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FALL/WINTER 2003 Vol. 8, No. 3

## OFFSHORE REVOLUTION

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## OFFSHORE REVOLUTION

Experts say the global private banking model will only work for the behemoths . . . others must adapt to a new world order

by Susan Bourette

**T**alk about change. The last few years have brought sweeping changes in the private offshore banking world. What's more, the experts predict, the pace of transformation will only intensify as the decade unfolds.

Indeed, there's a new world order in the making, providing both opportunities and challenges for Canadian players vying for a stake in the increasingly competitive yet lucrative offshore finance market. "There has been considerable pressure placed on

***BANKING ON BARBADOS:** Maurice Fortier vice-president of investment services outside the head office of Bayshore Bank & Trust located in the Caribbean Island of Barbados.*

offshore jurisdictions causing significant changes that have increased the cost of doing business," explains Penny Ettinger, managing director of the Barbados office of Bayshore Bank & Trust. "It will eventually result in many providers falling by the wayside."

A recent study by PricewaterhouseCoopers in the UK forecasts a staggering wave of consolidation over the next five years. All told, the consulting firm counted more than 50 players currently doing business in the global offshore market. Within five years, the report warned, less than 30 will survive.

Beat Guldemann, senior vice-president of global private banking and trust for CIBC, agrees there is likely to be more consolidation in the future. However, he believes it will be somewhat less than that predicted in the PricewaterhouseCoopers study.

Both Guldemann and the management firm agree: The global model will only work for the behemoths. Wealth managers must use this period of retrenchment to protect revenue and slash costs. That means playing to strengths rather than operating across geographic territories.

The way Guldemann sees it, an increasing number of banks are likely to shutter their doors in satellite branches, concentrating their offshore operations in one jurisdiction. "Instead of having five different jurisdictions, more of the big banks will consolidate their operations," Guldemann says. The problem with this direction is that no jurisdiction can effectively administer all international structures.

John Bujouves, chief executive officer of Bayshore's financial services group of companies, says increased regulatory scrutiny, a shrinking asset base and slower revenue growth have all contributed to the velocity of the industry's transformation. "The calamity of events surrounding September 11th, combined with the last wave of CCRA's new non-resident trust and foreign investment entity rules have driven the changes," Bujouves adds, referring not only to worldwide industry

consolidation, but also restructuring in Barbados, where Bayshore Bank & Trust is headquartered.

The terror attacks on New York and Washington two years ago have given impetus to US authorities to crack down on banking secrecy with the enactment of the *Patriot Act*.

President Bush signed the *Patriot Act* into law on October 26, 2001, to provide financial institutions and federal regulators with important new tools to combat money laundering and terrorist financing.

In July 2002, the US Treasury and the Securities and Exchange Commission ("SEC") announced proposed rules implementing the "know your customer" requirements embodied in Section 326 of the *Patriot Act*. All financial institutions dealing in US securities or currency are affected by these rules. Similar rules are being applied in the European Union.

On June 3, 2003, the European Union's Council of Economic and Finance Ministers ("ECOFIN") formally adopted the tax package of the *Directive on the Taxation of Savings*. In short, most EU jurisdictions will automatically exchange information with each other about the beneficial ownership of accounts.

Here at home, CCRA has also clamped down hard on foreign reporting rules. It is a seismic shift worldwide: tough changes in disclosure and tax law amendments recommended by the Organization for Economic Cooperation and Development are also expected to cause a major flight of capital out of Europe and into new jurisdictions, adds Howard Wasserman, a tax accountant at Cadesky and Associates and a member of the Society of Trust and Estate Practitioners (STEP).

"Once upon a time, offshore banking was thought to be a little bit of the Wild West," Wasserman explains. "A place where you could put your money and no one would ask any questions. Today, anyone who tries to get involved in one of the offshore institutions is put through rigorous questioning."

That rigorous questioning—or due diligence—has sent bank costs through the roof, forcing a number of institutions in the offshore banking business to close shop.

Undeniably, the industry is maturing. Paul LeBreux, an international tax lawyer and president of Bayshore Bank's Canadian



**WEEDING OUT:** "The pressure placed on offshore jurisdictions will eventually result in many providers falling by the wayside," says Penny Ettinger, managing director of the Barbados office of Bayshore Bank & Trust. She is joined above by Bayshore CEO John Bujouves.

consulting arm, says it was not so long ago that offshore banking was considered the preserve of the super wealthy. But the early 90s brought a change in thinking, spurred in part, by the best-selling Canadian how-to book, "Take Your Money and Run" by Alex Doulis which extolled the virtues of offshore living and investing, LeBreux explains.

