AT ARM'S LENGTH

Major private research funders make secretive offshore investments, raising ethical concerns

By **Charles Piller**

A few years ago, scientists funded by the Wellcome Trust, one of the world's wealthiest private philanthropies, published sobering findings about the deadly effects of air pollution. In a long-term study of elderly residents of Hong Kong, China, those exposed to higher levels of smog—especially tiny particles of soot produced by burning fossil fuels—were more likely to die of cancer than people who breathed cleaner air.

The study, published in *Cancer Epidemiology, Biomarkers & Prevention* in 2016 by researchers from the University of Hong Kong and the University of Birmingham in the United Kingdom, is one of many to highlight the health threats posed by soot. And it is just one product of the extensive investments that Wellcome, with $29.3 billion in assets, has made in environmental science. "We aim to stimulate research excellence and develop global collaborations to drive change," the London-based philanthropy explains on a web page that highlights its commitment to making "cities healthy and environmentally sustainable."

The trust does not highlight, however, that some of the more than $1.2 billion it has handed out annually in recent years comes from investments in companies that contribute to the same problems the philanthropy wants to solve. Not long before the Hong Kong study was published, for example, the trust became an investor in Varo Energy, a company based in Cham, Switzerland, that sells fuel to shipping firms. One of Varo's main products is bunker fuel for marine engines: a cheap, sulfurous residue of oil refining that is a major source of soot pollution. Particulates billowing from ship stacks contribute to the premature deaths of 250,000 people annually, researchers estimate.

Wellcome didn't invest directly in Varo. But according to a trove of confidential documents known as the Paradise Papers, many of them leaked from a law firm that helped manage such deals, Wellcome committed $50 million to an offshore investment fund, Carlyle International Energy Partners, based in the Cayman Islands. That fund, in turn, owns a stake in the energy firm. (Wellcome declined to give details on its offshore holdings.)

Large investors commonly use offshore funds to maximize returns, in part by reducing the taxes investors would otherwise pay to their home nations. Though offshore investments can be legal, they are controversial—partly because the funds' activities are nearly always tightly held secrets. And Wellcome's investment in bunker fuel illustrates a common contradiction facing some major scientific grantmakers

ILLUSTRATION: STEPHAN SCHMITZ/FOLIO ART

involved in offshore investing. Specifically, offshore investments can have impacts that diminish or negate the high-minded social experiments, education, and research backed by science funders, according to a *Science* investigation. And their routine use of offshore funds raises questions about transparency, accountability, and social responsibility.

Critics of offshore investing also say that foundations, by lending their sterling reputations to offshore strategies, are helping legitimize tactics that others widely use to bend or break the law—including investors eager to conceal lawful but extreme tax avoidance as well as criminals seeking to hide illicit profits and launder money. Such practices deprive governments around the world of revenue, the critics note, worsening economic inequality and undermining efforts to repair crumbling infrastructure.

The secrecy surrounding offshore funds complicates efforts to document exactly how much money major research charities have moved into such vehicles—or where the cash ends up. *Science* gained some insight by reviewing publicly available tax returns and financial statements and by searching the roughly 13.4 million leaked documents in the Paradise Papers, more than half of which came from Appleby, a global law firm founded in Hamilton, Bermuda, and one of the world's leading offshore dealmakers. (The papers were shared with *Science* by the International Consortium of Investigative Journalists in Washington, D.C., which acquired them from the *Süddeutsche Zeitung* newspaper in Munich, Germany.)

Science examined seven of the largest private research funders and found that, according to conservative estimates, they have in recent years placed and committed more than $5 billion to funds in offshore tax and secrecy havens. Missing data and a lack of precision in many documents, however, suggest the philanthropies' investments are larger (see table, p. 1102). Among the investigation's findings:

- Wellcome committed more than $926 million of its holdings to at least 57 tax haven funds, documents from the Paradise Papers indicate. Other offshore investments were shown in the foundation's tax returns. (Totals could not be determined but in 2007, Wellcome's offshore holdings were so extensive that Appleby ranked the foundation as its 14th largest client.) In a statement to *Science*, Wellcome officials declined to discuss the size or placement of its assets in offshore accounts, saying they "do not collect or keep" data relating to tax domicile.
- The Howard Hughes Medical Institute in Chevy Chase, Maryland, which has $20.4 billion in assets, holds at least $891 million in offshore funds, from which it earned $123 million in the year ending 31 August 2017, according to public documents. It declined to discuss its investments.
- The Robert Wood Johnson Foundation in Princeton, New Jersey, which has $10.8 billion in assets, has placed at least $3 billion in offshore havens. Foundation officials discussed their investing practices with *Science*.
- The Bill & Melinda Gates Foundation in Seattle, Washington, has no apparent involvement in offshore funds, according to the Paradise Papers and public documents.
- Three other private research funders—the David and Lucile Packard Foundation, the Gordon and Betty Moore Foundation, and the William and Flora Hewlett Foundation, all based in Silicon Valley in California—have made offshore investments of up to $168 million each, according to the Paradise Papers and public documents. In written statements, the foundations said they comply with tax laws but declined to comment otherwise.

