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OFFSHORE PILOT QUARTERLY

Of Vice and Men

In 1997 a volcanic eruption on the Island of Montserrat, a British Dependent Territory in the Caribbean, was devastating. Not only did it profoundly affect the lives of the inhabitants, but it brought an abrupt, and perhaps, permanent halt to the island's financial services industry. Montserrat had already become famous for a disaster of another kind: its offshore banking. The issuing of bank licences was the domain of the local island government and not the Governor appointed by the Queen. Inexperience, lack of technical knowledge and vice contributed to the ensuing scandals that became the subject of international government investigations and newspaper articles. In the mind of the offshore novice, Montserrat reflected the general state of play in all the other regional offshore finance centres. To my mind, that's like comparing Belgium with Bosnia today. Besides the many glaring shortcomings of the Montserrat supervisory system, one fundamental problem was that the bank licensing authority was not separated from government control. The British Government is now considering erecting such a fence between regulators and the local government in its Caribbean offshore finance centres, including the Cayman Islands. Following a string of financial fiascos,

the Mexican Government is proposing this autonomy as well.

Previous Offshore Pilots have featured the regulatory review being undertaken in the British offshore finance centres and as the process gains momentum, a growing number of practitioners are expressing apprehension, some of it bordering on alarm. The fatalists are resigned to the fact that change is inevitable and that possibly many of the advantages in place today (especially confidentiality) will be either compromised or completely swept away. The alarmists think that Her Majesty's Government is going to "do a Montserrat": devastate their respective offshore finance industries. Legislation, for example, has been passed in the Turks & Caicos Islands (Proceeds of Crime Ordinance) that extends the reach of money laundering legislation to include the proceeds of all crimes. This is good, but the fear is that foreign tax offences could be eventually added to the catch-all definition. If the Dependent Territories have such legislation thrust upon them, they could become like satellites of foreign tax authorities cast in the role of unpaid tax collectors for foreign governments. World temperatures in 1998 have been their hottest in twenty years and I have no doubt that the type of heat being created by mainland governments this year has not been experienced in many offshore



finance centres in the last twenty years either.

Banking on the Future

Very often, the quality of an offshore finance centre is gauged by the calibre of its banking laws, and on that basis the new Banking Law in Panama scores high. The new law in Panama has been designed to stimulate business and although the banking sector's assets of US\$36 billion are small by international standards, nonetheless, the industry is important to Panama's economy and accounts for about 11% of gross domestic product. Foreign banks holding international licences have increased their assets this year by US\$505 million. The new law will also improve the competitiveness of a banking system which already compares favourably with many other countries in the region. When it comes to operational costs, for example, around 50% of bank income is consumed by operating expenses in Colombia and Venezuela, whereas in Panama about 2% of income is expended.

The National Banking Commission that previously issued licenses has been replaced by a Superintendency which comprises a Board of 5 Directors and a Superintendent. The Superintendent will oversee the soundness and efficiency of the banking system and endeavour to strengthen it as part of the continuing development of Panama not only as a regional, but as an international, banking centre. The Board of Directors of the Superintendency will function as a policy committee and will be responsible for the establishment and implementation of the general policies of the Superintendency. Both the Superintendent and the Board of Directors are appointed by the Executive branch of Government.

The Government of Panama recognises its responsibilities as a leading South

American banking centre. The new law reflects many of the guidelines of the Basle Committee on Banking Supervision and, for example, requires all banks holding a General Licence (unrestricted domestic or international commercial banking activity) to maintain at all times capital that is equivalent to at least 8% of total assets, weighted in proportion to respective risks. Generally-accepted indices of weighting are to be introduced and guidelines will be issued regarding capital adequacy, risk asset reviews, statutory reserves and the definitions applicable to primary and secondary capital and concentration of risk.

I have said before that a bank licence is only as good as the quality of supervision behind it and the Superintendent has wide powers of examination and investigation. Supervision, however, is subject at all times to the observance of strict rules of confidentiality. Heavy criminal and civil sanctions can be imposed on bankers as well as the Superintendent and his Board of Directors for wrongful disclosure. Although confidentiality is enshrined in the new law, a prima facie case proving funds are illicit will not protect criminals from exposure. Panama is already one of the toughest jurisdictions in which to open a new bank account. In Panama, however, there is no grey area when it comes to wondering whether or not a European edict will compel the Superintendency at a future date to include foreign fiscal offences in the definition of money laundering crimes.

