider. Some interviewees argue that the role of mutual trust between the office and its clients is the main explanation for the limited openness that characterizes the industry. This lack of openness can easily be translated into secrecy and a lack of transparency. Some of the interviewees argue that another label (instead of *trust*) could be helpful in improving the often negative public attitude towards the industry. This negative connotation of the use of the word *trust* in this context is remarkable, as in modern economic theory the concept of trust plays a prominent role in transaction costs economics. Fukuyama (1995) put the spotlight on the importance of trust, but see also Nooteboom (2002) and Mosch (2004). In the principal/agent situation between client and trust office, where there is asymmetric information, since the trust office has more knowledge on tax exemptions and administration rules than the client, trust and the reputation of trustworthiness is instrumental in the reduction of transaction costs (see e.g. WRR; 2003, Mosch, 2004).

3.4 Clients and UBOs

The clients of the trust offices are the holding companies of the entities they manage. Clients and ultimate beneficiary owners (UBOs) are not necessarily the same.¹⁶ UBOs are the clients' shareholders, at the end of the chain. UBOs play an important role in trust regulation, because under ASTO trust offices are required to identify the ultimate beneficiary owners of their clients. Trust offices deal directly with their clients, but not necessarily with UBOs. The Dutch trust firms serve about 16 000 clients, holding about 20 000 legal entities.¹⁷ The average turnover per legal entity amounts to € 12 100.

Figure 3.3 Distribution of turnover (total = € 242 million) over types of clients



The clients of trust offices can be broadly categorized into two groups: enterprise and non-enterprise.¹⁸ About 20% of the trust offices' turnover is accounted for by non-enterprise clients (see Figure 3.3). We may conclude that the Dutch trust industry mainly renders services to corporate clients. Within the group of corporate clients, we distinguish financial institutions, listed multinational corporations (MNCs) and not-listed MNCs. Not-listed MNCs account for about € 93 million of turnover, nearly 40% of total turnover of the trust offices. Financial institutions (€ 52 million) and listed MNCs (€ 43 million) both generate about one fifth of turnover.

Providing services to corporate entities with foreign shareholders is the core business of the trust sector. Yet, about 7% (€ 18 million) of turnover is derived from UBOs in the Netherlands. Services rendered to these 'domestic' clients are merely administrative. Europe is the most important region for trust offices: about half of the turnover is accounted for by ultimate beneficiary owners (UBOs) located in the EU (including the Netherlands), see Figure 3.4. About € 26 million or 11% is derived from European non-EU countries. The USA and Canada account for 18% of turnover, which boils down to about € 43 million. Asia, the Pacific and Australia account for € 30 million or 12% of total revenue. Latin and Central America generate 6% or € 15 million of turn-

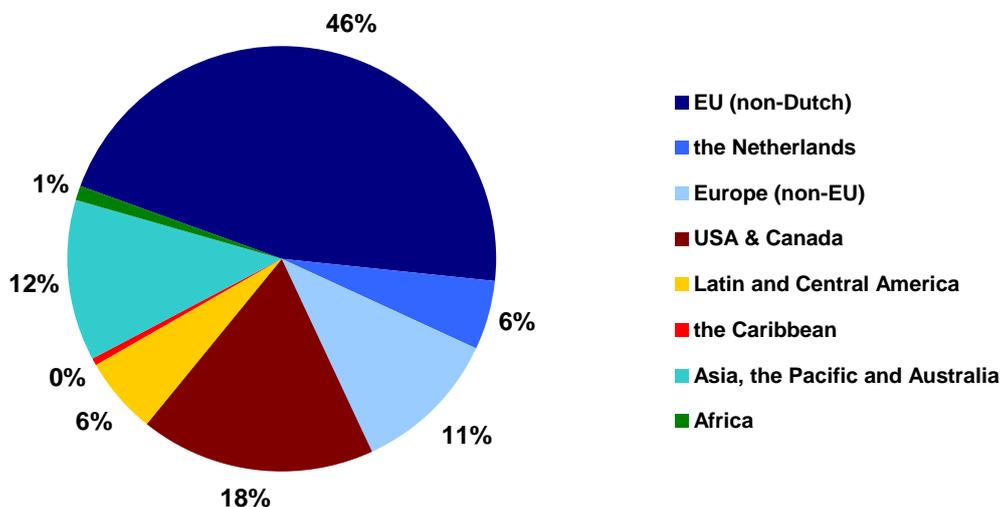
¹⁶ In Dutch: *uiteindelijk belanghebbende*.

¹⁷ This is consistent with the results of Van Dijk *et al.* (2006), who counted 19 647 legal entities registered at the Chambers of Commerce, and matched them to licensed trust offices. Note that not all legal entities qualify as Special Financial Institutions (SFIs, in Dutch *Bijzondere Financiële Instellingen* – BFIs). According to *De Nederlandsche Bank* (DNB 2003, DNB 2007a) there are about 10 000 SFIs in the Netherlands, 75% of which are serviced by trust firms.

¹⁸ The distinction between 'real' enterprises (say multinationals or financial institutions) and non-enterprise (say wealthy families) clients is not strict. Wealthy families or individuals may be major shareholders of large firms, and even if the trust entity consists of 'free' family capital, there always lays a corporate structure behind it.

over. UBOs located in Africa account for a modest 1% of turnover (€ 2.7 million). The share of UBOs in the Caribbean (less than a half percent) is very small. For international investors, the Caribbean is merely a transit region.

Figure 3.4 Distribution of turnover (total = € 242 million) over origin of the UBO



3.5 Services rendered

The basic service provided by trust offices is the management of legal entities on behalf of foreign shareholders (DNB, 2006). Trust offices generally provide three basic trust services to clients:

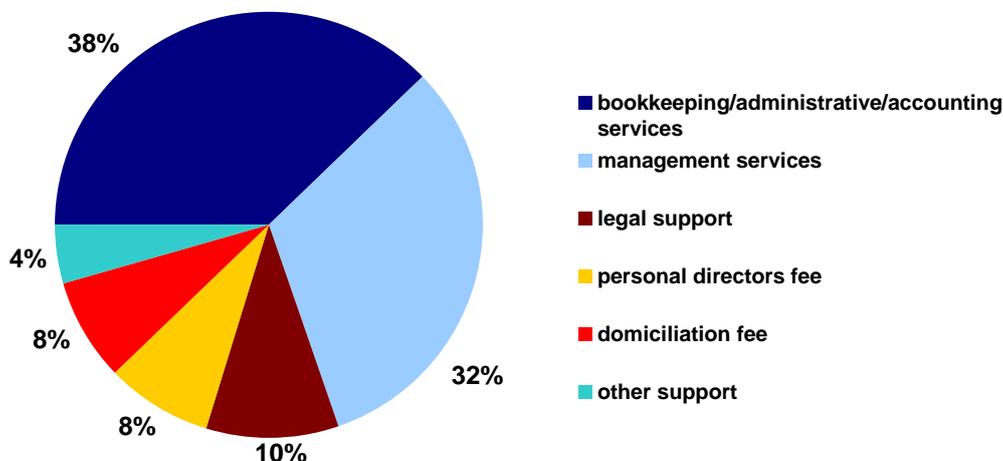
1. *domiciliation*: the provision of an address in the Netherlands;
2. *management services*: trust offices manage the legal entities on behalf of their clients;¹⁹
3. *administrative services*: bookkeeping, administrative and accounting services.

The distribution of turnover over different types of services is depicted in Figure 3.5. Most important are administrative, accounting and bookkeeping services, accounting for 38% of turnover (€ 92 million). These services also include the completion and documentation of large, complex transactions, mainly provided by the larger firms. Management services generate 32% of turnover (€ 77 million), followed by legal support, generating 10% (€ 24 million). Fees paid for the domiciliation of the legal entity and the provision of personnel to the legal entity both account for about 8% of turnover (about € 19 million). The domiciliation fee per entity is estimated to be about € 930.

These basic services do not always require a high degree of sophistication. The value added by trust offices is to be found in additional, client specific consulting services, like tax declarations, complex administrative and financial restructurings, auditing services, maintaining contacts with banks and regulators, or the completion and documentation of transactions.

¹⁹ That may also include holding directorships and supplying personnel, or providing a professional infrastructure for the expatriate staff of foreign holding companies.