"That set the stage for the 1990s run offshore. There were literally thousands and thousands of people clamoring to transfer assets offshore," he says.

The burgeoning cadre of Canadians utilizing offshore banking throughout the 1990s began to slow by June of 2000, LeBreux says, when the Department of Finance began to draft legislation to plug a variety of tax loopholes. LeBreux, who also chairs the Canadian technical committee for the Society of Trust and Estate Practitioners, has worked closely with the department of Finance on this legislation. "Although the new offshore legislation undoubtedly makes access to offshore markets more difficult, the swing to the average Canadian was too great," LeBreux comments, "perhaps we are now getting back to a manageable medium."

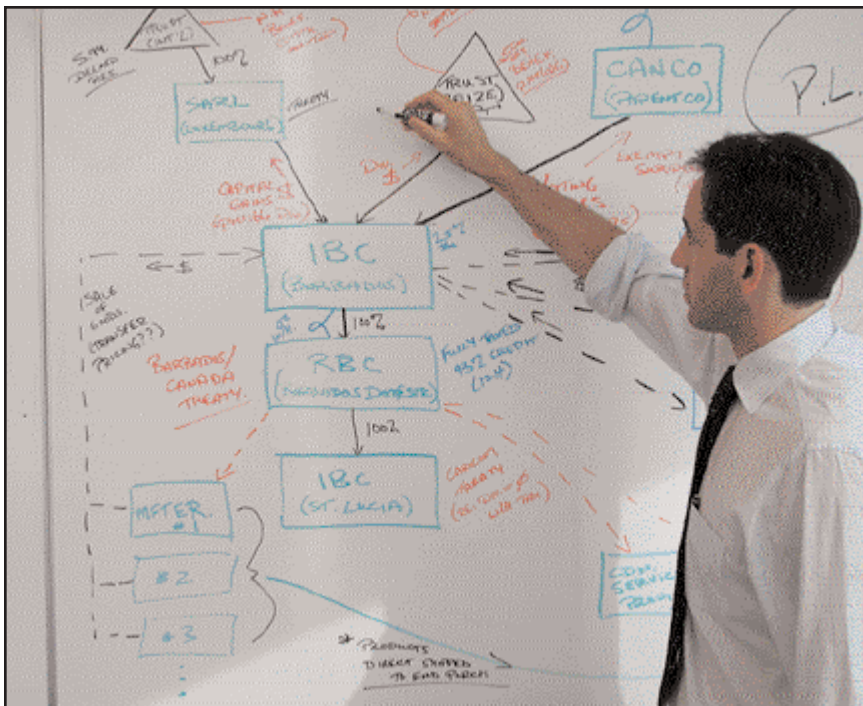
Volatile stock markets and the increased costs of international structuring have also

slowed the march of investors to offshore jurisdictions, as investors shift their focus from wealth accumulation to wealth preservation.

Over the past two years, there's been much hand wringing about the flight of capital from offshore institutions. But it's not all doom and gloom. Some are optimistic in their outlook. New research from Merrill Lynch, for example, predicts that offshore assets will continue to account for a 31% share of the total high net worth marketplace in 2005, compared with 33% currently. Clearly, wealthy individuals will always need offshore services.

Undoubtedly, though, these sweeping changes have presented vexing challenges for all three stakeholders: clients, banks and offshore jurisdictions. Despite narrowing opportunities, all three groups are poised to reap rewards as the new world unfolds, according to the experts.

On the client side, high net-worth individuals who have seen some of their tax advantages usurped by stricter reporting rules, can still see significant advantages in protecting their assets through offshore banking and structuring. For example, affluent clients who have assets located in countries around the world—and with family members in multiple jurisdictions—



**FINANCIAL PLANNING:** Paul LeBreux, an international tax lawyer and president of Bayshore Bank's Canadian consulting arm, says new offshore legislation has undoubtedly made access to offshore markets more difficult, but wealthy individuals will always need offshore services.

can protect their assets in a holding company or a trust.

As well, high net-worth individuals who are immigrating to Canada may utilize pre-immigration tax and estate planning techniques to all but shelter income from taxation in Canada. Such clients might also seek private offshore banking services to protect themselves from future hostile claims, and succession duties.

