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Pyramids, Punctures and Pancakes

I wonder if Steven Spielberg has considered making a film about financial chicanery? I'm sure the central characters, if based on reality, would prove as fascinating for him as large underwater predators and extra-terrestrials have been in the past. In advance of preparing an article on offshore scams for a journal, I was reviewing one which I had written several years ago and I soon realised that the text of my article was as applicable now as it had been when I first wrote it; all that had changed was the year of my calendar. The fact is that nothing had changed and that people have been falling into the same traps and swallowing the same improbable stories forever.

Once again I remind regular readers of an anonymous pamphleteer's thoughts when he wrote about the collapse of the South Sea Bubble (the 1720 plan to relieve Britain's national debt in return for interests and sole trading rights in South America) still ring true today: "There must be a vast Fund of Stupidity in Human Nature, else Men would not be caught as they are, a thousand times over, by the same Snare; and while they yet remember their past misfortunes, go on to court and encourage the Causes to which they were owing, and which will again produce them". (Readers of my Latin Letter in the Offshore Investment journal will find further commentary related to the South Sea saga in the October, 2013, issue of that column.) It is no wonder Sir Isaac Newton observed that he could "calculate the motion of heavenly bodies, but not the madness of people" and, in the same vein, Charles Mackay, when considering a title for his 1841 book about the 1630s tulipmania in the Netherlands, chose "Extraordinary Popular Delusions and the Madness of Crowds".

Despite some variances, the two most common plays practised and written about are known as pyramid and Ponzi schemes. Each fraudulent ruse relies on an ever-increasing number of new participants who, by supplying fresh contributions, provide funding for generous interest

payments to earlier investors: if, however, the metaphorical punctured tyre isn't constantly pumped with air, soon there will be none left, leaving it as flat as a pancake. The pyramid scheme has its origins in the sale of detergent by a group of companies back in the 1970s whose sales people spread the message that the direct distribution of detergent would erode the excessive profits of soap powder manufacturers. The detergent might wash, but the theory didn't. It was the group of companies which made most of the money whilst the hapless victims filled their garages with unwanted detergent; puts a different spin on money laundering doesn't it? Charles Ponzi, on the other hand, was an Italian-American banker who, in the 1920s, claimed, and convinced others, that international arbitrage in postal reply coupons was the road to riches. It was for him. Going offshore does seem to add extra panache to the pitch but it is where, unfortunately, wise counsel is most needed. But still, a mix of common sense and analysis is the best defence against the fraudsters because following the herd, like the great annual wildebeest migration in Africa, means possibly falling prey to lions and crocodiles along the way.

Some 2 million zebra, wildebeest and other antelope in East Africa migrate annually from the Serengeti Plains in Tanzania further north to Kenya in search of food and water; the distance covered is around 1800 miles in a clockwise circle. The animals have to cross rivers where crocodiles lie in wait while the huge, concentrated number of animals is welcomed by predators such as the lion, hyena and wild dog. By the time the circuit is completed, around 250,000 wildebeest will have lost their lives.

Unfortunately, in the age of fast-food meals many people want everything handed to them on a plate, and quickly. Such indolence can work against you in your dealings offshore, where being attentive is very important. Explanations that absolute secrecy must be observed and

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denying access to information for independent verification, should set off alarm bells. Remember also that a veneer of respectability is the finest weapon in the trickster's arsenal (the infamous Bank of Credit and Commerce International had a blameless Jimmy Carter's name on its letterhead) and naive lawyers, for instance, are targeted because they provide a layer of professional legitimacy and probity to a transaction.

Drowning Men and Caged Tigers

But it is the internet that has become the deceiver's best friend and which poses the greatest threat today. Meetings, the telephone and letters – once essential tools for the charlatan – can now be circumvented. Virtual deception has eclipsed the actual kind once employed by Henry Morton Stanley, the explorer (he was eventually knighted by Queen Victoria and also bumped into Doctor David Livingstone) who became an agent for King Leopold II of Belgium, the monarch who controlled the Congo until his reign ended in 1908.

In order to convince local chiefs to sign over their land to Leopold, Stanley told them that whites had the magical power to not only resist bullets but to control the power of the sun. Stanley would have someone shoot at him with a blank cartridge and miraculously retrieve a planted bullet from his shoe. Then, using a magnifying glass to light his cigar, he would tell the natives that he could also have the sun burn down a nearby village if he desired it. What's more, the internet is at the forefront of replacing human contact with technology, prompting Albert Einstein to fear the day "that technology will surpass our human interaction. The world will have a generation of idiots".

But every now and then there is, for me at least, that delicious moment when human beings, and not machinery, prevail, for better or for worse, like the case in Germany when a worker briefly fell asleep (perhaps from staring at a monitor's screen) on his keyboard while processing a US\$85 debit from an account. He repeatedly pressed the number 2 and transferred some \$285 million. Such an error when dealing with real money – as opposed to the kind on offer from the United States of America's treasury secretary, Ben Bernanke, – could be serious; but fortunately, the bank noticed the error before their customer did.

"We can know only that we know nothing. And that is the highest degree of human wisdom". That was Leo Tolstoy's opinion, but in the case of business I would offer

my own Lincolnesque view: you can't know everything about everything and you can't even know something about everything. But in business you can strive to know everything about something. Knowledge, combined with efficiency, is a rudimentary element for success in business but with the advances in technology the array of information on hand is daunting – not to mention the speed with which access to it is available. That's all very well, but speed – like the tragic railway disaster in Spain in July at Santiago de Compostela shows – is not always a wise option. There's still a need to hasten slowly in the service industry. And not just in the service industry, bearing in mind Warren Buffett's assertion: "lethargy bordering on sloth remains the cornerstone of our [his company's] investment style". It can also be a good defence. Fabius Maximus, a Roman general, was known by the sobriquet "The Delayer", and by avoiding pitched battles he was able to wear down Hannibal's invading army.