Figure 3.5 Distribution of turnover (total = € 242 million) over services



Text box 3.1 Special Purpose Vehicles

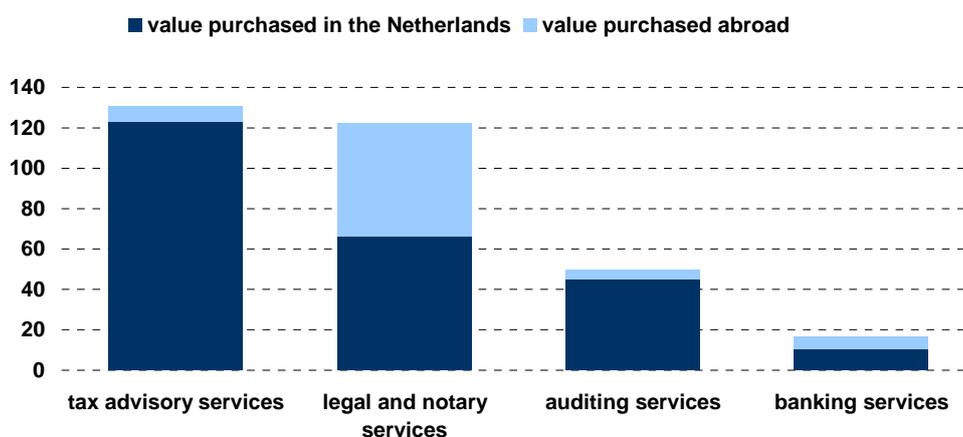
About 12% of turnover stems from Special Purpose Vehicles (SPVs). SPVs are different from SFI's, in a sense that they are single-purpose entities, managed by the trust firm. Gorton & Souleles (2005): «An SPV (...) is a legal entity created by a firm (...) by transferring assets to the SPV, to carry out some specific purpose, or circumscribed activity, or a series of such transactions. SPVs have no purpose other than the transaction(s) for which they were created, and they can make no substantive decisions; the rules governing them are set down in advance and carefully circumscribe their activities. Indeed, no one works at an SPV and it has no physical location. ... Their administrative functions are performed by a trustee who follows pre-specified rules with regard to the receipt and distribution of cash; there are no other decisions».

Besides supplying trust services to their clients, trust offices frequently call in other, specialized, advisors on behalf of their clients. We distinguish four categories of services (Figure 3.6). Most important in this respect are the financial and legal industries. Legal and tax advisory firms are frequently consulted for tax planning structures. Notary firms take care of the incorporation of legal entities for clients.²⁰ Here, part of the asset specificity (cf. chapter 2) of the activities of trust firms is knowledge on which specialized advisors are warranted, coordinating the activities of these advisors. It indicates the importance of the trust industry being embedded in a network of specialized financial services in Amsterdam (see later) and the geographical proximity of these services. The total value of additional professional services rendered to clients of trust offices amounts to € 320 million (Table 3.1). Over three quarters of these services (€ 245 million) is provided by suppliers located in the Netherlands.²¹ Consequently, about € 75 million is purchased abroad.

²⁰ There is variety of other sectors benefiting from the trust industry in the Netherlands. The trust sector is an industry characterized by intensive business travelling; therefore one may safely assume a substantial impact on the aviation and the hospitality industries. See Text box 4.1 for some rough calculations on the impact of trust activities on other industries.

²¹ A turnover of € 245 million by additional advisors providers is an *underestimation*. For legal entities already established in the Netherlands, trust offices coordinate the whole bundle of services. For newly established entities, clients or UBOs usually deal directly with advisory (legal, fiscal, notary) firms. There is no information on the size of the financial flow involved, although it is generally thought to be 'substantial'.

Figure 3.6 Value of services purchased outside the trust sector (excl. VAT, X € 1 million)



Not surprisingly, tax advisory services are the most important services bought from suppliers. With a share of 41 percent in the total value of additional services purchased, the turnover of tax advisors via the trust offices adds to € 131 million. The purchase value of legal and notary services adds to € 122 million.

Table 3.1 Value of services purchased on behalf of clients by trust offices (excl. VAT)

		Purchased in the Netherlands	
		%	value
Tax advisory	€ 131 mln	94%	€ 123 mln
Legal and notary	€ 122 mln	54%	€ 66 mln
Auditing	€ 50 mln	91%	€ 45 mln
Banking	€ 17 mln s	63%	€ 10 mln
Total	€ 320 mln	77%	€ 245 mln

About 94% (€ 123 million) of the total value of € 131 million of tax advisory services is purchased domestically. The average trust office maintains structural relations with 8, and ad hoc relations with 6 tax advisors. On average, € 6 600 is spent on tax advisory services per legal entity.

€ 122 million is spent by the clients of trust offices on legal and notary services, about half of which (€ 66 million) abroad. The average trust office maintains relations with 11 preferred legal and notary service suppliers, and another 10 service providers on an incidental base. The average value per legal entity is € 6 200.

Auditing services account for € 50 million, mostly (over 90%) spent in the Netherlands. The number of auditing firms involved is small, not surprisingly given the market structure (in the Netherlands and abroad) for auditing services. On average, trust offices call in 5 auditing firms, 3 as preferred suppliers and 2 incidentally. The value spent on auditing services is about € 2 500 per legal entity.

Banking services count for € 17 million; about 37% of this value is purchased abroad. The average trust office calls in 19 banks for services, 8 on a regular basis, and 11 banks incidentally. The value per legal entity is approximately € 800.

Figure 3.7 Establishment of client relations by trust offices

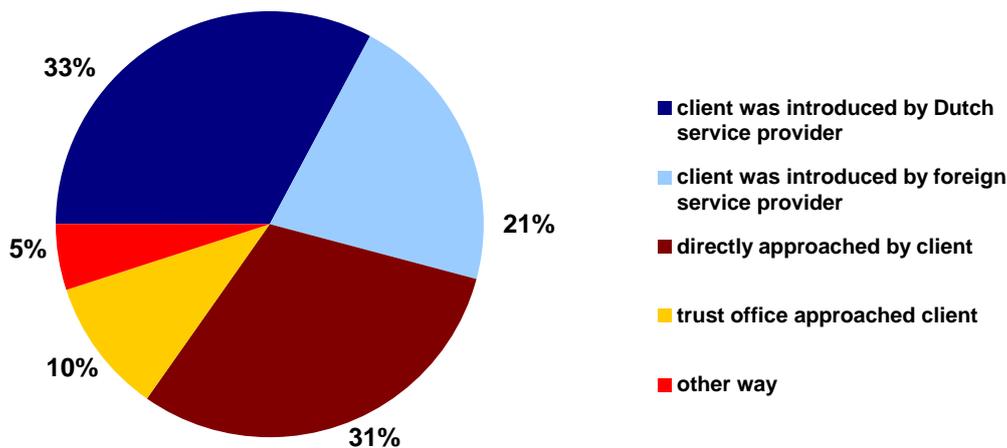


Figure 3.7 shows the symbiosis of trust offices and other advisors. More than half of the trust offices clients are introduced by other service providers, either domestic (33 percent) or foreign (21 percent). The other advisors act both as suppliers and as distribution channel. Trust offices, legal and fiscal advisors together make the trust industry.

3.6 Market structure

There is no specific market leader in the Dutch trust industry. The market is more or less segmented among large and small trust offices. Large firms derive most of their turnover from international corporate clients, small and especially medium sized firms servicing corporate structures of non-enterprise clients. Small and large firms hardly compete with each other. According to the interviewees, large corporate clients mainly seek continuity, and prefer to deal with large trust firms, less vulnerable to unexpected events. Small trust offices argue that they are more capable of giving personal attention and care to their clients than do larger firms. It illustrates how differences in asset specificity of the trust office services bring about market segmentation.

We divide the ASTO-licensed trust offices into three groups according to their size, see Figure 3.8. As in all industries, the majority of the firms is small: two thirds of the firms count three employees or less, including the working owner. There are twelve large firms, with thirty employees or more.²² Despite their small number, the large trust offices account for 70% of total employment (Figure 3.9), which is 1200 of the total employment of 1700 jobs in the industry (see section 3.3). The small firms, account for less than 10% of total employment, about 150 out of 1700 jobs. The medium sized trust offices, with 3 to 30 employees, account for about 30% of the number of offices and about 20% of employment (360 jobs)

²² According to a rule of thumb in the discipline of small service business management, there are transition points at three, ten and thirty employees. A firm with three employees or less can do without much structure: lines are short, and the coordination of activities takes place on an ad hoc basis. From three employees on, some basic coordination is required. This coordination function becomes *managerial* as firms approach the size of ten employees. The next step comes on the level of (approximately) thirty employees. The entire organization (by then often working at more than one location) needs a formalized structure.