> ***"Shouldn't we be more than a private investment company that uses its excess cash flow for good?"***
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> **Dana Bezerra**, Heron Foundation

Foundation officials and philanthropy experts say offshore investment can play an important role in enabling those charities to meet their fiduciary responsibility to nurture their endowments. But the practice also opens the foundations to intense criticism. "Foundations that invest in tax havens need to know that … they are alongside criminals, tax evaders, and kleptocrats," says Gabriel Zucman, a University of California, Berkeley, economist who has studied offshore investing. Such foundations are helping "normalize these practices and blow up the volume, so the infrastructure exists also for the illegal uses," says Annette Alstadsæter, an economist at the Norwegian University of Life Sciences in Oslo. "They are robbing the taxpayers," says economist and Nobel laureate Joseph Stiglitz of Columbia University, and "are giving life to an institutional arrangement which is basically nefarious and bad for our global society."

FOR AT LEAST A CENTURY, wealthy individuals and institutions have moved money outside their home nations—for example, by parking it in the anonymous numbered accounts made famous by Swiss banks. In recent decades, however, the popularity and complexity of offshore investing has grown dramatically. Some small nations and territories—including the Cayman Islands, Bermuda, and Malta—have aggressively moved to become offshore havens by promising secrecy, light regulation, and low or no taxes on profits.

As of 2014, at least 8% of the world's financial wealth—some $7.6 trillion—was invested in funds based in offshore havens, estimates Zucman, who wrote a seminal 2015 book on the topic. Offshore funds enabled companies to legally avoid paying $130 billion in U.S. taxes each year, he estimates. And illegal tax evasion involving offshore funds subtracted an additional $35 billion annually.

In the past, many philanthropies—which national governments ordinarily exempt from most taxes because they are seen as providing a public service—would have viewed tax avoidance as shameful, says Brooke Harrington, an economist at Copenhagen Business School. But no more. In the United States, for example, many foundation officers regard minimizing taxes "almost as a necessity," she says. "If you don't do that, you're not fulfilling your responsibility to donors. Kind of the way corporate directors will say: 'It's our duty to maximize shareholder value, and that includes reducing our tax payments to as close to zero as possible.'"

But some foundation officials tell *Science* that, because their tax burdens are already low, other factors are more important to their decisions to invest offshore. For example, fund managers increase profits for themselves and their clients by avoiding costly regulatory red tape, says Edmond Ghisu, chief investment counsel at Robert Wood Johnson. Offshore havens often have minimal requirements on "how many records [funds] need to have" and "how open their books and records need to be to investors," he says. The Cayman Islands, for example, "has risen to the top" in popularity among money managers because it has scant reporting requirements, Ghisu says.

Offshore funds can also open doors to a wider array of investment options and top advisers, who often run the funds from offices in financial centers such as New York City or London. Ghisu, for instance, says his foundation looks first for "the best managers, to maximize our returns so that we have resources that we can deploy in support of our mission." Wellcome takes a similar position. "Many of the best-performing funds have offshore domiciles," it wrote in a statement. “Our successful long-term investment strategy,” it added, “is based on exposure to a globally diversified range of asset classes.”

Normally, fund managers, not the foundations, choose investments. But some foundations bar certain investments that they believe would pose conflicts of interest. Robert Wood Johnson, for instance, says it has no involvement in firearms, alcohol, or tobacco. “For us to invest in, say, a tobacco company, would be so antithetical to what we want to do that it would be a travesty,” says Brian O’Neil, the foundation’s chief investment officer.

Yet Robert Wood Johnson’s offshore investments and managers have still generated controversy. Tax returns show that since at least 2014, the foundation has invested heavily in Cayman Islands funds managed by GSO Capital Partners, a unit of the investment titan Blackstone Group, headquartered in New York City. The foundation’s most recent filing showed about $50 million in those funds. GSO has drawn harsh criticism for how it handles credit default swaps—a once-exotic type of risk-hedging security that became notorious for contributing to the Great Recession. U.S. lawmakers and regulators have reined in the swaps, which are legal, but they remain less regulated elsewhere. “The hedge fund industry can’t do what it wants to do under the onshore regulations of the U.S. because it’s too risky,” Harrington says. “But the Caymans will let them do it.”

