



OFFSHORE BANKING: AN ANALYSIS OF MACRO-MICRO PRUDENTIAL ISSUES

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ABBREVIATIONS

ABBREVIATION	FULL FORM
OFC	OFFSHORE FINANCIAL CENTRE
IMF	INTERNATIONAL MONETARY FUND
BIBF	BANGKOK INTERNATIONAL BANKING FACILITY
SBIF	SUPERINTENDENCY IF BANKS AND OTHER FINANCIAL INSTITUTIONS
IOFC	INTERNATIONAL OFFSHORE FINANCIAL CENTER

Introduction

Due to a limited number of offshore financial centres and the volume of transactions, offshore banking is a pervasive activity. There are a number of reasons which determine the business an OFC would be getting such as favourable regulatory frameworks, easy fiscal regimes, the chances of indulging in illegal activities, for example, money laundering. Offshore banking appeals to those financial markets which are highly regulated and mature in emerging economies, specifically where there are high growth rates and an ever-increasing need for investment financing. Presently for emerging economies, OFCs are vital and growing intermediation channel, which is visible from the huge and increasing share of OFC liabilities and assets with regards to these countries.

The IMF's management and executive board acknowledge the fact that the fund can play a pivotal role in acknowledging some of the problems surrounding offshore banking via surveillance, dissipation of internationally accepted prudential and supervisory standard, consultation and conditionality.¹

Offshore banking has a wide impact on the financial system surveillance. The offshore banks are more vulnerable to solvency and foreign exchange risk than onshore banks due to the favourable regulatory frameworks in OFC. The regulatory framework for the onshore could be transmitted to the offshore banks in order to ensure the soundness of the same. Consequently, a detailed understanding of one's financial sector surveillance activities of the offshore banking system is required.

Emerging economies which are more vulnerable to a reversal in capital flows, spontaneous accumulation of short-term external debt, and has exposure to currency fluctuations and selective capital account liberalization becomes a qualitative issue for offshore banking in these areas.- major part in the Asian financial crisis can be attributed to offshore banking. Even in the recent Latin America crisis, offshore banking played an important role, though not of a catalyst. A combined and focused effort is necessary to assist the emerging economies, to avoid financial crisis by disseminating internationally accepted regulatory standards which shall be adequate and appropriate for offshore banking the standards will act supplementary to *Basel Committees Core Principle*² and shall include the *Basel's Committees Minimum Standard*³s along with their other related initiatives of the International Supervisory Community. However, there are a number of discrepancies in the present regulatory and accounting framework which not only complicates but also has a negative impact on the defective consolidated monitoring of offshore banking activities.

Third, the Fund's work on promoting good governance also takes a negative blood owing to these offshore banking. It is an obvious fact that offshore banking are not as transparent as normal cross-border transactions for the reasons such as of complex ownership structure and relationships among The jurisdictions that are involved in the transaction. These activities are usually suspicious and skeptical leaning towards illegal characteristics which end up weakening the case for good governance in the banking industry.

This paper intends to throw some light on offshore banking with regards to the aforementioned considerations. The focus of this paper shall be offshore banking as it constitutes the major portion of offshore activities, keeping in mind that nonbanks, corporations etc also play a vital role in offshore markets.

¹ Donato Masciandaro, *Offshore Financial Centres: Explaining the Regulation*, SSRN Electronic Journal (2006)

² International Monetary Fund, *St. Vincent and the Grenadines: Report on Observance of Standards and Codes -- Basel Core Principles for Effective Banking Supervision--Offshore Banking*, 04 IMF Staff Country Reports , 1 (2004)

³ International Monetary Fund, *Antigua and Barbuda: Report on Observance of Standards and Codes--Basel Core Principles for Effective Banking Supervision--Offshore Banking*, 04 IMF Staff Country Reports , 1 (2004)

An overview of Offshore Banking

A. What it is and Where it is done

“Offshore banking is the cross-border intermediation of funds and provisions of services by banks residing in OFCs to non-residents.”