Figure 3.8 Distribution of trust offices over firm size

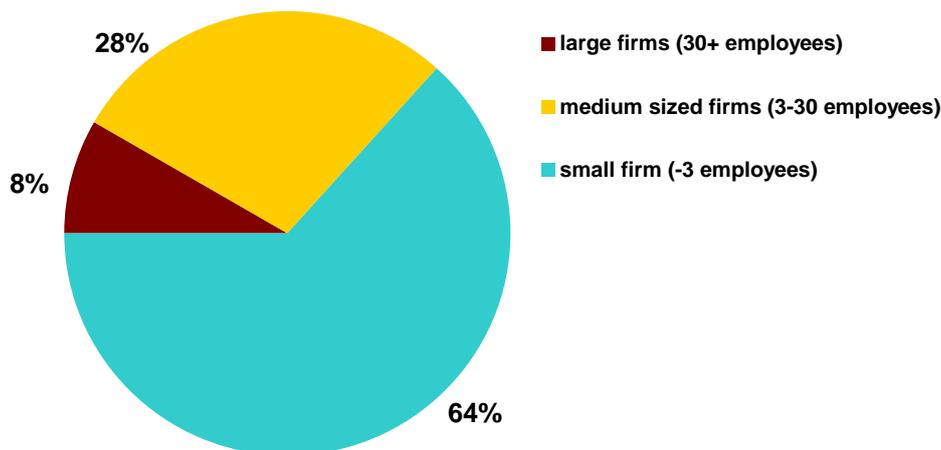
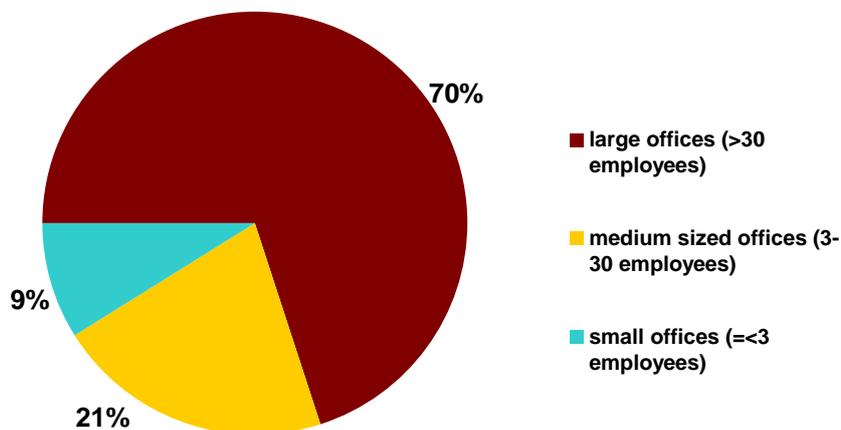


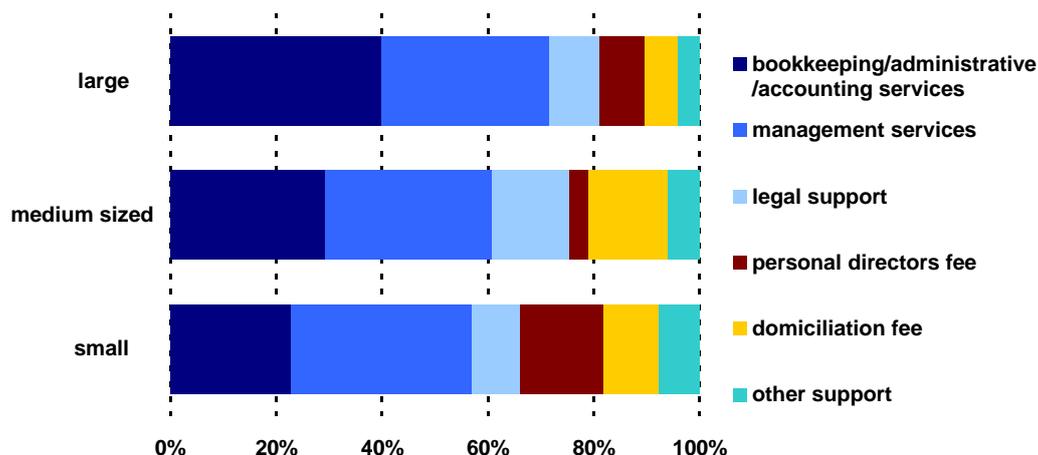
Figure 3.9 Distribution of employment over firm size



Statistical tests indicate that categorization by size is justified: the three groups differ significantly from each other in terms of services offered (Figure 3.10), types of clients (Figure 3.11) and regional orientation (Figure 3.12). Large trust offices, with over 30 employees, offer a full range of services; service a wide range of different types of clients, ranging from private clients to MNCs and financial institutions; and compete on geographical markets outside Europe.

On the other hand, smaller trust offices generally lack the capacity for offering a full range of services to their clients. Small firms less frequently enter markets outside Europe and rely more on non-enterprise clients. Small firms can by definition only have knowledge of a limited number of foreign legal and cultural systems and languages. It is likely that there are investment thresholds in entering different markets (either service or regional based): acquiring specific knowledge and complying with regulations requires scale in operations.

Figure 3.10 Distribution of turnover over services



At first hand, the distribution of turnover over different services, as depicted in Figure 3.10, does not seem to differ really between the three groups. Nonetheless, the graphic is based on the distribution of turnover at group level, not at firm level. Small trust offices generally do not offer the full range of services. They focus on a subset of services, whereas large trust offices generally do offer full range services on firm level. On group level, the small trust offices offer all services in a way comparable to the groups of larger trust offices.

Figure 3.11 Distribution of turnover over type of client

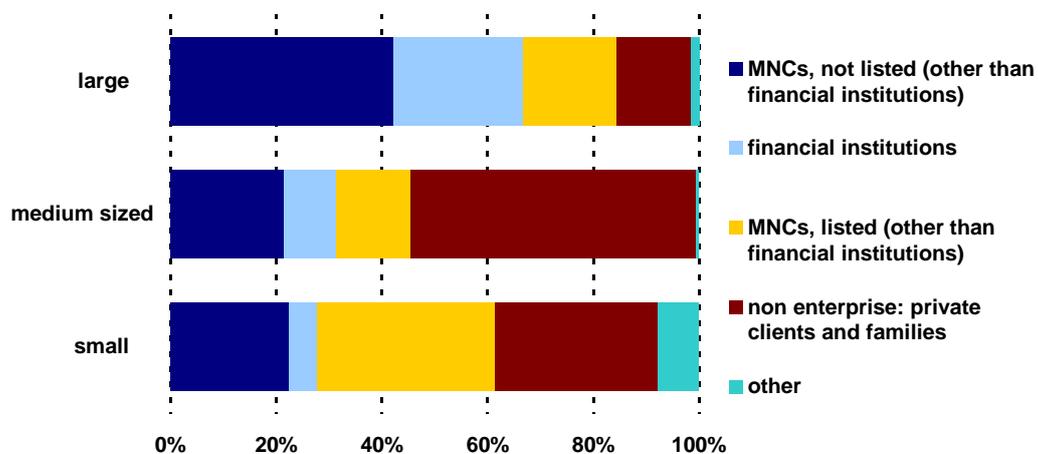


Figure 3.11 makes clear that the three groups deliver their services to different kinds of clients. Large firms derive most of their turnover from international corporate clients, and financial institutions. Turnover from non-enterprise clients is relatively small. For medium-sized firms, non-enterprise clients are very important (see however footnote 18, the distinction between enterprise end non-enterprise clients is not always clear). Small firms have on aggregate a mixed portfolio, but as stated above, they mainly stick to a limited number of services and clients. Small trust firms appear to be the niche players of the industry.

Figure 3.12 again shows differences between the portfolios of large, medium sized and small firms. The share of turnover derived from USA- (and Canada-) based UBOs is especially high for large firms. Large firms also have a higher share in the Asian market. As a rule we conclude that small trust offices mainly deliver to clients nearby, in Europe. That is a corroboration of the in-

tuition that small firms by nature only can cover a narrow range of legal, cultural and lingual systems. Note the share of turnover from more exotic markets like Africa and the Caribbean with the small trust firms. These markets are real niche markets.