In particular, GSO has drawn scrutiny for swaps that involve distressed companies and a strategy in which GSO offers a troubled firm an incentive to intentionally default on a loan, triggering a process that enables GSO to realize hefty profits. For years, such deals have attracted substantial media attention and lawsuits. A recent investigative story in the *Financial Times* said such practices made GSO the industry’s “biggest predator.” GSO told the paper it has acted legally and in a manner “consistent with the expectations of its sophisticated market participants.”

In April, the U.S. Commodity Futures Trading Commission took notice, decrying the kinds of actions taken by GSO as “manipulation” that “may severely damage the integrity” of the market. GSO then stepped away from a pending deal. At about the same time, Robert Wood Johnson officials raised their own concerns with GSO. O’Neil says the firm has “really backed off” from the controversial swaps.

Critics contend that offshore machinations increase income inequality by reducing tax funds for public services while shifting the tax burden from companies and wealthy individuals to the middle class. And, as studies funded by Robert Wood Johnson itself have suggested, inequality can damage public health. For example, the foundation underwrote a landmark 2015 study showing extreme income inequality—rather than poverty alone—is a key contributor to ill health and shorter life expectancy. The foundation has also funded grassroots campaigns to address such problems, including a public-private partnership in Richmond, where residents suffer from some of the nation’s worst income inequality. But O’Neil rejects the suggestion that the foundation’s own investment practices contribute to inequality. “I don’t think you can take the harm that is caused by that and impute it to us.”

At Wellcome, where researching the effects of climate change has become one focus of giving, officials consider environmental issues when making investment choices, the trust said in a statement to *Science*. But Wellcome declined to discuss how those concerns have shaped its offshore investments. And public records indicate environmental issues have not prevented the foundation from taking hefty, ongoing, direct equity stakes in fossil fuel companies—including Royal Dutch Shell of The Hague, Netherlands, and Schlumberger of Houston, Texas—whose operations have drawn criticism from climate change, environmental, and human rights advocates.

Wellcome has resisted calls to divest from the firms, saying the investments serve as leverage to influence corporate practices. “Engaging with these companies will strengthen their commitments toward reducing carbon emissions more effectively than divestment,” it argued. The foundation declined to describe how it engages with the companies or to what effect. But even if direct shareholders can wield influence through moral suasion or proxy votes, critics of offshore investing note that such engagement is rarely possible for investors in offshore energy funds, which are often structured to insulate owners from company actions.

Wellcome also notes that its investment profits—directly from Shell or indirectly through Cayman Islands funds that invest in energy firms—fuel the trust’s good works, including projects that fight the impacts of global warming. But Dana Bezerra, a prominent advocate for ethical investing by charities and head of the Heron Foundation in New York City, questions that reasoning. “It’s a justice question,” she says. “I have yet to meet a community willing to trade off our ability to generate returns with their clean water and healthy soil, on the promise that we’ll be back to fix it with charitable dollars in the future.” (Heron, she says, screens its entire $307 million investment portfolio to ensure that it supports—or at least does not counter—the foundation’s philanthropic goal to fight poverty.)

TO SOME CRITICS of offshore investing, its biggest downside is secrecy. The lack of transparency can make it difficult for donors, grant recipients, and the public to reach their own conclusions about whether an offshore investment poses a potential conflict.

Most offshore funds, for example, carry vague names that offer few hints about their purpose. For example, Howard Hughes holds $187 million in “Coastland Relative Value Fund Ltd.” and “Cerberus HH Partners LP” (managed by a company named after the mythological three-headed hound that prevents the damned from escaping through the gates of hell). Robert Wood Johnson has $143 million in another canine-inspired fund, “Hound Partners OS.” All three are based in the Caymans.

The funds rarely reveal to the public where they place investments—and normally also bar their investors from sharing that information. Both Wellcome and Robert Wood Johnson, for example, say confidentiality agreements with fund managers prohibit them from making such disclosures. Fund managers often want to avoid leaks of sensitive information that could move markets or aid competitors.

Sometimes, even investors don’t know how offshore funds use their money. O’Neil says in his experience, there are “only a few funds that really don’t tell us anything.” But contracts revealed in the Paradise Papers

When money flows offshore

The Paradise Papers and publicly available financial statements reveal some, but not all, offshore investments and commitments by seven private foundations that are major funders of scientific research.