Those jurisdictions that have been thrust into the regulatory spotlight must adopt new transparency rules—or risk suicide. "When the OECD came out with a list of offshore jurisdictions that were unacceptable—it caused quite a ripple," says STEP's Wasserman. "The countries fought back by actually changing their laws because none of them wanted to be on that list."

Countries like Barbados, for example, have been proactive in responding to increased scrutiny by enacting new laws to thwart international fraud. Last year, the country amended its existing laws and created the Anti-Money Laundering Control Authority to monitor and police bank compliance with the *Anti-Money Laundering Act*. It is designed to facilitate onsite inspection of offshore as well as local banks, as well as to assist in information sharing with overseas regulators. The Act also raised capital requirements and increased the due

diligence procedures for vetting bank directors. Such transparency will allow them to shore up the flight of capital, according to the experts.

Bankers face some of the most grueling tests in the wake of the changes. Only those that are nimble enough and willing to adapt to the dictates of the new world order, will survive and emerge as dominant players in the future, observers say.

Several strategic options are open to offshore providers. The first is to go the M&A route to build scale; for others it will be to play a niche game, focusing on selected markets and specific market segments.

Bayshore's Bujouves says some players who were once dominant in Barbados are winding down their operations. They are also tripling or quadrupling fees that clients currently pay, forcing them to either close the account, repatriate the money, or find a different service provider.

Those changes have provided unique opportunities for mid-sized banks like Bayshore, he adds, enabling Bayshore to grow to a scale once reserved for the private banking divisions of major institutions like Barclays and HSBC.

Better, more rounded, financial advice is vital to the success of offshore private

banks. "Client relationship officers need to be re-skilled to advise on a broader range of more sophisticated proprietary and non-proprietary products and services designed for more unpredictable markets," said an IBM Business Consulting Services report earlier this year. "Banks must transfer their front-office model to better enable advisors to deliver higher value solutions and bring advisory services closer to the clients."

One way to improve customer service has been to provide a more independent advisory service through open architecture, adds Bujouves. "There needs to be a split between the manufacture and distribution of financial products—but this is simply not profitable for all but the most efficient institutions because many banks rely on the profits generated by in-house products."

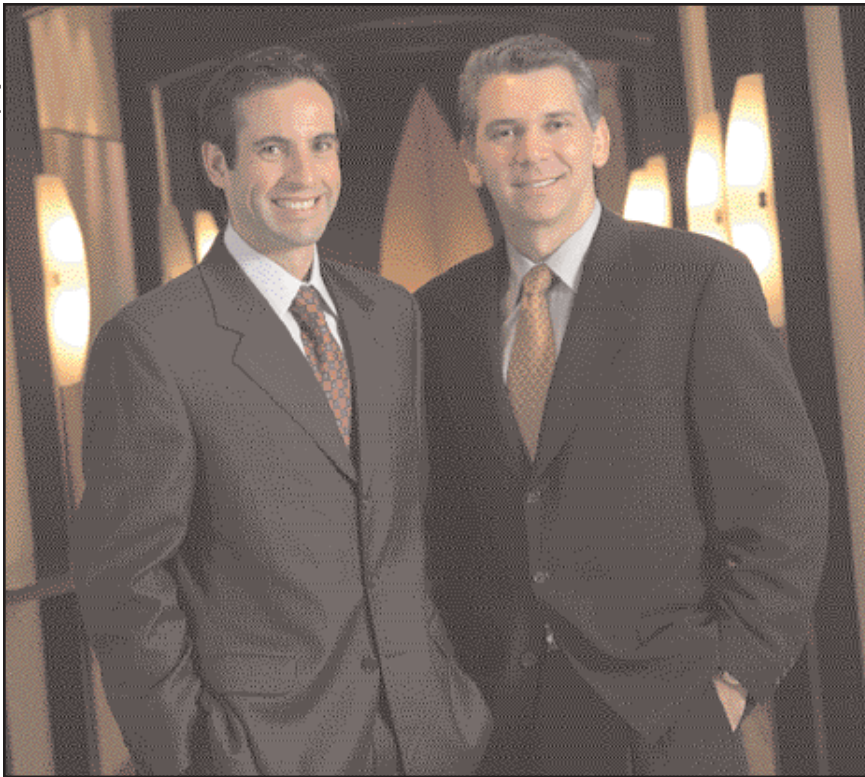
The recent PwC survey also concluded that wealth managers now realize that "open product architecture" means that it is no longer necessary to operate globally. Bayshore counts itself among the few wealth managers actively pursuing an open architecture strategy as a way of adapting to the shifting environment.