Usually, it is the financing institutions with whom the offshore banks deals the most and the entire business transactions are denominated in currencies other than the currency of the hosting country of the OFC⁴.

OFC's are located in jurisdiction wherein they are exempted from various regulations which are mandatory for the onshore institutions to comply with. So to state an example of the same, the reserve requirements are not applicable on deposits, the transactions are either treated under favourable fiscal regime or are mostly exempted from tax, restrictions pertaining to exchange rate and interest are not applicable. Furthermore, compliance with liquidity and capital adequacy are also exempted for the offshore banks. Transparency or in other words the disclosure of information is low. OFCs are defined as “Financial system through external assets and liabilities out of proportion to the current account transaction of the domestic country is caught by the IMF at a macroeconomic level.”⁵

There are various reasons which can be taken into account to understand why a country decide to establish OFC, which includes getting access to international capital markets, and attraction of foreign technical expertise and skills, the element of introducing competition in the existing domestic financial system while assuring that a shelter is provided to the domestic institutions. Furthermore, there is always a hope to get an advantage from ancillary income generating activities and increase in employment opportunities.

OFCs are situated not only in countries but also majorly at the border of countries. An example of the same would be your international banking facilities, Japanese offshore market, the Bangkok international banking facilities in Thailand, and the lab and international offshore centre in Malaysia.

Additionally, OFC is also preferred and have been used for dubious purposes. The reason why people usually invest in OFC is because of the promised anonymity and also to gain a chance at tax avoidance.⁶ The high-level of bank secrecy or vital and significant reason which works in the favour of OFC, which is usually have used for activities such as of money laundering as well. OFCs how are categorised into three main groups depending upon the factors such as sources and uses of funds, market liquidity, transactions type and are then categorised into three groups which are primary, secondary or booking centres?⁷

Large international full-service centres accompanied by advance settlement and payment systems, which operates in liquid regional markets wherein the sources and uses of funds are readily available are referred to as primary OFCs.

⁴ R. Christensen, *International Scrutiny of Offshore Finance Centres*, 7 *Trusts & Trustees*, 27-30 (2001)

⁵ Lucy Chernykh & Sergey Mityakov, *Offshore Schemes and Tax Evasion: The Role of Banks*, SSRN Electronic Journal (2015)

⁶ Dominika Langenmayr & Franz Reiter, *Trading Offshore: Evidence on Banks' Tax Avoidance*, SSRN Electronic Journal (2017)

⁷ Hilton McCann, *Offshore finance* (Cambridge University Press) (2009)

London is considered to be the largest and most established OFC with regards to assets, which is followed by US international banking facilities and Japanese offshore market.⁸ It is pertinent to note that during the period of 1987–97 the transactions of cross-border as it has declined via primary OFC.

The difference between primary and secondary OFC is that The secondary OFC transactions funds in and out of there Is it in accordance with the deficit or surplus of funds in that particular region. Examples of such regional centres at Hong Kong and Singapore Asian currency unit for Southeast Asia, Bahrain and Lebanon for the Middle East, Panama for Latin America, and Luxembourg for Europe. A despairing behaviour is observed during the period of 19 87–97 in the shares of secondary OFC in total cross-border assets. The share of Asian OFC has however increased to a great extent in total cross-border aid, on the contrary, the shares of other secondary OFC such as of Bahrain and Panama either remained static or in some cases declined as well.

The Booking OFC is different from primary and secondary OFC as they do not involve themselves in regional intermediation of funds, rather they serve as registries for transactions which are arranged and managed in different jurisdictions. These OFC are also termed as tax havens and mostly include Caribbean OFCs. During the period of 1987 to 97, the Caribbean OFC total cross-border remains somewhat stable at around 8.6%.