FOUNDATION	ENDOWMENT ASSETS*	KNOWN OFFSHORE INVESTMENTS
Bill & Melinda Gates Foundation	$51.8 billion	None
Wellcome Trust	$29.3 billion	$926 million
Howard Hughes Medical Institute	$20.4 billion	$891 million
Robert Wood Johnson Foundation	$10.8 billion	$3+ billion
William and Flora Hewlett Foundation	$9.9 billion	$168 million
David and Lucille Packard Foundation	$7.9 billion	$140 million
Gordon and Betty Moore Foundation	$6.9 billion	$40 million

*Restricted and unrestricted net assets, as of most recent audited financial statements

DATA: PARADISE PAPERS; FOUNDATIONS'S MOST RECENT TAX RETURNS AND AUDITED FINANCIAL STATEMENTS

A cargo ship steams through the Bosphorus past Istanbul, Turkey. The Wellcome Trust invests through an offshore fund in a firm selling ship fuel, which is a major source of particulate air pollution. It also funds studies that highlight the dangers that particulate pollution poses to human health.

PHOTO: BULENT KILIC/AFP/GETTY IMAGES

specify that investors often have no "liability, obligation, or responsibility whatsoever" for how a fund operates or any obligation to verify that the fund has actually used its money for planned investments.

Such opacity is not appropriate for charitable institutions, established for social benefit, Bezerra says. "Not only should you [provide investment details], but you are compelled to because you are managing money in the public trust," she says. "Shouldn't we be more than a private investment company that uses its excess cash flow for good?"

TO REDUCE ETHICAL CONFLICTS, Stiglitz says policymakers should change charity governance rules to make it "a violation of fiduciary responsibility to engage in something that might have reputation risk," such as investing in an offshore tax haven with a "sleazy" repute.

Persuading policymakers to make such changes, however, is likely to be difficult, in part because foundations typically operate under a patchwork of national and local laws. Instead, some observers believe action will have to come from foundation board members and officials. One needed reform, Bezerra says, is to end—or at least curb—the "perverse incentive" that foundations create for their investment officers, who make many of the day-to-day decisions about how to grow or protect a charity's endowment. Their compensation is often tightly tied to how well their investment portfolio performs. And good performance is handsomely rewarded. In 2016, Wellcome's Danny Truell (who retired last year) made $5.8 million and O'Neil made $1.8 million; last year, Landis Zimmerman of Howard Hughes made $3 million. Each was by far the highest paid employee of his foundation.

At Wellcome, the incentives are based on performance of the portfolio as a whole. Robert Wood Johnson ties compensation for O'Neil and others to both investment performance and "alignment of investment objectives with foundation's mission and strategic objectives," such as maximizing returns and ensuring that no funds are invested in tobacco, alcohol, or firearms.

Requiring managers to place social, environmental, and philanthropic goals—not just investment returns—at the heart of their investment choices need not mean they will miss financial targets, Bezerra says. Last year, Heron's holdings gained nearly 16%, according to the foundation. In comparison, at Robert Wood Johnson—the major science philanthropy most heavily concentrated in offshore funds—the portfolio rose by about 13%.

Such policy changes would probably require approval from a foundation's board of directors. In general, however, board members often prefer to focus on grantmaking and rarely become deeply involved in investment decisions, philanthropy experts say. At Wellcome, for instance, former board member Peter Smith says investment issues arose just a few times during his 10-year tenure, from 2005 to 2014. In one case from 2013, he recalls, board members learned from media reports that Wellcome had invested in a payday lender accused of preying on the poor. The 13-member board ultimately directed trust staff to divest from the company, says Smith, an epidemiologist at the London School of Hygiene & Tropical Medicine.

"There is a tension," Smith says, "between the philanthropic mission that the trust has as a charity and the way in which it invests to maximize the income … which [charity officials] say they have a duty to do." But the tensions surrounding offshore investments never came up at any board meeting he attended, he says. Smith didn't pass judgment when asked whether the trust's holdings in a bunker fuel merchant contradict the charity's goals. But, "If there were things that were ethically dubious, then I would have expected it to be discussed at the board level," he says.

James Gavin, a physician and diabetes expert at Healing Our Village, a health care company in Atlanta, who served as a trustee of Robert Wood Johnson a decade ago, says that if offshore investing undermines the foundation's philanthropic goals, "that would be of extreme concern." But he, too, doesn't recall board discussions of the practice.

The increased scrutiny surrounding offshore investing, driven partly by the release of the Paradise Papers, is making it more likely that charities—including research funders—will have to grapple with the issue, observers say. That's a good thing, says Dana Lanza, who heads the Oakland, California, nonprofit Confluence Philanthropy, which encourages foundations to align investment choices with their philanthropic mission. Foundations that invest heavily in offshore havens, she says, need to ask themselves a basic question: "Do you owe it to the world to be an ethical investor?" ■

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At arm's length

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