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Views and News on Matters Offshore

Mosquitoes and Money Laundering

Almost a 100 years ago, in 1904, a successful programme to control malaria enabled the Americans to do what the French could not: build the famous waterway that traverses the Republic of Panama. Significantly, by proving that mosquito-free enclaves were achievable, the programme boosted the colonisation of Africa. It seems, however, as an aside, that the proliferation of banks rather than the eradication of mosquitoes encouraged the colonisation of the Cayman Islands, another offshore financial services centre not far away from Panama, because when I first set foot on Grand Cayman back in the 1970's mosquitoes and money were the dominant forces. Spray planes would roar out of the night sky, sounding like German Stuka fighter aircraft, discharging pungent anti-mosquito chemicals.

Now, nearly a century later, Panama has again found itself in a leading role, this time on the financial front in the fight against money laundering rather than mosquitoes. Observers have expressed the opinion that by implementing the measures which removed them recently from the money laundering black list of the Financial Action Task Force (FATF), a creation of the Organisation for Economic Co-operation and Development (OECD), Panama and 3 other jurisdictions (the Bahamas, the Cayman Islands and Liechtenstein) have set the standards others will be expected to follow. This is the first review since 15 countries were put on the FATF list, and it has been an anxiously-awaited review as jurisdictions speculated over which of their number would either be removed or added. In its twelfth annual report published on 22nd June this year, the FATF acknowledged the enactment of legal reforms in the de-listed jurisdictions as well as the concrete steps each had taken to implement these reforms.

Back in 1998 it was estimated that there were some 4,000 offshore banks licensed in almost 60 offshore jurisdictions and which controlled as much as $5 trillion in assets. About 44% of the banks were located in the Caribbean and Latin America. That's a lot of statistics to digest but let me say that one should be circumspect about statistics – particularly in the case of those which relate to offshore financial services centres. Even though I place more reliance on such offshore statistics than those presented by some statisticians who have estimated in the past that 8 spiders will be eaten accidentally at night during the average lifetime and that if a snail (and perhaps an OECD bureaucrat?) isn't disturbed it can sleep for up to 3 years. I am reminded of the man who drowned crossing a stream which had an estimated average depth of six inches. But putting statistics to one side, whatever the Caribbean and Latin America's share of the banking pie is, Panama, because it is an important banking centre in Latin America, will be justifiably pleased with its new FATF rating. Its removal from the black list is a plus for its banking industry and will encourage an increase in the number of foreign banks in the country whereas for the Cayman Islands and the Bahamas, the number of their respective banks is set to shrink. Both jurisdictions are committed to no longer licensing brass plate banks, meaning those with no physical independent presence in a jurisdiction. It's thought that some 75 banks out of a total of 570 in the Cayman Islands and 65 out of a total of 400 banks in the Bahamas could be affected by this new policy. Panama has never

permitted brass plate licensing and this type of banking business is likely to find a sanctuary in places such as Nauru in the Pacific (400 bank licences have been issued so far) and the Yugoslav Republic of Montenegro which has sold private bank licenses over the internet for just $9,999.
Meanwhile, the United States, which gave the world its first specific money laundering law in 1986, has removed Panama from the list of countries to be closely monitored in relation to all transactions with United States based banks and other institutions. The FATF, incidentally, also has a second list which targets members of the OECD who are rated by their implementation of 28 FATF money laundering control recommendations. So it does seem somewhat ironic to learn that the United States comes in third from the bottom in the ratings. A United States Treasury official has said that the score "does not accurately represent the reality". How many times have some beleaguered offshore financial services centres, for a multitude of reasons, expressed the same sentiment on countless occasions to the OECD?

