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CARIBBEAN REGIONAL COMPLIANCE ASSOCIATION

Navigating Conflict of Laws Issues

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Conflict of Laws

- *Conflict of laws* – rules which deal with cases having a foreign element. The rules implement the reasonable and legitimate expectation of the parties to the transaction or occurrence
- The rules determine (i) the legal system (jurisdiction) and (ii) the law (choice of law) applying to a legal problem
- A court will apply its local law (*lex fori)* to questions about its court procedures
- However, substantive question of law are resolved by the system of law with the greatest connection to the legal issue

Some easy examples

- Land disputes are resolved by applying the law of the country where the land is located and invariably will be resolved in that country's courts
- Corporate capacity to enter into a transaction is resolved by the law of the country where the company is incorporated
- A person's domicile is acquired at birth according to generally accepted rules (depends on parent's marital status at birth etc.)

Not so easy examples

- Which tax system applies to multi-jurisdictional transactions?
- Multi jurisdictional contractual obligations with no ‘proper law’ (choice of law) clause
- Inheritance and succession questions with assets in different countries
- Attitude of some countries to their jurisdiction (‘long arm’ jurisdiction)

‘Dual criminality’

- Arises in the context of extradition, arrest warrants mutual legal assistance and <u>money laundering issues and reporting obligations</u>
- ‘Dual criminality' test requires conduct to constitute a crime under the law of the home country **<u>and</u>** the foreign country at the time it is committed
- ‘Single criminality’ test involves conduct committed anywhere but only regarded as criminal conduct by reference to the law of the home country

Money laundering issues

- Proceeds of Crime legislation – originally single criminality test in many places (e.g. English POCA 2002)
- The ‘Spanish Matador’ problem (or ‘legal marijuana’ if you prefer)
- Led to amendments – English SOCPA 2005 section 102
- Concept of offences punishable by imprisonment in excess of 12 months and other exceptions

Dual criminality

- In the UK, for example, understanding the difference between summary offences v indictable offences is important
- Need to understand the difference between the two types of offence <u>and</u> to understand how foreign law views the offence
- Need to train staff to be alert to these issues and to know when to report

What test/law applies in your jurisdiction?

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- Check your local Proceeds of Crime/AML legislation (dual criminality applies in the UK, Singapore, Hong Kong etc)
- Cayman Islands – Proceeds of Crime Law 2008 – 'dual criminality' requirement
- BVI – The Proceeds of Criminal Conduct Act - conduct: (i) amounting to any indictable offences in the British Virgin Islands except drug trafficking offences; or (ii) which would amount to such an offence if it had occurred in the British Virgin Islands.
- **<u>But</u>** the 'big issue' is tax

Tax as a predicate crime

- The starting point: Historically civil courts will not enforce civil actions to collect foreign taxes – *Govt of India v Taylor* [1955] AC 491
- But tax evasion is a criminal offence and involves dishonesty so raises AML issues
- Not all tax systems are alike
- Even if tax systems are different there are often common offences of 'cheating the revenue', 'false accounting', 'deception' etc

The approach in ‘nil tax’ jurisdictions

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- One view : if no direct taxation in Jurisdiction A then tax evasion in Jurisdiction B cannot be recognized (or committed) in Jurisdiction A
- The alternative view: Jurisdiction A may have different forms of tax (stamp duty, import duties, payroll taxes, accommodation taxes) but still imposes taxes so tax evasion is regarded as criminal conduct in Jurisdiction A as well as Jurisdiction B

Where are we heading? (a personal view)

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- Starting point: tax evasion is a crime. If you are present in a country you must obey its tax laws
- Tax evasion likely to become a predicate offence in offshore jurisdictions due to FATF/EU/UK pressures
- Automatic reporting should (in theory) lessen the risk for service providers if information is already in the hands of a foreign tax authority

Compliance red flags in multi jurisdiction outsourcing contracts

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- Need to establish and maintain a supervisory system and written procedures which meet minimum requirements
- Designated person must review the outsourced activities for compliance with applicable regulations
- Must monitor the service providers’ compliance with the outsourcing agreement
- Periodic assessment of continued fitness and ability to perform the activities

Why outsource?

- Understand the reasons behind the decision to outsource
- What selection process applies?
- Does your regulator approve of or permit the outsourcing?
- Who provides the service (is it an affiliate?)
- Where is the information stored?
- What laws apply to the servicer provider?

Red flags

- A lack of written supervisory procedures for determining adequate outsourcing providers
- Outsourcing agreements that lack details
- A lack of internal compliance testing of each outsourced service
- Must be a proper charge for the service

(e.g. SEC v. Penn, 14-05811, U.S. District Court, Southern District of New York (Manhattan). – fraudulent charges for bogus $9M due diligence scheme)

Outsourcing contracts

Needs a formal contract which addresses the following:

responsibilities, controls, confidentiality, responsibilities relating to IT security, business continuity plan, quality control measures, provision for audit, compliance with regulations and access to information, provision for dispute resolution, ongoing monitoring, liability for delay or erroneous matters, insurance coverage, limitations on subcontracting, description of fees, and complete access to books and records for the outsourced activity

Reliance on multi jurisdiction 3rd party due diligence

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- Reliance on introducers and intermediaries – do your regulations permit this?
- Eligible introducers – do you understand their procedures and requirements?
- Minimum requirements – FATF recommendation 10 suggests 25% but most jurisdictions have a lower threshold (e.g 10%)
- Requirements to keep and preserve records (do limitation periods differ)
- Do you have access to the KYC information?

Consolidated supervision rules

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- “Parent bank and parent *supervisory* authorities monitor the risk exposure of the banks or banking groups for which they are responsible, as well as the adequacy of their capital, on the basis of the totality of their business wherever conducted.”
- Basel Committee on Banking Supervision Guidelines

Consolidated supervision rules

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- Regulators want to see transparency of legal and managerial structures
- Avoid regulatory arbitrage
- Avoid double gearing of capital

Consolidated supervision rules

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- Need to ensure branches and subsidiaries observe head office standards and regulations from that jurisdiction
- Need to keep branches and subsidiaries informed as to current group policy
- Ensure branches meet local standards

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