Indeed, open architecture represents a real paradigm shift for traditional private banks. Essentially, it means that institutions connect clients with outside providers of investment management, trustee and corporate services as well as mutual funds, hedge funds and other products, rather than restricting them to in-house brands. This is a shift that many established institutions are not ready to make.

Open architecture allows high net worth clients the ability to maximize their investment returns, Bujouves adds. Investors are becoming more sophisticated and despite the complication for banks in selling other institutions' products and the associated costs, it is the best solution.

Bayshore's partnering strategy best addresses each client's needs and ensures that performance objectives are met or exceeded. Essentially, open architecture allows Bayshore to cherry-pick the best investment managers to tailor a customized solution for each client.

"If you do everything "in-house", there's no way you can be the best in say Canadian fixed income, US equity, European fixed income and so on. History has proven that it is not possible. When everything is done "in-house", the result always turns out the same. The client will get, at best, a mediocre performance," Bujouves says.



**OPEN ARCHITECTURE:** Paul LeBreux (left) and John Bujouves say Bayshore's partnering strategy allows the bank to customize solutions for each client. "If you do everything in-house," Bujouves says, "there's no possible way you can be the best in all investment markets."

Open architecture also means that although clients have their money peppered all over the world with different service providers, companies like Bayshore can bring it all together. The system allows access to investment services, research, and administrative support all under one roof. This service not only saves clients fees, it delivers diversification across the best service providers. Bayshore offers investment managers on a fully segregated basis or on a pooled basis through Bayshore's Cayman Islands regulated fund company Integris Funds Limited.

Clients have access to the best money managers worldwide, Bujouves says, and do so at no additional cost. For example, Smith Barney might have a \$25-million minimum investment requirement in order to hire their best institutional fixed income manager. Since Bayshore would have already satisfied the requirement with its pool of other investments, the company can bring smaller investors on board with no additional costs.

"Investors get the economies of scale as well as the depth of Bayshore's expertise in evaluating and overseeing the management of each client's portfolio," Bujouves explains.

According to LeBreux, Bayshore Wealth Management Corporation, the consulting arm which normally advises trustees and

legal and tax advisors regarding offshore structures, has found itself winning large families of private clients on the strength of its quality advice. "Through our sophisticated research, we can offer independent advice on asset allocation, risk management, in conjunction with sound international tax and estate planning. Lawyers are now approaching Bayshore for macro financial consultation."

In Canada, the big institutions are only just beginning to wade into an open architecture model, Bujouves says. Bayshore has been able to react quickly to market changes, he says, adding that his company has been involved in it for seven years.

Open architecture has also meant sweeping changes in the way banks deal with one another. In the past, bankers eyed each other warily as competitors. Today, they're more likely to call on one another to provide services. Bujouves puts it this way: "We will, without hesitation, contact another institution to provide a service that is best suited to the unique needs of a client. Part of the battle is knowing which company provides the best service for each particular situation," something that Bujouves insists Bayshore evaluates on an ongoing basis.

Providing the best service is key since competition for clients will reach a new

level of intensity. It's not just about gaining new clients but retaining existing ones. Offshore providers will be in a head-to-head battle for the wealthiest clients.

For investors, it means being wooed like never before. However, investors should proceed cautiously in order to keep their money safe from offshore scams, warn the experts.

STEP's Howard Wasserman offers these words of advice: "The one thing that is common to all these scams is taking advantage of people's greed. All people see are the profits so they don't check it out. You shouldn't make a decision any differently in the Caymans for example, than you would in Canada. Do your due diligence."

The ferocious competition among wealth providers for market share has also highlighted a crucial question for investors: How does one pick an appropriate bank? Wasserman says, at the very least, investors want a bank that's reliable and experienced in the services that a client needs.

Bayshore's LeBreux says investors may want to choose a bank with a presence in a G8 country. However, he says, for Canadians, it also makes sense to choose a bank with ties to Canada to ensure recognition and expertise in navigating Canadian tax issues.

Clients should ask three crucial questions when evaluating the suitability of an institution, adds Bujouves:

- Whether the bank can deliver on specific needs;
- Provide a corporate style that is in keeping with the client's; and
- Ensure that investment performance is risk-adjusted.

Further Bujouves adds, "using a bank such as Bayshore, that does not lend, encumber or leverage clients' assets whatsoever is also a key determinate when evaluating the safety of one's investments."

