

OFFSHORE FINANCIAL CENTRES - DEVELOPMENT STRATEGY OR NEO-LIBERAL ILLUSION? THE CASE OF THE FIRST INTERNATIONAL BANK OF GRENADA.

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I. INTRODUCTION

With declining Foreign aid flows to the region, Caribbean countries now need to intensify their focus on national and regional means of financing development. The Monterrey Consensus (2002) notes that many developing countries increasingly depend on local funds to finance their development needs. Domestic financial institutions are important in this respect, as by intermediating between savers and borrowers, they can efficiently mobilize and use society's savings (Levine 1997).

The limited choices available to micro-states such as Grenada for fighting unemployment and poverty, for increasing welfare and achieving development have nudged these states into exploring new avenues of growth in the form of offshore centres. C.Y.Thomas (1988) refers to offshore centres along with tourism as new poles of growth against the background of a declining agricultural sector that in the case of Grenada had been the mainstay of the economy. The drawbacks of the tourist sector exemplified by its vulnerability to storms, competition from newcomers into the industry (Williams, Suss and Mendis 2005:1173) and demand fickleness of the tourist sector. Furthermore, the requirements of often large inputs of scarce foreign capital for investment in the sector and the lack of viable alternatives based in the manufacturing give a special brilliance to the appeal for promoting offshore financial centres (Williams, Suss and Mendis 2005). Offshore financial centres (OFCs) seem to offer a welcome alternative for quick monetary gains in terms of tax income and fees to the government as well as employment for skilled people in commerce (clerks, accountants and lawyers) without much investment of the host country's own capital. Often citing the offshore financial centres in the Bahamas and Cayman Islands as success stories (Roberts 1995) researchers often note the volume of money passing through those centres in optimistic terms. It is expected that there are positive economic spinoff effects from these centres

but the problems related to these centres as a result of the strategy are hardly discussed. It is true that the servicing of such financial flows can provide much needed capital for development, but does that really happen? What is the significance of offshore banking contribution to development?

In 1996, Prime Minister, Dr Kieth Mitchell¹ and his New National Party (NNP) bolted headlong into creating an offshore financial centre almost over night. In that year his government passed a series of laws² to establish Grenada in the business of financial offshoring³ (Laws of Grenada 1997 and SRO.17:1997). This was done without a corresponding supporting financial infrastructure and availability of skills necessary for regulating and monitoring the sector.

The conservative Mitchell, flaunting a neo-liberal ideology, saw it as essentially important to liberalize and gave the market its 'true place' in directing development in Grenada (Mitchell 1999). The OFC strategy represented a perfect example in the respect of a quick connection to the changing global financial economy's liberal thrust. The OFC was a way of expressing the concreteness of this policy of neo-liberalism as it lined up well with the driving force of the global restructuring of capitalism.⁴ The operative words guiding the Mitchell regime were deregulation and liberalisation (Mitchell 1999), cost it what it will.

In addition, offshore operations fit in neatly with the requirements of the Washington Consensus⁵ that shadowed and influenced the NNP's government towards a shared neo-liberal ideology. The result of this strategy has not served Grenada's international reputation well among investors, nor increased the confidence of the people in the government's integrity at the domestic level. For the centre attracted a large number of crooked people whose activities overshadowed the expected positive effects.

Not long after the opening of the centre a number of fraudulent international business companies (IBCs) and banks that established themselves in Grenada under the program were forced to close. The flagship of the program, First International Bank of Grenada (FIBG), failed and in due course it was revealed that its principals were responsible for a massive fraud in which depositors around the world were swindled of more than US \$170 million (The first Report of the liquidator 2001). Superficially, Grenadians were affected only in the loss of jobs and reputation at this juncture. Nevertheless, these developments set some doubts regarding the establishment of the booking type of offshore centre, the easiest to get into. In addition, many doubts or concerns were raised regarding the sector's significance to economic growth and development. The scandal of the FIBG has hurt the government's integrity, reputation

and the pride of the Grenadian people both at home and abroad. Finally, amid it all, not only had there arisen accusations of a cover up and corruption involving the Prime Minister as is usually the case in such a situations, but the greater problems of governance (in the wider political sense), oversight and regulation of the sector have been exposed.

II. AIM, SOURCES AND METHOD

The aim of the paper is to examine some of the drawbacks and benefits of the offshore centres to small states developing such as Grenada. The focus therefore is not on offshore centres per se but on the employment of this strategy for development. I therefore do not go into details of the functioning of offshore centres. For more on offshore financial centres see (Sikka 2003), (Roberts 1995), (Palan 1998) and the IMF and Financial Action Task Force (FATF) homepages.

In this article, I argue that the strategy of using the booking type offshore financial centre for development, namely in banking and securities, is not reliable in that it may not deliver the desired results even if there have been some successes by early entrants in some quarters of the Anglophone Caribbean, viz. Cayman Islands and Bahamas. Furthermore, the adoption of the booking type offshore financial strategy of development poses serious risks to the reputation of the country's development possibilities and can jeopardize a country's ability to attract future investment. *Why then adopt this as a development strategy? What is the basis for the motivation of the Grenada government in establishing an offshore financial centre? What are the limitations of the offshore operations for small states that are poorly equipped for the task of regulating an offshore sector? What are the consequences of a poorly operated offshore system?*

In order to write this article I have relied on published articles for general background information on the *problématique* of offshore financial centres. However, the bulk of the empirical material related to the focus of the article comes from the Supreme Court's documents by liquidator in the case concerning the First National bank of Grenada.