Figure 3.12 Distribution of turnover over regional origin of the UBO

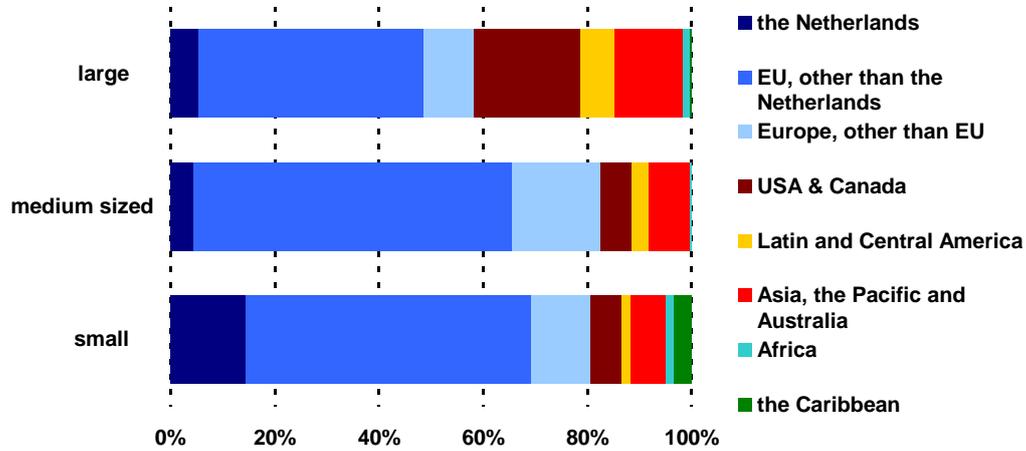
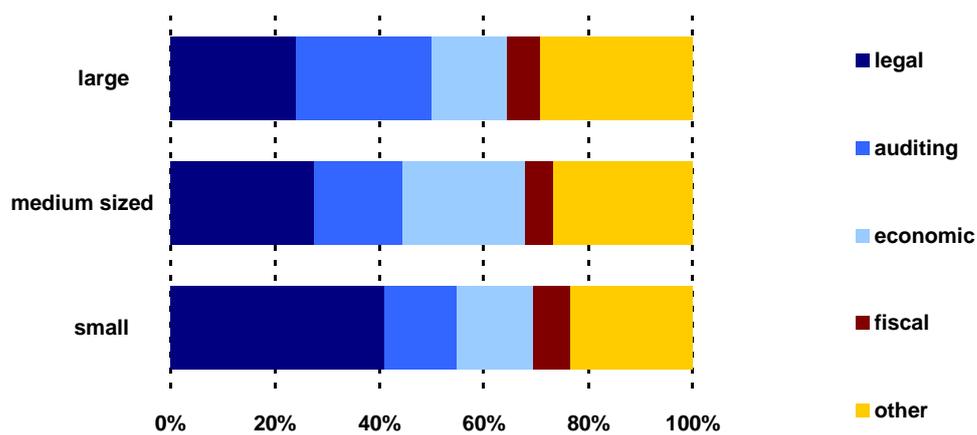


Figure 3.13 shows the distribution of professional staff over the relevant disciplines. The trust firms offer employment tot a mixed population, in which legal and auditing specialists dominate. The number of economists is remarkably low, as is the number of fiscal specialists. The main services of trust firms consist of managerial, accounting and bookkeeping services. International tax planning is a sophisticated activity, which is mostly outsourced to external specialists. This is also reflected by the importance of tax advisory services purchased additionally, as was shown in section 3.5.

Figure 3.13 Distribution of professional staff over type of educational specialization



Large firms

The average large trust office has about 100 employees, 30% of which with an academic education. Another 40% is educated on a vocational level.²³ Most important educational specializations with large trust offices are accounting and legal advice, both accounting for about one fourth of the total staff (Figure 3.13).

Large trust offices offer a wide range of services. Administrative, accounting and bookkeeping services are the most important services for large trust offices in terms of turnover (Figure 3.10). Large firms mainly service corporate clients (Figure 3.11). MNCs, both listed and non-listed, account for over 60% of the turnover of large trust offices. Another one fourth is generated by financial institutions. Private clients account for only 14%. The EU is the most important geographical market for large trust offices, just as it is for medium sized and small offices (Figure 3.12). Half of turnover stems from UBOs located in the EU, including the Netherlands. North America is the second most important market, generating 20% of turnover, followed by Asia, the Pacific and Australia accounting for 13%. Between 5 and 10% of turnover is accounted for by non-EU Europe and Latin and Central America. The Caribbean accounts for 0.4% and Africa for 1.2% of turnover.

Competition between large firms is fairly intensive, although the larger offices usually have their own niche or unique selling point. This is either a specific field of expertise (e.g. securitization, fund administration, in-house banking services, etc.) or a geographical market orientation.

Medium sized firms

Average employment with medium sized firms is 9 full time jobs. The staff is more or less equally distributed over different levels of education, with the academic level accounting for 36% and the vocational level accounting for 32%. Educational specialization follows the same lines as with the large firms, except for the fraction of economists, which is considerably larger (24%). This goes at the expense of the fraction of auditing specialists (Figure 3.13).

The product mix of the medium sized firms resembles the mix of the large firms. The share of legal services and domiciliation fees is somewhat higher, the share of administrative, accounting and bookkeeping services is lower (Figure 3.10). The most remarkable aspect in the portfolios of medium sized trust offices is the high share (54%) in revenues from non-enterprise clients. (Figure 3.11). Presumably, non-enterprise clients seek trust firms large enough for providing a wide range of competencies, and small enough to deliver their services in a personally dedicated fashion. Over 80% of turnover at medium sized firms stems from UBOs from Europe (Figure 3.12). In addition to this, Asia, the Pacific and Australia (7.9%), North America (5.8%) and Latin and Central America (3.4%) are regional markets of noticeable importance to medium sized firms.

Small firms

Small trust offices facilitate employment for on average of 0,7 employee besides the working owner. Almost two thirds of the workforce of small trust offices is academically educated, usually

²³ Vocational education: *Hoger Beroeps Ondernijis*.

the working owner him- or herself. A legal background is most common (41%), but Figure 3.13 shows there are also economists and auditors running their own trust firm.

Small trust offices offer a narrow product range, and compete mainly on price. Small trust offices generally deliver services as domiciliation (11% of turnover), directorships (16%) and management services (34%). Administrative, accounting and bookkeeping services generate 23% of turnover for small firms. Even though private clients are more important in terms of turnover to medium sized firms, non-enterprise clients still account for over 30% of turnover at small firms (Figure 3.11). The fraction of turnover accounted for by MNCs (56%) is remarkably high. Small firms play largely on the European market: 80% of turnover is derived from European UBOs (Figure 3.12). North America and Asia, the Pacific and Australia each account for about 6%. Central and Latin America and Africa each account for less than 2% of turnover. Figure 3.12 also shows that the Caribbean is a niche market for some small trust firms.

Concentration

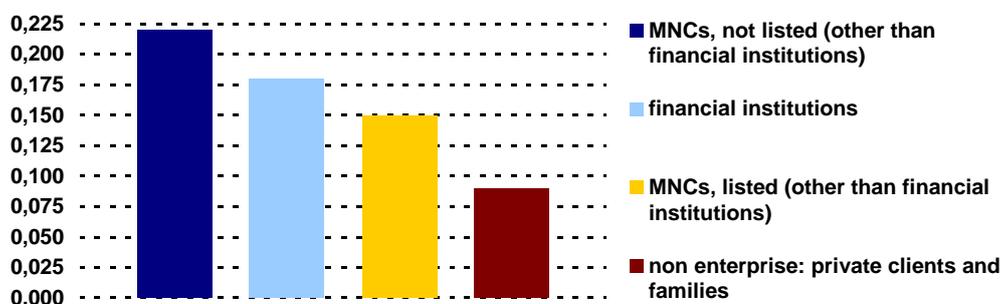
According to the interviewees, competition between large and small trust offices is limited, although some of the smaller players indicate that they actually compete with the large firms. In order to check this notion, we analyze concentration on several market segment, defined in terms as we described above: type of client, type of service and regional origin of UBOs. As a measure for concentration, we use the Herfindahl-Hirschmann Index.

Text box 3.2 The Herfindahl-Hirschman Index

The Herfindahl-Hirschman Index (HHI) is an indicator of the degree of concentration of an industry. It is defined as the sum of the squared market shares of individual firms active on a specific market. It ranges from 0 to 1, with 0 being a very competitive market with many firms each having little market power, to 1 being a market with only one monopolistic producer. A decrease of the HHI generally indicates intensifying competition. A HHI-score below 0.1 indicates a low market concentration, a HHI-score above 0.18 indicates a high market concentration (European Commission, 2001).

