TRUSTS & TAMALES
Speech given at the STEP CARIBBEAN CONFERENCE

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A preacher addressed an alcoholics anonymous audience on the evils of drink. By way of illustration he produced two jars. One contained pure water and the other alcohol. He produced a worm which he proceeded to place in the jar of water. It wriggled around before he retrieved it and then dropped it in the jar of alcohol. It immediately disintegrated and the preacher with a look of triumph on his face asked: "What does that tell you about alcohol?" A voice in the second row replied: "That you'll never get worms". As is the case with many prejudices, some people will never be convinced. Many of you have come to Panama for the first time and will have travelled, along with your suitcases, perhaps with preconceived ideas of the place. I hope that you will leave encouraged by what you find.

Let me start with some local background. When I joined STEP, membership could still be counted in the hundreds so it is pleasing to see how the society has developed and grown into an international and respected organisation in similar fashion to how Panama, Central and South America's finance centre, has grown in stature.

I have often described Panama as neither a first nor third world country and perhaps a new term, second world, should be applied. I say this because it is a country of contradictions. On the one hand it displays a surprising level of sophistication in certain fields while on the other hand, it lags behind. I first visited Panama over 25 years ago and liked what I found. It had a feel for me of Africa, where I had spent my formative years, with its weather and easy going pace of life. The weather here is still the same, but over the years the pace has quickened; the one constant, however, has been the friendliness of its people.
GDP growth in 2007 was the highest in Latin America at 9.5%. The Intelligence Unit at The Economist has predicted that in 2008 Panama will have one of the world's fastest GDP growth rates at just under 10%. In February, Standard & Poor's raised Panama's long-term sovereign credit rating to BB+ on the basis of strong economic growth and continued improvement in the government's fiscal health.

The fact that the 10th annual STEP Caribbean Conference is being held in Panama for the first time bears testament to the country's higher profile as a growing IFC. But I would add that Panama throughout its history has always been a commercial hub. The dominating feature of the Panamanian economy has been its canal and like the title of this conference suggests, the canal has provided a trading path between the seas for international shipping. Its relevance cannot be emphasised too much. About one-third of GDP is derived from canal-related revenues and the country's shipping registry remains the world's largest (in number of ships). The canal, indirectly, also helped bring about the introduction of trusts to Panama, due to the large American presence. More on this later.

Panama only passed its first banking law in 1971. Today it is Latin America's largest banking centre (in number of banks) and along with jurisdictions such as Cypress, Liechtenstein and Singapore has very strong bank privacy laws.

That said, the International Monetary Fund has complimented Panama's banking regime: "While no system is infallible, the mission team concludes that the legal, regulatory and supervisory systems in place in the banking sector compare favourably with internationally accepted prudential supervision practices. The team's review was confined largely to banking and trust activities, which fall under the supervision of the Superintendency of Banks. The legal and regulatory requirements are strict and many requirements exceed those in place in industrial countries".

It is true to say that when it comes to bank accounts, there is no question that in many cases it is easier to open one in Europe or the United States. Let me quote from another IMF report on Panama: "the authorities and the banking industry are very aware of the prudential risks associated with money laundering and have in place adequate safeguards to deter improper use of the banking system for illegal purposes. While no system is infallible, the mission team concludes that the legal regulatory and supervisory systems in place in the banking sector compare favourably with

internationally accepted prudential supervision practices…"

Trust companies such as mine fall under the Superintendency of Banks' control and there is an established supervisory and regulatory regime for them in place. Switzerland is only addressing such supervisory issues now and trust company licensing in Panama pre-dates the systems in Jersey and Guernsey in the British Channel Islands. The requirements are extensive and I'll mention just some of the main ones. Trust company applicants must be bonded, produce sound business plans, and provide senior management and shareholders résúmes, personal and business references, police clearances and evidence of experience and qualifications. Once a licence has been issued regular audited accounts must be filed with the authorities who can and do undertake inspections. Any breaches of client confidentiality by a trust company are treated in the same way as they would be in the case of a bank with the attendant fines and imprisonment.
In today's environment clashes over trusts and taxes are like hurricanes in the Caribbean: both are inevitable. And what a storm. With its higher profile, Panama's offshore activities have caught the eye of the OECD in relation to the organisation's concerns about fair tax competition world-wide.
At this point I am reminded of a verse from a song about Americans fleeing their country for tropical climes that I heard frequently on the radio in Grand Cayman after I moved there nearly 30 years ago. It went: "Some of them are running from lovers, leaving no forward address. Some of them are running tons of ganja. Some are running from the IRS". The song was written by Mr. Buffett, not the sage of Omaha, but his namesake, Jimmy, the troubadour of Mississippi. Perhaps women and ganja are still strong motives for going offshore, but I wouldn't say that taxes were. Either in Cayman or Panama.