Steering in the Wrong Direction

It is understandable that those working in the offshore financial services industry have had their attention focused on the OECD's harmful tax competition and money laundering initiatives. There are, however, several more initiatives tucked up the OECD's sleeve which will be revealed (and, doubtless, reviled by some) during the next couple of years. One in particular, which has already received publicity, concerns the operation of offshore corporate vehicles. The worry is the efficacy of the corporate structure put in place: is it bona fide or bogus? The corporate equivalent, in other words, of the real or sham trust controversy. The OECD Council of Ministers has adopted a report entitled "Misuse of Corporate Vehicles for Illicit Purposes". The report was apparently written by an OECD Steering Group on Corporate Governance and I must confess that I was filled with apprehension when I read that experts from government finance and securities ministries were its authors. Unfortunately, as feared, whilst many valid points and observations were made in the report – such as details of beneficial ownership being available to the authorities when justified – there were obvious misconceptions revealed as well. The report, for instance, suggested that the management of companies and trusts were interchangeable terms, thus equating directors with trustees. There are similarities between the two but each has its own distinct character, so the report's inclusion of trusts in the category of corporate vehicles is a gaffe. The very nature of trusts, anyway, usually sees their role as passive when commercial ventures are established offshore. Passive or otherwise, what is not at issue is whether or not information concerning a trust should be available when illicit activities occur. Trustees, just like directors, should be required to divulge relevant information under the proper circumstances. But we should become concerned when elementary errors of definition are made regarding the nature of products used offshore in a document presented to the OECD Council of Ministers. Twinning trusts with companies is a contentious move which is bound to draw fire from many members of the international legal fraternity who will rightly argue that the pairing of the two is ridiculous.
Unfortunately, when inaccuracies are given the weight of official endorsement – in this instance by pliant OECD ministers – they can assume the mantle of legitimacy. Official distortions of fact are not new and have plagued many offshore jurisdictions, not least of all Panama. In many ways, Panama can be compared with antique carpets in the art market: although being blessed with beauty and mystique, they have been undervalued by collectors and historians. Panama is a developing nation with all the problems which that process implies, making the country a difficult place sometimes for those from more structured societies to understand and feel completely at ease about. Living for many years in Africa, I must confess, has given me a better understanding of the problem. Consider the concerned patron (true story) at a New York restaurant who was served chips cut with a British potato chipper. On finding that the chips were not standard in length, like Burger King fries, for example, he thought there might be something wrong and so he sent them back. And whilst Panama continues to deal with the problems common to all of Latin America

(modernisation of the state and the restructuring of government institutions) it is also a magnet for those seeking more individual control in their business and personal lives. Less french fries. It is true, for example, that the United States is the Land of the Free but its legal system today requires the constant intervention of lawyers such that it has also become the Land of the Fee. More than 150 years ago, Alexis de Tocqueville, when considering the zealous approach taken by the United States government and its legislature in their desire to protect the rights of the individual, commented that what has been created as a result is "a network of small complicated rules, minute and uniform" whose number and complexity has only increased. There was a time when rights and liberties in the United States were more narrowly defined such that Oliver Wendell Holmes Jnr was at one time able to write this on the dismissal of a policeman in Boston: "Petitioner may have the constitutional right to talk politics but he has no constitutional right to be a policeman." Today city officials fire their policemen at their peril in a society that so often seems to be suffering from a fixation with abuse of one's rights. Which brings us back to the OECD Steering Group and trusts. Even though, as I have said, the inclusion of trusts in a report on corporate vehicles is misplaced, there can be no doubt that trusts are an increasingly common element of offshore financial structures. But I would submit that it has more to do with Boston policemen: it's litigation, not facilitation of money laundering, that is the reason. It reflects the growing concern, especially in the United States, over lawsuits often filed because of the ever-widening definition of rights which can deprive individuals of their hard-earned assets. And evidence suggests that "the American disease", as it has been called, is spreading internationally. I suggest that the trust connection with the activities (such as tax evasion and money laundering) contemplated in the report adopted by the Council of Ministers will not justify the level of scrutiny trusts are now likely to receive. There may be an estimated 3,000,000 so-called anonymous corporations (beware spiders and snails) but there is a far smaller number of trusts connected with them. The OECD appears to be on course to attack this bastion of asset governance and protection which has existed in its present form since the early part of the 17th century when paper money, the root of money laundering, was only appearing in Europe. Now we are faced with bothersome bureaucrats in a muddle over the motives for trusts.

