All the main news in offshore finance and international tax planning

OffshoreRed

June 2014 Volume 19 Number 5

established in 1994

Publisher: Stephen Harris
Editor: Chris Hamblin
Production: Jackie Bosman
ClearView Financial Media Ltd
Heathman's House, 19 Heathman's Road,
London, SW6 4TJ, UK

Tel: +44 (0)20 7148 0188
Fax: +44 (0)20 7504 3610
Subscriptions: +44 (0)20 7148 0188
Email: info@clearviewpublishing.com
ISSN 1465-2528
It is forbidden to replicate this publication

Guyana falls foul of the CFATF

The Caribbean Financial Action Task Force, an international regulatory body that oversees improvements in its member-states' anti-money-laundering regimes, has come down hard on yet another jurisdiction.

As a result of not meeting the agreed deadlines (or 'timelines') in its action plan, the CFATF has slated Guyana as a jurisdiction with significant money-laundering and terrorist finance-related deficiencies that has failed to make significant progress in addressing those deficiencies. It has gone so far as to declare that it considers Guyana, an aspirant player in the offshore financial world, to be "a risk to the international financial system," a system, some say, that is dominated by countries where the top management at banks are immune from gaol however much their banks launder. Members of the entire CFATF are therefore called upon to take further 'counter-measures' to 'protect' their financial systems from the proceeds (or, in the case of terrorist money, the 'pre-ceeds') of crime. Also, the CFATF has referred Guyana to the Financial Action Task Force, the world's AML standard-setter.

Countermeasures

'Countermeasures' – a piece of American naval jargon to do with warding off submarine attacks that the FATF unaccountably took to using after 11 September 2001 – could entail, among other things, the requirement to perform 'enhanced due diligence' on any person from Guyana; the introduction of more stringent reporting mechanisms or the "systematic reporting of financial transactions," which perhaps might entail suspicious transaction reports for everything above a certain volume, or everything that involves sectors that pose a high risk of money-laundering; refusals by the regulators in the country concerned to allow the establishment of subsidiaries or branches or representative offices, or other things that take into account the fact that the relevant financial institution is from a country that the powers-that-be want to punish. This last could, the CFATF thinks, include limitations on business relationships or financial transactions that involve the stricken country or persons in that country.

The latest round of regime improvement

In November 2011 the CFATF brought certain jurisdictions (including Guyana) with, in its opinion, significant strategic deficiencies in their compliance efforts to the attention of its members. With a view to encouraging the recalcitrant state to rectify its putative deficiencies, the CFATF induced Guyana to sign an 'action plan' with identified target dates. The CFATF issued a public statement in May 2013 to recommend that Guyana should take steps to ensure that it addressed its AML/CFT deficiencies – a conclusive sign that nothing was happening. Then, in November 2013, the regional body issued a further public statement calling upon its members to 'consider' implementing counter measures to protect their financial systems from the ongoing money laundering and terrorist financing risks emanating from Guyana.

The CFATF's demands

The governmental club issued a statement that said: "Guyana has failed to pass the relevant legislation necessary for it to significantly improve its AML/CFT regime and therefore has not substantially addressed the outstanding deficiencies from its mutual evaluation report. The CFATF urges Guyana to urgently, immediately and meaningfully address its AML/CFT deficiencies, in particular by: 1) fully criminalising money laundering and terrorist financing offences, 2) addressing all the requirements on beneficial ownership, 3) strengthening the requirements for suspicious transaction reporting, international co-operation, and the freezing and confiscation of terrorist assets, and 4) fully implementing the United Nations conventions."

It is a peculiar fact that even though much of the ancestry of its population stems from the Indian sub-continent, there are no reported *hawala* or other money- or value-transfer services in Guyana. Casinos, however, are legal there and may pose a money-laundering risk. ■

News

Cayman Islands

Cash-strapped CIMA needs senior staff

Patrick Bodden, the deputy managing director of the Cayman Islands Monetary Authority, which allegedly has trouble getting its annual reminders out on time, has admitted that his organisation is understaffed. He was answering a parliamentary question about staffing from McKeeva Bush, a politician who was reportedly charged in March last year with two counts of misconduct in a public office, four counts of breach of trust by a member of the Legislative Assembly under *s13 Anti-Corruption Law 2008*) and five counts of theft under *s241 Penal Code 2007 Revision* to do with a governmental credit card and the import of explosive substances. Reports suggest that he has been on bail ever since.

The *Cayman Compass* quoted Bodden as saying that "certainly we are at no way to the level that is needed for the regulation of the financial industry in a very robust way." He went on to say that the authority employs 173 staff, including 152 Caymanians, and has 25 as-yet unfilled vacancies, between 5 and 7 of which are senior. The exchange took place at a meeting of a parliamentary committee. The *Cayman Compass* was perhaps lucky to be able to hear it; in the neighbouring Turks & Caicos Islands, the House of Assembly has denied private media the privilege of recording any future proceedings.

The Government is planning to drop the budget for CIMA this year from $6.3 million to $3.3 million, because of revenues that it expects from the *Director Registration and Licensing Law (2014)* which came into effect on 4 June, and which gives directors of Cayman "covered entities" 3 months from that date to register or licence, unless they are corporate entities in which case they have six 6. Other reports suggest that CIMA's real problem is monetary and it is waiting for the extra income before it can recruit the necessary staff. ■

Hong Kong

HKMA probes firms for signs of laundry

The Hong Kong Monetary Authority, which regulates financial services in the jurisdiction, is investigating a number of institutions, including at least one bank, for possible criminal breaches of the city's anti-money-laundering laws, according to the *South China Morning Post*.

The report said the probes are the first to be made since the *Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance*, better known as the *AMLO*, was enacted more than two years ago.

The HKMA confirmed that investigations were in progress, but declined to give any details on the sums involved, the names of the institutions or the alleged breaches of the law, the report said.

Investigations are only launched, however, if routine regulatory audits of anti-money- laundering controls reveal potential breaches.

Stewart McGlynn, acting head of the authority's anti-money-laundering and financial crime risk division, said the body would "consider using the full range of powers afforded to it under both the *Banking Ordinance* and the *AMLO*, including disciplinary and prosecution action" in the event that breaches of the law were discovered.

The fight against AML offences has reached new heights in recent weeks; BNP Paribas, the French bank, faces a $10 billion penalty in the US for breaches of sanctions related to Iran and other nations; the issue has hit Franco-US relations. ■

British overseas territories

British offshore citizens can now travel in Europe visa-free

As of the beginning of this month, all British Overseas Territories citizens, British overseas citizens, British protected persons, and British subjects are allowed to travel visa-free to the EU Schengen Area for a maximum of 90 days.

The Schengen Area consists of 26 States, including four which are not members of the European Union. The full list of countries in the Schengen Area is: Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, Switzerland.

The visa concession will also apply to Romania, Bulgaria, Croatia and Cyprus.

The United Kingdom and Ireland, though both EU Member States, do not participate in the 'borders and visas' aspects of the Schengen Agreement and continue to operate border controls with other EU Member States.

Citizens who hold either a full British passport or a BOTC, BOC, BPP or BS passport will have visa free access to the Schengen Area. The visa concession covers visits only. The maximum duration is 90 days in a period of 180 days. The visa concession does not cover employment or study - with those, the appropriate visa must be obtained prior to travelling. ■

Malta

Malta on track to beat gambling rivals?

The Lotteries & Gaming Authority (LGA) has recently published its audited Financial Statements for the year ended 31 December 2013. The total revenue that it generated during the 2013 financial year amounted to €52.7m, the same as the previous year. During the same period total operating expenditure amounted to €2.9m as compared with €3.3m in 2012. The LGA has been transferring about €48 million to the Government annually for some time now.

Commenting on these results, LGA Executive Chairman Joseph Cuschieri

News

said that the authority was currently undergoing a major restructuring, investment and capacity building programme in order to "reposition Malta as the top gaming jurisdiction globally." He took the opportunity to introduce his new executive management team. ■

USA

Internal Revenue Service eases rules on offshore tax disclosure

The Internal Revenue Service has announced major changes in its offshore voluntary compliance programs, providing new options to help both taxpayers residing overseas and those in the US who unintentionally fail to disclose their offshore assets.

The IRS said it believes the move will significantly increase the number of people coming forward to report on their undisclosed foreign accounts.

The US revenue service said it was expanding the streamlined filing compliance procedures that were announced in 2012 to cover a much broader group of US taxpayers who have failed to disclose their foreign accounts but were not willfully evading their tax obligations. The agency said it will also be reshaping the terms for taxpayers participating in the Offshore Voluntary Disclosure Program (OVDP).