Outline

The paper is divided into the following parts: Section two conceptualises and clarifies the term offshore and the implications for sovereignty in this regard. In section 3, the nexus between the globalization of finance and offshore centres is established. The development of the Grenada offshore centre is dealt with in section 4. The collapse of the First International Bank is discussed in section 5 and its fraud is exposed and the

aftermath of this is dealt with in section 6. I make some concluding remarks in section 7.

III. CONCEPTUALIZING OFFSHORE OPERATIONS

The term offshore has been used in a numbers of ways. According to Ronen Palan 1998, the concept can be used to encompass foreign direct investment (FDI), export processing zones, call centres, internet operations, financial tax havens and also includes the registration of ships in another country, under a 'flag of convenience,' to avoid the strict regulation and to lower costs (Palan 1998:64-65). It was first used literally in the sense of drilling for oil offshore (Palan 1998). In another sense it is used to describe production activities of multi-national akin to outsourcing or overseas branch production. The journal *Economic Outlook* talks of 'offshoring' as "the shift ...of production and employment to other, overseas locations in order to satisfy demand from...consumers" (Economic Outlook 2004:9). For the OECD, the main view of offshore financial centres is that of tax havens (OECD 1998) or areas where money laundering occurs of ill gotten funds from criminal activities such as fraud or drug trade and the funding of terrorism.

Thus the concept 'offshore' has a shifting meaning depending on the reference in mind, for example: It can refer to the physical location of an operation such as offshore oil drilling as earlier indicated, or the location of a foreign enterprise that is sequestered from the rest of the economy in special zones (such as the export processing zones in terms of manufacture) usually near a port operating under special rules, i.e. there is no organic link with rest of the economy. Again, these are somewhat literal meanings indicating extra-territorial or beyond the shores of the home country. However, there is another and more important aspect to the use of the term in relation to finance. It is a space that is physically integrated in the host country but judicially separated, i.e. different regulations apply between them that distinguish offshore from onshore operations (Palan 1998).

Such a view regarding offshore financial operations has implications for categorizing sovereign spaces as discussed by Palan. The tendency to have dual regulations for onshore and offshore operations, define the boundaries between domestic and foreign, internal and external (Palan 1998). Much of these spaces are fictitious and it is the voluntary limitation of the exercise of judicial sovereignty in these spaces that determines the 'offshorenness' of an operation. In the booking type offshore financial centre the international business corporations and banks can trade only with non-residents. This seems to be self-defeating since such a limitation of the flow of funds, in terms of investments, does not benefit the host country. Since

actual funds do not pass through the jurisdiction the only evidence of asset transfer is in the form of a ledger entry.

IV. GLOBALIZATION AND OFFSHORE FINANCIAL OPERATIONS NEXUS

An appreciation of the rise of financial markets and their growing inter-connectedness provides an insight into the rise of offshore financial centres. In the 1960s, there was a rapid development of financial centres in the developed countries namely in the cities of Zurich, Paris, London and New York (Park 1982). In the face of restrictions of the flow of finance capital and currency exchange, these centres grew into offering services that can be considered offshore, such as trading in foreign currencies, banking and providing capital to international clients in dollars and other hard currencies (Dabar, Johnston and Zephirin 2003). Despite the fact of having offshore functions, these centres are generally not thus classified and are instead referred to as international banking facilities (IBF) serving international financial markets such as the Euromarket and Asian Financial markets; markets that are integrated world wide. In this way these centres led the way in financial globalization but the continuing process of the financial mobility of capital is intensified via OFCs.

OFCs act as vehicles for capital that is in search of higher returns. The importance of OFCs is validated by their rapid expansion from 30 to more than 60 in the 1980s (Sikka 2003:366) world wide. From the US alone it is estimated that there are more than US\$800 billion in assets in offshore banks in the Cayman Islands motivated by the secrecy laws, low taxation and lax regulation. The offshore locations in the Caribbean stretched from island of Nevis with a population of 10 000 to Barbados with a population of approximately 270 000 people many of which are quite recent.

The newly established OFCs are often promoted or facilitated by the state in the competition for clientele. The state does this by lowering the regulation of the sector and withholding tax requirements, and in some cases eliminating them all together while sticking to a strict regime of confidentiality. In many cases a financial audit report is not required. In such a lax regulatory environment it is not difficult to understand that there will be unintended effects such as: the attraction hot money, criminals, tax-evaders, fraudsters and provide opportunities for funding terrorism.

These problems and the means for solving them have been hotly debated by the OECD countries (See OECD 1998). There are real challenges that affect both the home country and the host country. The response of the OECD has been to attempt to coax the jurisdictions to

revise their laws and regulations and to co-operate with regulatory authorities of the OECD countries. Official international monitoring duties have been assigned via the FATF and the IMF and offshore jurisdictions can be sanctioned via black listing, or the withholding of aid or loans. Needless to say many of the changes sought by the home countries in regulations have costs associated with them for the operations of the offshore sector in the host country. The greater the costs, the less competitive will be offshore sector and thus reduced revenue.

OFCs, who uses them?