Today 80% of my clientele are concerned with non-tax issues whereas back in the 1970s the same percentage was definitely seeking tax relief. Confidentiality (already addressed by Messrs. Pease and Harty), succession, asset protection and international asset diversification have taken over as priorities for Jimmy Buffet's Americans, not to mention the nationals of other countries.

The OECD's list of tax havens as we know contains over 30 jurisdictions and only 3 of these have not given undertakings to co-operate long-term with the harmonisation of international tax policies. The rebels are Monaco, Andorra and Liechtenstein, the latter having been in the spotlight in recent months following the fall-out with Germany over its secrecy laws. The Crown Prince of Liechtenstein argues that it's about culture and not collection of taxes and that privacy is there for those who place a high value on it. This is a debate to which the perpetuity rule definitely does not apply.

The whole OECD tax harmonisation exercise, however, has succumbed to self-interest and contradictory signals which has made both real progress and the work of the OECD's Global Forum on Taxation, very difficult.

Panama, for its part, however, objects to being lumped in with what, for want of a better description, it sees as manufactured tax havens. By comparison, Panama's economic development as well as its tax laws are, to quote the government: "a consequence of history and not of initiatives to help evade taxes in other parts of the world". Panama has assured the OECD that it will continue in good faith as a member of the Global Forum but it has also said that its willingness to co-operate will not come at the expense of relinquishing its sovereign right to conduct its international agenda as it pleases.
The government has also said that if, at the end of the day, even-handedness is not applied to all jurisdictions then the conditions will not exist, and I quote, "in order to develop effective commitments between the OECD and Panama".
Even-handedness presents a problem when we take into account the rebel Gang of 3 already mentioned and the fact that 3 OECD members, Austria, Luxembourg and Switzerland, have bank secrecy laws. Austria, a member also of the European Union, has them enshrined in its constitution. And don't forget the very tight bank secrecy laws in Cypress and Singapore.

Panama's territorial tax system harks back to a time long before so-called tailored tax havens existed. The country has never focused on traditional offshore financial services for revenue any more than it has, until recent times, on tourism; more than half the banking business today is domestic and although traditional offshore banking and related services make their contribution, one that is growing, they are not the economy's driving force. Its economic success, unlike some of its Caribbean counterparts, has not been dependent on the attraction of beaches and bank accounts.

Personally, and perhaps not the majority view, I would like to see Panama remain a minor IFC and continue its economic growth with a blend of canal-related and commercial banking business plus associated services such as corporate and fiduciary management. The bright lights of success in offshore services can have a downside, as the Crown Prince of Liechtenstein can attest to.

Corporate management has always been good business in Panama but what about fiduciary management which has traditionally meant trusts? It was the famous 19th century British legal historian, Francis Maitland, who said that "if we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence I cannot think that we should have any better answer to give than this, namely, the development from century to century of the trust idea". Unfortunately, the idea of English trusts – unlike tamales – has not been well received in Spanish-speaking Central and South America.

Why is that? The short answer is that Anglo-Saxon trusts spring from a common law environment whereas trusts in most of Latin America must be created within a civil law system. Consequently, the trust as we understand it in Europe and America is often treated with suspicion in the region. That said, it is natural for lawyers, whether in Panama or elsewhere, to assert that their own legal system is, despite any imperfections, the finest available. Criticism of other countries laws, therefore, is not uncommon and I am reminded of the American lawyer and political figure, Newton Minnow, who, during the days of the old Soviet Union, said: "In Germany, under the law everything is prohibited except that which is permitted. In France, under the law everything is permitted except that which is prohibited. In the Soviet Union, everything is prohibited, including that which is permitted. And in Italy, under the law everything is permitted, especially that which is prohibited".

Let me preface any further comment by saying that although I have been described as a transplanted trustee, Panama is not my first experience of trust administration under a civil code. In fact, I began my career in Rhodesia (known today as Zimbabwe and by some as Grimbabwe) which has a Roman-Dutch law system. The law that the first European settlors in South Africa had brought with them in the 17th century was to be materially influenced by the subsequent British conquest of that country, which began in 1795. Not just the country, but its legislation, fell into British hands and not surprisingly, the flexible and functional trust, forming part of the bedrock of English family law, was incorporated into the civil code; by extension, it found its way into Rhodesia as settlors from the south travelled across the Limpopo river at the end of the 19th century.