Suppose an industry has five firms each with a market share of 20%, the HHI would then be $5 \times 0.2^2 = 0.2$. If one of the producers manages to increase its market share to 80% and the other four producers would each be left with 5%, then the HHI would increase to $0.8^2 + 4 \times 0.05^2 = 0.65$.

Figure 3.14 Herfindahl-Hirschman Index scores on client markets

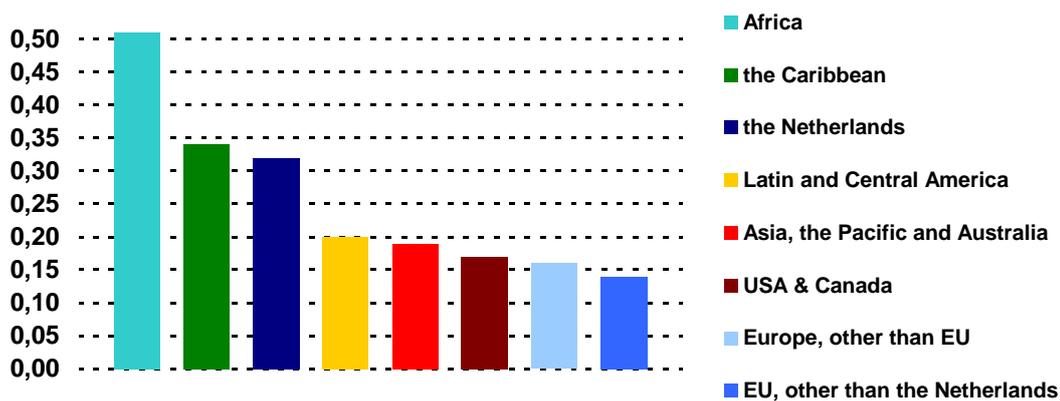


The market for non-enterprise clients is most segmented. The HHI-score is 0.09 (Figure 3.14).²⁴ This segment consists is mainly serviced by small trust offices. The market for non-listed MNCs is fairly concentrated (HHI=0.22); this segment is dominated by a small number of large trust firms with a high market share. The markets for listed MNCs (HHI=0.15) and financial institutions (HHI=0.18) lay in between. As noted above, small trust firms derive a large share of their turnover from listed MNCs.

Although it does not necessarily follow from the HHIs in Figure 3.14, we may safely assume that the degree of concentration represents average customer size: we expect the average turnover per enterprise client to be significantly higher than turnover per non-enterprise client.

The rate of concentration in geographical markets (in terms of origination of the UBO) is strongly correlated with the size of the market. Figure 3.15 shows that concentration is highest for the smallest markets. Africa and the Caribbean are niche markets, dominated by a handful of trust offices. The same goes for the market for Dutch UBOs. Concentration on the main (EU and rest of Europe) is low. These markets are contested by a lot of small players.

Figure 3.15 Herfindahl-Hirschman Index scores on geographical markets



²⁴ The HHIs presented here are derived from the trust firms that participated in the current study. These firms cover approximately 70% of the market. Therefore, the HHI-scores do not resemble the entire market. Actual HHI-scores are likely to be somewhat lower, since large trust offices are overrepresented in the data.

4 Benefits for the Netherlands

In this chapter we discuss the importance of the trust sector for the Netherlands' economy. We limit the discussion to direct, measurable effects: tax revenues, high-quality jobs with the trust offices and their suppliers, and the economic impact of clients of trust offices on the Dutch economy.

4.1 Financial revenues

According to the Dutch Central Bank (DNB, 2007b), the value added of the trust industry consists of three components: tax payments by legal entities managed by trust offices on financial flows channeled through the Netherlands; turnover from trust offices located in the Netherlands; and the value of additional services purchased by clients of trust offices in the Netherlands. The Dutch Central Bank (DNB, 2007b) estimates the revenues for the Dutch economy from Special Financial Institutions to be € 1.5 billion, or 0.3% of GDP. About € 1.0 billion are tax revenues for the Dutch state from SFI-related financial flows, totaling to € 4500 billion. The remaining € 0.5 billion consists of fees paid by SFIs to professional service providers like trust offices, legal advisors and tax advisory firms.

We estimate the total amount of financial revenues for the Netherlands, stemming from the legal entities managed by trust firms to be € 1.8 billion.²⁵ The total tax revenues for the Dutch state stemming from the presence of the trust industry in the Netherlands amount to an estimated € 1 310 million (see Table 4.1). This estimate includes tax payments by trust offices, their clients and additional suppliers. The estimated tax payment by legal entities managed by trust offices on financial flows channeled through the Netherlands is about € 1.2 million, 6.7 percent of the total sum of corporate taxes.²⁶

Table 4.1 Tax revenues for the Dutch state stemming from the trust industry

tax payments by legal entities	€ 1 195 million
tax payments by trust offices	€ 57 million
tax payments by additional suppliers	€ 58 million
total tax revenues	€ 1 310 million

The total tax payment by trust offices stemming from their own business activities (e.g., VAT and corporate taxes) is estimated to be € 57 million. Assuming that the average tax rate paid by suppliers is equal to the average rate paid by trust offices, the additional tax revenues from suppliers of additional services stemming from trust industry related turnover is estimated to be about € 58 million.²⁷

²⁵ The difference between our 1.8 billion and DNB's 1.5 billion is mainly caused by the fact that less than half of the legal entities managed by the trust firms do not qualify as SFIs, as was explained in footnote 16.

²⁶ To put this figure in a context: according to DNB (2008b), in the years 2004, 2005 and 2006, Dutch banks paid annually about 3.5 billion in corporate taxes. In 2007 this sum sank to 1.85 billion.

²⁷ The majority of additional services is delivered by professionals who work as partners within civil partnerships (*maatschappen*). These professionals pay income taxes, presumably in the upper tax brackets. We abstain from estimates, but we may safely assume 58 million to be a serious *under*-estimate.

Table 4.2 shows the total added value of the trust industry to the Dutch economy. Total value added is € 1.8 billion, 0.33% of Dutch GDP and 0.46% of exports. The estimate by DNB of the fees paid by SFIs to professional service providers of € 0.5 billion is in line with our estimate of € 579 million including VAT.

Table 4.2 Value added of the trust industry to the Dutch economy

taxes	€ 1 310 mln
turnover Dutch trust offices (excl. VAT)	€ 242 mln
value of additional services purchased (excl. VAT)	€ 245 mln ²⁸
total value added	€ 1 797

Text box 4.1 Value added in other sectors

There is wide variety of other sectors that benefit from the trust industry in the Netherlands in addition to the aforementioned financial and legal sectors, such as transportation and hospitality. The trust sector is an industry characterized by intensive business travelling. This means that the impact of the trust industry on these supplying sectors in terms of e.g. flights, taxi rides, and nights spent at hotels or restaurant visits should not be underestimated. The impact of the trust industry on these sectors is difficult to quantify.

Based on observations of a number of trust office representatives, we estimate the average client to visit his trust office in the Netherlands once a year, with two representatives. In 2006, the average room price of a luxury class hotel in Amsterdam amounted to about € 150 (Gemeente Amsterdam Economische Zaken, 2007). Including restaurant meals (roughly € 250), taxi rides from Schiphol Airport to Amsterdam vice versa (approximately € 60) and from the hotel to the trust office vice versa (approximately € 40), a client visit to Amsterdam boils down to about € 650 of extra revenues. For the total estimated number of 16 000 clients of trust offices in the Netherlands this would add to extra revenues of € 10.4 million, excluding revenues for the aviation industries.²⁹

In section 3.2, we discussed the Dutch Chambers of Commerce benefitting from the trust industry, by the collection of contribution fees. The contribution fees vary from about € 85 to € 115 for a typical legal entity. The Chamber of Commerce in Amsterdam charges € 115. Trust office representatives estimate the fraction of legal entities registered in Amsterdam to be about 70% of the total of 20 000. This means that the Chamber of Commerce annually collects € 115 on 14 000 entities in Amsterdam and, conservatively, € 85 on the remaining 6 000. This adds up to € 2.1 million for the Dutch Chambers of Commerce solely on the collection of contribution fees.