OFCs are used mainly by corporations and wealthy individuals (Sikka 2003), to increase their wealth by avoiding tax obligations in their home country such as US banks forming branches in OFCs to “book Eurocurrency loans and avoid US taxes and regulation of capital flows” (Sikka 2003:371). If we accept the old adage that capital follows capital, then we understand that where there is an opportunity to optimally increase the present wealth, capital will flow there to. Williams, Suss and Mendis (2005) outline three of these functions to include private investment that “minimise potential tax liabilities” (Williams, Suss and Mendis 2005:1174) under the protection of secrecy. A second function is asset protection and the third is estate planning (Williams, Suss and Medis 2001). The downsides of offshore centres are demonstrated by their use as conduits for capital flight, financial speculation, criminal and other illegal reasons. They are as follows:

It is fashionable to regard OFCs in Europe and elsewhere as tax havens. The reasons are obvious. According to US Senator Carl Levin, already in 2001 the US was estimated to be losing \$70 billion per year in tax revenue to OFCs (Mogenthau 2001). For Europe the figure was £100 billion and for Britain £85 billion per year. Russia lost an average of £16 billion per year in the 1990s to tax havens (The Times 9th June 2000) and in 1998 alone according to the US Treasury, it is estimated that Russia lost ‘\$70 billion to offshore accounts in Nauru, which has of 10 000 people, one main road and 400 banks’ (CNN 2001). The uncontrollable flow of capital raises concerns about the destabilizing effects that such activities may have on macro-economic management regarding the provision of social benefits the citizens of these countries.

The second is the facility that OFCs offer for money laundering. This has become a serious problem in recent times especially with the rise of terrorism. It is pointed out that problems arise for both the host country and the home country. Money Laundering threatens the reputation of the host country and the integrity of the financial system by its destabilising effect.

Thirdly, OFCs has a strong attraction for con-men who use the facility of secrecy, lax regulation and ease of establishment to defraud unwitting depositors who are looking for an opportunity to increase their wealth.

The negative aspects OFCs above are so numerous that they overshadow their legitimate functions which are to provide certain innovative means of increasing the returns on capital. While there are problems in all business operations some are more tainted by others, or some deliver more than others. It would therefore be of interest to examine the various types of offshore centres.

Types of offshore centres

Having knowledge of the various types of offshore financial centres can give an insight into their significance for, and level of contribution to growth and development possibilities. Their functions and focus of business operations reveal their classification and thus their capacity to achieve the stated expectations.

Four types of offshore centres have been identified by Park (1982) as are given in the Table 1 below. Type 1 is called *primary* offshore centre, examples of such is London and New York, and is an organically or spontaneously occurring centre. It serves the world as a whole providing a range of financial services and becoming the “hub of international banking and finance” (Park 1982:33). The origin of the London centre can be dated from around 1958 in relation to the Suez crisis when restrictions were imposed to prevent speculation against the pound. Banks began to trade in dollars and other hard currencies. This was the dawn of London as an offshore financial centre, as an international financial intermediary.

Another type is the *funding* centre. In this centre, funds are collected from outside and channelled inwards to invest in some productive project in agriculture or manufacturing, hotels or infrastructure development. The lack of investment funds from within the domestic borders, for example Singapore and Panama, are the basis motivating their operation type (Park 1982:34).

The opposite is true for the *collection* centre. In this case there is an excess of funds domestically and because of the low absorptive capacity, borrowers must be found externally for this idle capital. The collection centre serves to channel funds outwards where they can be efficiently invested (Park 1982:34). Such a centre needs an advanced infrastructure and a high level of co-ordination between participants of the centre.

| Type of Centre | Sources of Funds | Uses of Funds | Examples |
|----------------|------------------|---------------|------------------------|
| Primary | worldwide | worldwide | London, New York |
| Booking | Outside | Outside | Nassau, Cayman Island, |
| Funding | inside | inside | Singapore, Panama |
| Collection | Outside | Outside | Bahrain |

Source: Y. S. Park 1982:33

On the extreme of the primary (also referred to as an international banking facility (IBF)) centre is the *booking* centre. In this type of centre there is little or no infrastructure needed for its operation. The businesses operating there are usually referred to as “shell branches” needing little more mail boxes and a few file cabinets. Some are bit more sophisticated and may invest in a building. This type of centre services only non-residents who use the services for investment in third countries. It is this type of OFC that small countries such as Grenada are establishing, because of the relative ease of doing so and because of the promise of the ready income that can be derived from it. The three main reasons that makes there centres competitive with the primary are 1) low or non-existence of taxes on profits or assets, 2) Lax regulations (sometimes not requirement to prepare end of year audited statements) and secrecy. It is therefore not surprising that these centres have thus come be regarded as tax havens.

V. GRENADA OFFSHORE DEVELOPMENT AND ITS REGULATION

In 1996, the Mitchell regime launched the offshore financial sector as a way to provide employment opportunities and to raise funds for the government’s use in projects that can contribute to national development. The strategy was to integrate the offshore financial sector and the tourist sector, thereby seeking to attract investment to both. His strategy on the surface seems plausible as it appeared to be an innovative solution to the dwindling sources of funds for development project investment. The national debt was rising as a result of the government’s engagement and planned engagement in a number of infrastructural projects that were to modernise or upgrade Grenada to be a world class destination (Mitchell 1999). Underpinning his strategy was his market oriented ideology that naturally opened Grenada to investors from all over the world. His parliament passed an initial package of laws to concretize the direction of in which his government was heading. Over time there were additions, such as the Economic Citizenship Program and the International Betting Act 1998 to complement his development strategy. Betting never got off the ground but the law is still operative.