The changes include eliminating a requirement that the taxpayer has $1,500 or less of unpaid tax per year and doing away with a questionnaire that applicants were required to complete. For eligible US taxpayers residing outside the US, all penalties will be waived, while for those US taxpayers residing in the US, the only penalty will be a miscellaneous offshore penalty equal to 5% of the foreign financial assets that gave rise to the tax compliance issue.

"In this rapidly changing environment, we listened to feedback from the tax community as well as the National Taxpayer Advocate about our voluntary programs. We have made important adjustments to provide opportunities for all US taxpayers to come in, including those who are not willfully hiding assets," said IRS Commissioner John Koskinen.

Under the new rules, taxpayers that choose not to reveal their accounts could face far stiffer penalties. The IRS said it was increasing the offshore penalty percentage from 27½% under the previous rules to 50% if a tax payer applies to the OVDP after it becomes public that a financial institution where the taxpayer holds an account is under investigation by the US authorities.

The OVDP allows individuals to avoid criminal prosecution if they disclose their foreign accounts and pay a substantial penalty. The current OVDP was launched in 2012 and is the successor to prior voluntary programmes offered in 2011 and 2009. Koskinen said that since the launch of the first programme over 45,000 taxpayers have come into compliance voluntarily, paying about $6½ billion in taxes, interest and penalties.

"These changes will help focus this programme on people seeking certainty and relief from criminal prosecution. From now on, people who want to participate in this programme will have to provide more information than in the past, submit all account statements at the time they apply for the programme, and in some cases pay more in penalties than they would have done had they entered this programme earlier," said Koskinen.

This comes less than two weeks before the implementation of the *Foreign Account Tax Compliance Act*. According to Treasury Department figures published in the Federal Register last year, 3,000 US citizens handed in their passports – three times the average of the past five years. Although the Treasury has given no reasons for why they handed back their passports and green cards, many observers believe that the dramatic spike over previous years is due to them wanting to avoid paying taxes as a result of *FATCA*.

The IRS has been criticized for coming down disproportionately hard on taxpayers with small accounts and on those that may not understand the filing requirements.

Koskinen said that the aim was to get people to disclose their accounts, pay the tax they owe and get "right" with the government.

"At the same time, for important categories of these non-willful people with offshore issues, a compliance regime that is too harsh won't net the desired result," he said. ■

Malaysia

Malaysian investors buying UK property must adjust To new tax reforms, says offshore law firm

More Malaysian investors, particularly the middle class, are looking into buying property in the UK to generate income returns, according to Channel Islands-based law firm Collas Crill.

In a media release, the company said that Malaysian middle class have an average budget of around £800,000 ($1.36 million) and are interested in buying into regeneration zones outside prime London. This means properties near central London or larger properties in the booming east London postcodes.

Collas Crill notes that while the potential is great, investors must also know that new taxes introduced by the UK government can make the decision a little more complex. Based on common practice, Asian buyers have usually acquired property through an overseas company that is often incoporated in the Caribeean or the Channel Islands. Thus, purchasing UK residential property could mean additional taxes.

"Malaysian investors need to take specialist advice both at home and in the UK to ensure that the relevant property taxes are being taken into consideration when deciding how best to structure their purchase," said Michael Morris, UK property expert at the firm, which services Malaysian property investors through its office in Singapore.

Malaysian firms that have successfully invested in London properties include SP Setia, Sime Darby and the Employees Provident Fund. ■

News

UK
London grows as RMB trading hub

The UK government yesterday announced measures to boost financial market dealings with China, reflecting the rising clout of the renminbi currency. The moves coincide with the announcement that China Construction Bank has been appointed as the first official renminbi clearing bank outside Asia, in London.

While the linkages between London and Chinese markets have been controversial – the purchase of prime luxury properties by Chinese investors has raised concerns about skyrocketing prices and lack of affordable housing – the latest moves also suggest linkages are growing.

UK finance minister George Osborne hailed "a significant next step in the UK becoming the offshore centre for the Chinese currency and investment". He hosted Chinese Premier Li Keqiang and other senior policymakers from Britain and China at the first Financial Forum to be held between the two countries. The creation of the forum was first announced by Osborne during a trip to Hong Kong earlier this year.

The forum discusses opportunities that China's increasing economic and financial importance presents to both countries.

Anglo-China measures include direct trading between the British and Chinese currencies for the first time; granting further licences to British firms to enable them to invest directly into Chinese markets. (Blackrock and HSBC Global have been granted renminbi Qualified Foreign Institutional Investors (RQFII) status by the China Securities Regulatory Commission.) In October last year, the UK secured an 80 billion renminbi RQFI quota. Another measure has been approval of renminbi-dominated loan guarantees by the government's export credit agency, UK Export Finance.

The rise in offshore renminbi activity through London has been rapid, the UK government said in its statement. "From almost no offshore renminbi activity in London in 2011, by the end of 2013 SWIFT data showed that London accounted for almost two-thirds of renminbi trading outside of Mainland China and Hong Kong," it said.

"The latest data also shows that London accounts for 57% of all renminbi-denominated SWIFT payments between Europe and Mainland China and Hong Kong," it added. ■

New Zealand/UAE/South Africa
NZ signs *FATCA* with IRS, while UAE and South Africa reach deals

New Zealand has become the latest country to sign an agreement with the US to implement the *Foreign Account Tax Compliance Act*.

The inter-governmental agreement was signed by New Zealand's revenue minister Todd McClay and US Chargé d'Affaires Marie Damour, the New Zealand government said.

FATCA was enabled in 2010 as part of the US government's plan to curtail offshore tax evasion by encouraging transparency through the collection of information on accounts held by US citizens abroad.

It is set to take effect on 1 July and requires all financial institutions outside the US to regularly submit information on financial accounts held by US persons to the IRS. When the act comes into force, those who are not compliant will suffer a 30% withholding tax on income and gross proceeds, as of January 2015.

Under the IGA, rather than individually sending account information for US taxpayers to the US Inland Revenue Service, New Zealand financial institutions will instead provide this information to the New Zealand Government, which will then exchange it with the IRS.

McClay said the agreement will make it easier for New Zealand financial institutions to comply and thereby reduce additional costs being passed on to New Zealand customers.

"The IGA is reciprocal, meaning that New Zealand will also receive information about certain accounts held by New Zealand residents with US financial institutions. This will help prevent tax evasion and enhance the integrity of both countries' tax systems," said McClay.

The agreement is similar to the one negotiated by a number of other nations including Denmark, Australia and the UK. The key difference is that New Zealand has managed to negotiate a number of specific exemptions for entities and accounts that are considered low-risk from a US tax evasion and avoidance perspective. This includes superannuation, KiwiSaver schemes, tax pooling accounts, registered charities, and Maori authorities as defined by tax legislation.

Last month, New Zealand's main opposition Labour party called on McClay to release details of the *FATCA* agreement to the New Zealand Parliament. Labour's revenue spokesperson David Clark said at the time that the government had let its negotiation on the agreement run too late.

"It appears to have backed itself into a corner. It must now pass this law or the US will place unsustainable penalties on the New Zealand banking system," Clark said in a statement.

South Africa and the UAE have both reached deals to cooperate with the US in its fight against tax evasion. South Africa has signed an agreement with the US to implement *FATCA*, while the UAE has also reached a deal in substance. ■

Switzerland/Bermuda
Wealth tech firm Temenos secures multi-product deal with Bermuda bank

Swiss-listed wealth and banking technology firm Temenos has signed a deal with the Bermuda Commercial Bank to provide it with its T24 core banking system Model Bank, along with a suite of products including those designed to deal with anti-money laundering and *FATCA* compliance.

BCB has selected a multi-product approach from Temenos, including T24

News

Model Bank to be run on the Microsoft SQL Server platform, Temenos said in a statement last week.

BCB was founded in 1969 and in September 2013 held $468 million in customer deposits. ■

Hong Kong
US investment firm unveils growth-leaders' fund

BlackRock, the American investment firm, has expanded its Asia offering with the launch of a new Asia-focused fund for retail investors in Hong Kong.

The BlackRock Asian Growth Leaders Fund invests in a concentrated and high conviction portfolio of 30 to 60 Asian companies that the managing team identifies as "growth leaders," irrespective of their current benchmark ratings, according to the firm's propaganda. This is a response to the rising number of wealthy emerging middle class, which is causing a sharp increase in demand for goods and services.

The fund is co-managed by Andrew Swan, BlackRock's head of Asian equities, and Emily Dong, portfolio manager in the Asian equities team.