B. How it is done

Offshore branches or subsidiaries along with other offshore establishments are responsible for carrying out offshore banking. These branches are legally speaking indistinguishable from there onshore parent banks. Due to this reason, it is easier to download and upload assets and liabilities to and from the parent branch in the name of inter-branch transfers.⁹ In A particular case of offshore branches, there shall be branches or booking offices. In a standard case, such branches have low overheads and very few employees and they do not actively involve themselves in offshore banking activities, as they prefer serving as registries for the transaction which are arranged and managed from various other jurisdictions. OFCs also have autonomous legal offshore subsidiaries which operate as a separate legal entity is incorporated under the OFCs. The subsidiaries may be partially or wholly owned by their onshore parent banks. Another way of conducting offshore activities is to do so via parallel owned banks, these are such banks which established in different jurisdiction by the same owner or owners and are not subsidiaries of one another. Generally there are three types of transaction¹⁰ in which offshore banks are involved. These are

1. Euro currency Loans and deposits
2. Underwriting of euro bonds
3. Over the counter trading in derivatives for risk management and speculative purposes.

The bulk of optional banking operations are the euro currency transactions. Transactions include the transactions between banks and original depositors, banks and ultimate borrowers, and between bank themselves on the interbank

⁸ London Array, *London Array: the world's largest operational offshore wind farm*, Engineering & Technology Reference (2015)

⁹ Conrad Oberg, *A balancing act: offshore financial centre strategy and the global anti-money laundering movement*, 7 Journal of Money Laundering Control , 153-157 (2004)

¹⁰ Evert Lataire et al., *The Influence of the Ship's Speed and Distance to an Arbitrarily Shaped Bank on Bank Effects*, 140 Journal of Offshore Mechanics and Arctic Engineering , 021304 (2018)

market. The last kind of transaction which is the interbank market is the major portion of euro currency transaction making the euro currency market interbank market. The Internet nature of the offshore market indicates that, if there is financial distress, contingent is most likely. The significant portion of offshore banking is the underwriting of euro bonds which are then floated in the international capital market. Over the period 1992-97, there was a growth of an average annual rate at 20.2% of the outstanding international money market instruments such as bonds and notes.¹¹

There has been an immense growth in the use of OFC dedicated, however, this growth was focused in major financial centers instead of OFCs. The reason for the same could be attributed to the developed financial centre's infrastructure as derivate entails substantive counterpart, settlement, liquidity and legal risk, are the use of such instrument is most likely. Among OFCs, in the IBFs and the JOM and to some extent in secondary OFC is the use of OTC trading in derivatives has grown. However, stratify data to verify the same is not readily available. Period of 1987-96, it is assumed that the growth rate of 31.8% and 54.3% in the notional values of interbank currency and interest rates respectively.¹²

Micro and Macro-Prudential Issues

The offshore banks enjoy favourable regulatory treatment which enhances their operational leeway for balancing management when compared to onshore banks. It is these exemptions from reserve requirements of deposit, liquidity requirements, restrictions on concentration of liability and thresholds of capital adequacy and strict foreign exchange position limits which gives the freedom to offshore banks to manage their balance sheets accordingly. It is up to the OFC to decide whether to exploit these regulatory benefits that are available by OFC or to let go of the same, forego the benefits of the prudential fortitude accompanied with internationally accepted best practices relying on the management of each bank. There may be circumstances wherein the internal management of the bank prohibits the abuse of prudential arbitrage, making the offshore bank dependent upon the tax benefits to increase their profitability.

It is because of OFC tax treatment that offshore banks are likely to be more profitable when compared with their onshore banks. When you compare the sample of OFC bank with an onshore bank sample, one would find out that the ratio of net income to shareholders equally, the OFC are highly profitable and the circumstances of them getting unprofitable are way less than the onshore banks.¹³ Offshore banks have been taking advantage of the tax and regulatory schemes, however, with the growing adoption of standard accepted prudential practices internationally, the standardization of these practices have decreased the advantages of low implicit taxation. Currently, the only left advantage of a functional offshore is the favorable explicit taxation. Additionally as stated chances of abusing OFC purposes is also one of the reasons which still remains a reason for people to explore the options via an OFC.