The laws that were passed or revised to create the offshore centre included, the International Companies Act, The Offshore Banking Act, The International Insurance Act, The International Trust Act, the Company Management act and the Offshore Services (fees) Regulation (GIFSA 1998). The fees for application, for licenses and Renewal of licences are given the tables 2, 3 and 4 that follow.

| Table 2 | Application fees | Fee |
|---------|---|----------|
| | Unrestricted Class I offshore banking license | \$10 000 |
| | Restricted Class II offshore banking license | \$10 000 |
| | General trust license | \$5000 |
| | Restricted trust license | \$2500 |
| | General offshore license | \$2000 |
| | Company management license | \$1000 |
| | Source: SRO 17 Offshore Services (fees) Regulations | |

| Table 3 | License | Fee |
|---------|---|----------|
| | Unrestricted Class I offshore banking license | \$60 000 |
| | Restricted Class II offshore banking license | \$50 000 |
| | General trust license | \$30 000 |
| | Restricted trust license | \$20 000 |
| | General offshore license | \$12 000 |
| | Company management license | \$10 000 |
| | Source: SRO 17 Offshore Services (fees) Regulations | |

| Table 4 | Renewal License fee | Fee |
|---------|---|----------|
| | Unrestricted Class I offshore banking license | \$40 000 |
| | Restricted Class II offshore banking license | \$35 000 |
| | General trust license | \$25 000 |
| | Restricted trust license | \$15 000 |
| | General offshore license | \$12 000 |
| | Company management license | \$10 000 |
| | Source: SRO 17 Offshore Services (fees) Regulations | |

There were 44 offshore banks in Grenada in 2001 (Williams, Suss and Mendis 2001) but there is no information whether they were class I or class II banks. As a source of funds it is clear that the offshore sector provided some income. Calculating for the income received using class II banks fee schedule, the lower estimate, we arrive at the figure of US\$2.2 million income received to year 2001. Assuming that these banks would have renewed their licenses, the expected renewal income per year would have been approximately US\$1.54 million.

In 1997, the Citizenship (amendment) Act was passed establishing a category linked to the Offshore Banking Act and a program for Economic Citizenship (GIFSA 1998). After having been approved the applicant would pay a fee of US\$38,889 the applicant would become a citizen of

Grenada with all the privileges accorded. This citizenship program was promoted citing the countries where Grenadians did not need a visa for entry. A number of countries, including Canada, reacted to this and introduced a visa requirement for Grenadian citizens (Grenada Today may 2001).

In calculating the economic contribution of the Economic Citizenship program to the Grenada treasury, of the 3000 people who were approved for citizenship and paid their fee would have yielded an income to the government's treasury of about \$116, 6 million from the start of the program to its termination after 9/11. There were very few rejections of applicants to the Economic Citizenship program in the first years of its operation (Cheltenham Commission 2007). The low numbers of rejection is understandable since the motivation was the obtain fees.

A hidden part of the program seemed to have allowed the appointment to the position of Ambassador at Large for some applicants for a certain sum of money (Cheltenham Commission 2007). The result was the appointment of an international fraudster as ambassador-at-large and Honorary Consul of Grenada in the Bahamas and Egypt, Eric Resteiner, who subsequently was convicted for fraud and now sits in a US prison. The trade promotion and tourism duties that Resteiner should have performed were never realized and was not accounted for by the government.

The foregoing paragraphs outlined the establishment of Grenada's offshore financial centre. Because it is the booking type, this strategy does provide the magnitude of income needed to undertake the major development projects that could make a difference to the lives of the unemployed. According to William, Suss and Mendis (2003), the sector earned 4.5 % of the government's total revenue. When compared with Antigua which has had its OFC since the 1980s its income from the OFC is also an unimpressive 7% of all government revenues. The returns from OFC strategy is more impressive in the British Virgin Islands (BVI), with 55% of government revenues being accounted for by OFC. In the case of Grenada, the income generated is miniscule when compared with the task faced and taking into account the increasing demand by OECD countries for more regulation (OECD 1998). These regulations will carry a cost that would reduce the competitiveness of Caribbean OFCs. And as the ultimate decision making regarding regulation of the offshore centres is in the hands of the OECD countries and the IMF the future of the sector as a reliable pole of growth becomes uncertain.

The shakiness of the OFC strategy is further exposed in the light of the 9/11 attack, greater responsibilities have now been placed on states to ensure the centres are not used to finance terrorism. The abrupt ending of

the economics citizenship program in Grenada along with a tightening of regulations and de-registration of several banks attest to this. Furthermore, the fact that offshore financial centres (OFCs) are viewed as tax havens makes them irritating to OECD countries and sets them up as targets for reform. The implications are that they have to constantly adjust their regulations in line with the Financial Action Task force (FATF).⁶ This OFC monitoring body has effectively laid some burdens on states to adopt regulatory measures, the costs of which are to be borne by host states effectively reducing the expected gains from the strategy. These burdens are also placed on onshore banks as well since they are to act as regulators to catch tax evaders and regulate money laundering from the developed countries (Geiger and Wuensh 2007). Failure to comply can lead to sanctions of various types of sanctions of which the most prevalent is blacklisting that can have negative consequences⁷. I do not intend to suggest here that there are absolutely no regulatory mechanism in Grenada regarding offshore sector, there is in the form of the Eastern Caribbean Central Bank (ECCB).

