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## OFFSHORE PILOT QUARTERLY

### *Commentary on Matters Offshore*

September, 2011.

Volume 14  
Number 3

#### **Preface**

I am writing this issue in advance of my trip to the United Kingdom where I will be delivering two papers at a symposium at Jesus College in Oxford in September. The Director of Studies asked me to talk on current Latin American tax issues and regulatory competition vs. regulatory standardisation. As we are in the middle of economic bedlam – much of which can be attributed not just to the profligacy of professionals but regulatory recklessness – I thought I would incorporate extracts from my Oxford paper on regulation and which will follow this preface.

The final flight of the space shuttle Atlantis arrived back on earth in July. Will Washington, DC? It seems to me that while Nero fiddled and Rome burned, today's American government is fiddling the rules while the country's economy burns. The compromise reached on the country's deficit ceiling at the beginning of last month has painted over the cracks rather than fixed them and clearly Standard & Poor's, the rating agency, in removing America's triple A status felt the same. The next day after the announcement was made, Japan marked the 66<sup>th</sup> anniversary of the Hiroshima atom bomb attack and whilst I don't believe the fallout following the rating agency action will be severe, its impact on national pride will be profound.

The late H. L. Mencken, famous raconteur, commented once that "It is inaccurate to say that I hate everything. I am strongly in favour of common sense, common honesty and common decency. This makes me forever ineligible for public office". You can see his point. But before I share several facets of regulation with you, let me quote from Bob Dylan's popular – and prophetic – song: *The Times They Are a-Changin'*:

*Come senators, congressmen  
Please heed the call  
Don't stand in the doorway  
Don't block up the hall  
For he that gets hurt  
Will be he who has stalled  
There's a battle outside ragin'.  
It'll soon shake your windows  
And rattle your walls  
For the times they are a-changin'.*

Given the predicament Washington, DC finds itself in, Dylan's clarion classic might have been written today. He wrote that song in 1964 – 1900 years after Nero watched Rome burn in 64 AD – and on both sides of the Atlantic expect window-shaking and wall-rattling to continue for some time to come.

The original copy of Dylan's composition was sold at Sotheby's in New York in 2010 for US\$422,000. Who bought it? A hedge fund manager – an appropriate point at which to move on to the dreaming spires of Oxford and the tedious subject of regulation.

#### **What a Mess**

On my desk I have my notary's seal from the Turks & Caicos Islands with the words "Sambrook's Folly" engraved on the handle. It is a constant reminder of the truism that the road to hell is, indeed, paved with good intentions. Many of you here today will be aware of both the past and present difficulties which exist in the Turks and Caicos Islands, a dependent but delinquent territory of the United Kingdom. Twenty two years ago I was sent there by the British government as the first financial services regulator and my remit included recommendations concerning financial services legislation. My three-year tenure brought both triumph and disaster and I did try, as

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suggested by Rudyard Kipling, to treat those two impostors just the same. On the positive side I was able to form a joint committee comprising government and private sector members to address the multitude of issues which confronted us. At the same time I was able to draft regulations for banking and captive insurance as well as a trust and captive insurance law. The Chief Minister at the time said he wanted the islands to become the Liechtenstein of the Caribbean but recent events have made them the Frankenstein of the Caribbean. Sadly, the prevailing conditions in the 1980s have returned to haunt the islands in 2011: a suspended constitution and a corrupt political system. The constitution had been suspended in 1986 and after two reports by Sir Louis Blom-Cooper QC, as well as a report prepared by the former Coopers & Lybrand accountancy firm, the stage was set for my appointment in 1989.

Fast-track to Panamá this year and I am having lunch with Mike Gapes MP from the UK who is chairman of the Foreign Affairs Committee looking into the governance of the TCI. A most interesting discussion ensued. But the question must be asked: the Organisation for Economic Co-operation and Development is critical of offshore regulation, but where one of its members, in this case the UK, has the power and control to intervene it fails to do so effectively. Why? Not once, but twice. To answer that question would take too long but it underlines a failure of communication, a common denominator in the offshore/onshore battle over regulation.