"The profound shift in the region's economic growth drivers is creating compelling new opportunities for investing in Asian equities. Regional economies are moving away from the traditional manufacturing and export-oriented industries, which have formed the basis of their growth stories to date," commented Swan.

The new offering invests at least 70% of its total assets in the equity securities of companies domiciled in, or exercising the predominant part of their activity in Asia, excluding Japan.

It has been a busy past months for the US firm in Asia. In early June, the firm's North Asia subsidiary received a significant quota to invest in Renminbi activities in China. Prior to that, it launched its second Asian equities fund geared toward UK investors. ■

Hong Kong/Singapore
French fund manager allowed to expand East

AXA Investment Managers, the French asset management firm, has received regulatory approval to expand its fund offering in Hong Kong and Singapore, according to a statement.

The move effectively increases the firm's total number of registered funds to 13 in Singapore and 23 in Hong Kong. In the city-state, the new funds include AXA WF Framlington Europe, AXA WF Framlington Global Real Estate Securities and AXA WF Framlington Health, while the Hong Kong launch includes AXA World Funds–Framlington American Growth, AXA WF Framlington Emerging Markets and AXA WF Framlington Euro Relative Value.

The bond strategies are managed by the fixed income team, while the equtiy products are handled by AXA Framlington.

This latest move complements efforts to expand in the region, it says. Early this year, the company named Jim Veneau, from HSBC Global Asset Management, as head of credit for Asia.

AXA Investment Management's Asia presence covers Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, Singapore, South Korea, Taiwan, the Philippines, Thailand and Vietnam. ■

Hong Kong
SFC bans two advisors

The Hong Kong Securities and Futures Commission has banned two former Morgan Stanley advisors for giving clients misleading information. Christopher Ma Chun Leong and Wong Man Chung are banned from re-entering the industry for 10 years and two years respectively. Leong's ban began on 28 May 2014, while Chung's started on 30 May.

The actions follow an investigation by the regulator which found that Ma, the supervisor of a programme trading desk, and Wong, a trader under Ma, acted against the interests of clients and took advantage of order executions of institutional clients on the Stock Exchange of Hong Kong. According to a filing on the SFC website, Ma and Wong cancelled trades executive for clients and re-filled them with trades at lower stock prices.

The cancellations and reallocations involved over 2,500 trades in 20 stocks, causing institutional clients to pay a total of around $8 million more for their shares in 2009 and 2010.

Both are no longer licensed representatives. Morgan Stanley reported the wrongdoings to the SFC and has returned $8 million in cash or commission credit to clients. ■

Dubai/Switzerland
Swiss bank moves in on UAE

Banque SYZ & Co has opened a representative office in Dubai. Its clientele is expected to comprise institutional and private investors in the Gulf Cooperation Council States – Saudi Arabia, Oman, Kuwait, Bahrain, the United Arab Emirates and Qatar. It will operate within the framework of the Dubai International Financial Centre. The office won regulatory clearance from the Dubai Financial Services Authority on 9 June.

The Swiss firm plans to promote its activities for institutional investors, such as sovereign funds, pension funds, institutions, multi-family offices; it also is targeting wealthy individuals. The office will cover all six GCC States and also promote its OYSTER investment funds.

To start with, the staff of the representative office will consist of George Azar, who will be the manager, and Imran Ahmed. Azar has more than 20 years in the financial sector. Prior to joining SYZ & Co, Azar was in charge of the local office of Jefferies International Limited. Previously,

News

he had spent 11 years with UBP, where he was chief executive of the Qatar office, and five years as a private banker with SCS Alliance (which has since become Compagnie Bancaire Helvétique) in Beirut. Other roles include stints at Merrill Lynch in Geneva.

Ahmed also joined SYZ & Co from Jefferies. Previously, he had spent nine years with UBP, where he was deputy director and deputy head of institutional sales for North Africa and the Middle East. Prior to that, he had been a senior analyst in the Investment Banking division of the National Bank of Abu Dhabi and a senior analyst in the private office of His Highness the late Sheikh Zayed Bin Sultan Al Nahyan. ■

Singapore
Standard Chartered fined for bad advice regime

Standard Chartered Bank has been fined $40,000 by the Monetary Authority of Singapore for failures relating to the way in which its staff provided clients with financial advice.

The Monetary Authority of Singapore said that on 4 March 2014, Standard Chartered Bank paid $10,000 fine for allowing 38 of its representatives to provide financial advisory services on its behalf that they were not appointed to do so.

SCB paid a $30,000 fine for allowing 28 of its representatives to deal in securities with one also advising on corporate finance, before the respective names of the representatives were entered into the public register between 26 November 2010 and 18 July 2013.

According to Singapore regulations, all financial institutions should ensure that they do not permit any individual to conduct any type of regulated activity, or provide any financial advisory service on their behalf, unless the individual is an appointed representative, provisional representative or temporary representative in respect of that type of regulated activity or financial advisory service. ■

Switzerland/Luxembourg/Singapore
Crédit Agricole private banking expands offshore

The Commission de Surveillance du Secteur Financier, Luxembourg's financial market regulator, has given the go-ahead for a major Swiss private bank to offer services in the Grand Duchy.

The approval awarded to Crédit Agricole Private Banking Services opens up new opportunities for the firm to grow its business in Europe and is consistent with its plans to expand internationally. CAPBS is the logistics centre of Crédit Agricole (Suisse).

"In Europe, demand for business process outsourcing from private banks is strong, and there are currently few providers in this segment," commented Jean-Claude Favre, director, in a company press release. The company specialises in business processing outsourcing services in the wealth management arena.

The firm also announced that it is teaming up with a "highly regarded international private bank" that is establishing operations in Singapore. It has not revealed the bank's identity. CAPBS has expanded into the Asian market by integrating with Crédit Agricole Private Banking's offices in Singapore and then Hong Kong into its S2i platform.

CAPBS' platform handles SFr115 billion ($127.7 billion) in assets for 25 client banks in ten countries. S2i is its proprietary banking solution that is compliant with the tax systems of seven European and three international jurisdictions. ■

Singapore
Singapore asset manager receives RQFII licence in China

Nikko Asset Management Asia, the Singapore-based asset management firm owned by Japan's Nikko Asset Management, has received a renminbi-qualified foreign institutional investor licence from the China Securities Regulatory Commission.

An RQFII licence allows international banks to tap into offshore renminbi funds to access China's financial system. In a press release, Nikko AM said it intends to generate $200 million through its maiden product and is targeting $800 million to $1 billion across three to five more products over the next three to five years.

"The Chinese onshore bond market is the largest in Asia, and about $4 trillion of which, less than five per cent are held by foreign investors. This is larger than the entire bond market in the rest of Asia (ex-Japan) added up together," said Phillip Yeo, head of product development and management at Nikko Asset Management Asia.

China introduced the RQFII programme in 2011 as part of efforts to internationalise the renminbi. In October 2013, it allocated some 80 billion ($12.8 billion) renminbi for European firms and around 50 billion renminbi for Singapore-based institutions.

Nikko AM Asia is the combination of Nikko Asset Management Singapore and the former DBS Asset Management. The former acquired the latter in September 2011. ■

Hong Kong
Barings plans to expand fund range

Baring Asset Management, the London-based international investment management firm, has announced plans to launch a new range of Hong Kong-domiciled funds in early 2015.

Subject to regulatory approval, the new local fund line will help

News

position the firm in time for the mutual recognition platform between Hong Kong and China to ensure that it is ready for the surge in demand that will follow, according to a statement. Barings has decided in principle to appoint HSBC as administrator, trustee, transfer agent and custodian for the range.

Barings has been active in China for more than two centuries and opened its first office in Hong Kong in 1973. It launched one of the first mutual funds investing in the region in 1982, managed the first dedicated China fund in 1985 and was one of the early investors in China's domestic A-share market.

The company manages some $14.4 billion in assets in Asia ex-Japan, of which $3.7 billion are in China/Greater China. It employs more than 130 staff in this region. ■

Indonesia

OJK releases Sharia securities list and plan

Indonesia's Financial Services Authority (OJK) has reviewed its investment guideline, known as the 'Sharia securities list,' for investment managers of Sharia mutual funds, Sharia insurance and investors intending to invest in Sharia securities portfolios. It has also released a guideline for Sharia index providers such as the Indonesia Stock Exchange which issues the Jakarta Islamic Index and Indonesia Sharia Stock Index.

There are 322 types of security on the list and 584 issuers and public companies, 28 of the companies having joined this year so far. At the same time, the Directorate of the Sharia Capital Market is drawing up a so-called 'road map' for the market's medium-term development. The process of consultation, which involves a kaleidoscope of focus groups, has begun. The directorate is also overhauling its regulations, especially Reg No IX.A.13 which governs the issuance of Sharia securities, and will finish sometime this year.