The Financial regulatory system in Grenada

Grenada belongs to the organization of Eastern Caribbean States (OECS). This body governs the overall function of the financial system in all the member countries via the ECCB. The OECS forms the central secretariat comprising of the council of Ministers (has political and policy making in function) and the secretariat for the ECCM. The OECS structure thus comprises the following institutions:

Eastern Caribbean Telecommunications Authority (ECTEL) Eastern Caribbean Civil Aviation Authority (ECCAA), and Eastern Caribbean Supreme Court, Eastern Caribbean Central Bank (ECCB).

The central bank of the OECS, the ECCB that has oversight and management of the overall “The financial system in the Eastern Caribbean Currency Union (ECCU) comprises domestic banks, offshore banks, credit unions, insurance companies, national development foundations, development finance institutions, building and loan associations and finance companies” (www.oecs.org) as legitimized by treaty.

Over the period 2004 to 2006, the Banking Acts in the territories of the Participating Governments of the OECS were revised and upgraded in relation to the Basle core principles of banking. This harmonised banking legislation has strengthened the legal framework for the conduct of banking business and enhanced the regulatory environment. Nevertheless, despite the existence a regulatory mechanism and framework, the FIBG was able to perpetuate a massive swindle.

VI. THE BIG FIBG FRAUD

The case of the First National bank of Grenada (FIBG) is a good example of the challenges of the offshore financial centre as pole of growth and the dubiousness of its contribution to overall development. The bank turned out to be the biggest fraud of all times emanating from Grenadian soil. After having accepted deposits from clients from the world over the deposits evaporated. As mentioned earlier, the FIBG swindled over \$170 million dollars from investors, the bulk of the victims coming from the Canada and the United States. The perpetrators were able to appeal to unsuspecting depositors by offering very high interest rates of more than 250% per year at times (Second Report of the Liquidator 2001). The principals of the bank absconded with the savings of many retirees by siphoning off the deposits in a ponzi scheme. With the loot, they bought themselves expensive houses in Oregon and Uganda (to the value of \$4.5 million) (Third Report of the Liquidator 2001), a yacht worth almost one million dollars and maintained a luxury lifestyle for the time of their operation. Even if the perpetrators were eventually caught the damage caused to the depositors and the reputation of Grenada internationally will take a very long time repair and resuscitate the credibility the financial offshore sector.

The FIBG was incorporated on October 2, 1997 under the provisions of the International companies Act of 1990. It received its a Class I Offshore Bank license in October 9, 1997 a mere seven days after incorporation. According to the documents of the liquidator its operations began in January of 1998 but deposits only began to trickle in, in April (First Report of the Liquidator 2001). The founding directors of the bank were Van A. Brink (Formerly Gilbert Zeigler), Rita Regale, Cynthia Hastety and Robert Skirving.

Apart from incorporation and the payment of licensing fees there were other requirements to comply with under the Offshore Banking Act of 1996 in the course of its operations. The capital had to be fully paid up for the shares issued. The FIBG used a scheme in order to circumvent the law in order to comply with capital requirements. Having been required to have a paid up capital of EC\$6 million (approximately 2.25 million US\$) FIBG submitted \$100 000 in cash, a guarantee from Fidelity International Bank (FIB), registered in the Republic of Nauru on July 3, 1996, of US\$400 000 and a photocopy a document of assignment of asset of a 10000 carat ruby (not owned by FIBG) that was appraised at \$20 million (First Report of the Liquidator 2001). The document used as supporting evidence of the possession of the asset was later confirmed to be false after the liquidator checked with the FBI who had begun their own investigation into the bank.

It was revealed that the owner of the ruby had it in his possession for the last 20 years and had no knowledge of the FIBG principals. It was later discovered that there were several copies of this of assignment of asset document about the said ruby in circulation and being presented in the manner that the FIBG had done (First Report of the Liquidator 2001).

Using the same means, assignment of asset document, the operators of the bank found other efforts to shore up its financial image publicly. They co-operated with a number of Corresponding Banks, the chief of which was Fidelity Bank. These banks' primary role was to channel funds to the FIBG while the FIBG performed their administrative functions and preparation of their financial statements (Second Report of the Liquidator 2001).

The bank operators further continued with its scheme in many directions. They formed a number of subsidiary companies to help the bank in its operation. The first and most important of these was a company for insuring the bank. With a similarity in name to the US Federal Deposit Insurance Corporation (FDIC), the insurance company was called International Depositors Indemnity Corporation (IDIC) and was located on the island of Nevis in the Caribbean. The bank was insuring itself by its own self, i.e. the insurance company was owned and operated by FIBG and had no assets.

Apart from the unusually high interest rates used to entice customers the bank operated with a number of business organizations and banks with whom it was either related by ownership or worked with for its promotion. As it was prohibited for the bank to directly advertise in Canada, the US or the European Union without registering itself, the bank used these organizations to report to potential customers of the good deals they can receive at FIBG, mostly by word of mouth (First Report of the Liquidator 2001). The persons passing the information were independent contractors (IC) or sales persons connected with one or more of the organizations below.