¹¹ Donato Masciandaro, *Offshore Financial Centres: Explaining the Regulation*, SSRN Electronic Journal (2006)

¹² Wen-wen ZENG, *An Empirical Study on the Linkage Between Offshore and Onshore Interbank Offered Rate*, DEStech Transactions on Environment, Energy and Earth Sciences (2018)

¹³ Hong, J. (2014). A Study on the Extend of Perception to Abuse of Judgement on Resident and Offshore Tax Evasion through Tax Havens. *The Journal of International Trade & Commerce*, 10(4), pp.811-829..

Given regard to the fact that onshore banks operate mostly in the inter-bank market, onshore going illiquid is more likely than the offshore banks. When one compares the samples of the offshore and onshore bank, in the ratio of liquid assets to total deposit and borrowed funds, the onshore banks are most likely to be illiquid and the offshore banks are found to be highly liquid.

The offshore banks owing to the operational leeway are highly unlikely to be solvent when compare to onshore banks, offshore banks can be categorized into two groups on the basis of a ratio of shareholders equity to the total assets for the same sample of offshore and onshore banks. The ratio when is between 0% to 7% then this group is referred to as the first group which includes the offshore banks and are considered to be highly leveraged therefore less solvent than offshore banks. In the second group comes the offshore bank's percent of 14% to 25% and this group is considered to be less leverage and more solvent than onshore banks.¹⁴ In the sample, about 43% of offshore banks fell in the first group while 11% of the offshore banks of the sample fell into the second group which clearly indicates that offshore banks are unlikely to be sold but when to compare to ensure bags. Now this result could be attributed to either poor management and internal control or intentional abuse of lenient regulation, and is still open for discussion.

While accounting for the rest composition of portfolios, offshore banks are more leveraged when to compare to onshore banks. It is the same regulatory advantages that allow offshore banks to be more profitable which also gives them the leverage against onshore banks while accounting for risk. Offshore banks have greater flexibility in managing their balance sheets which allows them to allocate a higher proportion of assets to higher risk and higher return activities. In other words, the ratio of capital to risk-weighted assets of offshore banks decreases vis-a-vis that of onshore banks.

In offshore banking, higher probability along with leverage, regardless of risk-weighted or not, indicates that familiar risk-return tradeoff is a common scenario in finance. Offshore operations are used by onshore parent banks to enhance their returns on equity along with enhanced risk owing to the fact that the offshore banks are liable for their branches and even for their subsidiaries to some extent. Therefore, the risk is shared between the offshore and onshore banks accordingly with regards to the activities of offshore banking.

Giving regard to the macroeconomic perspective the flow of funds between parent onshore banks and their offshore establishment is only possible if the restrictions regard to the transmission of risk on capital account is not applicable. Capital account restrictions such as that of uploading and downloading of funds arising from transmission of risk is not possible when the offshore establishment resides in another country or a resident of a particular country X.¹⁵ In one case as the onshore establishment considered as non-resident of country X capital account refrains from a flow of funds between the offshore establishment and parent banks residing in the country X it is only the dividends that can be transferred from offshore establishments to parents bank. In the next case, it is an extreme restriction on

¹⁴ Langenmayr, D. and Reiter, F. (2017). Trading Offshore: Evidence on Banks' Tax Avoidance. *SSRN Electronic Journal*.

¹⁵ Edward J. Stone, *OCC reveals thinking on key issues*, 12 *Banks in Insurance Report*, 1-4 (1996)

transactions between the resident parent banks and after establishment instead of the flow of funds in countries ex balance of payments that would have been measured in the country's capital account restrictions.

The majority of mismatch is accentuated whenever there is the downloading of funds from offshore establishment to parent times with regards to the liquidity, credit, solvency, foreign exchange risks, then the expansion of payments bank balance sheet can attribute it to shifting of foreign currency dominated funds in large or short-term which are captured in the interbank euro currency markets. It is only after a certain delay that an onshore parent bank would be able to build up their capital base in order to deal with the expansion of assets which interns make them more vulnerable in the interim. It is an obvious fact that such kind of funding enhances the risks associated with normal banking.

