December, 2013

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special NEWSLETTER

THE SECRETS OF OFFSHORE BANKING - part one

Offshore or onshore banking?

Most of us tend to forget the fact that there is an enormous difference between the operation of the two types of bank account mentioned above. First of all, however, we should clarify exactly what we mean by offshore and onshore banking. It will be easier to understand the difference between the two if we look at the second one first. In the case of onshore banking, speaking strictly about corporate accounts, the company generally opens an account in the country in which it is registered, which also tends to be where the owners live or are resident and where the company carries out its business activities.

In the case of offshore banking transactions, the difference occurs in the first and most important of the elements listed above: the company is not registered in the country where the bank operates. Furthermore, the company owners and beneficiaries, or at least some of them, are foreigners from the bank's point of view, and the company does not physically operate in that country either.

And this is exactly where the problems start, as the necessary trust towards the company, or rather the client, is not there. While the owners and directors of an onshore company usually appear personally in the bank (obviously we're talking about private companies here, not those registered on the stock exchange), this step does not generally occur in the offshore version. The main protagonists are not physically present, and as a result the bank has less confidence in the client. But what is behind this lack of trust? If I had to reply to that question in one word, then that word would be intimidation.

Under pressure from the anti-money laundering laws

At the beginning of the last decade a new department appeared in the banks alongside the legal department. This was the compliance department. In most languages they didn't even bother to translate the name, and banks throughout the world have adopted the name "compliance" for this division within the bank. The role of the compliance department is to ensure that the bank's regulations are in line with anti-money laundering laws in both the identification of clients and the continuous monitoring of transactions. There is no universally accepted definition of money laundering, and it is interpreted differently from country to country, even though the international powers that be have issued guidelines. In the past the term was clearly used to define the "washing" of the proceeds of crime, such as income from drug trafficking, illegal arms deals, prostitution and protection rackets, but today the list has been expanded significantly. The legislation of numerous European and North American countries includes the recording of any funds from illegal sources as legitimate income in the money laundering category. The "everything suspicious" category does little to increase trust and confidence. Nobody knows

exactly what to include in this list, which then leads to a type of over-carefulness appearing in the system. The service providers, and within this group primarily the banks, are not prepared to establish new client relations or maintain existing bank accounts for those clients or ventures where even the slightest suspicion may arise. And when I say slightest, I mean slightest. If any point arises creating just a tiny doubt in regard to a client, then they would rather not take the risk, and prefer to turn away very tempting, potentially profitable clients.

So what lies behind this? The answer is very simple: constant intimidation. Try and think about it from the banker's point of view: if you put yourself in the banker's shoes and have to face the fact that the bank is going to be investigated because of a client who became involved in money laundering, and it was you who opened the account and sat by idly for years without reporting the suspicious transactions to the authorities, then it is easier to understand. If the accusations prove true, then in numerous cases the bank officer responsible may face a prison sentence of 5-10 years. Who wants to take that risk? Not to mention the fact that such a case would almost certainly mean instant dismissal from the bank, where it is common knowledge that employees are well paid.

For this reason, in order to reduce the risk to a minimum new clients are very carefully vetted, and any suspicious transactions arising in the dealings of existing clients are reported to the authorities to avoid being held responsible. The whole matter turns tragicomic in that the body dealing with such reports is not at all happy as they are faced with a huge increase in the number of cases, 90-95% of which turn out to be false alarms with absolutely nothing suspicious in the background. Quite simply, the bank employees are increasing the burden on the authorities.

The role of international organisations

When drafting anti-money laundering legislation, national legislators use the recommendations of the international organisations as foundations. Among the international organisations influencing legislation, the OECD (Organisation for Economic Co-operation and Development) stands out. According to the OECD website (www.oecd.org), their mission is to "promote policies that will improve the economic and social well-being of people around the world." One of the specialist bodies of the OECD is the FATF (Financial Action Task Force), established in 1989. The primary goal of the FATF is to elaborate and publicise rules and regulations designed to prevent money laundering and the financing of international terrorism. Since 2004 these guidelines have appeared on their website (www.fatf.org) in the form of recommendations (40 or 40+9 recommendations), so are openly available for everyone to read and study.