The deposits were first channelled via an affiliated organization and /or related companies of the FIBG:

- Subscription to the "life Offshore" newsletter

- Offshore educational institute (OEI) seminars

- Registration of International Business Corporations (IBCs) through the Granite Registry services (GRS)

- Asset Research and Development Association /ARDA)

- GIFT (Given in Freedom Trust) program

All these organizations listed above were incorporated in Grenada in 1998 as IBCs at about the same time the bank began its operation.

According to the Liquidator “The bulk of the operating expenses and initial capital of these IBCs were funded or guaranteed by FIBG” (First Liquidators report 2001 §57). They together performed the task of wooing depositor to the FIBG.

Fraudulent Affiliates

The FIBG strengthened its operation and deposits collection through a number of affiliates or correspondent banks which they either helped wholly or partially to be established both by funding and letters of sponsorship. Nevertheless, despite the fact that the operators of FIBG attempted to give the impression that there was an independent relationship between them and these banks, in their functioning, they acted as subsidiaries of the FIBG either by contract or ownership (First Report of the liquidator 2001). These affiliate banks would solicit deposits from clients through the alleged sale of debentures and certificates of deposits. According to the liquidator these Correspondent Bank played a major role in obtaining deposits for the FIBG scam. Listed below are a few of the affiliates below to show the extent of the conspiracy in the scam:

- One of the first affiliates was the Fidelity International Bank (FIB) (Later was merged with the FIBG) that helped in the creation of the FIBG by a loan of US \$100 000 and assignment of assets to help in achieving its paid up capital requirement (Second Report of the Liquidator). The FIB had a relationship with the fraudster, Teddy Wayne Solomon who, in a case against him with the Security and Exchange Commission (SEC), had named Zeigler/Brink as having in his possession investor’s money that he refused to return (Ayers 2005).
- Affiliate Bank of Nations was created by Robert Skiving, former CEO of the FIBG, with the help of attorney Guy B. Rencher. This bank attracted US \$6 million before it was ordered to close by the Oregon authorities.
- Affiliate Cambridge International Bank and Trust, was run by Frank Rowe and a convicted penny stock fraudster Gerry Burns who raised \$30 million according to the SEC. Rowe was involved in a firm called Canadian Global International Corporation that could not account for \$5 million of investors money (Ayers 2005).
- Associate to FIBG was the World Investors Stock Exchange (WISE) run by Mark Kennedy sold unregistered securities. This organization was sanctioned by the Quebec Securities Commission.
- The mother company of FIBG, Fidelity International Bank had a connection with Fred Rausher and Niel Mc Allister who were involved

in fraudulent investment schemes in California and Arizona (Ayres 2005).

- Wellington Bank and Trust was a Grenada-licensed FIBG affiliate and collected \$10 million for investment in Wellington and FIBG on the promise of 100 % profits (Ayres 2005). This bank was run by two men from Ohio John E. Brinker Jr and Gary J. Bentz.

These organizations are just a small number of the dozens involved in the network established to conduct fraudulent activities or were related to companies that did, confirms the pervasiveness of offshore fraud and raises questions about the ability of the Grenadian authorities to regulate the sector.

The Liquidator's final judgement

In his three reports to the court, the liquidator was successively impressed that the bank was fraudulent and that there was criminal wrong doing by the board of directors from the act of registration to the bank's defaulting. The string of operations it began in wooing customers, taking their deposits and selling unregistered securities were all in contravention of many banking regulations in Grenada and overseas. Falsifications of documents, failure to do an audit are among the inconsistencies that lined the path of operations the FIBG (Second Report of the liquidator 2001). These made it difficult for the liquidator to ascertain and unravel the state of the assets and liabilities of the bank and the amount, manner and type of business that FIBG had completed. However, in examining an un-audited financial statement the core extent of the bank's fraud was exposed via 1) the bank Capitalizations, 2) Income/debenture trading, assets of the bank and 3) the disbursements of funds.

- Capitalization: While original capitalization of the bank required by law was EC\$6 million, the un-audited financial report created by a convicted unauthorized accountant showed that the bank was capitalized at over US \$32.7 million. The components of capitalization included cash to the tune of US\$500 000, a precious stone to the value of US \$15 million and shares from Aristocratic Endeavor Shares at US 17,25 million. Of these the only amount of the capitalization that could be verified was US\$100 000 of the cash component.
- Income/debenture Trading: The financial report showed that the banks activity in the market was US\$25,99 billion. The liquidator could not find any evidence of debenture trading from examining the bank's records, all of which were due to creative accounting.
- Disbursement of funds: The liquidator identified a total amount of potential deposits as \$125,3 million⁸ and itemized the uses the funds

were put to using the financial records. It was revealed that FIBG paid returns to customers of US\$26.5 million from their own deposits and not from returns on investment or through trading. The banks officers used US\$9.1 million to replenish debit card withdrawals for customers as well as bank officers. Including the debit card withdrawals and other expenditures such as commissions and operating expenses amounted to US\$18, 2 million; US\$8.5 million in cash support and advances to affiliates; US\$55.3 million were traced to other cash loans and investments. In the end the liquidator could not account for US\$16.8 million.