Another reason for the increase of risk with regard to the transmission is that in entire funds and perhaps the entire franchisee is uploaded from parent bank to offshore establishment. In many cases to escape the repercussions that might arise there is a, problematic asset download or upload to an offshore establishment, or to get away from the onshore supervisory authorities. There are also cases wherein the offshore establishment ends up becoming substantially way larger with regard to the asset and liabilities than the parent bank onshores entire franchisee was uploaded to the offshore establishment, it is a classic case of the tail wagging the dog.¹⁶ It is pertinent to note that upload banking activities come along with its own risks as these uploading activities by onshore activities which are usually the transactions between the onshore clients and the parent bank. There can be various means to upload these funds some of them are deposit, shares in mutual funds, and other investment vehicles. As it has been already stated in previous segments that offshore banks can exploit potential arbitrage, the funds that have been uploaded from the onshore bank can now be used to finance onshore activities only such as of real estate and construction, which in other words would deviate the risk of onshore activities to the offshore establishment. However, when offshore banks are used as an intermediate to finance the onshore activities from the onshore funds itself then in case of troubles the parent bank can be in major trouble as the offshore banking unit can become insolvent and can carry along the onshore banking parent with itself.¹⁷

It is important to understand that the transactions that takes place between offshore banks and onshore banks with regard to the transmission of risk are concurrent to the ordinary course border banking wherein the banks are not related. Firstly, the bond shared between the unrelated units of the bank is more transparent, excluding the exploitation of prudential arbitrates as an option. Secondly, in an unrelated offshore and onshore banking relationship, the onshore bank is approved by the offshore banks only on some substantial commercial grounds, and the transaction is done on commercial market base interest rates, quantities and majorities.

¹⁶ Luca Errico & Alberto Musalem Borrero, *Offshore Banking: An Analysis of Micro- and Macro-Prudential Issues*, 99 IMF Working Papers, 1 (1999)

¹⁷ Daniel Haberly & Dariusz Wojcik, *The End of the Great Inversion: Offshore National Champion Banks and the Global Financial Crisis*, SSRN Electronic Journal (2018)

The Role Of Offshore Banking In Recent Crises

A. Asia

One usual characteristic that was noted in the crisis in Asia was that large capital inflows were driven by financial liberalisation along with exchange rate which was channeled through the offshore banking system and fuelled by credit expansion which in turn led to increased exposure to foreign exchange, liquidity, and credit risk.¹⁸ As mentioned to you that OFC offers regulatory and tax advantages which attract onshore banks and industries to enter into the international capital market via offshore establishment. In 1993 unhedged domestic lending to finance equity and real estate purchases increased substantially due to offshore borrowing short term borrowing via establishment of the Bangkok International Banking Facilities¹⁹. A massive regulatory and accounting frameworks were put to change owing to the financial crisis which was because of a substantial loss in one of the offshore operation which went unnoticed in Malaysia. Short-term International borrowing with the help of financial system for on-lending to industries was encouraged and the regulations restricting the commercial banks from medium and long-term borrowing in international market accompanied with a perceived official support to bank took place in Korea. There are many countries which refrain from establishing a formal optional banking facility as they already had a liberal capital account in place. In such economies of offshore banking did not play a vital role in the financial system of the country, one such example of the same would be Indonesia.

