

A Brief Overview of the Offshore Banking and Financial Crimes Within

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ABSTRACT: Offshore banking topic is infrequently explained by academicians and scholars in their researches and written articles. Offshore banks do not exist in all countries, unlike the conventional one. Hence, information regarding the offshore banking system is limited. Offshore banks collect and distribute large amount of money in international financial system. This bank type has negative perception among world societies, mainly after 9/11 incident in New York. This bank was accused as the bank that facilitating terrorists with its money to perform their terrorism act, crashing WTC building with their hijacked airplane. This article aims to acquaint offshore banking basic concept to public, particularly to this article's readers. As the writer found that there is still lack of journal articles discussing this bank type, I intend to enrich its literatures and references. This article is expected to be useful for those who want to understand offshore banking in brief explanation and financial crime inside the offshore banking system.

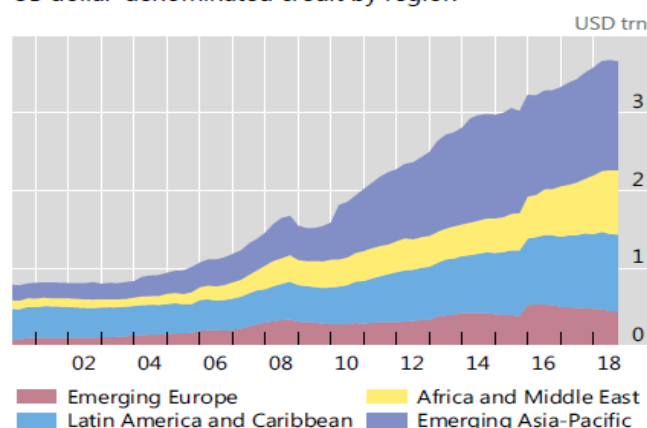
KEYWORDS: *Offshore Banking, Offshore Financial Center, Bank Secrecy, Tax Haven*

I. INTRODUCTION

In the middle of 2016, Indonesia was issued to establish its first offshore bank in Batam. This kind of bank which rarely to be discussed among academicians and Islamic scholars has many attractivenesses for people. Those are tax-free or lower tax banking system (more popular as tax haven), greater banking secrecy than local or onshore banks, and higher interest rate than other banks. Those advantages for people can attract them to keep their funds and wealth inside all offshore banks across the countries. All of these bank clients' wealths coming from both, *halal* and *haram* sources.

Eurocurrency market is a market where all type of banks, including offshore bank, make deposits and loans using a range of specific currencies outside the home country for those currencies (Chisholm, 2002). Eurocurrency market makes a bank be able to lend money to individual or company outside the country. A bank in Cayman Island, a british overseas territory, which is famous for their offshore banks, will be involved in eurocurrency market when a bank loaned money to borrowers outside Cayman Island using a specific currency other than Cayman Island's local currency. An offshore bank is actually always involved in eurocurrency market, because this bank type is prohibited to do banking activity inside the country where it existed. Almost all offshore banks can only receive deposits and lend their clients' money outside the nation.

US dollar-denominated credit by region



source :the Bank for International Settlement Report, March 2019

According to the Bank for International Settlement Report in March 2019, US dollar, the local currency in United States is mostly borrowed by Emerging Asia-Pacific region. The amount of loan reaches over USD 3 trillion only for Asia-Pacific region, including Indonesia as one of those borrower countries. The data above tells us that the majority of USD dollar loans in eurocurrency market is given for countries in Asia-Pacific region, either the source is from bank or non-bank institutions, including offshore banks in United States.

Two common nations referring to offshore bank are Switzerland and Cayman Islands. The world has already known that these two countries are renowned with their offshore banking system. Beside these two countries, there are several other jurisdictions offering offshore banking system. Those are : Singapore, Malaysia, Panama, Cook Islands, Dominica, Saint Kitts and Nevis, Antigua, Anguilla, New Zealand, Luxembourg, Bahamas, Barbados, Bermuda, British Virgin Islands, Cyprus, Channel Islands, Monaco, Mauritius, Hong Kong, Malta, and Macau (Masten, 2008). According to *the New York Times*, Cayman Islands has US\$1.9 trillion on deposit in 281 banks, including 40 of the world's top 50 banks, so offshore banking is an integral part of Caribbean economy. Fourteen nations in the wider Caribbean have been named by the US as "major money laundering" countries in the 2016 International Narcotics Control Strategy Report (INCSR) (Plummer, 2017). Meanwhile, one recent research estimated the wealth to be hidden inside offshore banks across the world is roughly US\$ 6000 billion. Most of this money come from the richest people over the countries. It is believed that those money largely escapes taxation (Zucman, 2013).