Employment

We distinguish a direct impact, employment with the trust offices themselves, and indirect impact, employment with the suppliers of additional services. We estimate *direct employment* to be approximately 1 700 jobs. 85% (1 450 jobs) of these jobs are fulfilled by domestic staff, 15% (250

²⁸ See also footnote 21; € 245 million is clearly an underestimation.

²⁹ These calculations are aimed to get a grasp of the impact of the trust industry on these sectors; they are not supported by empirical evidence.

jobs) by ex-pats living and working in The Netherlands.³⁰ We estimate indirect employment from the total value of services rendered by suppliers, assuming that productivity in these sectors is comparable to the productivity in the trust industry. Employment with legal, auditing, accounting and banking firms boils down to another 1 300 jobs. The total employment generated by the trust industry in the Netherlands is therefore estimated to be 3 000 jobs (Table 4.3).³¹

Table 4.3 Impact of the trust industry on employment in the Netherlands

direct employment (at trust offices)	1700
indirect employment (at supplying firms)	1300
total	3000

The contribution of the trust industry to the quality and reputation of the Dutch financial industry, remains outside the scope of the report. It is clear that the existence of an industry, providing at least 3 000 highly qualified jobs, involving contacts with 16 000 international clients, many of them multinational corporations, enhances the strength of the Dutch financial sector.

4.2 Spin-off client activities

The domiciliation of a financial holding company can be the first step of a growth strategy, which may eventually lead to the establishment of a fully operational subsidiary in the Netherlands. The subsidiary can fulfill a wide variety of functions e.g. that of regional headquarters, logistical centre, IT-support or customer support. The establishment of a subsidiary is supposed to be easier if the MNC had the opportunity to build up a local business network and to get acquainted with local business habits, culture and legal and tax systems through its financial holding company.

This kind of impact appears to be limited. Only 15% of the trust offices in our survey rank the establishment of operational activities in the Netherlands as one of the five most important reasons for clients to call in a Dutch trust office. The interviewed experts do not agree as to whether it is very likely for a multinational corporation to domicile a financial holding company in the Netherlands as part of a growth strategy ultimately leading to physical presence in the form of a subsidiary. Some interviewees argue that such a strategy is seldom adopted. Others point at large companies like Siemens, Nissan, Fuji, Prada, Nike and Coca Cola, which actually adopted such a strategy. The question to what extent the Dutch government should promote the establishment of trust offices, in order to attract additional activities of multinationals and to foster location choices for the Netherlands, remains unanswered.

³⁰ This figure is excluding ex-pats working in the Netherlands, who are directly employed by foreign holding companies.

³¹ This is an underestimation. As explained in footnote 21, the other advisors also deal directly with clients, especially when new entities are established. Further, we abstract from the impact on jobs in the hospitality sector, with the Chambers of commerce, etc.

5 International competition

In this chapter we discuss the international perspective of the Dutch trust industry. We start by discussing the most important international trust clusters competing with the Netherlands. Then we elaborate on the specific strengths, weaknesses and future prospects of the Dutch trust industry in its competitive environment. The findings in this chapter are based on the series of interviews with experts and questionnaire results.

5.1 Overview of competing international clusters

The trust service jurisdictions of Luxemburg and Ireland are considered to be the main competitors of the Netherlands. Other jurisdictions mentioned in this respect are Switzerland, Singapore, Denmark, Cyprus, Malta and to a lesser extent the Channel Islands, the Cayman Islands, Mauritius, the Isle of Man and the state of Delaware (USA). Some experts name countries like Belgium, Austria, the UK and Spain to be competitors on the trust market as well, mainly in terms of administrative services. A few interviewees mention small tax havens, like the British Virgin Islands and the Bahamas, as competitors of the Netherlands. However, most argue that these jurisdictions are not relevant. Their main competitive advantage is found in tax exemptions, whereas the competitive strength of the Netherlands is its vast network of international tax treaties and the participation exemption.

Although the Netherlands has a (relatively) long history as a cluster for trust activities, Luxemburg has been able to catch up with the Netherland in short notice. According to the interviewees Luxemburg has been able to catch up in recent years, partly by copying the Dutch trust industry. Luxemburg is a small country with short governmental lines, which makes it possible for the trust industry to be flexible, and to move quickly. On the other hand, the sheer size of Luxemburg's economy sets a limit to its competitive position, since it will sooner or later reach the boundaries of its capacity. This in turn provides the Netherlands with an opportunity to enhance its competitive position.

Another important European competitor on the trust market is Ireland. Ireland offers low tax rates, an absence of transfer pricing at group level, and an active, government supported regime for enhancing international financial services.³² Thanks to a flexible labor market and an English speaking population, Ireland has been extremely successful in attracting operational activities from multinational operating firms.

Switzerland is recognized as an important trust cluster particularly on the market for private clients, mainly because of its famous banking secrecy. The Cayman Islands were mentioned as an important player particularly with respect to so-called structured finance projects by USA-based investors in Europe.

³² See <http://www.ifsconline.ie/>.

Text box 5.1 Liaison with the Netherlands Antilles

Historical background

The initial development of the trust industry in the Netherlands, in the early 1980s, was mainly due to its ties with the Netherlands Antilles, in particular the island of Curacao. The liaison of the Dutch financial sector with the trust sector in the Netherlands Antilles, often called the Antilles-route, dates even back to the period prior to World War II. Confronted with the threat of war in Europe, international corporations that were statutorily located in The Netherlands transferred their statutory seat to the Antilles, in order to be able to relocate funds. It was after the war ended, when the trust sector in the Netherlands Antilles, and Curacao in particular, came to a fierce development. This is to a considerable extent due to work of notary A.A.G. Smeets, the designer of the relevant tax legislation and the founding father of the Curacao International Trust Company (Citco). Smeets travelled through the United States promoting the Netherlands Antilles as a trust jurisdiction. In the United States, this piece of tax legislation is still commonly referred to as ‘Smeets Law’. Other successful entrepreneurs in the trust sector started their career in the trust sector in the Netherlands Antilles (Lugard, 2005).

Regulation

Prior to the effectuation of ASTO in the Netherlands, the Netherlands Antilles developed their own trust regulation regime with the *Landsverordening toezicht trustwezen* (Ltt), aiming at ‘maintaining quality and high standards of service provision and to prevent for money laundering’. The Ltt (resembling the Dutch ASTO-regime to a large extent) was introduced in 2003.

Characteristics of the Netherlands Antilles’ trust industry

According to the Bank of the Dutch Antilles, about 135 trust offices have been permitted a license to provide trust services under Netherlands Antilles regulation (Ltt). Trust offices in the Netherlands Antilles provide the same kind of services as their counterparts in the Netherlands to the same types of, corporate and private, clients. The fiscal regime, still a key factor, is less crucial for attracting clients nowadays. Legal security, quality of professional and financial infrastructure and the speed with which business is done have gained importance as key factors for clients in locating funds in the Netherlands Antilles. For example, a legal entity such as an incorporated private enterprise is founded within a few hours.

Competition between trust offices, both on the local market as well as internationally, is fierce. The competitive advantages of the Netherlands Antilles vis-à-vis competing jurisdictions are its (historic) reputation, the expertise of professional staff in the financial sector, the central and safe geographical location, the linguistic skills of the local labor force, the attractiveness of fees for financial services and a state of the art financial infrastructure. Nonetheless, the Netherlands Antilles experienced an outflow of clients and funds over the last decade because of the diminished attractiveness of the fiscal regime relative to competing jurisdictions such as Luxemburg, Cyprus, Malta, Switzerland and Hong Kong.

Although no official data on the economic impact of the trust industry on the Netherlands Antilles’ economy are available in the public domain, the trust sector is said to have a major economic impact. In terms of direct and indirect employment, value-added, tax-receipts and foreign exchange generation, the sector plays a key role in the local economy.

5.2 Strengths of the Dutch trust industry

The Dutch trust industry was built on a history of international trade, a central geographical location, an excellent infrastructure, a strong financial sector and a business friendly fiscal and regulatory environment. From our interviews and questionnaires it appears that these strongholds still exist.

The trust firms rank the Dutch fiscal regime most frequently in their top five of most important reasons for clients to call in the services of the Dutch trust industry. This attractiveness does not stem from a low nominal corporate tax rate, which is slightly higher than the EU and OECD average, but from the effective tax rate, strongly influenced by the extensive network of bilateral tax agreements, the participation exemption (see Text box 5.2) and the absence of withholding taxes on interest. Another key element of the Dutch tax system is the feasibility of advanced tax rulings. «An advanced tax ruling is an agreement on the tax characterization of international corporate structures, such as advance certainty on the application of the participation exemption.»³³ Advanced tax rulings between MNCs and the tax authority reduce uncertainty for MNCs concerning the fiscal consequences of their corporate financial structures.