Thailand

In the late 1980s parlance capital account was dominated by long-term flows, however, this change in the early 1990s When short term inflows became more prominent and called for 60% of the total BIBF exchanged an average of about 38% annually during the period of 1993–1996, and towards the end of 1996 the figure stood at approximately around US\$32 billion.²⁰

Considering the fact that the BIBF had permission to make foreign currency loans domestically, where out-in credit ratio to total sector credit increased to about 9.8% towards the end of 1994 211.6% and 70% by the end of 1995 and 1996 respectively. Manufacturing, financial institution and real estate constituted of a major portion for the lending from BIBF. The banking systems vulnerability was at all-time high towards the foreign exchange risk as most of these lending is were unhedged.²¹

The main source of funds for Thai BIBF was in-office borrowing as they borrowed mainly from their foreign branches, who continuously rolled over from being classified as shorter borrowings to long-term finance to in turn lend to their parent BIBF. This practice misled the supervisor thought the 80s into believing that Thai BIBF was not getting involved in excess of maturity transformation. Although, the foundation of this belief was just mere assumption, and for each Thai BIBF Bank when considered as a whole the maturities were matched at all points of time.

¹⁸ Saibal Ghosh, *Foreign Banks in India: Liabilities or Assets?*, 31 Economic Papers: A journal of applied economics and policy, 225-243 (2012)

¹⁹ K. Alec Chrystal, *International Banking Facilities*, 66 Review (1984)

²⁰ Pongsak Hoontrakul, *Global Financial Crisis & Implications to Thailand: An Ex-Banker's View*, SSRN Electronic Journal (2008)

²¹ Chaiporn Vithessonthi, *What explains the initial return of initial public offerings after the 1997 Asian financial crisis? Evidence from Thailand*, 27 Journal of Multinational Financial Management, 89-113 (2014)

In 1996 a preferential tax rate on BIBF profit was reduced in order to cope up with the surgeon pressures from capital Inflows through B I BF. Simultaneously on 23 June 1996, the bank of Thailand came up with the 7% reserve requirement or new foreign borrowing then it surety of less than one year by commercial banks and BIPS. Consequently, this led to a shift from short to medium term borrowing in B I BF. However, by September 1996 There was a downgrading of Thailand short-term sovereign ceiling rates to prime 2 from prime 1 and long-term credit ratings in 1997 by the Moody's.²²

Malaysia

The international offshore financial centres of Labuan in Borneo was operating 52 offshore banks by the end of December 1995 which had short-term liabilities of approximately US\$10.2 billion or in other words 34% of total short-term external liabilities.²³ The authorities felt a need to undertake reform form analysis of the assets and overall condition of Malaysia not sure banks was initiated by bank Negara as a response to the financial outburst. The idea behind this program was to regulate and improve the transparency in the financial system which included intensified monitoring of off-balance-sheet items and consolidating the practices with regards to accounts and reports. Additionally, there was a stress test analysis of all the loans and capitalisation which one non-performing and would then crossed sector across onshore and offshore operations. It was found that there were heavy losses which went not acknowledged for at least one bank. As a consequence of these reviews, there was a commitment by Malaysia to protect the depositors of valuation banks even in the offshore banks unlikely to their client approach wherein the only protected the depositors of onshore banks.

Korea

Korea attempted liberalizing the capital account in the era between 1993 and 1996.²⁴ As a consequence of this initiative, there was an increase in international placements of syndicated loans and bond issues, as the banks in Korea were specifically very active in the international bond market. However certain restrictions were still kept on records such as of limitation on access to trade credit or quantitative ceilings with regards to the amount that could be borrowed for domestic operations internationally. Additionally, the ability to borrow from foreign branches via Medium and long-term funds was reduced to the quantitative regulatory ceilings for the commercial banks. However, there were pros to the steps as well as it encouraged the industries to enter the international capital market via establishments of offshore banks which belong to the same parent company, the possibility is no arm's length. Due to the lack of consolidated supervision and accounting, this practice still remains largely unnoticed.

Indonesia

The capital account of Indonesia is driven by long-term floors especially the foreign direct investment which

²² Ramkishen S. Rajan & Sakulrat Montreevat, *Financial Crisis, Bank Restructuring and Foreign Bank Entry: An Analytic Case Study of Thailand*, SSRN Electronic Journal (2001)

²³ Wan Fauziah & Wan Yusoff, *Corporate Governance And Firm Performance Before And After Financial Crisis 2006-2013: An Analysis Of Financial Sector In Malaysia*, 3 Archives of Business Research (2015)

²⁴ Jiyoung Kim, *Corporate financial structure of South Korea after Asian financial crisis: the chaebol experience*, 6 Journal of Economic Structures (2017)

occupies an almost 1/3 of net private capital flow during the area of 1990 to 1996.²⁵ This ratio increased drastically in the preceding years and was approximately at about 1/ 2 of the total private capital flow. It is because of the reason that Indonesia had a liberal capital account that there was never a need felt by the country to establish formal offshore banking facilities and therefore the same was not paid heed to.