I worked initially for Standard Bank, which is Africa's largest bank, and mine was very much a domestic trust officer's role in the former British colony: 80% of my work involved the liquidation of deceased estates, which included preparing the necessary tax returns and liquidation accounts. In the case of important bank customers, funerals could be added to the list. The rest of my time was spent administering trusts, all of which were pretty routine. But that changed when I moved to the Cayman Islands at the end of the 1970s after a spell in London with the HSBC Group. My transition from Rhodesian trust law was achieved with little difficulty because the principles remained the same.

Trusts in Panama, however, like tamales, have a distinct flavour. I remember many years ago, a South American telling me that the Latin American equivalent of the trust was the bearer share. And certainly bearer shares remain popular in the region, despite their oft-quoted sinister connotations. Transferring ownership upon demise as easily as you would the bearer bank note in your pocket is very attractive but for me the basic question raised by bearer shares is this: how secure is the chain of control between death and onward delivery?

A trust law was passed in Colombia in 1923 and Panama quickly followed suit in 1925. The 1925 law was replaced by a new one in 1984 which has since been amended to streamline some procedures. We'll be looking a little closer at that law in due course. But blending this offspring of English equity with a civil law system, such as the one Panama has, was never going to be easy. And certainly Francis Maitland's version of a trust found itself an interloper confronting a legal system brought from Spain by the conquistadores.

The Swiss, on the other hand, have put out the welcome mat for trusts and then appear to have dealt with them in their midst by having their governing law situated elsewhere, such as the Channel Islands, displaying Switzerland's traditional stance of neutrality when conflict arises.
How then, did the trust get here? Simply put, the driving force was competition, rather than coercion. In an effort to lure capital principally from the United States of America, it was considered necessary to offer investment vehicles, such as trusts, that Americans frequently used and were very familiar with. Trade and investment were the spur, so it was the power of capitalism and not, as in southern Africa, the cannon that brought about the fideicomiso, which is the Spanish translation of the Latin word fideicommissum, and is the closest translation one gets for the word "trust" in Spanish.

It is not surprising that Panama's own trust law should follow fast on the heels of Colombia's because of the American presence here, referred to earlier. Not only did America complete the

canal, it then controlled it right up to midnight 1999 when it was handed over to the Panamanians along with the immediate surrounding land known as the Canal Zone. America had exercised sovereignty over the Zone and ordinary Panamanians were denied access. Senator John McCain, the Republican Senator running for President, was born in the Zone without any subsequent negative effect on his status as a US citizen. The Zone really was a piece of America and nothing proves it better than that.

Further study of the commercial motive behind the fideicomiso reveals how in Latin America it has traditionally been used for business rather than family purposes with banks or financial institutions often managing commercial investment funds. In Mexico, for instance, only banks can act as trustees and the law prohibits the trustee from being a beneficiary of the trust. The trust, in other words, is seen as a practical, financial investment vehicle.

Last year in a STEP Journal article I suggested that although Panama does have trust legislation, I believe that any sudden surge of trust business in the future would be confronted with library shelves containing few trust legal precedents. This will change over time and especially as more international business takes place with foreign trustees who begin to use Panama more frequently. STEP has a key role to play in this. Besides STEP, Panama already has very strong business ties with the UK, home of the trust. Britain is the country's largest investor and there is even a Panama British Business Association for which I serve as Treasurer.

Speaking of poorly stocked library shelves, the same precedent problem applies to foundations set up in those common law offshore jurisdictions which have now incorporated them into their legislation as part of a drive to be all things to all men. Civil and common law foundations have already been the subject of this morning's breakout session.

But let me say at this point that when the Panamanians passed a foundation law in 1995, like the title of a John Lennon book, it threw a Spaniard in the works. As it happens, a rather appropriate term in this case because the foundation concept is something the conquering conquistadores, who brought their laws with them, would have understood. Understandably, therefore, this civil law creature has found more regional favour than the trust. Reluctantly, and whilst appreciating that my view may be contentious, I can see, even as a trust aficionado, why the Panamanian foundation with its codified, simplified and straightforward law could present real competition for its Anglo-Saxon cousin. In many ways it evokes a time when trusts and the rules surrounding them were less complex.

In my profession I'm all for simplicity whenever possible, especially when it comes to legislation or a trust deed. Not everyone shares this view but that doesn't mean that complexity always delivers clarity. Take, for example, a county ordinance in Pennsylvania in the US which stipulates that strippers must cover one-third of their buttocks when they are dancing. The ordinance defines a posterior as being the "rear of the human body" and "between two imaginary lines, one on each side of the body (the 'outside lines'), which outside lines are perpendicular to the ground and to the horizontal lines described above and which perpendicular outside lines pass through the outermost point(s) at which each nate meets the outer side of each leg". Those who would like my definition of a bare trustee would find that the answer wouldn't be titillating but it would be clear.