Churches, Candles and Litmus Paper

In 1997 Panama was the first Latin American country to join the Egmont group, an alliance of 30 nations with centralised financial analysis units established to combat money laundering. It was doubtless unfortunate, therefore, that Panama found itself placed on the initial FATF list of jurisdictions determined by the OECD to be too passive in their attempts to curb money laundering. Clearly, the first annual review was to be a litmus test in determining which governments named were committed to taking positive action in order to deter money laundering. Panama has shown its colours and is already setting a good example since its removal from the FATF list within not only the region but beyond. The country famous for its canal is being regarded as a benchmark for others to attain in order to meet the criteria laid down by the FATF. Both Guatemala and Costa Rica are being helped by Panama at present with their money laundering controls. Guatemala was added to the black list in June when the FATF made its review and Costa Rica has yet to be evaluated by the FATF. Guatemala's lax banking controls and poor regulation in the last decade has meant that its government has had to guarantee the deposits of failed banks in order to avoid general panic and loss of confidence in the financial system. In Costa Rica, where state banks dominate, a scandal which followed a bank's failure in 1995, saw several directors of the state bank, Banco Anglo, jailed for fraud earlier this year. One of the largest thorns in the side of the FATF, however, is Russia which was given a September deadline to make substantial progress towards implementing money laundering controls. Now, following an earlier request from Russia, Panama's bank superintendent and chief financial regulator has assisted with the drafting of anti-laundering legislation which has meant that President Vladimir Putin was able to sign into law new money laundering legislation last month after its speedy passage through the Duma, Russia's federal parliament. Yuri Lvov, Russia's deputy finance minister, is optimistic that the FATF will be removing his country from the black list.. It is fitting that the chief legal adviser to Panama's banking superintendency will take up his appointment as deputy director of the FATF's Caribbean group of jurisdictions this month.

Having funds offshore does not mean that your actions should be automatically suspect. But if, as we have seen, bureaucrats can confuse companies with trusts, they can just as easily get it wrong over the extent of controls needed for offshore financial activities. Everyone should have access to the facilities which both offshore companies and trusts offer, just as the doors of a church remain open to saint or sinner. On a more temporal note, it does become clear that Panama has shown its support (given, I suggest, without the degree of political persuasion the 3 other de-listed jurisdictions have been subjected to) for deserving OECD initiatives. Any offshore financial services centre which cannot exercise common sense when faced with issues of criminality deserves to be shunned. It doesn't mean, however, that jurisdictions such as Panama will not remain at odds with the OECD concerning, for example, international taxation policies which, since the United States intervened, have been knocked off their axis. Restrictive and tyrannical tax initiatives which are predicated on vested interests can never be right. Frédéric Bastiat comes to mind who, some 200 years ago, applied wit to his economic argument in favour of free trade. In an essay he petitions the French parliament on behalf of the candle makers of France who were facing disastrous competition from a foreign competitor "who works under conditions so far superior to our own for production of light that he is flooding the domestic market with it at an incredibly low price". The competitor was the sun. Bastiat facetiously suggested that mandatory shuttering of all windows would not only benefit the candle industry but all the industries that supplied it. What the OECD's harmful taxation offensive needs is less shuttered minds. The British have a saying about assertions which have little value: they are just not worth the candle. How appropriate.

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Bankers
HSBC Bank PLC
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Auditors
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Physical Address: Suite 522, Balboa Plaza, Avenida Balboa, Panama, Republic of Panama.
Mailing Address: Apartado 0832-1630, World Trade Centre, Panama, Republic of Panama.
Telephone: (507) 269-2438 – Telefax: (507) 269-4922
E-mail: marketing@trustserv.com Website: www.trustserv.com