On the agenda is the simplification of the registration statement document, new rules for disclosures associated with sukuk, the Islamic equivalent of bonds, new rules for sukuk trustee contracts, the completion of a regulation to govern types of Sharia mutual funds, more choices for Sharia mutual fund portfolios, and the completion of a regulation to do with Sharia asset-backed securities.

Islamic business takes up almost 5% of Indonesia's banking business. The OJK says that the country has 11 fully-fledged Islamic banks and 23 Islamic windows operated by conventional banks. Their combined Islamic banking assets grew by 24% to 242 trillion rupiah ($21.4 billion) last year. ■

Everything you wanted to know about offshore custody but were afraid to ask

The world of custody is a fascinating one but very few people outside its borders understand it. Increasingly, high-net-worth families and major trusts are organising their money in a new way that involves the separation of custody from fund management. Chris Hamblin of *Offshore Red* talked recently to Guy Paterson, a partner at private investment office Stanhope Capital in London's West End. The result was a marathon question-and-answer session that ranged over many of the permanent effects that the market crash of 2008 had on the offshore world.

Q: What's happening to the established offshore custodians? Are there winners and losers in this process of separating fund management from custody?

A: It's one of these classically Darwinian processes where the people who are good and have invested serious amounts of money and are strong in balance-sheet terms are pulling away from the also-rans. Many institutions have given up custody because the margins are wafer-thin and unless you've got all the upscale kit you need and the services, your business base is going to shrink.

One of the lessons that was learnt in 2008 is that potentially the weakest link in the chain for an investor is his custodian-bank. If you ask most British families 'who is your custodian?' or 'what is a custodian?' they may not know the answer. The investment management industry has grown up expecting custody to be bundled in with portfolio management. In the old days, you never actually paid for custody as a separate item.

> "The weakest link in the chain for an investor is his custodian-bank. We do not wrap custody up with other services"

Stanhope Capital does not wrap custody up with other services – that is a key part of our *modus operandi*. Our refusal to wrap everything together gives us insights into the world of custody that many firms and clients do not have. We think that 'unbundling' is the way in which most families and trustees who are reading your editorials should be operating. The bundling of everything together in 2008 was actually quite dangerous because trustees and others were often unable to see where the risks lay.

Q: So who in custody is doing well out of the new direction that things are taking?

A: If you are going to be taken seriously as a custodian you have to have a big balance sheet to make you unsinkable. There are great financial institutions around the world that are very unlikely to fail. Even if they do fail, your assets should be ring-fenced from any liquidator or administrator but cash is often held on the custodian's balance sheet and that, in theory, is at risk.

A custodian holds assets as your nominee – investment funds, individual shares, that kind of thing. The cash that's deposited there, however, is on the custodian's balance sheet. So as Barings was about to fail, back in 1994, the general view was that if it had gone down on that Monday morning and if ING hadn't come and bought it, the client securities were probably safe but the cash would have gone and the investor would have ranked as an unsecured creditor.

So there are a lot of risks out there. In 2008 people were using Lehman Brothers as a custodian, often bundled in with whomever their fund manager was, and people's assets were all frozen. The world had become much more complicated because of the activities of prime brokers – stock-lending and supporting the good work of hedge funds. So when Lehmann Brothers went down, the arguments over who owned which assets became very complicated.

Q: Are your clients interested in stock-lending?

A: We generally avoid investing in funds which practice stock lending. The returns are small and there is a theoretical risk of loss in a Lehman-style scenario. It's another dry area of global custody that is increasingly of interest in the offshore world. The primary duty of a trustee is to safeguard the trust fund. That's number one on his check-list. He should make sure that his assets, which in many cases are liquid asset investment portfolios, are held somewhere safely and are not going to be challenged by creditors of a stock-lending operation.

Q: How should trustees protect against custodial risks?

A: We increasingly promote the concept that trustees should appoint their custodians separately from their fund managers. Most trustees will appoint fund managers according to their performance records, which is a rational thing to do, but custody is often bundled in there and a firm's track record as a fund manager is not as important as whether the assets are held safely there to begin with. We have certainly seen a move towards trustees appointing custodians separately.

When a bank gives something away

This can be more expensive in the short term. When you go to a bank for your fund management they will probably throw in your custody for free. That may or may not be a mirage, though, because what a bank gives away free may not really be free. It might be bundling the price of some other service in with it – perhaps by making a mortgage slightly higher. If the bank is working as the trustee and the portfolio manager and the custodian, it can choose where to charge. It can make back its margin on transaction costs, or the portfolio management charge, or the trustee charge.

Lots of people provide custody but we think that trustees should be relying on the very large financial institutions because of the counterparty risk associated with holding assets. In theory, if you are a wealthy individual or a trustee and you place your assets, as the people at Barings did, with a fund manager, they will be acting as a nominee only for all the assets that they hold apart from cash. So, in theory, the investors should be able to say to the fund manager: "you were acting as my nominee, give me back my assets!" They would have had the right to do this if Barings had gone down and this was the case when Lehman Europe went down.

But life is never quite as easy as that. In the case of Lehman, there were incredibly complex sub-custody agreements with a series of financial institutions that were also counterparties in their trading business. So the first thing that anyone to whom Lehman's owed money did was to seize the assets of Lehman's clients and claim that they were trading assets.

Q: What's the point of sub-custody?

A: Investors need to hold certain securities in the jurisdiction in which they are traded. If you

buy a Kenyan stock because you want to invest in a Kenyan publicly quoted company, you need a custodian in Kenya to hold that asset. So a major global custodian might have a sub-custodian to 'custody' the asset out in Kenya and it will sub-contract that work to it.

Q: Do you think that custody is something that central banks could do?

A: I don't think they'd want to get involved. It's such an enormous administrative task and banks can make money out of it because not only do they charge a fee for the custody work, but the custodian holds all the cash and that cash is moved from one currency to another depending on the investments that are being made, so the custodian will be given the task of doing the foreign exchange transactions. The custodian will therefore take a margin on the forex transactions, it will take a margin on the cash that is sitting on deposit, it will charge nominal fees such as $100 here and there for a transaction, so there are lots and lots of different slices of fees that it charges. It also gathers up large amounts of cash deposits, which these banks can then lend on to individuals and companies at a much higher rate. So it's still for them an interesting world.

"You might become an unsecured creditor if you don't have the right contractual relationships with whoever is holding the assets"

When a bank fails in an offshore jurisdiction

Your mention of central banks, however, is pertinent. Most offshore trustees operate in small jurisdictions like Jersey, Guernsey, Gibraltar, Cyprus etc. What happens there if a bank fails? The difference between the offshore and onshore markets is that in most major onshore jurisdictions the central bank will typically not allow the deposit-taking institutions to fail. We saw that in 2008 – even the people who deposited money with IceSave, the Landsbanki subsidiary which went bust, were made good by the Bank of England, but when Kaupthing, Singer and Friedlander (Isle of Man) Ltd went bust in the Isle of Man, that was the end for those depositors. When Landsbanki's subsidiary went bust in Guernsey, that was the end of those deposits. There is no central bank in those places to step in and say "don't worry chaps, we'll make it up."

So for that reason, when you're using an offshore custodian, which most offshore trusts would want to do to prevent money from seeping into high-tax jurisdictions, you have to make sure that it is a subsidiary of a banking group that is large enough to step in and protect its own subsidiaries.

We therefore feel perfectly comfortable with our clients using subsidiaries of major global banks (whose balance sheets are larger than most jurisdictions) as custodians in the Channel Islands. We'd be very nervous using an offshore subsidiary of a bank that wasn't so highly capitalised.

Q: So you really are focusing very hard on the downside risk?

A: Absolutely. It is a significant part of the planning that we do when we're setting up the infrastructure for our clients. Our job is to look at all the risks to which our clients are exposed and the operational risk is just as great as the currency risk or credit risk. It's a big consideration. It's not fully understood by lots of people – that's what's so interesting about it. 2008 came as a huge shock to people when they discovered that banks could go bust and not be bailed out. The issue of whether you had your money deposited with the onshore subsidiary or the offshore subsidiary suddenly became life-changing. So custody is important and that's why we believe in unbundling because you should choose the best place for safe custody of your funds as carefully as you should choose your fund manager.

Q: Is your general universal philosophy 'unbundling is good' in any circumstances?