Latin America

The option establishments in Latin America are subjected to heavy regulation and capital controls and serve as an alternative to the domestic financial system rather than being an intermediary for capital inflows into the region. Though, the political and economic and stability acted as a catalyst for an establishment of offshore units to act as safe havens for the same. There has been a constant abuse of credential arbitrates due to ineffective supervision in the uploading and downloading of assets and liabilities among the offshore establishment and their onshore parent banks.

Argentina

The offshore establishment played a vital role in creating financial issues during the 1995 Argentine banking crisis however their role was not that of a catalyst. There were heavy losses to Argentina's creditor in depositor which ranged from US\$ 3 billion to US\$4 billion in April 1995 due to the failure of these offshore establishments.²⁶ At the time of crisis, Argentina had categorized its offshore establishment into two. The first category included large provincial banks in the Cayman Islands and while the second category included the shell branches of wholesale banks in the Caribbean. It was the latter category which shall be held attributable for the losses.

During the tequila crisis²⁷, the investors and the bankers in urgent Tina found various incentives to invest or operate offshore. There were various factors which contributed to the increased use of offshore banks some of them were the tradition of exchange that was prevalent in the 1970s and 1980s, accompanied by the countries need to transact in foreign currency. Strict Prudential loans were introduced which were accompanied by higher reserve requirements after the country adopted the currency board are you it's been in the 1990s while relaxing the exchange controls. However, despite this, the banks continued exploiting the positive effects of the offshore establishments to maintain their profit margins via lower taxation and lenient regulatory oversight. Similarly, the investors continued investing in the offshore establishment in order to escape their liabilities and the supervision of fiscal authorities. Moreover, offshore banks enjoyed immunity from country risk such as of expropriation are from deposit by investors. The ease of managing funds electronically giving regards to the advancement in technology was another incentive that added to the operation of offshore establishments.

The uploading of funds by depositors to their offshore establishment was particularly encouraged by the onshore parent bank as to effectively load the part of the Banking franchise. These kind of transactions were encouraged because of the fact that both the parties had an advantage from the lower tax regulations. Moreover, the promise of

²⁵ Shalendra D. Sharma, *The Indonesian Financial Crisis: From Banking Crisis to Financial Sector Reforms, 1997-2000*, 71 Indonesia , 79 (2001)

²⁶ Ysabel Fisk, *Argentina: The Thirteen-Year Crisis*, 22 Foreign Affairs , 256 (1944)

²⁷ Brad Setser & Anna Gelper, *Pathways Through Financial Crisis: Argentina*, 12 Global Governance: A Review of Multilateralism and International Organizations , 465-487 (2006)

high-interest rates on return also attracted the depositors to invest in the offshore units.²⁸ Offshore establishment involved themselves in speculative investment as well in the emerging market fixed income instruments along with investing frequently in the real estate and commercial projects in Argentina. The Prudential arbitrage was also abused to escape liquidity and capital adequacy requirements, provisioning, diversification of credit portfolio, and disclosure requirements.