If someone takes the time to read through all the recommendations, they will soon realise that we should not even get out of bed in the morning or carry out any business activity whatsoever, as anything can be used to achieve money laundering or even the financing of terrorism. Putting aside the irony, unfortunately we now have to take this whole matter much more seriously than it first seemed. Particularly if we are to be involved in the process, in any capacity.

One of the most important basic principles defined by the OECD/FATF is transparency. This applies to both the individuals participating in a structure and the transactions performed by a given company. A structure can be considered transparent if the structure is clear to an outside observer. That is, the ownership and beneficial ownership of a structure must be clear, and the identity of the directors and other officers must also be available. As regards the company activity, certified balance sheets should be available from the registrar or the chamber of commerce, and in the given country anybody should have access to these details and figures.

Looking at the question from this point of view, we can divide the world into two groups. The first group would contain those jurisdictions where the details of the owners and officers as well as the financial statements are freely available through public records from an official body (registrar of companies, court of registration, chamber of commerce etc.). In the other group we would list those countries or jurisdictions where these details are not available, or are only partly available. The majority of offshore jurisdictions, such as the deservedly popular British Virgin Islands, the Seychelles, Belize, Panama would fall into this category. In these countries, there is no public record of company directors or shareholders. Financial statements can not be found from official sources as in these countries the annual tax is typically a fixed amount of between 100 and 350 USD, irrespective of turnover, and as a result the state tax authorities do not require or keep copies of financial reports.

Is it worth kicking up a fuss about this?

No. It was not by chance that my reply was so categorical and laconic. If you would like to open an account for a company from the second category listed above, that is a company which is not transparent, or is only partially transparent, then you have no choice but to bow down to the bank's rules and expectations. All the banks state that the opening of accounts is not automatic, and they also reserve the right not only to ask for additional documents and explanations to be provided, but also to reject your request at any time during the account opening process and refuse to open an account. And this will be no better in the future either; if anybody wants to open or maintain an account for an offshore company, they will be forced to pay attention to the conditions set down by the bank. I know that from the client's point of view the questions posed by the bankers seem very blinkered, but believe me, there is no point in getting upset with them, as they are just doing their job and trying to stick to the guidelines issued by the legal, or rather compliance department.

Is our approach wrong?

Maybe, but it's the same the world over. Not long ago, the managing director of a European bank was handed a several hundred thousand euro fine by an inspection team from the country's national bank. They picked a number of company files at random from the bank's branches and asked the managing director to explain why and according to what economic rationale the bank had opened accounts for these offshore companies. They asked him to provide organograms, and contracts and invoices related to the companies' true activities. In their opinion, the banker could not provide suitable answers, and it cost him his job. They also stated in their report that they could return the following year, and if their findings were similar, then they could even revoke the bank's licence.

I can say, without fear of contradiction, that on this basis the licence of any bank in the world could be revoked. What constitutes "economic rationale" in a given structure is an extremely relative question both economically and financially. From this point of view, a local onshore company is no less risky for a bank in any given country. Just think how many local companies have been registered in your country for the sole purpose of balancing certain figures, or maybe with no other aim but to channel the salaries of family members into a corporate system. Strictly speaking, this is a bogus employment contract, designed to save on costs, and thus is in breach of the penal code. Interestingly, however, not one single compliance department manager has paid sufficient attention to this question. Over the years I have managed to catch out more than one compliance manager with this test, shining a little light on the stupidity and relativeness of the rules. Despite this, the situation never improved, and I got shouted at over the phone for my troubles, but the next day our clients still faced the same rules in the banks. And I can be proud of myself as I've actually spoken to a real compliance manager, who generally never speak to mere mortals; they are deliberatley out of reach, untouchable.

So what should you do, if despite this you still want to open and use an account for an offshore company?

Reply to the questions posed by the bank!

This is extremely important. Particularly if you are not actually there in person when the account is being opened, or if your signature on the forms sent to the financial institution is verified by somebody else. It is for exactly this reason that any additional questions put by the bank must receive an answer. As I have already mentioned earlier, when the client is not there in person, there is less trust. It is more difficult for the bank to become acquainted with the client's activities and background.