Because of lack in references and articles explaining offshore bank, this article attempts to take a role in discussing basic concept of this bank type across the world.

II.METHODOLOGY

Research method applied in this article is literature study by accessing any writing found in foreign journal articles, websites, and other information sources that can be a help in writing this article. As mentioned before that the information of this bank type is very limited, thus the article describes and explains in brief explanation.

III.RESULTS AND DISCUSSION

OFFSHORE BANK

Offshore bank is simply defined as a financial institution, more specific is a bank, which is located outside the clients' countries they live. If someone is living in Australia, a bank in United States is becoming an offshore bank for him. Otherwise, if someone is living in United States, a bank located in Australia is becoming an offshore bank for him. This offshore bank is open for both, individual and company. An individual or company can select to open their first offshore bank's account based on offshore bank's tax regulation or financial and bank activity secrecy applied inside each offshore bank. These two points are generally the main consideration for offshore bank's clients to open their account in an offshore bank they want (Masten, 2008).

Regulation among offshore banking system jurisdictions takes an important role in influencing people for giving their wealth to be managed by offshore banks. Small differences in regulation concerning taxes or repatriated profits may be sufficient to induce international capital to enter or exit particular places. Many small states or jurisdictions take decision to deregulate as much as possible for international capital benefit, repatriated profits, and eliminate taxes with a hope that global money will select their place (Warf, 2002).

Due to their greater privacy, offshore bank is popular to be known among world societies as a financial institution which allows money from illegal transaction, money laundering, underground economy, and other illegal financial activity to be kept inside the bank. In addition, this type of bank was accused for facilitating terrorism activities, like case of terrorists airplane crashed World Trade Center building in New York City on September 9, 2001 (Rugy, 2001).

There are many reasons for countries to build their offshore banks and Offshore Financial Centers (OFCs). The countries often build offshore banks and Offshore Financial Centers (OFCs) within the border of countries. Some of their reasons to establish this kind of bank are to gain access to international capital markets and introducing an element in order to maximize competitiveness level inside local financial systems (Errico and Musalem, 1999). Those also can be called as economic impact of offshore bank on the host countries. In addition, offshore banks can eliminate time zone problems which usually became matter in doing banking business over the nations (Chang, 1989).

Positives and negatives are always becoming part of the phenomena of offshore bank in contemporary financial discourse and academic debates. Offshore banking system is seen to be a banking system legalizing financial criminality act for bank clients, like : money laundering, tax evasion, and so on. In other side, this banking system contributes some positive impacts to host countries, particularly in gaining access to international money from international bank clients.

BANK SECRECY

Bank secrecy can be defined as a professional obligation that a financial institution should keep and do not disclose and expose customers' financial information to third party. It is intended to ensure the customers feel safe with their privacy given to their financial institution. Customers' financial information should be protected legally and should not be invaded by other parties (Ping, 2004).

Although bank secrecy or financial privacy is understood by the world as customer's financial information, the implementation can differ among the countries. It is included customer's deposit, investment in stocks, insurance, retirement funds, loans, and mortgage information. It shall not be exposed to other parties without their legal interests. All materials purchased by customers can be visible in their financial information. Even their political beliefs can be clearly understood by associating to banking records (Ping, 2004).

It should be kept in mind that bank secrecy or financial privacy is intended to legally keep customer's financial information. But we cannot deny that a tight bank secrecy brings up a financial criminality act, like money laundering, can be easier to be done. Money laundering can undermine public confidence in the financial system. Furthermore, this act will ruin public trust to financial institutions. When it comes to offshore banks which concern with bank secrecy, it will make negative perception in people's mind about this bank type.

One reason attracting people to bring their wealth and keep them safe inside offshore bank is this bank's secrecy regulation. In 2018, Switzerland became the most secret country listed on Financial Secrecy Index for bank clients' privacy.