Many of the same principles apply in picking an appropriate trustee, experts say. However, there are a few key notable differences. First, it is important that investors make certain that their representative is a *bona fide* trustee—that means licensed, regulated and insured in the jurisdiction in which they reside. Above all, it's crucial that the trustee be properly insured and regulated because it is the trustee that is accountable for the preservation of assets and must act in the

best interests of the trust's beneficiaries. The trustee is accountable for negligent acts and clearly has a fiduciary duty to its beneficiaries. "And it must still maintain flexibility to accommodate the evolutionary needs of a client," adds Bujouves.

Indeed, the scale of change sweeping the offshore banking market has thrust new

decision-making demands and opportunities on both investors and wealth managers. For investors, the future will unfold with a plethora of choice; they will seek and receive an increasingly sophisticated level of service. For private offshore banks, it promises to be a brutally competitive and creative period as providers jockey for position in a shifting

landscape. Many wealth providers will fall by the wayside. However, those that are most agile and willing to adapt to the new world order will not only survive, but also prosper. ■

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*Susan Bourette is a Toronto writer and former reporter for the Globe and Mail and CBC Radio.*



# SPECIAL RELATIONSHIPS

## The Barbados tax treaty offers a very advantageous tax structure for Canadian corporations doing business internationally

by Jason Lidero

There's no denying Barbados is a preferred jurisdiction for Canadian businesses. "There are about 1,700 international business companies in Barbados, plus numerous captive insurance companies and offshore banks, all of whose owners are Canadian," says former Barbados Minister of Tourism Peter Morgan in a recent article for the *Barbados Daily Nation* newspaper.

"Canada and Barbados have a very special relationship, given the *Barbados-Canada Tax Treaty*," says Maurice Fortier, vice-president of investment services at Bayshore Bank and Trust (Barbados) Corp. "That is the number one reason why we chose Barbados over Cayman or Bahamas or Bermuda."

The treaty offers benefits to both countries, says Morgan, by allowing companies to remit profits back to Canada on a tax-free basis. For Barbados, Canadian firms pay local taxes and licenses, hold considerable Canadian assets on the island, employ locals, lease office space and rent homes for resident Canadian managers. For Canada, the treaty assists Canadian companies to be more competitive in international business markets in terms of licensing, franchising, joint ventures and marketing and it provides those companies with capi-

tal for research, development and expansion, all of which provide more jobs to Canadian workers.

"Bayshore's location in Barbados rather than New York or Toronto is not due to a preference for 'sun and sand,'" adds John Bujouves, Bayshore's chief executive officer. "It is the combination of financial planning options and structures, such as offshore banking, IBCs, trusts, variable life and annuities, all in a low-tax environment governed by comprehensive legislation interwoven with a network of tax treaties that make the domicile appealing."

Bayshore was licensed as a Barbados chartered bank in 1997 and has been working on developing its own special relationships ever since. The personal touch is one of the bank's calling cards and service is at the foundation of its business strategy. Fortier says the bank's main role isn't simply selling investments or getting banking transactions out of its clients, but rather working with private clients who have unique and sophisticated wealth management issues.

"We're not a retail bank," he says, "we're an investment bank that has wealth management planning and trust planning as part of our package. People can come to us, get all of that and they can deal with another

financial institution for their day-to-day retail banking needs."

What Bayshore does offer its clients is a wide array of investment options. For the "do-it-yourself" type of client, Fortier says Bayshore provides investment options from stocks to bonds to options. "You name it, we can facilitate it." For these clients, who need to invest at least \$2 million to ensure proper diversification, Bayshore conducts personal interviews before having clients fill out their *Client Investment Profiler*, a questionnaire that helps Bayshore determine what portfolio structure and asset mix best matches the client's goals.

After getting the information, Bayshore checks it against the company's database of more than 1,200 investment management firms and matches the clients with the investment managers best suited to their needs.

For clients without the time to manage their portfolios, however, Bayshore offers what are essentially managed programs. One of those programs is Integris funds, a pooled family of funds located in the Cayman Islands, which Bujouves says allows Bayshore to provide access to "world-class investment managers" they wouldn't ordinarily have access to. "Our client service offering combines leading-edge technology, global financial and investment products and a strong commitment to the human factor in helping investors realize our goals," he says.

"Our 'best of the best' approach ensures that clients have access literally to a world of investment choice, frequently to advisors who would otherwise be inaccessible to them in virtue of asset size or relationship strictures, or simply because they are not aware of their existence or areas of expertise."

Indeed, special relationships are a common theme in Barbados business circles. ■

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