So my views on the subject have been shaped and influenced by personal experiences as both a poacher and a gamekeeper. But having been now more than 30 years offshore I can remain objective and, in fact, those few brief years as a regulator have given me a clear insight into the difficulties which offshore centres encounter when their commercial endeavours collide with governmental bureaucracy. It sometimes just boils down to a failure of either side to understand the priorities of the other and from which a level of hostility manifests itself – whether the players are a tiny island which is a dependency of a developed country or an independent country confronting the OECD.

Others add fuel to the fire and quite often the agent provocateur in the mix is the press whose journalists are not even close-quarter participants but certainly are always on the lookout for a good story. The famous publisher, William Randolph Hearst, famously said: “You furnish the pictures and I’ll furnish the war”. He sent that cable to his illustrator, Frederick Remington, and theirs was a major contribution to the start of the Spanish/American war which followed the sinking of an American naval vessel, The Maine, in 1898 in Havana Harbour. Much more recently, some of you will have perhaps seen the published picture of Uglund House in the Cayman Islands singled out by US President Barack Obama as an outpost of massive tax evasion (can he really be unaware of Delaware?) Hasn’t he seen the Financial Action Task Force report that says that Delaware company agents promote the fact that the state offers greater secrecy than offshore tax havens? One agent’s website states: “The Delaware LLC provides the anonymity that most international jurisdictions do not offer”. Fortunately, the only thing the Uglund photo has started is a war of words. But it illustrates another difficulty which makes it hard to reconcile onshore and offshore: hypocrisy.

Secrecy and confidentiality for some are one in the same, just as so many misguided souls have reached the conclusion that evasion and avoidance are interchangeable for the purposes of taxation. Part of the pincer movement employed by the leading economies is to throw the accusation of secrecy – a much more emotive word than confidential or private – at International Financial Centres. There again, as Humpty Dumpty would say, a word means what I want it to mean and it’s all a question of who is master. More on that subject later.

Secrecy, of course, can denote something sinister, whereas privacy (an alternative meaning found in the dictionary) does not. I understand that something that is confidential in business should remain private unless a legitimate cause arises for disclosure because harm has been done. It is the definition of harm that becomes contentious and which often puts offshore centres at odds with onshore regulators. The US Judge Learned Hand suggested that words are chameleons,



which reflect the colour of the environment. I'm not sure what the colour of prejudice is.

For the same reason that onshore and offshore jurisdictions should not have standardisation of their tax systems, so it should be with regulation. The OECD approach supports Henry Ford's quip that you can have your Model T in any colour you want provided that it's black; eventually competition produced other cars in other colours and earned praise from consumers.

Many IFCs treat privacy and taxes as secondary, because they have specialised in particular fields. The long-established centres offer the means to smooth the way for essential, but complex, wholesale finance transactions, such as reinsurance in Bermuda. Many IFCs offer lawful tax savings anyway, although one country's tax haven will always be another country's criminal haven. But as the heat continues to be turned up by developed countries scrabbling for taxes, more and more of these centres are shifting from an emphasis on confidentiality and tax planning to just plain business and personal long-term financial planning with regulatory simplicity.

Simplicity is most certainly not the word that springs to mind when onshore regulation is considered and which, as events over the last few years have shown, is still found to be wanting. A report published by the Small Business Administration, a US government agency, has estimated that red tape costs US companies US\$1,750 billion a year. In Europe, a think-tank called Open Europe, which is campaigning for easier trade rules in the European Union, has calculated that between 1998 and 2008 the cumulative cost of regulation introduced in EU countries was US\$1,970 billion.