A: Yes. It puts everything on the table so that we can see it. The beauty of it is that it's utterly transparent. You can identify the risks associated with any unbundled element. When the markets become stressed, as they did in 2008, it's the only way you can have all the corners covered. You can re-bundle as much as you like. You can take more than one service from one provider as long as it's been disclosed to you how it all fits together. You can then put the right combinations together. That's what the great families do. They unbundle everything and decide on the best firm for each piece of advice and each service that they need to get. Then they can assemble the right team. You have to have a proper working knowledge of how it all fits together. Custody was one of the biggest bundled risks that suddenly became apparent in 2008. You can get second-rate tax advice or poor investment performance but nothing's more important than the entity in which the money is held.

Q: Do you ever oversee the management of physical gold as an asset?

A: Yes. We have clung to old physical gold in depositories. It became very fashionable to hold gold in 2007/8, during the crisis. I think we tend to forget how serious it was. The integrity of the whole financial system was at stake.

You can have allocated gold and you can have unallocated gold. Your allocated gold means that the bar in the safe has a number on it and your name is attached to that number. Unallocated gold is when you own gold but you don't have an allocation number on a bar, i.e. when it's fungible. If a gold repository were to go bust, the unallocated gold would be essentially on its balance sheet.

You would lose it or, to be precise, you might become an unsecured creditor. That happens with custody if you don't have the right contractual relationships with whoever is holding the assets.

Q: So is this something you tell your customers to avoid?

A: Yes. We say to them that in this world there are rewarded risks and there are unrewarded risks. You run the rewarded risk when you buy emerging market equities because you're hoping that they're going to go up in value. You're taking a risk but you're going to get a reward if you're right. The unrewarded risks are in having your assets held by tertiary organisations which, if they go bust, will lose everything of yours. There's no point in running that risk. If you're a trustee sitting in Guernsey or Cyprus or Gibraltar, this is what you should be thinking about. It's one thing to say to your beneficial

owner "I'm terribly sorry, your fund manager has underperformed by 2% this year"; it's quite another to lose the whole lot. You don't lose the whole trust fund in market-based investments – that can only happen once in 100 years – but you could lose the whole trust fund if you get the custody wrong and an institution fails. So there's a bit of a revolution going on in the offshore world in terms of the way people look at custody.

So the first thing is realising that it is a significant decision and should be unbundled and the second thing is what's happening with some of the bigger pools of money run in the offshore trust market, which is that the trustees are increasingly looking to divide management between a number of managers. Gone are the days when they would say "OK, ABC or XYZ, you run the whole lot." They all have different people running it. They spread the risk. Then they say "how do we compare the performance of one with another?" because they all compose their own different reports, and they all use different custodians.

So you say "we as a family want to take control of the process, so we appoint a single global custodian, we tell the managers that they all have to use that custodian as the repository for the assets that they are managing." That way they get consistent reporting. Which is great in theory, except that most of the fund managers that are in operation prefer to use their own custody arrangements and aren't very good at managing pots of money held by the family's custodian. They all have their own custodial reporting systems.

Q: Are there any awkward regions or jurisdictions that make that difficult or, indeed, easy?

A: Oh yes. Russia, for example. We received a note from a custodian the other day to say that they had changed their sub-custodian in the Ukraine. It was the name of some rather obscure bank in Sebastopol, which is now no longer in the Ukraine! So you have to look at such things quite carefully. Although you might think that I've chosen a major institution as principal custodian for my assets, which include some Ukranian stock that I hold, it's not actually the global custodian that is physically holding that stock. It's some Ukranian bank acting as sub-custodian. Not everybody knows that. So it's important for us to be very clear about who is actually holding onto our clients' assets.

At Stanhope Capital we mainly deal in investment funds rather than individual securities and that tends to be slightly safer, because we're not buying shares in strange parts of the world. We're investing in funds whose job it is to have all these arrangements in place. When our partners visit the Channel Islands, which is frequently, and give presentations as part of trust companies' in-house continuing professional development (CPD) programmes, we explain the counterparty risks that trustees are typically running and many of them look rather taken aback. Custody is one big risk; the holding of exchange-traded funds that don't have physical assets behind them is another; then there is the importance of not leaving too much cash on the balance sheet of a bank.

Q: So what alerted you to these well-hidden risks? As most people don't think about them, what brought them to your attention?

A: The bulk of the financial services world consists of very large banks selling their services, which are themselves bundled. Stanhope Capital was created from the desire of its founders to access unbundled services, so we can look very carefully at the other parts of the unbundled process. You can point out where the inadequacies or weaknesses may be and, hopefully, avoid them. Our firm is using, believe it or not, about 45 different custodians for our clients, as a result of which we can tell families or trustees who come on board with us who's good and who isn't.

The refugee mentality

Many wealthy families from outside the UK will arrive with an existing custodian. If you ask the members of a British family to give you the name of their custodian-bank, they will give you the name of the firm which is managing their money. Continental families, however, have a different history. They have experience of political instability and worry constantly about these things, so they are focused on where the assets are actually held and not who's managing them. We have clients who arrive with up to three custodians. It's an interesting topic for trustees – having focused on the fact that you need to have very safe custody arrangements, and have a direct contractual relationship with your custodian, do you have only one? Or do you say that having only one is an unwarranted concentration of risk and that it's better to have three? If you're using a global titan as a custodian, do you have to worry about diversifying? Perhaps not, because if a global titan were to go bust then everyone else would have gone bust too. You do see families picking four or five because of concentration of risk and a number of families do it because of privacy – they don't want any one bank to know the totality of their assets.

And then you shouldn't underestimate the complications of having several custodians, because when you want to put an order in, or change something, you've got to find a custodian that's holding that particular stock out of the seven sets of telephone numbers and addresses you've got for your seven custodians. You have to have seven relationships. Somebody, somewhere, has to consolidate all this information into a single report.

> "A lot of European families come with a history of sequestration, of invasion and having to move, so having their assets in different jurisdictions makes them feel safe"

It's probably unnecessary, this obsession with privacy, because if you've done a good job as a trustee of selecting your custodian, you must have gone to someone of undoubted balance-sheet strength, who is reasonably competent at the business of transacting in securities, and as long as you recognise that there is a contractual difference between them holding a security on your behalf and them holding cash on your behalf, then you should be relatively safe. So we don't allow our portfolios to hold a lot of cash on deposit or even on current account with the custodians, because if the custodian failed, you'd be an unsecured creditor.

Q: Why do a lot of families want to ensure that no one bank knows the totality of their assets?

A: A lot of European families come with a history of sequestration, of invasion and having to

move, and so having your assets in a number of different jurisdictions makes you feel safe. That sort of attitude is being overtaken by the fact that there is no secrecy any more. Every organisation you deal with will have some obligation under some circumstances to report to a tax authority. So all you can hope for is confidentiality.

As a result, the trend that we're seeing in major pools of assets owned by major trusts is actually towards the recognition of custody as a key area, the concentration of it on one major provider but then a splitting-up of the portfolio management. So if you appoint a single, strong global custodian, you can have a number of managers managing parts of the money but the family gets a single, consolidated report. This means they can ensure that if they are using four managers, those four managers aren't all buying the same securities.

So when trust companies come to Stanhope Capital and ask us what the best way is of arranging custody, we say:

(i) organise it separately, so that you get the best of the custodians and the best of the portfolio managers;

(ii) go for a single custodian which is of sufficient financial strength that the parent company will look after its offshore subsidiaries, because they will need to use an offshore subsidiary for tax reasons to hold the assets; and then

(iii) you can appoint a variety of portfolio managers to do different things and get consolidated reporting.

"The Caribbean jurisdictions do provide custody but we don't tend to use them for that purpose simply because they're in the wrong time zone"

Q: What are the best jurisdictions for custody?

A: That's a good question. Historically the Swiss have done well with custodial work. Then the Channel Islands have various custodians which we use. The Channel Islands are very popular with British families because it's like being in the UK while actually being offshore. There are many subtle differences between jurisdictions. Ideally, you want a jurisdiction that is completely tax-neutral, so you can hold assets for a variety of clients with different tax profiles. The Channel Islands are a good example of that. If you use a custodian in Switzerland, you may have to pay Swiss stamp duty on your transactions. It's not a huge amount; it's just unnecessary leakage.

If you just focus on the big financial institutions which you can be confident will stand behind their subsidiaries, wherever they are located, then you can do some quite sophisticated planning when you're working out which jurisdiction is right for your trust by reference to its tax profile or the language that its people speak. We have two teams at Stanhope who look after French clients, one in London and one in Geneva. They speak French and they use French language custodians so all the statements are in French. Things like that are important – if you're a French-speaker and your command of financial English is not very good, it's not very helpful to receive statements in English.