Text box 5.2 Dutch participation exemption

Dividends, currency gains and capital gains on shares are fully exempt from Dutch corporate income tax if the participation exemption applies. Under the provisions effective from 1 January 2007, a recipient company is generally entitled to the participation exemption, if that company owns at least 5% of the nominal paid-up capital of the subsidiary.

The participation exemption is not applicable to benefits from a low taxed portfolio participation, or on the costs concerning the acquisition or disposal of that participation. There is a low taxed portfolio participation if the assets of the subsidiary in which the taxpayer holds a participation, largely, directly or indirectly, consist of free investments, that subsidiary is not subject to a profit tax which results in a levy at a rate of at least 10 percent over a taxable profit calculated by Dutch standards and the participation is not a real estate investment company. Free investments are other investments than those reasonably required by the business activities of the entity holding the investments.

According to the trust firms, the existence of a large, versatile and sophisticated financial services sector, to which the trust industry belongs of course, is a major asset of the Netherlands. The quality and capacity of financial service providers, banks and other financial institutions is the second most important reason for clients to call in a Dutch trust office. The role of Amsterdam as a financial hub cannot be underestimated. Professional legal and financial service providers are for the larger part located there, as well as the majority of the trust firms. See Text box 5.3 for some remarks on industrial clustering.

The geographical location and accessibility of the Netherlands are both considered to be crucial comparative advantages. The proximity of Schiphol Airport to Amsterdam is a strong asset: the absence of an international airport counts as a weakness for Luxemburg.

³³ Ministry of Finance, *Taxation in the Netherlands 2007*, p. 25

The high level of education of the Dutch labor force is well renowned internationally. The international orientation, linguistic skills, work attitude, quality of the pool of professionals and extensive experience with and knowledge of trust activities are important factors mentioned with respect to the attractiveness of the Netherlands as a destination for trust related business.

Text box 5.3 Agglomeration economies and industrial clustering

Why do trust offices tend to locate close to each other in Amsterdam, mainly clustered on the *Zuidas of Amsterdam*? This mechanism of what is called *industrial clustering* emerges because of *external* or *agglomeration economies*. Agglomeration economies affect supply and demand conditions in such a way that growth of existing firms in a cluster is promoted (Pandit et al, 2002). Location vis-à-vis competition is an important strategic decision for firms (Porter, 1980). Because of agglomeration economies, it can be more attractive for newly entering firms to locate in an existing geographical cluster near its main competitors than elsewhere in isolation. Nonetheless, cluster growth will not continue indefinitely; beyond a saturation point, congestion issues and intense competition on input- as well as output markets will eventually slow down cluster growth, and may in time contribute to cluster decline (Pandit et al, 2002 and Swann and Prevezer, 1996).

There are a number of benefits on both the demand side (customers) and the supply side (e.g. labor and additional financial services provided to clients) that a newly entering trust office benefits from when it locates near its competitors in Amsterdam. A number of supply side benefits can be identified in, attracting firms to a specific geographic cluster (Hayter, 1997, Pandit et al, 2002, Swann and Prevezer, 1996):

- the presence of a pool of skilled and specialized labor;
- the presence of range of suppliers of additional services to the trust office and its clients;
- spillovers (mutual learning effects) of knowledge;
- infrastructural benefits (such as access to communications network, roads, railways and airports affecting transportation costs);
- informational externalities (a new entrant benefits from observing an established firm produce successfully in that geographic cluster).

In addition to this, firms are also attracted to an existing geographical cluster because of demand side benefits such as:

- proximity to a large pool of potential customers;
- a new entrant gains market share easier if it locates near its established competitors, which is along the line of Hotelling's model of geographical clustering (Hotelling, 1929);
- search costs for clients are minimized if a new entrant locates in an existing cluster, which increases the likeliness for the trust office of being found by potential customers;
- informational externalities (market entrants are able to assess the trust market better if they have established firms nearby from which they can learn by observing).

Nonetheless, costs of locating in a cluster do exist as well. Increased competition and congestion on input and output markets can potentially offset the benefits. Increased competition can put profitability under pressure. Growth of the geographical cluster can lead to congestion of the physical infrastructure or increasing costs of e.g. labor or real-estate (Pandit et al, 2002).

Finally, the political, legal and economic stability are being mentioned as contributive to the Dutch competitive position. The Netherlands is considered a stable and internationally respected jurisdiction with a well-developed legal system, renowned for its integrity and transparency.

All in all these answers to the questionnaire and the results of the interviews indicate that, apart from the direct transaction costs of tax payments, other types of transaction costs (as mentioned in chapter 2), and the way the trust industry is able to reduce these costs, are important considerations for international corporations in their location choice for outsourcing financial services.

Future prospects of the Netherlands as a trust jurisdiction are generally considered to be positive. Three key conditions are considered crucial in order to maintain the current strong position of the Dutch trust industry in international perspective:

- a continuous strive for transparency with respect to the activities of trust offices, which will contribute to a positive attitude towards the trust industry;
- continuous investment in the quality of financial service sectors and the labor force;
- continuous attention for legal, fiscal, economic and political stability.

Challenges for the Dutch trust industry

Although the experts interviewed agree that the Netherlands as an environment for trust activities holds a strong position vis-à-vis competing jurisdictions, there are weaknesses and threats that need attention. A frequently mentioned issue is a lack of flexibility and speed in (political) decision-making processes. Dutch decision-making inertia gives a competitor like Luxemburg, reacting much faster to changing circumstances, a competitive edge.

Luxemburg holds some advantages over the Netherlands. The process of establishing legal entities takes days, or even weeks, in the Netherlands, while in Luxemburg it is a matter of hours. Next to that, Luxemburg offers the possibility to keep so called *shelf entities*: established legal entities, stored until a client needs them. No time is wasted if the client is in urgent need. In the Netherlands, the incorporation of shelf entities is not forbidden, but effectively made impossible by the Dutch Ministry of Justice, which refuses to provide the *nihil obstat*-declaration required in such cases. Regarding this element of policy, the Netherlands takes a unique position among its European competitors.

Uncertainty with respect to developments in fiscal legislation is recognized as a possible threat. Some of the interviewees argue that, even though decision-making processes in the Netherlands are generally inflexible and slow, in some cases the Dutch government attempts to be unnecessarily fast concerning the implementation of EU-legislation. Particularly new EU-legislation on the practice of advanced tax rulings, which was ultimately cancelled, is mentioned in this respect. The implementation of an advanced tax ruling framework by the Dutch government largely put an end to this uncertainty. Nonetheless, developments in fiscal legislation remain an issue. Uncertainty about it should always be minimized.

Another threat to the Dutch trust industry recognized by the interviewed experts is uncertainty with respect to future developments of the international exchange of client-information. Nobody questions the importance of transparency, but it is argued that transparency with respect to ultimate beneficiary owners can also harm legitimate clients. For individuals from politically unstable

regions, it is potentially dangerous to be linked to specific companies. From this perspective, uncertainty about the future direction of this debate can become a threat to the development of the Dutch trust industry.

Some experts express their concern with respect to what's called the 'bargain sale' of high profile Dutch corporations representing the Dutch identity. Multinational corporations as ABN Amro, Stork, Numico, Grolsch, Corus and Hagemeyer are referred to, MNCs that have recently been subject to (rumors about) takeovers. Some experts argue that the series of takeovers of Dutch MNCs damages the reputation of the Netherlands as an important economic power in international business. Others argue that it is a normal phenomenon, stemming from continuing consolidation through globalization, far from unique to the Netherlands but a worldwide trend (Couzy, 2008, Kleinnijenhuis, 2008).

