DO OFFSHORE FINANCIAL CENTRES STILL OFFER CONFIDENTIALITY

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The question is often asked, with all the talk of disclosure and transparency in financial systems, is there still such a thing as 'confidentiality' in business, in particular through the use of offshore structures. The answer is no longer a simple, yes. The answer is ***yes but.***

The days where jurisdictions sought to make money from hosting shell banks or politically exposed persons' or known terrorists' monies no questions asked are long gone. There has been a dramatic transformation in the offshore world where regimes, such as that of St. Vincent and the Grenadines, that once touted the slogan of 'strictest privacy' have embraced the fight against money laundering and terrorist financing and introduced operational regimes to ensure this. In addition, most countries have also subscribed to the principles of transparency and information exchange in the area of taxation, accordingly to the OECD 'harmful tax initiative.'

However, as I indicated above, there is confidentiality but. Where the ***but*** comes in is in relation to the reason for needing confidentiality. If you need confidentiality to protect the fact that your monies come from ill gotten gains, or the 'proceeds of crime', your confidentiality will not be protected. In most offshore centres that are serious about being reputable members of the international financial community, there is no protection of criminal monies. In fact there is in place highly efficient mechanisms for the sharing of

information in relation to charged or suspected criminal activity. However the playing field is not level even in the sharing of information in relation to criminal activity. For example, some countries will share information when requested to do so about a suspected criminal offence, other countries will require that a person be charged before sharing information. Another country may require that there be what is known as a dual criminality standard, for example the crime must be a crime both in the requesting State as well as the requested State.

The playing field is even less level in relation to the confidentiality that is afforded to civil matters, such as information that is relevant to taxation. A benchmarking exercise is currently being carried out by OECD and Non-OECD members who have committed in principle to the sharing of information and transparency to determine just what the playing field look like. The results of this benchmarking exercise will be discussed at the OECD global forum in Australia in November 2005.

What are the factors that one can look to in determining whether a particular jurisdiction or the structures within it will offer a high or low level of 'protection of confidentiality' both in relation to criminal and civil matters? There are so many factors to consider in determining the level of transparency in particular jurisdiction, some of these are listed and examined below.

(1) Sovereign or dependent status

(2) Existence of Tax Information Exchange Agreements (TIEAs)

(3) Mutual Legal Assistance Treaties (MLATs)

(4) Statutes on Criminal Information Exchange

(5) Individual Statutes governing Financial Institutions (the Confidentiality provisions therein)

(6) General Information Exchange Statutes

(7) The existence and effectiveness/powers of a Financial Intelligence Unit (FIU)

(8) The Role/Attitude of the Courts/Judiciary to Confidentiality

(9) The quality/principles of regulatory authorities

(10) The principles of the Government towards confidentiality (exercise of public interest principle).

I shall now examine each of these in turn.

(1) Sovereign or dependent status

If a country is a Sovereign state, directives on information exchange from another country or Union will not apply. For example, the EU Directive on Individual Savings Income will apply directly to the financial centres such as the BVI and the Channel Islands that are dependents of the EU. While such dependencies may negotiate the way in which the Directive will apply to them, the bottom line is that it will apply. Meanwhile sovereign financial centres such as St. Vincent and the Grenadines will not be required to automatically share information on individuals' savings income to EU member states.

(2) Existence of Tax Information Exchange Agreements (TIEAs)

A country may commit to the sharing of tax information (criminal or civil or both) in principle, but it is only where there is in place an effective TIEA can such information actually be effectively shared with another State. It is important therefore to see what TIEAs are in place, and with which countries. The 'investor' would be keen to know if a TIEA exists between the offshore centre and his home jurisdiction.

While there is a standard model TIEA set by the OECD, in practice TIEAs can vary widely. Important thing to look for are: does the TIEA cover civil tax information as well as criminal tax information. What are the conditions for obtaining information under a TIEA? Does the TIEA provide for automatic sharing of tax information. This would be highly unlikely. Most TIEAs provide for the sharing of tax information ***upon request.*** Also many TIEAs are also limited to the sharing of tax information if it is linked to tax evasion, that is a criminal tax offence.

(3) Mutual Legal Assistance Treaties (MLATs)

Similarly with TIEAs it is important to look at what bilateral arrangements in the form of MLATs and the like, are in place for the sharing of information between your home country and your offshore center for doing business. Also like TIEAs it is important to look at the fine print, as the MLAT will set out the type of information that can be shared and the circumstances under which it can be shared. For example it may read that information can be shared on a tax matter only if that information is relevant to a criminal

matter. It may read that the Government may share information if it is in the 'public interest' to do so. In such cases one would then have to look at the policy statements of the said Government to determine the manner in which such a provision is likely to be interpreted.

(4) Statutes on Criminal Information Exchange

There may be a generic statute such as St. Vincent's Mutual Assistance in Criminal Matters Act that provides for assistance to be given to another country in criminal matters. This Act, which is found in many Commonwealth offshore centres, provides for the sharing of information with Commonwealth countries in particular. Again, it is important to look at the detail in these Acts to determine the extent to which they affect secrecy. For example, it may be that information exchange under these acts be limited to information that is relevant to an indictable or 'serious' offence. Accordingly if the individual on whom information is sought is charged with a summary offence, the Act may in a sense protect their confidentiality. However, it is important that while something may not be caught under one Act, it may be caught by another Act or even a Memorandum of Understanding (MOU).

