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To: Jeffrey E. Epstein
From: Erika Kellerhals
Re: The International Banking Center Regulatory Act
Date: October 23, 2012

By his signature dated September 11, 2012, the Honorable Governor John P. deJongh, Jr. signed Bill No. 29-0308, The International Banking Center Regulatory Act (hereinafter the "Act") into law. The Act repeals Title 9, chapter 21 of the Virgin Islands Code ("VIC") and replaces Exempt International Banking Facilities ("EIBF") with International Banking Entities ("IBE"), which will be administered by the Director of Banking and Insurance of the Office of the Lieutenant Governor ("Director").

We have provided a short summary of the Act below and laid out the specific requirements for an entity to qualify as an IBE. On behalf of our clients, we met with current Director, John McDonald, to discuss the mechanics of the application process and the expected regulatory framework that will govern the IBE program. Although he indicated that he would accept applications for IBEs now, he also indicated that he was not likely to have an application packet in the near term, and further that he did not have the manpower necessary to draft the required regulations. However, he advised that if we submit an application that contains all the information required by the Act, he would proceed with processing the application. We anticipate having a leadership role in the formation of the application and the drafting of the regulations so we will continually update you on any progress on that front.

I. Organization of an IBE

Pursuant to the Act, an IBE may be a person, other than an individual, incorporated or otherwise organized under the laws of the United States Virgin Islands ("USVI"), the United States or a foreign country, or constituted as a unit of another person, other than an individual, incorporated or otherwise organized under the laws of the USVI, the United States or a foreign country. An IBE is deemed to be an IBE by virtue of a license issued by the Director.¹

In the case of a corporation, the operative documents must provide for the amount of authorized capital stock, which must not be less than \$5,000,000 and of which at least \$500,000 must be fully paid at the time the license is issued.² In the case of a person other than a corporation, the amount of proposed capital must not be less than \$5,000,000 and at least \$500,000 must be paid at the time the license is issued.³ The Director will have discretion in certain circumstances to waive these capitalization requirements.⁴

¹ See Title 9, Section 721 of the Act.

² *Id.* at Section 719(b)(3)(A).

³ *Id.* at Section 719(b)(3)(B).

⁴ *Id.* at Section 719(b)(3)(A) & (B).

In addition, each IBE must possess not less than \$300,000 of unencumbered assets or acceptable financial securities or a lesser sum authorized by the Director. The unencumbered assets must be physically located in the USVI.

The articles of incorporation, the partnership agreement or any other written document establishing an IBE must specify the name by which it is to be known, the address of the principal place of business in the USVI, the term of existence, the purpose for which it is organized and any other provision established by the regulations of the Director.⁵

II. Applying for a License as an IBE

An IBE must apply in writing to the Director and submit a nonrefundable application fee of \$10,000.00. The application must include the following information in the form specified by the (to be drafted) regulations of the Director:

- Proposed articles of incorporation, partnership agreement or other written document establishing the IBE;
- Identity and business history of applicants;
- Location of principal place of business within the USVI;
- Identity, business history and credit history of any persons who will directly or indirectly control ten percent (10%) or more of the company;
- Statement of assets and liabilities of any applicant or any person who controls ten percent (10%) or more of the company for each of the three (3) years preceding the application; and
- The identity and background of all proposed directors and officers or persons who intend to act in a similar capacity.

The Director shall undertake a background investigation of the principals, directors and officers of the company that will include an examination of each person's financial solvency, credit, banking experience and business integrity. The Director shall investigate the adequacy of the capital available for the operation of the proposed IBE and of all organizational documents submitted as part of the application. The applicant shall pay all costs incurred in preparing such background investigation up to \$25,000.

In its application for certification, an IBE must, at a minimum, commit to the following:

- Invest at least \$50,000, exclusive of inventory, into the business related to banking;
- Employ a minimum of three (3) full time employees⁶; however, an IBE must hire one (1) additional employee for every \$1,000,000 of net income prior to salaries;
- Commit to ensuring that eighty percent (80%) of the company's employees are residents of the USVI;
- Notify the Department of Labor as to availability of employment;

⁵ *Id.* at Section 719.

⁶ Title 9, section 740 requires that after the third year of operation, an IBE have at least 60% of its management, supervisory or technical positions filled by residents of the USVI as defined in Title 29, section 703, unless granted a waiver by the Director. A waiver can only be granted where (1) the Commissioner of Labor has certified that the IBE company has not been able to recruit or train individuals to fill the positions or the IBE company has demonstrated to the Commissioner of Labor that the IBE training program has failed to provide the individuals capable of filling the positions and the IBE company has made a public effort to recruit personnel for the positions; or (2) the Director made a finding that the economic position of the IBE company is such that it cannot comply without further erosion of its financial position or for such other practical reasons.