- At the end of the liquidator's reports, of the US\$125 million identified as potential assets, only between US\$1.8 million and US\$5.3 million, was deemed realizable. The rest vanished into thin air. This was made possible because the Registrar of the Offshore Services, Mr. Michael Creft, who earlier received reports of possible wrong doing by the Bank failed to take action (Deposition of Creft to US Court 1999). In addition, the Prime Minister Dr. Kieth Mitchell failed to act on a report of the Bank's auditor (Mr. Wilson) of his suspicion that the Registrar of the Offshore Services may have compromised himself in his dealings with the directors of FIBG and that the bank may be bogus (Wilson's letter to the Prime Minister 1999).

The collapse of the bank began when its inability to honour a Certificate of Deposit landed it in Grenada's courts in June 1999, by then it was too late to stop the unavoidable. It was placed in receivership in August 2000. There was a parallel investigation from the FBI and a court case involving the principals of the FIBG all of whom were sentenced to jail terms in Oregon, the place of origin of the scam.

The important thing arising out of the debacle of the FIBG is the revelation of the inability of the government to regulate the offshore financial sector given its complexity, the lack of personnel that are dedicated to the promotion of Grenada's interest and the lack of the necessary infrastructure to monitor the operations of IBCs and banks in the sector. The effects of the FIBG failure are demonstrated by the decline of the sector.

In 2001, before publicity of the scandal of the FIBG became widespread, the offshore sector had grown to 44 offshore banks, 3400 IBCs, 11 insurance companies and 11 trust companies (see table 5 for changes in the size of the offshore sector between 2001 and 2003, following the failure of the FIBG). The IBCs declined by approximately 12%, banks by 65,9% and insurance companies by 55%.

| Years | Number of IBCs | Offshore banks | Insurance companies | Trust companies |
|--------|----------------|----------------|---------------------|-----------------|
| 2003 | 3000 | 15 | 6 | 11 |
| 2001 | 3400 | 44 | 11 | 11 |
| Change | -400 | -29 | -5 | 0 |

Source: Compiled from IMF report 2003 and Williams and Mendis

This decline in the size of Grenada's OFC is clearly related to the performance of the FIBG and the embarrassment it cause in Grenada. It shook the confidence of investors in Grenada's ability to properly regulate the sector.

Operations of the FIBG and the regulatory system

The manner in which the FIBG functioned exposes a great deal regarding the regulatory instruments and the monitoring system employed by the authorities. As it has been seen it is not enough to provide domicile for business but that there must also be a willingness to exercise regulatory control and oversight. It is quite clear that the authorities failed to monitor effectively the operations of the FIBG. This is confirmed by the fact that Michael Creft, Registrar of the Grenada Offshore Financial Services (Letter from Creft 1999), in letter, gave the bank a clean bill of health in February 1999 when the Bank was at the peak of its swindling operations. Many have laid blame at the doorstep of Creft, questioned his competence and even his honesty (see Wilson Letter from calling Creft corrupt). In this letter Wilson recommended names that could be in a committee to strengthen the functioning of the Offshore Financial Services. The fact that the Prime Minister took no action to redress the situation prior to the Banks's default raises questions of impropriety among the electorate, one of which is the Prime Minister's involvement in the whole affair.

VII. UPDATING REGULATION IN THE AFTERMATH OF THE FIBG FRAUD

The scam of the FIBG took place mainly because of regulatory weaknesses in the system – some were structural others were related to incompetence. In addition, the scheme could not have taken place in the magnitude it did without the use Corresponding Banks, related/affiliated organization working in tandem and parallel with each other. It also revealed problems related to responsibilities of the board of directors. The revised Banking act of 2005, attempts to address these problems.

Through the act a number of measures have been taken to upgrade the oversight within the offshore financial centre sector. In addition, the ECCB, the ultimate regulatory body, has issued a number of guidelines for the region known as the Organization of Eastern Caribbean States (OECS). They are as follows: 1) The Banking Prudential Guidelines No. 1 of 2006 –

this covers reporting requirements issues of risk related to liquidity, volatile liabilities, handling of assets and regulatory reporting requirements. The intention is to provide “minimum standards that should be implemented for the identification, management, monitoring and management of liquidity assets” (Venner 2006a). 2) The Banking Prudential Guidelines No. 2 of 2006 – this has the aim to establish proper governance of the institution, as would be reflected in its structure to enable safe and sound functioning of a financial institution.3) The Banking Prudential Guidelines No. 3 of 2006 is concerned with limiting the possibility of defrauding depositor via an affiliate or cross director and the third set of guidelines (Venner 2006c)⁹.

It is expected that this would increase oversight but while oversight is increased a greater expenditure is expected in order to monitor the sector. How competitive will the sector be against others that have been operating for years and have the advantage of experience as well as greater skill is left to be seen.