Let's look a bit more closely at some practical aspects of trust law in Latin America. Panamanian trust law may spell out clearly the ownership relationship between trustee and beneficiary but this is not uniform across the region. Fideicomisos can clash with the root civil law principle of numerus clausus. Because under this principle the law has a definitive and unalterable list of real rights, the registration of interests in land and other property is finite. How then, can a trustee hold legal title and at the same time have that title diluted? Consequently, in some Latin American countries the beneficiary may only have an in personam claim against a trustee.

I'd like to look now more closely at Panama's trust law which is embodied in 43 Articles and in doing so mention a few features of significance for foreign trustees:

Article 4: The intent to create a trust must be stated expressly and in writing. Consequently, oral, constructive or resulting trusts shall not be valid as trusts.
Article 7: The trust shall be irrevocable unless the contrary is expressly provided in the trust deed.
Article 9 of the law records, inter alia, the requirement that the three certainties, as we understand them in English trust law, must be present and if the trust is created by private document the signatures of the settlor and the Trustee or of their attorneys-in-fact must be authenticated by a notary public who can be located anywhere. If, however, any real estate located in Panama forms part of the trust, the trust deed must be recorded at the Public Registry.
Article 10: Inter-vivos trusts may be created by a public or private instrument.

Article 15: In noting my previous numerus clausus comments, this is an important Article because it states that the trust assets shall constitute a patrimony separate from the personal assets of the Trustee for all legal purposes and may not be attached or embargoed except for debts incurred in the performance of the trust, or by third parties when the assets have been transferred or retained by fraud and to the detriment of their rights.
This Article keeps the door wide open in the case of fraudulent conveyance and, coincidentally, I took the same approach when drafting the Turks & Caicos trust law back in 1989. I felt that the trust's creation would either stand firmly on its own or would have feet of clay.

Article 35 confirms that no income tax will be levied on assets located abroad, in line with Panama's territorial tax policy and with apologies to the OECD.
Article 38 allows a foreign law to govern a Panamanian trust (the Swiss would appreciate this) and Article 40 permits foreign trusts to be re-domiciled to Panama.
But despite everything, the fideicomiso and England's marvellous idea have much in common and all of my remarks should be seen as complementing those of Dr. Aleman who spoke to you yesterday. In either case, and in simple terms, a bond is created between the giver and the receiver for the benefit of someone else. Civil law has the principle of unjust enrichment and common law has equity. The principles of equity, as we know, were first applied by a Chancellor who was more often a clergyman of high rank who followed the procedures of the ecclesiastical courts. He reached his conclusions by exercising his moral conscience and put aside legal rules and decisions. The decisions were more influenced by common sense than common law. Herein lies the key and the connection between unjust enrichment, equity and trusts.
If equity concerns matters of conscience then unjust enrichment sits comfortably alongside it. In fact, it was Lord Wright in the English case of Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd. who recognised this, and I quote the judge's words: "any civilised system of law is bound to provide remedies for cases of what has been called unjust enrichment or unjust benefit, that is to prevent a man from retaining the money of or some benefit derived from another which it is against conscience that he should keep". Unquote.

Just in April we had a high profile example of this philosophy when the European Court of Justice delivered a judgement based on the principle of unjust enrichment but in a case involving a British plaintiff and British defendant. The court ruled that Her Majesty's Revenue and Customs should refund some 3.5 million pounds in VAT overpaid by the British company, Marks & Spencer, on the sale of chocolate teacakes. According to your point of view you might think that this takes the cake, but one thing is for sure: the outcome did, indeed, prove to be sweet revenge for M&S.

I have been at home in either the civil or common law systems as a trustee because whether it's trusts, fideicomisos or foundations the common denominator is the word fiduciary and its application. Unlike the conceptual differences highlighted in yesterday's talk between US and UK trusts, no matter how you pronounce fiduciary, it is a tomato whose fruit tastes the same.

So English equity and civil law may be awkward bedfellows but there is no reason why Panamanian and foreign practitioners cannot share a mutual understanding, if not a language, in the case of trusts and fideicomisos. I have called this the Casablanca Rule because the fundamental things apply as time goes by or as Seneca the Elder, centuries ago, so wisely put it: "certain laws have not been written but they are more fixed than all the written laws."

I see that time has caught up with me and this retailer of Panama (with apologies to Mr. Le Carré) thanks you for your attention. Living in Panama has certainly been enriching from both a personal and professional standpoint for me and I hope that I have been perhaps a little more convincing than that preacher and his props in projecting some of this little Republic's virtues.

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