- Provide educational assistance to USVI residents or provide a financial contribution to an educational fund established by the Director or the USVI Legislature;
- Provide a management training plan;
- Procure insurance locally; and
- Procure goods and services locally to the extent possible.

III. Approval of IBE

There are two mechanisms for approval of an IBE: (1) approval by the Director after the conclusion of the investigation and review of the application; or (2) failure of the Director to act on an application within sixty (60) days after the conclusion of the investigation, subject only to the final approval of the Lieutenant Governor, which must be granted within ten (10) days.⁷ Unlike the EDC program, approval of the Governor is not required.

IV. Allowable Activities of an IBE

Once a license has been granted, an IBE may:

- accept transaction related funds from foreign persons in accounts as well as demand or fixed deposits and interbank deposit funds;
- accept or provide wholesale or retail repurchase agreements;
- make, arrange, guarantee, secure, bond or service loans or other financial undertakings provided that none of the loans or financial undertakings may be granted to a domestic person and in the case of financial securities for debt, issue transactions in the USVI;
- issue, confirm, give notice, negotiate or refinance letters of credit if the client and the IBE requesting the letter of credit is not a domestic person;
- issue, confirm, give notice, negotiate, or refinance letters of credit in transactions for financing of exports, even if the IBE is a domestic person;
- engage in money services, money transmission, payment services, bill-payment services, payment systems, check cashing, sale of instruments or other payment devices, currency exchange, or other financial and business management services, including providing, discounting, rediscounting, dealing or otherwise trading money orders, stored value, bills of exchange, drafts, or other instruments or payment devices, provided that the purchaser, payee, or IBE is not a domestic person;
- invest securities of the Government of the USVI, its public agencies and instrumentalities or in other local securities, if there exist any, exempted from the payment of taxes in the USVI;
- make commercial loans in excess of \$1,000,000 to USVI borrowers that (i) have been rejected or not approved within thirty (30) days from submission by any USVI financial institution; or (ii) bear interest at an interest rate of not less than five percentage points above the Federal Home Loan Mortgage Corp's posted yield on the last business day of the month on a thirty (30) year standard conventional fixed rate mortgage;
- make capital contributions in excess of \$1,000,000 to USVI business entities in the USVI;
- carry out banking transactions permitted by this chapter in the currency of any country, or in gold or silver, and participate in foreign currency trade;

⁷ See Title 9, Section 746 of the Act.

- underwrite, issue, distribute, and otherwise deal in securities, notes, debt, instruments, drafts, bills of exchange, issued by the international banking entity, or by a foreign person, for final purchase by a person outside of the USVI;
- engage in insurance brokerage for risks or objects outside of the USVI;
- underwrite insurance for risks or objects outside of the USVI;
- engage in trade financing of import, export, barter and exchange of raw materials and finished products activities with domestic persons, when the Director has determined, through regulations or order, that the international aspects of the underlying transaction override any involvement of local financial and business community, and that such activities would be appropriate for the IBE;
- engage in any activity of a financial nature for clients outside of the USVI which would be allowed to be done, directly and indirectly, by a bank holding company or by a foreign office or subsidiary of a US bank under applicable US law;
- after obtaining a special permit from the Director, act as fiduciary, executor, administrator, registrar of stocks and bonds, property custodian, assignee, trustee, agent or in any other fiduciary capacity; but, such fiduciary services may not be offered to, nor inure to the benefit of domestic persons;
- acquire and lease personal property to a foreign person, including any transactions, at the request of a lessee or seller/lessee who is a foreign person, pursuant to a financial lease agreement, rent-to-own, or sale/leaseback agreement, subject to any regulations adopted by the Director;
- buy and sell securities and non-life insurance annuities for clients outside the USVI, and provide investment advice in relation to such transactions or separate therefrom, to such persons, and in addition offer these services and products to the Government of the USVI and any of its instrumentalities, agencies and investment vehicles;
- act as a clearinghouse in relation to financial contracts or instruments of foreign persons, subject to regulations adopted by the Director;
- organize, manage and provide management services to international financial entities, such as investment companies and mutual funds, on the condition that the stock or participation in the capital of such companies is not distributed directly by the IBE to domestic persons;
- engage in activities authorized by the regulations or order of the Director;
- participate in granting and securing of loans that originate or are secured by the Economic Development Authority of the USVI or for the University of the Virgin Islands Research and Technology Park;
- establish, with the Director's authorization and subject to regulations, branches outside the USVI, the IBEs are authorized to establish a service unit or office in the USVI, in which only specific operations related to the services of the international banking entity are conducted, in the manner and form provided through regulations, but by no means may the service unit or office constitute a branch;
- with prior authorization from the Director, provide to other IBEs or to foreign persons or entities outside of the USVI, those services of financial nature, as these are defined and generally accepted in the banking industry of the United States and the USVI; and
- IBEs may conduct their permitted activities on the internet and if the IBEs use a computer server located in the USVI, the transaction is considered to occur in the USVI and venue for any disputes must be in the local and federal courts of the USVI.