VIII. CONCLUSION

In examining the usefulness of the OFC strategy for promoting economic growth and development the evidence provided in this paper indicate that:

- The case of the FIBG exemplifies the dangers of small countries embarking on the establishment of an offshore centre without having in place the expertise and monitoring infra-structure to properly regulate the sector. Apart from increasing the vulnerability of Grenada the ill-planned establishment of the OFC may have created more problems than gains received. Rather than attracting business, the fraud of the FIBG has tarnished the credibility of the jurisdiction for a very long time as a place where crooks operate. And, as Grenada was blacklisted following the failure of the FIBG this may have reduced the flow of FDI.
- The failure of the FIBG signalled that more regulation and better oversight of the sector is needed. This is evidenced by the fact that after the FIBG debacle, more than 50% of the offshore banks were asked to cease operations. In order, to rebuild and maintain the integrity of the sector, it would require greater financial inputs, the costliness of which would reduce the competitiveness of the sector.
- While its is true that the OFC is not the only legitimate sector that attracts fraudsters, it nevertheless would be foolhardy to risk the country’s reputation for such a small gain as 4,7 % increase in its total revenue when there are less risk free alternatives such or the resuscitating an agricultural production on a modernised and

restructured basis that is linked to the service sector, tourism. In this case, the emphasis would be removed from OFC as a strategy and placed on the productive sector in agriculture and tourism while maintaining the rational kernel of parts of the OFC. It would have the effect of reducing the import food bill, which is the largest collective item of import, and at the same time increasing job opportunities.

- OFCs and banking regulations adopted via the ECCB will no doubt affect the competitiveness of the financial sector. The result will be the reduction of income and because of fewer clients and increasing cost of regulation.
- The funding type OFC offers greater benefits than the booking type OFC. It provides an opportunity for raising capital to be directed towards domestic development projects in agriculture, tourism and light manufacturing that cannot be achieved with the booking type OFC. As it stands the booking type OFC is delinked from the domestic economy in terms of the provision of capital inwards for development is virtually non-existent because of its speculative nature. The revenue provided by the sector is too small for the effort required for its regulation. It is therefore not a good main strategy for promoting growth and development and in addition, the strategy has been proven unreliable as main strategy because of the external factors e.g. 9/11 and the problems that come with the criminal activities that it is prone to attract.
- Finally the effort required in terms of costs of operating and monitoring OFCs especially where the final decision regarding regulation does not rest with Grenada places the sector at the at the whims and fancies of another jurisdiction. The fact that these countries could be sanctioned increases the vulnerability not only of the sector but the country as a whole.

From the foregoing, we learn that the contribution of the booking type offshore financial centre to economic development is at best dubious and according to the unfolding events can be injurious. It is obvious there are income opportunities to people with special skills, lawyers, clerks and accountants. Finally it is a source of revenue via fees collected by the government for continuous registration of IBC and offshore banks and can help shore up the government's budget. Nevertheless, the strategy has little absorptive capacity for the persistently unemployed who come mainly from the agricultural sector or are unskilled. In addition, there is not an organic link with the economy as investment funds are not connected any way to major projects that are needed for development and that at the same time generate massive employment opportunities. The nature of the booking

type OFC is financial speculation that involves the buying and selling of securities and currency, in short a paper trading sector.

The case of the FIBG is one result of the governments deregulation and its attempt at connecting via the OFC node of financial globalization based on the neo-liberal economic ideology of the paramountcy of the market, in this case the financial market. The policy or strategy has proved to be nothing more than an illusion, for the damages sustained can be said to far outweigh the little gains that this strategy has earned.

NOTES

- ¹Dr. Mitchell ceased to be Prime Minister when his party (The New National Party) was voted out of office on July 8, 2008. The bank scandal along with circulating rumours of his receiving a bribe from fraudster Eric Resteiner are attributed by many to have been the cause of the electorate voting the NNP out of office. The present government is formed by the National Democratic Congress led by Tillman Thomas.
- ² These formed a package of legislations referred to as the Offshore Services Regulations. Most of which were passed in Parliament in 1996. Complementing the regulations was the Economic Citizenship Program offering a second citizenship to qualified investors. In 1998 the International Betting Act # 24 was passed adding to the activities allowed within the offshore centre. The special oversight body was the Offshore Financial Services Division. The New body, Grenada Authority for the Regulation of financial Institutions began operations in February 2007 after the first Bank failure and the effects of the 9/11 attack.
- ³ 'Offshoring' is a term that covers all types of overseas or non domestic operations that may involve outsourcing of production and non domestic financial transactions/operations of a concern that seek to take advantage of lower taxes, secrecy provisions and reduced regulations.
- ⁴ Ayres explains this attitude in the following way "Perhaps island policy makers were lulled by the utopian nature of the prevailing ideology of economic libertarianism whose rose-coloured view sees only the possibilities of business freedom and is blind to the predatory competition and fraud which are also its consequences. Or perhaps they too were caught in a cycle of perceiving a need to adopt these policies to survive by competing with their neighbours" (Ayres 2005:2) at [Http://home.att.net/~fcwriter/carib.htm](http://home.att.net/~fcwriter/carib.htm). Accessed 2008-11-1.
- ⁵ Although in recent time the traditional operation of the Washington Consensus has been de-emphasized it remained a corner stone of the Mitchell's regime.
- ⁶ FATF is an inter-governmental organization of most OECD and many others responsible for monitoring OFCs.
- ⁷ Grenada landed on the black list following the FIBG fiasco.
- ⁸ The FBI's own report showed that an amount of approximately US\$170 million were defrauded. The discrepancy between the two estimates has to do with the incomplete records the Liquidator had access to at the time. His reports were revised with the coming to light of new information.

⁹ Full details can be obtained from the home page of the Eastern Caribbean Central Bank at <http://www.eccb-centralbank.org/>.

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