### ***In Need of a HIP Replacement***

I have heard that when regulators see light at the end of the tunnel they order more tunnel. No one disputes the need for regulation but it should be practical and not driven by prejudice; there has been too much onshore hostility in the case of the IFCs, most of which have built their legal framework from a common law base which their regulatory models reflect. Being streamlined, however, hasn't stopped them from being maligned. Earlier in the year a fellow dinner guest in

Panamá was the Permanent Secretary of a UK ministry and his views on the virtues of IFCs reminded me of an old car battery: he was leaking acid. In order for the offshore world to reconcile itself with developed countries, the latter have to eradicate a HIP problem: hypocrisy, already mentioned, ignorance and perception.

Dura lex sed lex: the law is harsh but it is the law. An apt Roman quote in the case of regulation which all financial services, whatever their hue, have to comply with; in some cases more so than in others. But just like ice cream there is more than one flavour, despite the OECD's protestations; while standardisation of regulation would make things simpler, in the real world, where countries have different cultures – not to mention languages – it is just not possible. As businesses compete with each other to gain market share, so do countries to attract investment to their shores, whether their populations are 300 million or 30,000; as I write this we have the spectacle of the United States of America expressing anxiety over the possibility that its own regulatory changes, following derivative and other débâcles, might produce adverse competitive advantage if other countries do not follow suit (this is nothing new and students of 20<sup>th</sup>-century financial history will remember the birth of the eurodollars market that catapulted London into becoming, due in part to American inflexibility, a major force in banking). So regulatory rivalry is not just an onshore/offshore phenomenon and is most certainly nothing new.

The OECD assertion that offshore centres divert funds away from developed countries should not be taken at face value either. Consider the situation in the case of America where, because it taxes (so far) very little of the money held in its banks by non-resident foreigners, foreign deposits in 2009 were US\$2.5 trillion. Compare this with Switzerland where similar deposits totalled well under half that amount. The UK has gone one step further. It has drawn very rich residents from overseas to its shores like a moth to a flame because it is perhaps the biggest personal-tax haven of all. People living there, but who can claim domicile elsewhere, are classified as resident non-domiciles and as such they do not have to pay tax on any external income; that said,



because of the state of the UK's finances, a levy has now been introduced and may be accompanied by further measures in the future.

Due to the existing economic malaise in the West today, with governments drowning in debt, the IFCs are seen by many as the villains of the plot, secreting billions of unpaid taxes in their vaults, protected by lack of transparency and wrapped in secrecy. What is forgotten by hostile factions are the services which IFCs provide; they embrace: international banking (useful to both individuals and corporations in politically or economically unstable countries; I lived in Zimbabwe and know this from first-hand experience), headquarters services (about 730 companies trading on US stock exchanges, including Coca-Cola and Oracle, reported to the SEC that they are incorporated in the Cayman Islands), Foreign Direct Investment (financial management and treasury operations of multi-national companies often include offshore affiliates that support various transactions, such as mergers and

acquisitions), structured finance (via investment vehicles funded in onshore financial markets which purchase onshore assets), insurance (for management of risk, including reinsurance) and collective investment schemes (hedge fund participation).

There are justifiable criticisms about offshore weaknesses in regulation and a need to tighten them up is valid in some instances; the criticism, however, has equal application onshore and the regulator, like the doctor, needs to be reminded of the proverb, "Physician heal thyself". And a lot of healing is needed. Three years after the banking crisis governments across the globe are introducing and altering rules and regulations in a frantic effort to make both banks and the financial system in general more stable. They are in search of the lost chord that will bring harmony and a sustainable business model. Meanwhile, discord is the order of the day. Regrettably, IFCs will draw little sympathy and must expect things, from a regulatory standpoint, to get much tougher.

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*Offshore Pilot Quarterly has been published since 1997 by Trust Services, S. A. which is the British face of trust business in Panama where it is licensed under the fiduciary laws. It is written by Derek Sambrook, our Managing Director, who is a former member of the Latin America and Caribbean Banking Commission as well as a former offshore banking, trust company and insurance regulator. He has over 45 years private and public sector experience in the financial services industry about which he has written extensively and our website provides a broad range of related essays including his Latin Letter column which appears in every issue of Offshore Investment.com, a British professional journal published since 1986.*

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