2018 Secrecy Ranking	
See full index here	
1.	Switzerland
2.	USA
3.	Cayman Islands*
4.	Hong Kong
5.	Singapore
6.	Luxembourg
7.	Germany
8.	Taiwan
9.	United Arab Emirates (Dubai)
10.	Guernsey*
11.	Lebanon
12.	Panama
13.	Japan
14.	Netherlands
15.	Thailand
* British overseas territory or crown dependency. If Britain's network were assessed together, it would be at the top.	
See full index here	

source : www.financialsecrecyindex.com

Switzerland focuses on their banking secrecy system. According to a survey obtained by The Organization for Economic Cooperation and Development (OECD), most of the 82 countries committed to provide personal information of banks' clients if it is needed by the government to disclose. However, Switzerland did not accept to open their clients' bank secrecy to foreign tax authorities, in simple case of tax evasion. When it was related to criminality act, Switzerland will disclose their clients' financial privacy only as defined by the Swiss Penal Code (Johannesen, 2013).

TAX HAVEN

An observation in 2009 found that roughly 15% of all countries in the world are tax haven countries. For a country with population under one million, its potential becoming tax haven countries rises from 26% to 61%. Most tax haven countries are coming from small countries, affluent, and have high-quality governance institutions (Dharmapala and Hines, 2009).

Tax evasion from countries acted by rich people and companies is believed to be factor which declining countries' revenue, particularly in developing countries. The average of tax revenue to GDP in developed countries is approximately 35%, and 15% in developing countries (Fuest and Riedel, 2009).

Tax haven can attract foreign currencies to flow into the countries which applied the regulation. Money is coming from both sources, *halal* and *haram*. A high-tax policy made by a country government will reduce profit obtained by individual or companies. Thus, tax haven is one solution for them to maximize what they earned from their financial activities. But, tax haven attracts foreign investment not only because income earned is taxed at favorable rates, but also tax haven regulation can show up banks' customers with intention for tax avoidance (Fuest and Riedel, 2009). Tax avoidance (sometimes called as tax evasion) is an act from the banks' client who do not want to pay taxes based on the government's tax regulation in one country. Implementation of tax haven in offshore banks which allow only foreign currencies (often called as eurodollar currency) to be deposited into that bank type can show up world societies' negative perception.

Offshore banks in Switzerland are heaven for those banks' clients who want to hide their wealth from the government in case of paying tax, or more common to be called as tax evasion. In 2002 until 2007, New York Times reported that United Bank of Switzerland (UBS), the biggest bank in Switzerland, was suspected to help American clients to hide US\$20 billion illegally, and letting them evade from paying tax approximately US\$ 300 million a year. Furthermore, this bank earned US\$ 200 million a year from this business (Browning, 2009).

OFFSHORE BANKING LICENSE

An offshore bank is not supervised by the central bank of the country. It has no regulation prepared by the government. Nevertheless, it does not mean an offshore bank can operate their banking system as they wish without regulation from anyone. There is license called as offshore banking license to regulate operational of offshore bank. It is an international license which allows offshore banks to do their banking business across the world.

Offshore banking license can be defined as a license given to an offshore bank to conduct its business activity only with citizen outside jurisdiction that issued the license, and using specific currencies other than local currency. In order to obtain this kind of bank license, an offshore bank needs to meet its requirements. Business plan is the most important requirement before an offshore bank acquires its offshore banking license. It shows how an offshore bank doing its banking business, managing the funds, also including its financial ratios. The bank also has to prepare its capital requirement, people who will manage the bank, computer systems, and compliance systems. In addition, an offshore bank should have a correspondent bank account with other banks outside the country and its tax consideration (low or free-tax regulation) being charged to the clients of the bank (Reeves, 2017).

IV. CONCLUSION

Lower or free-tax banking system, greater privacy than conventional banks, and higher interest rate applied in offshore banks for their bank's clients are the most interesting factors for international customers to keep their money in this bank. These are mostly perceived by world societies in negative way for facilitating financial criminality act, such as : money laundering, tax evasion or tax avoidance, and hiding illicit money from illegal transaction due to its strict bank secrecy implementation.

Offshore banking system is actually not illegal financial institution even it has no tight regulation as general banking system in the world. It has an international license called as offshore banking license which has to be hold by offshore banks' owners before they operate those financial institutions. They have to fulfill some components of requirement in order to obtain that kind of banking license. This license is usually issued by particular offshore financial center jurisdictions, where offshore banks will be established.

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