V. Prohibited Activities

An IBE may not:

- accept funds or borrow money from domestic persons, except from the Government Development Bank of the USVI, the Economic Development Bank of the USVI, and from other IBEs;
- make loans or other financial undertakings, unless all loan proceeds are to be used outside of the USVI, subject to certain limited exceptions;
- issue, confirm, or give notice of letters of credit, unless all proceeds of credit are to be used outside the USVI, and that both the issuer and the IBE are foreign persons, with the exception of export financing transactions in which the IBE is a domestic person;
- discount bills of exchange, unless all proceeds of the bills would be used outside the USVI and that both the drawer and the IBE are foreign persons;
- purchase or hold any of its own capital stock, or the capital stock of or the interest in the capital of the person of which it is a unit, except when previously authorized in writing by the Director;
- grant any kind of financing or credit to any of its directors, officers, employees or stockholders, except when previously authorized by the Director; and
- directly or indirectly place, underwrite, insure or reinsure risks or objects that reside, or are located or will be executed in the USVI, or participate in reciprocity or retrocession arrangements or agreements covering or relating to such risks or objects, or assign insurance to, or assume reinsurance from any insurer authorized to do, or who is doing, insurance business in the USVI.

VI. Available Tax Benefits

Each IBE granted a license is exempt from the payment of the following taxes⁸ (presumably subject to the sourcing/effectively connected rules):

- **Income Tax Reduction:** The income tax reduction applies in a manner similar to the EDC program in that an IBE shall have its income tax liability from income derived from the business for which the license is granted and income from investment reduced on a current basis. Section 743(e)(2) allows for a reduction in income tax liability of seventy-five percent (75%) if its principal place of business is located in St. Thomas, St. John or within the town limits of Christiansted, and one hundred percent (100%) for businesses located within the town of Frederiksted. These reductions are subject to the provisions of section 934(b)(1) of the Internal Revenue Code of 1986, as amended (the "Code"), which only allow for the reduction of taxes on income which is sourced in the USVI or effectively connected to the USVI. By virtue of the language of section 743(h), this reduction in tax liability would flow through to partners, shareholders, members, partners, trusts, individuals or other direct or indirect owners of corporations or entities.
- **Withholding Tax Reduction:** Similar to the EDC program, Title 9, chapter 25 grants a withholding tax exemption of one hundred percent (100%) for persons who receive payments of dividends or interest subject to tax under section 871(a)(1) or 881 of the Code, or subject to tax on the dividend equivalent amount imposed by section 884 of the Code. The IBE itself has a one hundred percent (100%) exemption from the requirement to withhold pursuant to sections 1441 and 1442 of the Code.

⁸ *Id.* at section 742.

- **Property Tax Exemption**: IBEs receive an exemption from the USVI property tax on property that is used in the business of the IBE. This exemption does not apply to personal homes.
- **Gross Receipts Tax Exemption**: IBEs receive an exemption from the USVI gross receipts tax, which is generally imposed at a rate of five percent (5%) on all receipts derived from the IBEs business, with no deduction for expenses.
- **Excise Tax Exemption**: IBEs receive an exemption from excise taxes on building materials necessary for the construction, alteration, reconstruction or extension of the physical plan or facilities of the applicant.
- **Corporate Income Tax Exemption**: IBEs receive an exemption from corporate income taxes to the extent applicable.

An extension of an additional ten (10) years of tax benefits is available if an IBE is in compliance with its initial term. It should also be noted that IBEs may make capital contributions to USVI business entities and will be eligible to utilize the benefits on distributions from such entity.⁹

VII. Modification, Transfer and Revocation of an IBE License

The Director has the discretion to grant a modification of benefits upon application by the IBE. Any transfer of greater than ten percent (10%) of the interest in an IBE must be approved by the Director, in writing.¹⁰ An IBE license may be revoked, suspended or modified by the Director, after notice, public hearing and written findings that the IBE has failed to remain in compliance with its reporting obligations, has been dissolved, has had an officer, shareholder or director convicted of a felony or engaged in bribery.

⁹ *Id.* at Section 744(c).

¹⁰ *Id.* at Section 724.