Of course, procrastination can be fatal, as the drowning man could attest to before he went under for the third time. In the past some offshore jurisdictions held the belief that the growing menace posed by the Organisation for Economic Co-operation and Development, elements of which evoke memories of Spain's inquisition, could somehow be avoided by a last moment miracle. But that heady level of optimism tempts comparison with Winston Churchill's second world war view of a beleaguered ally: "An unfortunate man in a cage with a tiger, hoping not to provoke him while steadily dinner time approaches".

In the British Virgin Islands the mouse replaced the tiger as a metaphor when they pondered at one point whether life might imitate art if the offshore centres did the opposite of procrastination and were courageous enough to confront the industrialised nations, drawing inspiration from the film "The Mouse that Roared". In the story a diminutive duchy declares war on the US and ends up in a position to claim victory. Time has shown how putting your money on the tiger was wise in the case of those overseas territories belonging to the United Kingdom. Now the OECD net has spread well beyond traditional offshore centres with this year's G8 meeting (held annually by the group of leaders comprising 8 of the largest developed countries) calling for all countries to stop supporting tax exemption schemes used by companies to avoid taxes.



The Forest of Life

Tax exemption in the case of trade is nothing new and we need to look no further than the Magna Carta (the “Great Charter”) which will celebrate its 800th anniversary in 2015. Not dissimilar to the G8’s aim to curb the benefits of big business, it is a fascinating insight into the financial affairs of England’s ancient nobility.

A discredited King John of England had been forced by his barons into accepting the terse but comprehensive 61 clauses of Magna Carta, the historical ramifications of which could not be imagined at the time. Clause 41 gave generous dispensations to international merchants, permitting them, in essence, to enter and leave England for the purposes of their trade without being subject to any “evil tolls” except in time of war. Deliberate, as well as unintended, benefits arose from this toll exemption, not unlike the position today in jurisdictions which, for example, only tax resident companies and afford non-resident companies privileges similar in spirit to those given by England to those foreign medieval merchants.

Over many years US companies in particular have established corporations offshore (many of them, ironically, in British possessions) that function as tax-avoidance devices and subsidise US exports to the tune of billions a year. It remains to be seen whether the lofty aims of the G8, voiced in June, can be achieved because governments have proved to be as artful and adroit at negotiating as offshore governments and practitioners in the past have been at writing laws and using techniques in order to keep the foreign tax man at bay. That’s something that hasn’t changed since Magna Carta, and let’s not forget that its motives were hardly influenced by the interests of the common man, even although it covered England’s taxation, feudal rights and justice. Its real significance was that for the first time the king’s powers were limited by a written document.

It was also vital for establishing individual rights and freedoms in Britain and, subsequently, the US. In fact, its concepts and some of its words were incorporated into the American Declaration of Independence; the UK’s Lincoln Cathedral copy of Magna Carta was kept for the duration of the second world war in the US and, arguably, no country holds the Magna Carta in more awe than the US. One commentator has called it the grandparent of the American constitution.

But just like the fairy tale world of America’s Camelot, whose king was also called John, its modern branding (a common trend these days in all commercial and individual walks of life and part of herd-think) strays far from the facts. The Magna Carta was valid for just 10 weeks and was seen by the king as an expediency whilst he appealed to Rome for its validity to be voided and which Rome duly did. Far from being a declaration of individual liberty, the free men (this straight away ruled out half of England’s population at that time) which it was supposed to protect were actually just an elite group. But even so, if democracy in the West has its roots in the Middle Ages, Magna Carta is a good point of reference.

Italians say that a wolf sheds its coat but not its vices and Giuseppe Tomasi di Lampedusa, the late Italian writer, who was the Prince of Lampedusa, moves from the wolf to the leopard (which never changes its spots). His classic book, “The Leopard”, is a psychological study of the transfer of power in Sicily from the Bourbon aristocracy to the new Kingdom of Italy as well as an exposé of the greedy and unscrupulous liberal bourgeoisie of the 1860s. It’s been 20 years now since Mr. Spielberg directed “Schindler’s List” and if ever he makes that film about great cons of the past I can, at least, suggest a possible title for it: “Swindler’s List”. I am sure he would find this variety of shark equally intriguing and which is magnificently described in a word picture painted by Lampedusa in his book of one Sicilian character who could be the template for Mr. Ponzi’s acolytes who prey on their victims as well as at the alter of subterfuge: “free as he was from the shackles imposed on many other men by honesty, decency and plain good manners, and he moved through the forest of life with the confidence of an elephant which advances in a straight line, rooting up trees and trampling down lairs, without even noticing scratches of thorns and moans from the crushed”.

Sadly, it does look like independent thinking (just what the con man hates most) versus groupthink is in retreat; be that as it may, I for one will continue to write down my independent thoughts for those independent thinkers out there who care to read them. Meanwhile the wolf, leopard and elephant await the innocent, as do the lion and the crocodile the gullible, massed and moving together, like wildebeest, in a perpetual clockwise, confused circle inside which so many will lose, if not their lives, then money, along the way.





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Engaging an offshore representative is an important decision and we advise all persons to seek appropriate legal and tax advice from professionals licensed to render such advice in the appropriate jurisdiction before making offshore commitments.

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