Regulation, Not Revelation

In addition to increased investigative powers, the new law has tightened general controls and regulations and brought the country's supervision more in line with the regulatory standards found in the European and American banking centres. Significantly, the



Superintendency is autonomous from central government controls, with funding for its operation coming from licensing fees and other charges levied on the banks. In this respect, the jurisdiction enjoys a status not held in any of the leading Caribbean offshore finance centres, removing any concerns about a repeat performance of Montserrat's murky past.

Following several major banking scandals this decade, it is recognised that bank regulators need to have much closer liaison with their counterparts in other jurisdictions and one crucial element in this closer working relationship is consolidated supervision. The new law contains comprehensive provisions stipulating that foreign banks licensed in Panama must comply with the liquidity requirements, capital adequacy and other technical obligations that are imposed by the law of the country in which the main branch of the foreign bank is domiciled. The law goes further than this and permits a foreign regulator to make inspection visits to any related foreign banks in Panama. One of the grounds for revoking a licence in Panama can arise when a foreign regulator moves against a foreign bank's main branch. The importance of international co-operation is underlined in the law by requiring the Superintendent to establish areas of co-operation with international supervisory bodies in order to strengthen control mechanisms, develop appropriate regulations and exchange information pertinent to the supervisory function. The new law also confirms that the Panamanian Government cannot impose any restrictions, including attachments or withholding measures, upon funds deposited in Panama by central banks, or similar deposits representing the reserves of foreign states.

In short, here's regulation without revelation for the honest offshore investor who is seeking nothing more

than privacy but finding less of it than before. The new Banking Law is an encouraging addition to the existing slate of innovative legislation in Panama and should be welcomed by international investors and practitioners alike.

The Unacceptable Face of Regulation

Panama's future competitiveness in banking and connected fields will probably be spurred on by the changes being orchestrated mainly in Europe. Orchestration implies organisation and is probably the wrong word to use when describing this collective but disjointed effort to change the way offshore finance services are operated in many of today's leading centres. The United Nations bemoans the lack of progress being made by member states in co-ordinating matters and feels that greater political will is needed. Optimistically, the United Nations is asking member states to have relevant legislation in place by 2003. In 1988 members of the United Nations endorsed the Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances which, in essence, made money laundering an international crime and gave authorities the right to trace, freeze, seize and confiscate assets, regardless of banking secrecy laws. Panama has adopted the Convention, but as of February, 1998, 40 states of the United Nations 185 members had still not signed it. Even so, of those that have signed, the United Nations estimates that fewer than 30 are implementing anti-money laundering measures substantially in accordance with the convention. A dismal fact when one considers that the drug business is now worth an estimated \$400 billion a year, and although the car and oil industries still eclipse it, earnings from tourism run the risk of being surpassed. Adding to the morass are the conflicts, confusion and inexperience found in the corridors of power. Unfortunately,



because many of today's leading offshore financial centres are dependencies of the United Kingdom, the brunt of most criticism is directed at the British Foreign Office. The House of Commons International Development Committee has talked of "tensions and inefficiencies" in departments of the Foreign Office and the reports of other Parliamentary inquiries have described failures of communication in the Foreign Office - even going so far as to suggest that there is a general culture of amateurism and incompetence.

It is this unsteady hand at the helm that causes the apprehension being felt in such places as the Cayman Islands and the Channel Islands. When Robin Cook,

the Foreign Secretary, speaks about wanting a level playing field for onshore and offshore financial regulation, it is to be hoped that he does not take the approach of a certain Russian inventor who went to the patent office with a new mechanical shaving apparatus and was asked to describe its operation. "It is very simple. You drop a coin in the box and put your face in the oval aperture. Then two mechanical blades come up and shave you according to a standard template". The patent officer is puzzled and says, "but every man's face is different". The inventor smiles and replies, "that is certainly true, but only until the first shave".

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