The Caribbean jurisdictions do provide custody but we don't tend to use them for that purpose simply because they're in the wrong time zone. It's worth noting that you can have a Cayman structure – and there are plenty of them – but the assets of the trust fund can be held by a custodian in the right time zone. When you start unbundling, you see this very quickly and you can then be very precise about where you want all the different bits to fit in.

The choice of time zone is not the least important issue. If you're worried about something, you don't want to wait until someone gets into their office in Bermuda at one o'clock London time, only to discover that there's a hurricane and the office is closed – this has happened to me before now – instead, you want to be able to ring the guy up. Meanwhile, you know that most of the custodians in Jersey and Guernsey will go home at a quarter to five, so you have to make your decisions earlier in the day. If you're using a custodian in Singapore, you've only got three hours in the morning before they close.

Q: And Dubai? The jurisdiction that was set up to cater for that time zone?

A: There probably are sources of custody there – we don't happen to use any. I wonder whether the Gulf investors feel comfortable using somewhere next door as their custodian. I think a lot of families would probably prefer custody to be in Europe – not the United States, because the US can be intrusive for anybody from the Gulf. In Europe, no-one knows them personally. The same often applies to people from the former Soviet Union. They don't want an organisation in their home territory to know who they are and what their assets are.

So once you start unbundling, you get all these exquisite nuances that come into play as you select the right batting line-up for your family. It's a complex world but as we are 'unbundled' ourselves, we are able to look on it dispassionately. If I worked for a bank I'd have to tell you that our custody services were the best, our money transmission services were the best, and our gold depositories were the safest. Mercifully, I'm not in that business.

Q: Who regulates you?

A: We're regulated by the FCA and also regulators in the US and Switzerland. We are heavily regulated even though we don't hold any money, but because we don't handle money we are less of a high risk as far as the regulators are concerned.

There are not many places where you can get advice and insights on the good, the bad and the ugly in offshore custody, because most custodians are part of large organisations and are involved in selling those organisations' wares. ■

The Black Market Peso Exchange explained

For years, compliance officers in the financial centres of the Caribbean have been grappling with money-flows that use the Black Market Peso Exchange, the single most efficient money-laundering system in the Western Hemisphere. Michael DeBlis of the US tax litigation firm of DeBlis & DeBlis examines its origins and modus operandi.

A lesson in history

The date is July 2, 1991. Piled upon rectangular tables are stacks of United States dollars. The stacks reach three feet high and completely cover the table's surface. The tables extend from one side of the meeting room to the other, half the distance of a football field. The dollars make a level surface for most of the distance, except for the occasional hill and a speaker's podium in the centre.

In front of the speaker's podium, on the ground, are bags stacked one upon another reaching higher than the tops of the tables. These bags bear the markings of the Federal Reserve and although nothing green can be observed, they leave no doubt that they are filled with United States currency.

The occasion is a press conference announced by the United States Customs Service in Miami, to herald the seizure of one of the largest amounts of drug dollars ever seized in the United States from the cocaine cartels. The total amount from this seizure was $22 million, all in United States currency. But this money was not destined to be placed aboard a Lear jet and flown to Columbia. Instead, it was intended for a highly sophisticated and secretive system for laundering drug dollars, which had only recently been recognized as a serious threat to both the United States and Colombia.

The War on Drugs

For many years, the American anti-drug rallying cry had been the "war on drugs," with Colombian cocaine being the chief target. In the mid 1980s, however, the United States government widened the conflict by also targeting drug proceeds and introducing anti-money-laundering statutes as heavy-duty weapons into the conflict. One target of these weapons was the billions of dollars generated annually by the Colombian cocaine cartels and introduced into its principal laundering vehicle – the Colombian Black Market Peso Exchange.

This article undertakes to reveal how the Black Market Peso Exchange came to be and the mechanics of this Caribbean phenomenon.

The BMPE, as used by the cartels, is the single most efficient and extensive money laundering system in the Western Hemisphere. Back in 1999, the United States Department of the Treasury's Financial Crimes Enforcement Network warned that "this underground financial and trade financing system is a major – perhaps the single largest avenue for the laundering of the wholesale proceeds of narcotics trafficking in the United States."

> "The BMPE, as used by the cartels, is the single most efficient and extensive money laundering system in the Western Hemisphere"

The American cocaine industry has been estimated to be over a fifty-billion-dollar-a-year industry. As cocaine enters the United States through major source cities and makes its way to Main Street USA, the money trail follows a reverse flow, ending in major cities like Los Angeles, New York City, and Miami. In these cities, hundreds of thousands of bills in five, ten, and twenty-dollar denominations accumulate, awaiting their next change of ownership. The irony is that although this money belongs to the Colombian cartels, most of it will never leave the United States.

The money that accumulates in the United States belongs to the cartels. The cartels that have produced and shipped the cocaine now await the money that they are owed. The cartels need this money in Colombia in order to pay their operating expenses. Since it would be difficult to pay their operating expenses in American dollars, their ideal situation is to receive the money in Colombian pesos. The great dilemma for the cartel is how to get their millions of dollars located in Miami to Cali or Medellin, and convert them into pesos.

Decree Law No 444

While the cartel was confronting this dilemma, there were many Colombian people that needed dollars in the United States. In 1967, out of fear that Colombia's dollar reserves were depleting, resulting in inflation, the Colombian government passed Decree Law No 444, which limited Colombians in the amount of United States dollars they could purchase annually from the National Bank (the only legal source of United States dollars in Colombia).

Decree Law No 444 also required purchasers to pay a premium exchange rate to obtain dollars from the government. Finally, Decree Law No 444 required importers to disclose the types of items being imported, which resulted in purchasers making additional payments of taxes and duties to the government. This law eventually led to the creation of the Black Market Peso Exchange.

Originally, the BMPE in Colombia served as a way to send money to friends and relatives living in the United States, as well as a way for Colombians to accumulate stable United States dollars as a hedge against an unstable Colombian Peso. During this period, dollars were purchased by black marketeers from American tourists who were visiting Colombia or from American businessmen. These tourists and businessmen were paid a premium above the official government exchange rate. The black marketeers then sold these dollars to their Colombian clients at a percentage above the rate they paid, which was still cheaper than the government price of the dollars at the national bank.

The double coincidence of wants

During the 1980s, two groups came together – the black marketeers who needed dollars in the United States and the cartel families who needed pesos in Colombia. The result was the BMPE. The BMPE has been estimated to handle up to 85% of the money owed to cartels from the sale of cocaine in the United States. The billions of drug dollars from nationwide drug sales that flow back to major cities like Miami, New York, and Los Angeles do not remain idle and accumulate. Instead, they are used to purchase machinery, electronic items, and other equipment for Colombian industry and business.

The BMPE consists of two interrelated activities. One occurs in Colombia: the purchase of accumulated drug dollars in America. And the other occurs in the United States: the actual delivery of drug dollars to the money exchanger's associate in the United States.

[*Editor's note: A variant of the process we are*

about to describe, which became popular and had its heyday in the mid 1980s, is simply to fly the cash to banking centres such as the Bahamas, Aruba, the Caymans and the British Virgin Islands and deposit it there. This method is still in use today.]

Purchase of dollars in Colombia

The BMPE process begins when the cartel financial manager is contacted by his cartel representative in the United States and told that a particular trafficking organization in Miami is ready to turn over money owed to the cartel. For the purposes of this example, a figure of $1 million will be used. The cartel financial manager notifies money brokers in Colombia of the $1 million available in Miami.

A money broker may purchase the $1 million at a discounted rate of exchange of 1,500 pesos to the dollar (given an official exchange rate of 1,800 pesos to the dollar) and is given thirty days after delivery to remit the 1½ billion pesos to the cartel financial manager. The money broker will then notify money exchangers in Colombia of the $ 1 million available in Miami. Four different money exchangers may individually purchase $250,000 each of the $1 million dollar lot at a discounted rate of exchange of 1,600 pesos to the dollar (compared with the official exchange rate of 1,800 pesos to the dollar).

The money exchangers then notify their clients, who are likely to be Colombian businessmen and tourists, that they have dollars available in Miami. Five different customers may individually purchase $50,000 each of the money exchanger's $250,000 lot at a discounted rate of 1,700 pesos to the dollar (compared with the official rate of 1,800 pesos to the dollar). When placing this order, the customer specifies the manner of delivery. The customer will pay the money exchanger in pesos when the delivery has been confirmed.

The pesos received are then forwarded to the cartel family financial manager. In this method, the cartel family receives the proceeds of their cocaine distribution activities without the dollars ever leaving the United States.