React as quickly as possible!

Don't drag out time, and where possible, reply to the bank's questions immediately. It does little to increase trust if the client sits on the unanswered questions for weeks. And although you may hear nothing from the other side for months, you should react as soon as you can. If they don't receive an answer for a long time, they may think that you're trying to think up the response.

Don't give false details or information!

Don't forget that as you use and operate the account the bank will have numerous opportunities to check the details, contracting parties, business activities and amounts etc. which you gave. The bank sees everything through the incoming and outgoing transfers, and anti-money laundering software monitors and checks them in order to filter out suspicious transactions. It can be extremely inconvenient, for example, if the bank blocks the account, once the company's activites have begun, until they receive suitable answers. Just imagine the situation where you are unable to pay your partners because the bank has frozen your account.

Open several accounts!

One account is not an account. In order to reduce risk and avoid the possible incovenience of the above situation, it is worth opening a number of accounts, in different countries and geographical regions, for the same company. The importance of this has been highlighted by the banking crisis in Cyprus. The more places a company had money, the more times it could take advantage of the automatic 100 000 euro guarantee. Having 1 000 000 euros in the LAIKI Bank was to no avail if you were guaranteed to lose at least 900 000. If someone had 310 000 euros, but in three different banks in Cyprus, then they would lose 10 000 euros at the most.

Don't lose your temper!

The question "But why is the bank asking so many stupid things?" is not worth asking. It is all but impossible to stop the bank officer asking their list of questions, so to speed things up it is better to focus on cooperating. Although the questions may appear totally irrational to the client, the bank officer is obliged to ask them, and the logic of their system does actually handle questions like what the beneficial owner's occupation or activity was 20 years earlier surprisingly well. What the bank is actually doing is trying to prepare a dossier - an economic profile - for its own records, including detailed information on the company, its beneficial owners, and any domestic enterprises they may have. Accordingly, they examine and analyse any other companies connected to the client in order to establish a true picture of the new company's background.

Pay special attention to changes!

The times, rules and possibilities are changing all the time. What was true ysesterday may very much belong to the past today. While, for example, it was possible to carry out cash transactions relatively freely not long ago, today the

possibilities have been drastically restricted. From the point of view of the world financial system, cash transactions have become a sort of persecuted category. This is where they see the greatest danger of money laundering, as once the cash has been issued, it is impossible to keep track of who receives it and where it ends up, while with incoming cash payments the source or origin of the funds is uncertain.

Where possible, establish a company in a country where you can also open a bank account!

This is a totally new tendency. In order to prevent "aggressive tax planning", a significant number of banks will only open accounts for companies registered in that country and which have and can prove true business relationships with that country. It is worth paying attention here from the wider perspective, as these could mean the death sentence for those offshore jurisdictions where it is still possible to register companies, but which do not have the necessary banking infrastructure. The British Virgin Islands may be extremely popular, but it could be in vain as they are unable to satisfy the banking requirements of thsose hundreds of thousands of companies which are registered there. In contrast, Hong Kong and Cyprus offer excellent solutions from both points of view: company formation and banking jurisdictions in one, with extremely well developed infrastructures.

Is this the beginning of the end?

Yes and no. Obviously, for those accustomed to the convenience, security, and anonymity that offshore banking offered over the last 20 - 30 years it is easy to believe that from now on everything has become so restricted that the whole thing is no longer worth it. Naturally, this is the case. But if we consider the fact that there is no alternative, then it is still better to take out a certain amount each month with a bank card than to not take out anything at all. The possibilities have been reduced, but they have not disappeared altogether. Bearing in mind the costs, there still exist a number of solutions around the world which can be operated efficiently and conveniently. These options will continue to exist in the future, too, but they are continually undergoing transformation. In many cases, when one possibility ends, another takes its place. The main theorem is true here, too: in the university of life only one thing is constant, and that is change. The creativity of the clever businessman lies in the fact that he is able to adapt to the constantly changing environment, and to understand and select the alternatives which are best for him.

- To be continued -

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