(5) Individual Statutes governing Financial Institutions (the Confidentiality provisions therein)

Every international financial centre will have individual free standing statutes that govern the regulation or registration of financial institutions and structures, for example an International Business Companies Act an International Banks Act etc. Embedded in these statutes will be confidentiality provisions, which often refer to other domestic laws on information sharing. Take for example the confidentiality provision of the International Banks Act of St. Vincent which says as follows. Subject to subsection 19(6) the Authority … shall not disclose or transmit out of State any information relating to the identity of the affairs of the customer of a licensee (bank). Section 19(6) provides that information can be shared in accordance with the Mutual Assistance in Criminal Matters Act or any other enactment. The main thrust of that Act is that it allows for information to be exchanged only where a criminal matter is involved. Accordingly if the IRS were to ask for tax information on a US client of a St. Vincent bank with no link to criminal activity, such information would is not likely to be provided by the St. Vincent authorities. The reference to any other enactment of course opens up the possibility for disclosure further.

(6) General Information Exchange Statutes

Some jurisdictions, like St. Vincent and the Grenadines, have a general Exchange of Information Act. However one is not too be fooled into thinking that such an Act does not have limitations. The limitations in the St. Vincent act include the fact that the request for the information must come from a fellow regulatory authority. The SEC would be regarded as a regulatory authority, while the IRS would not. Accordingly it cannot be

used as a vehicle for the automatic exchange of tax information. This Act is designed to facilitate cooperation between regulatory authorities.

(7) The existence and effectiveness/powers of a Financial Intelligence Unit (FIU)

It is all well and good to have signed treaties and passed Acts that deal with information exchange, but if there is not a strong Competent Authority on the ground to obtain the information and to then share it, the country could just be paying lip service to the idea of information exchange. Most FIUs have the ability to exchange information with other FIUs. However it is important to look at what restrictions there are on their ability to first OBTAIN that information. The FIU of St. Vincent may obtain information by applying to the Court for a Production Order. For the Court to grant the Order it must be satisfied (according to the Proceeds of Crime Money Laundering Prevention Act) that there is present a ‘suspected offence’ or an ‘offence.’ Offence means ‘relevant offence’ which is a summary or indictable criminal offence. Accordingly it will not allow for tax or other civil information to be produced unless it can be tied to the relevant offence or suspected offence.

(8) The Role/Attitude of the Courts/Judiciary to Confidentiality

A judiciary that is well trained in and sensitive to anti money laundering and terrorist financing issues is likely to be rule more favourably for disclosure in the Production Orders or Confiscation and or Freezing matters that come before it under the Proceeds o

Crime or other relevant enactment. The sensitivity of the Court to such matters is also key in their assigning priority to AML cases, given that delay in the hearing of cases is a factor that goes against the proper administration of justice in many offshore financial centres.

(9) The quality/principles of regulatory authorities

If the country does not have a strong regulatory authority that enforces the maintenance of high regulatory standards, the quality of information available to be shared will be minimal. Proper regulation of financial institutions for example may require that annual financials as well as quarterly financial statements be filed with the Authority. If the Authority does not enforce this provision, such information may not be available either with the Authority or within the State to be shared. It is the regulatory authorities that play a large role in ensuring that institutions follow the law in terms of the types of records and information that is kept within the jurisdiction and/or filed with the Authority as required. If the Authority does not insist that the books and records of a bank be kept within the State, when such information is requested, the requesting state may have to commence a wild goose chase for information in a myriad of jurisdictions which is costly and often because of many things including the language barrier, impossible.

(10) The principles of the Government towards confidentiality (exercise of public interest principle).

The Government has many informal channels for the sharing of information. Its exercise of its discretion to so share information will be affected by its policy on confidentiality, the extent to which it values confidentiality and where it draws the line between when it is okay to disclose and when it is not. This is never an exact science.

To conclude, yes there is confidentiality to be obtained through the use of offshore jurisdictions. However, as set out above, just how much confidentiality can be obtained from a particular State is very difficult to determine without an indepth knowledge of the local laws and inclinations of the law makers, and the judiciary. What is certain is that no reputable offshore center wants to be associated with the protection of criminal assets; as such confidentiality in the hiding of proceeds of crime is virtually non-existent in terms of state policy. It is important to note however, that despite the best effort of regulators criminals still continue to find a way to hide their scams from the Authorities for period of time, both onshore and offshore. For example, an offshore bank may be used as the depository of the proceeds of a fraud scam. However it may not be until after than bank has been forcibly closed for other regulatory reasons that the jurisdiction in which it was registered receives a request for information on the institution in relation to that criminal matter.

The protection of confidentiality in relation to civil matters is much more intact. While there was an initial commitment to the sharing of information in civil tax matters by many OECD and Non-OECD members by the year 2007, such commitment have been placed on hold because of the absence of the level playing field in this arena. States with

viable financial centres do not want to be the first off the block in offering information exchange, and still understand the economic value of confidentiality in financial affairs.

How is an investor to navigate and understand how the level of protection that will be afforded to them by an offshore centre. The answer is to simply KNOW that jurisdiction, not only its financial laws but the entire legal regime for the sharing of information. Unfortunately most investors will not have the time to do such in-depth research, and would have to rely on the advice of experts. However a word of advise, that is to do due diligence on the experts before accepting their advice and always speak to the regulatory authorities before doing business with any financial institution. Do remember however, that because of confidentiality provisions, the regulators will be restricted in the information that they can share with you.

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