Delivery of dollars in Miami

Once the $1 million dollars available in Miami have been sold, the drug trafficker must deliver it to its new owner, the money exchanger and his 'associate' in Miami. How does the drug trafficker know who to deliver this money to? Can any person approach the drug trafficker and say, "show me the money?" Of course not. The drug trafficker is extremely cautious about revealing his identity, not only for fear of being arrested but also because he does not want to be robbed.

A secretive system of code-words, fake names, forwarding of beeper numbers, and covert meetings between unknown parties culminates in the delivery of money to the money exchanger's associate in Miami. For example, when the money exchanger purchases $250,000 from the money broker, he will give the money broker the pager number of his associate in Miami, who will receive the money. The money broker forwards this pager number to the cartel financial manager, who passes it on to the drug trafficker. The trafficker is instructed to deliver $250,000 to whoever responds to the beeper number and gives the correct code word.

Next, the trafficker in Miami will contact the associate in Miami using the beeper number, placing the number of a payphone and a numerical code into the beeper. The associate will recognize the numerical code as belonging to an anticipated money delivery and will know which code word to respond with. He will call the number in his pager and have a short, cryptic conversation with the trafficker.

A clandestine meeting

Once the associate gives the correct code word, the trafficker will confirm the amount of the delivery. The trafficker will arrange a meeting with the associate. At the meeting location, once the trafficker has identified the associate, he may approach him with a bag, box, or suitcase full of money. At this point, the trafficker may verify the associate by asking his name and password. Upon proper verification, the trafficker will turn the money directly over to him and leave, never to meet again.

Once the money exchanger's associated has received the box, bag, or suitcase full of money, the placement or initial laundering of money begins. Placement has been called "the most difficult step for would-be money launderers." Through the placement phase, the associate further conceals the illegal source of the money by placing it into the stream of commerce in the manner requested by the money exchanger's client. ■

DeBlis & DeBlis handle high-stakes tax defence and complex criminal cases. Michael DeBlis is available at MJDeBlis@gmail.com or on 001 973 783 7000.

Credit rating agencies and their influence offshore: does the system need fixing?

Banks, asset managers and other onshore financial institutions are always allocating resources according to the credit ratings of various offshore centres and securities. Public and academic opinion, however, has given the credit rating agencies that classify them a rough ride in recent years for their opacity and for portraying bad risks in a positive light, to the ultimate detriment of investors. Chris Hamblin of Offshore Red looks at the solutions on offer.

In general, a credit rating is useful for sovereign wealth funds, pension funds and other investors to gauge the credit-worthiness of this-or-that jurisdiction. A good credit rating therefore has a major effect on the country's borrowing costs and on its standing in general, helping it to attract business. Every jurisdiction welcomes a high rating.

Examples abound. When Moody's, the international credit rating agency, raised Cayman's ceiling for foreign currency bonds and notes from Aa3 or high grade, to Aaa or exceptional, placing it alongside the UK, US, Canada and Bermuda, it stated: "an Aaa country ceiling for foreign currency bonds and notes could be interpreted as having the best and/or exceptional quality with the smallest of investment risk." Another way of putting this, in the words of the jurisdiction's financial secretary, was that "Moody's expects a very low risk that the government will impose a limit on the foreign currency debt payments of the borrowing entity."

Storm clouds gathering

This system is under a barrage of criticism, however. Dominique de Villepin, a former French prime minister and chairman of the International Advisory Council, Universal Credit Rating Group, spoke for many two years ago when he claimed that the 'Big Three' rating agencies had largely failed in their ability to appropriately assess risk worldwide. He famously wrote: "The consequences of this failure stem from their having a predominantly US-centric perspective of the global economy."

His complaint centred around three great 'privileges' that the US had had in recent decades. One was control of the world's reserve currency, a control it had used to its own advantage by becoming the world's largest debtor, safe in the knowledge that other people would carry on trading in dollars. The second privilege was its control of the rules in financial markets, despite often reckless deregulation: "It is easy to win a game if you can change the rules during the game and according to your needs." The third privilege was the control of risk.

"The West invented risk and controls risk. It decides what is risky and what is not. To a large extent, it has also been the sole arbiter of where money should go and where it should not. Funds have, in fact, been directed towards projects in the West by undervaluing the risk of default there and then exaggerating those same risks in places such as China, India, Brazil and elsewhere.

"With about 95% of all credit ratings under their control, the three major agencies are not only concentrated in the US, but also impose an unrealistic template – culturally and ideologically – on the rest of the world."

Public sentiment, especially on the continent of Europe, has swung in de Villepin's direction since the Great Crash of 2008 in which the rating agencies played such a pivotal role by giving glowing ratings to worthless sub-prime debts. The model by which the recipient of the rating typically pays the agency – and this is also true of countries that are rated – was discredited but so far has not been replaced in a single country. As someone immortally remarked: "If you pay, you get an A." De Villepin's solution to this was to help set up a new global credit rating agency, with Russian participation, to offer more variegated ratings on the basis of more rigorous algorithms last autumn.

The offshore world and credit ratings

Vast sums of investors' money flow out of the EU and offshore. There are signs that the reliance of offshore centres on good ratings from the market leaders could be breaking down, even though not much onshore reform has yet taken place. In February this year, S&P, citing concerns about global pressure on so-called tax havens, cut the Isle of Man's credit rating from AA+ to AA. Following this development, the government of the island chose to stop paying for an S&P rating, preferring to only use Moody's, another agency, instead. The stated reason was that the cost of being assessed by different agencies was too much of a burden. The IoM's government has had to defend its decision in the face of stiff criticism from the insurance industry, which claims that it consulted nobody before making its decision.

The table below sets out Standard & Poor's ratings for 10 offshore financial centres, which compliance officers around the world may find of interest.

Local currency rating = LC
Foreign currency rating = FC
T&C assessment

	LC	FC	T&C
Bermuda	AA-	AA-	AAA
Cyprus (Republic of)	B	B	AAA
Hong Kong	AAA	AAA	AAA
Rep of Ireland	A-	A-	AAA
Jersey	AA+	AA+	AAA
Liechtenstein	AAA	AAA	AAA
Malta	BB+	BBB+	AAA
Luxembourg	AAA	AAA	AAA
Singapore	AAA	AAA	AAA
Switzerland	AAA	AAA	AAA

Territories not rated by S&P include the Bahamas, the Cayman Islands, Cyprus, Gibraltar, Guernsey, St Kitts and Nevis, Monaco and Isle of Man.

Four layers of a very expensive cake

With all this in mind, the world's policy-makers have been moving gradually in the direction of reform. In November 2012 the Financial Stability Board, the successor of the Financial Stability Forum and an international monitor of and policy-maker for the global financial system, published a timetable for the reduction of reliance on credit rating agencies. In response, the EU is taking a 'multi-layered approach' to its implementation.

One 'layer' is a regulation to force financial institutions to strengthen their own credit risk assessments. A second layer is a battery of new sectoral laws, most of which are already in the pipeline. These cover the asset management sector (amendments to the Undertakings for Collective Investment Schemes or UCITS Directive and the Alternative Investment Funds Managers Directive or AIFMD) and institutions' occupational and retirement provisions (directive 2013/14/EU) with regard "to reducing sole and mechanistic reliance on external credit ratings." In the banking sector, the Capital Requirements Directive (CRD IV) and Capital Requirements Regulation (CRR) contain measures to reduce reliance for the purpose of determining regulatory capital for banks. In the insurance sector, the 'implementing measures' for the 'Solvency II' directive (passed in 2009 and still not in force) that are currently in preparation "could reflect the same principle on reducing reliance on credit ratings" – this is clearly a work in progress.

The next 'layer' is supervision by the new pan-EU regulators, namely the European Securities Markets Authority or ESMA, the European Banking Authority or EBA and the European Insurance and Occupational Pensions Authority or EIOPA, which belong to a joint committee that makes pronouncements and publishes reports on behalf of all of them. The three regulators have yet to become very effective, however, as they are still understaffed and finding their way in life. On this same layer, the European Systemic Risk Board (the ESRB, a club of national and EU regulators which has a vague "mandate to oversee risk in the financial system as a whole", and for which membership is compulsory) is required to avoid the use of credit ratings in its warnings and recommendations if such references "have the potential to trigger sole or mechanistic reliance on credit ratings." The last 'layer' consists of anything that is done by the EU's member-states.

Sad to relate, the annex on the EU's most recently published plan to save investment funds management (i.e. collective and alternative investment schemes) from over-reliance on the big agencies states: "Currently, the relevant legislation in the investment fund management sector does not contain references to external credit ratings." There is some good news for money-market funds, however: one of the EU's organs has drawn up a draft law to impose a set of principles on that sector. The most important single phrase in this convoluted document seems to be at the start of article 23: "The MMF or the manager of the MMF shall not solicit or finance a credit rating agency for rating the MMF."