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Appendix B Advisory committee and list of interview partners

Advisory committee

Hans Bakker	Loyens & Loeff
Frank Graaf	Clifford Chance
Ed Kok	Fiscal expert
Geerten Michielse	Utrecht University
André Nagelmaker (chair)	VIMS, ATC Corporate Services
Pieter Veuger	PricewaterhouseCoopers
Jan Reint de Vos van Steenwijk	VIMS, TMF Group
Stef van Weeghel	University of Amsterdam, Linklaters
Jack Willems	Dutch Fiduciary Association, FTC Trust

Interview partners

Ruud van Bork	Loyens & Loeff
Jan Dekker	KPMG
Pieter Dijkmeester	VNO/NCW
DNB	Afdelingen Geldtransactie- en trustkantoren en Toezicht Beleid
Bart Joosen	DLA Piper
Wim Langeveld	Citco
Ralph Palm	KPMG Netherlands Antilles
Colin Powell	Jersey Financial Services Commission
Shelwyn Salesia	Bank of the Dutch Antilles
Bas Schreuders	Fortis Intertrust
Maurice Selhorst	Citco
Mw. Anneke Soedhoe	Fortis Intertrust Curaçao

Appendix C Extrapolation technique

The figures discussed throughout the report are derived from a questionnaire that was sent to all ASTO-licensed trust offices in the Netherlands.³⁴ 61 of 140 trust offices responded, which boils down to a response of 44%. The questionnaire results cover an estimated 70% of the licensed Dutch trust market, in terms of employment and turnover. The degree of completeness of the answers varies across the questionnaire, ranging from a minimum of 46 to all 61 trust offices answering a specific question. In order to describe the Dutch trust industry as a whole, we extrapolated the questionnaire results to industry level by correcting for the non-response. During the process of extrapolation we encountered two issues that needed attention:

- The distribution of trust offices over firm size is asymmetrical. The trust industry is characterized by a large number of very small firms with less than three employees and a few very large firms with up to 200 employees.
- The questionnaire response is not evenly distributed over firm size; large trust offices turned out to be overrepresented in the questionnaire.

To cope with these issues we divide the sample into three subsamples along the lines of firm size, largely coinciding with membership of industry associations: International Management Services Association (VIMS, large firms) and Dutch Fiduciary Association (DFA, medium sized and small firms) and non-members (small firms). We extrapolated the response within each group to group-level, and aggregated the extrapolated subgroup results to the level of the entire industry. In order to correct for a skew size distribution within the groups, we used the median value instead of the average value as a basis for extrapolation. Finally, some adjustments to the extrapolation were made on an ad hoc basis, following from specific knowledge with the members of the advisory committee.

³⁴ The aim was to approach all ASTO-licensed trust offices. Contact details of a few smaller trust offices could not be located.

Appendix D Questionnaire

Does your trust office have **external shareholders** (other than its management)?

- Yes, external shareholder(s) located abroad
- Yes, external shareholder(s) located in the Netherlands
- Yes, external shareholder(s) located both in the Netherlands and abroad
- No

What is the **number of employees** (natural persons) of your trust office on January 1st 2007?

What is the distribution of your professional staff over the following **levels of education** (as of January 1st 2007)?

- tertiary education, academic (WO)
- tertiary education, vocational (HBO)
- secondary education or lower (MBO of lager)

What is the distribution of your professional staff over the following **types of education** (as of January 1st 2007)?

- legal
- fiscal
- auditing
- economic
- other

What is the fraction (%) of the professional staff originating from **outside the Netherlands** (as of January 1st 2007)?

_____ %

What is the **number of legal entities** (*cliëntvennootschappen*) managed by your trust office in 2006?

What is the **number of clients** provided with trust services by your trust office in 2006?

How were **client relationships** established?

- your trust office was approached by the client
- the client was approached by your trust office
- the client was introduced to your trust office by another Dutch financial or legal service provider
- the client was introduced to your trust office by another non-Dutch financial or legal service provider
- other

In the following question, the value of the total tax payment to the Dutch fiscal authority by the legal entities (*‘cliëntvennootschappen’*) managed by your trust office is addressed.

If the exact value is not available, you can suffice by:

1. taking a representative random sample of client files;
2. determining the value of the tax payment to the Dutch fiscal authority in 2006 by the legal entities (*‘cliëntvennootschappen’*) of each of these clients;
3. estimating the total value of the tax payment to the Dutch fiscal authority by the legal entities (*‘cliëntvennootschappen’*) managed by your trust office based on the random sample of client files.

What was the total **tax payment** in Euros to the Dutch fiscal authority in 2006 by the legal entities (*‘cliëntvennootschappen’*) managed by your trust office?

Note: the sum of e.g. corporate tax payments, taxes paid on dividends, income tax payments. Tax payments by your trust office stemming from own business activities should not be included in this question.

What was your trust offices **gross total turnover** (excl. VAT) in 2006?

- < € 100 000
- € 100 000 - € 250 000
- € 250 000 - € 500 000
- € 500 000 - € 1 000 000
- € 1 000 000 - € 1 500 000
- € 1 500 000 - € 2 000 000
- € 2 000 000 - € 5 000 000
- € 5 000 000 - € 10 000 000
- € 10 000 000 - € 20 000 000
- € 20 000 000 - € 30 000 000
- > € 30 000 000

What is the fraction of gross turnover from clients **originating from the Netherlands**?

_____ %

What was your trust offices total **tax payment** in Euros to the Dutch fiscal authority in 2006 stemming from own business activities?

Note: the sum of e.g. VAT, corporate tax payments, etc. Tax payments by legal entities (‘cliëntvennootschappen’*) managed by your trust office should not be included in this question.*

What were your trust offices total **wage costs** in 2006?

What is the distribution of gross turnover over the following **types of services** in 2006?

- domiciliation fee
- management services
- administrative/accounting/auditing services³⁵
- legal support
- personal directors fee
- other support (e.g. clerical)

³⁵ The Dutch equivalent is to be read as ‘bookkeeping/administrative/accounting services’.

What is the fraction of gross turnover of your trust office stemming from services provided to **Special Purpose Vehicles** (SPVs, used in securitizations, CDOs, CLOs)?

_____ %

What is the distribution of gross total turnover over the following **types of clients** in 2006?

- non enterprise: private clients and families
 financial institutions
 multinational corporations, not listed (other than financial institutions)
 listed multinational corporations (other than financial institutions)
 other

What was the distribution of gross turnover over **regional origin of the ultimate beneficiary owner** (UBO) in 2006?

- the Netherlands
 EU, other than the Netherlands
 Europe, other than EU
 North America (U.S.A. and Canada)
 Latin and Central America
 the Caribbean
 Asia, the Pacific and Australia
 Africa

In the following 4 questions, the value of a number of additional financial services provided to legal entities (*‘cliëntvennootschappen’*) is addressed. If the exact value is not available, you can suffice by:

1. taking a representative random sample of client files;
2. determining the value of financial services provided in 2006 to legal entities (*‘cliëntvennootschappen’*) for each of these clients;
3. estimating the total value of a specific financial service provided to legal entities (*‘cliëntvennootschappen’*) based on the random sample of client files.

How many different **law firms and notary offices** did the trust office call in as a supplier in 2006? What is the total value (incl. VAT) of legal and notarial services provided to legal entities (*‘cliëntvennootschappen’*) by your trust office? What percentage of this value was provided by foreign suppliers?

number of structural legal service providers	_____
number of incidental legal service providers	_____
value of purchased legal services (incl. VAT)	_____
% purchased abroad	_____

How many different **auditing firms** did the trust office call in as a supplier in 2006? What is the total value (incl. VAT) of auditing services provided to legal entities (*‘cliëntvennootschappen’*) by your trust office? What percentage of this value was provided by foreign suppliers?

number of structural auditing service providers	_____
number of incidental auditing service providers	_____
value of purchased auditing services (incl. VAT)	_____
% purchased abroad	_____

How many different **tax advisory firms** did the trust office call in as a supplier in 2006? What is the total value (incl. VAT) of tax advisory services provided to legal entities (*cliëntvennootschappen*) by your trust office? What percentage of this value was provided by foreign suppliers?

number of structural tax advisory service providers	_____
number of incidental tax advisory service providers	_____
value of purchased tax advisory services (incl. VAT)	_____
% purchased abroad	_____

How many different **banks** did the trust office call in as a supplier in 2006? What is the total value (incl. VAT) of banking services provided to legal entities (*cliëntvennootschappen*) by your trust office? What percentage of this value was provided by foreign suppliers?

number of structural banking service providers	_____
number of incidental banking service providers	_____
value of purchased banking services (incl. VAT)	_____
% purchased abroad	_____

Could you rank the 5 most important reasons for your clients to call in a trust office **in the Netherlands**?

- 1. _____
- 2. _____
- 3. _____
- 4. _____
- 5. _____

Could you rank the 5 most important reasons for your clients to call in **your trust office**?

- 1. _____
- 2. _____
- 3. _____
- 4. _____
- 5. _____