New faces

Another way of assaulting the near-monopoly of the largest US credit agencies – the S&Ps and Moody's of this world – is to pave the way for new entrants in the market. De Villepin said as much when he wrote: "This pressing need to provide the market with more competition [necessitates] a new global credit ratings agency... with new and innovative tools, including broader and more finely nuanced ratings criteria designed to be more rigorous and more detailed than those offered by the Big Three."

The EU is doing its best to aid this process as well. In April it stated that the rules that governed credit rating agencies in Argentina, Brazil, Hong Kong, Mexico and Singapore were equivalent to its own rules on subject. This was the result of a 'technical assessment' of the regulatory environments in these jurisdictions on the part of the EU supervisor for credit rating agencies, which happens to be ESMA. Smaller agencies in those countries can now apply for certification in the EU so that EU financial institutions can use their ratings for regulatory purposes.

The real reforms – still in the future

Other, more radical, reforms are not yet on the table. The 'issuer-pays' market structure, in which the issuers or jurisdictional governments pay the agencies to rate their debt instruments or countries, has long been thought to be the source of distorted incentives. One lesson that many have drawn from the great stock-market crash of 2008 is that issuers want higher ratings to lower their cost of borrowing or just to attract business and can shop around among raters to maximise the ratings they are awarded. One of the leading papers on the subject (Pagano and Volpin 2010) suggests the following as a remedy. "Our preferred policy is to require rating agencies to be paid by investors rather than by issuers and to grant open and free access to data about the loans or securities underlying structured debt products. A more modest (but less effective) approach would be to retain the 'issuer pays' model but require issuers to pay an upfront fee irrespective of the rating, ban 'credit shopping', and prescribe a more complete format for the information that rating agencies must disseminate."

Unfortunately, there is nothing in the EU's staff working paper to suggest that it is thinking of imposing this model on its asset managers' risk assessment universe. Neither is it looking at the option of forcing credit rating agencies to be open and comprehensive in explaining their valuations of stock or countries to the authorities. Nor is it looking at the remedy suggested by US Senator Al Franken, which is to force the issuers to accept a rating agency appointed by some outside panel. Prof Alan Blinder of Princeton University, an authority on the subject, has also suggested this remedy: "This works more or less the way courts pick judges. If you are being tried, you are not allowed to pay your judge or pick your judge according to whether he is a softer touch than others. Judges are normally assigned randomly by means of balls in an urn or papers in a hat. Someone could assign agencies to bond-issuers in the same way."

Other solutions include a sharp increase in the agencies' legal liabilities. Blinder has written: "As things stand now, it is nearly impossible to sue a rating agency successfully...because ratings are deemed to be 'opinions' protected by free speech." In accordance with this, other analysts have referred to ratings agency staff as "little more than glorified journalists." Blinder believes that this solution, which is popular in some quarters, might be more trouble than it is worth: "The argument here is that if people believe that their shabby work will result in legal action, they have an incentive to work more carefully. I think, however, that it would lead to far too many lawsuits."

Despite the lack of imagination behind the EU's attempts to offset undue influence from the credit rating agencies, its policy will inevitably force itself on the British and Dutch overseas dependencies, many of which are financial centres in their own right. Reform, however feeble and expensive for firms, is on the way. ■

Recent developments in Singapore's corporate regulatory regime

Regulators in Singapore are changing the ways in which businesses – and individuals working in them – behave. Offshore operators who use conventional corporate vehicles will have to comply. In this article, Jacqueline Low, chief operating officer at Janus Corporate Solutions, brings tidings of recent developments.

The Singapore company regulator and the other relevant authorities constantly review the regulatory regime in order to remain relevant to evolving business needs. This has helped the city-state to retain its dominance in the region as a business and financial hub. The following is an overview of the impending changes that will soon be incorporated into the regulatory regime.

Tougher regulation for corporate service providers

In April 2014, Parliament passed a bill to amend the *Accounting and Corporate Regulatory Authority Act*. The new legislation requires corporate service providers that provide statutory filing services to their clients using the authority's electronic filing service, to be registered as filing agents. The employees of the corporate service provider who perform such transactions must also be registered as qualified individuals. Both the registered filing agents and the qualified individuals must be fit and proper persons who meet experience and qualification requirements.

The registered filing agents are obliged to perform 'customer due diligence' and to monitor transactions and, where necessary, must report suspicious transactions. With increasing surveillance on cross-border entities and capital transactions to prevent tax evasion, money-laundering and terrorist finance, the corporate service provider sector has come under scrutiny. The providers face a potential risk of abuse by criminals who could set up complex business structures concealing beneficial ownership and illegal transactions.

Registered filing agents and qualified individuals who fail to fulfil their obligations face censures and sanctions under the *Accounting and Corporate Regulatory Authority Act*. The details of the requirements have yet to be revealed and there will be a transition period for the corporate service providers that choose to register as filing agents until 2015. There will be orientation programmes to allow compliance people to familiarise themselves with the regime's improvements. The registered filing agents and qualified individuals must renew their licenses annually. The Accounting and Corporate Regulatory Authority has set up a new Corporate Service Providers Enforcement & Regulation Department to administer the new regime.

Registration requirements

The authority is proposing to ask for the repeal of the *Business Registration Act* and its re-enactment as the '*Business Names Registration Act*', with some amendments. The proposal has now been put forward for public consultation. Some of the key proposals for amendments are as follows.

- Individuals who carry out trade or business in their own names should be exempt from registration (individuals engaged in the business of freelance services, tutors, plumbers etc.).
- There should be an option to register/renew business names for a period of one year or three years in respect of individuals who have fully paid their Medisave, or who stay on a regular instalment plan with good Medisave contribution records.
- Criminal and civil penalties should be extended to business owners who carry on business after the ACRA has cancelled the registration or the registrant has notified the ACRA that he has ceased business.
- An increase in the maximum penalty for criminal offences, to bring the law into line with the other Acts that ACRA 'administers'.

The waiver of registration requirement for small business people will relieve them from compliance burden and cost. Likewise, the extended registration option will reduce the hassle of the annual renewing process and penalties associated with renewal beyond the validity period.

Business owners will soon be required to notify ACRA of any change in particulars within 14 days and failure to do so will be a criminal offence. To engage in business activities without registering one's business is also deemed a criminal offence. Such offence will attract a penalty of up to S$5000 ($3,990) or a jail term of twelve months or both. Also, there are civil implications inasmuch as any contractual rights arising out of the business can be enforced only with a court's approval. The proposed extension of penalties will hopefully lead to prompt renewals and registration and maintenance of accurate registers. The alignment of the maximum penalty, in line with other ACRA administered Acts, will ensure consistency in the regulatory regime.

Statutory audit exemption threshold to be raised

In his speech at the ACRA's 10th anniversary dinner, the deputy prime minister and minister for finance, Tharman Shanmugaratnam, said that when various amendments were enacted in the *Companies Act,* an increased number of small companies would benefit from 'relaxed compliance' and an exemption from annual audit requirements. This, he thought, would help nearly 25,000 companies. The proposed amendment is as follows.

A company will be exempt from statutory annual audit if it fulfils the following new 'small company' criteria.

- It is a private company throughout the financial year.
- It satisfies any two of the following criteria for each of the two financial years immediately preceding the financial year:

i the revenue of the company for a financial year does not exceed S$10 million;
ii the value of the company's gross assets at the end of a financial year does not exceed S$10 million ; and
iii it has at the end of a financial year not more than 50 employees.

A group of entities will qualify as a 'small group' – also exempt – if the group of entities satisfies any two of the following criteria for each of the two financial years immediately preceding the financial year:

i the consolidated revenue of the group of entities for a financial year does not exceed S$10 million;
ii the value of the consolidated gross assets of the group of entities at the end of a financial year does not exceed S$10 million;
iii the group of entities has at the end of a financial year not more than an aggregate of 50 employees.

The ACRA website revamped

ACRA relaunched its customer-centric website earlier last month. Its home page is well organised for easy navigation and quick access to information that is categorised according to types of business entities. The infographics, intuitive navigation and better design are sure to impress users. There are quick links in the home page to the frequently-used services. The 'how-to' guides in the home page are organised according to business life cycles.

ACRA constantly revamps its service platforms. One recent example is the BizFinx filing system, relaunched in March. This enables companies to file their financial statements in the now-compulsory XBRL. It replaced the old FS Manager. The system incorporates a BizFinx preparation tool, which is a free offline software app. ■