Venezuela

The 1994 banking crisis can be attributed to 4 factors at least.²⁹ The first is the answer trinity with regards to the 1993 presidential elections economy policy that cause chaos in the capital outflows the position of certain banks. While expecting a strict prudential regulation introduction in 1994 various insiders considered it as a wise decision to withdraw funds from the troubled banks. With the change of government there were implicit we could guarantees which form the third factor. The fourth was an increase in the rate of interest of real state during the first half of 1994. Although, the reforms that was to take place in 1994 came into being only in the late 1980s owing to lack of strong supervision or certainty in the economic policy of the nation.³⁰

The Venezuelan Financial system permitted the financial groups which were leaded by commercial banks to alter their losses by transferring their assets and liabilities around the group's balance sheet as per their interest, owing to ineffective consolidated supervision. The Ministry of finance control the Supeinrtendency of Banks and Other Financial Institution, concentrated on compliance with banking regulation instead of assessing the financial institution's solvency. Additionally, the SBIF did not have adequate staff or financial resources to hold meaningful prudential oversight.

The uploading of assets and liabilities, which was a common practice for offshore establishments, the true condition of the banks could never be assessed as there was a lack of monitoring the institution at the group level while taking into account the related transactions as well owing to an absence of effective supervisory regime. It was only during the middle of the crisis that SBIF started looking into the offshore establishment when the regulations pertaining to information disclosure, risk classification and other common standards for external auditors came into force.³¹ It was standard practice to deviate the problem loans and losses among the financial group whenever and wherever disclosure and supervision requirement what is the least. The liquid asset funds were also included along with the offshore assets in this activity by the offshore establishment. The channel funding to liquid asset funds, brokerage houses, and lastly the offshore establishment Took advantage of the non-uniform reserve requirements on deposit.

In lieu of securing higher expected returns, the commercial banks increase the risk-taking by the end of 1993 and early 1994, it had become a standard practice to channelise the funds of the deposit out within a financial group related companies and activities. Plain vanilla deposit along with funding in the form of liquid asset funds was used in speculative real estate, tourism and equity investment by the offshore establishments. One such instance was when

²⁸ ERNESTO SCHWARZ, *Sharp-based marine sandstone bodies in the Mulichinco Formation (Lower Cretaceous), Neuquén Basin, Argentina: remnants of transgressive offshore sand ridges*, 59 *Sedimentology*, 1478-1508 (2012)

²⁹ Orlando Ochoa, *What Future for Venezuela in the Wake of the Current Crisis ?*, IdeAs (2017)

³⁰ Luis Zambrano Sequun, *Gestiin Fiscal, Seoreaje e Impuesto Inflacionario en Venezuela (Financial Management, Seigniorage and Inflation Tax in Venezuela)*, SSRN Electronic Journal (2013)

³¹ Hilde C. Bjørnland, *A stable demand for money despite financial crisis: the case of Venezuela*, 37 *Applied Economics*, 375-385 (2005)

a troubled bank was acquired by a loan from the bank itself to the acquirer. It is obvious to state that the same loan was booked via one of the offshore establishment of the troubled bank.

The investors and depositors of offshore establishments were partially and in certain cases fully compensated for the losses that they had occurred during substantial fiscal pressures, owing to the crisis³². Consequently it important to note that the assistance provided by the government during the first half of the year 1994 to the depositors of troubled bank along with the leftover deposit liabilities of these banks, came out to be more than the total report deposit in the same bank at the end of 19 93 by 100%³³. As the crisis was unfolding, or should liabilities voice download it to the balance sheets of onshore parent banks.

Conclusion:

- The friction is associated with tax redeems, strict regulatory framework along with the restriction on capital flows, and accompanied with the chances of indulging in the dubious activities, makes offshore banking pervasive activity with regards to the number of OFCs and the volume of transactions.
- The harmonisation of tax regimes, financial liberalisation under the garb of prudential oversight and liberalisation and capital account have declined the appeal of offshore banking for corporate economies, as the distinction between the two categories of banks have blurred over time. Notwithstanding, the above said, Offshore banking still attracts the heavily regulated financial system of emerging economies, wherein the need of investment financing is relatively high to sustain the growth rates.
- The risk of the onshore banks is balanced out by the profitabability they all offer when compared to offshore banks, and in various instances, they are way more leveraged than the offshore banks. However, it is pertinent to note that the risk attached to exchange restrictions are not necessarily the optimal strategy while approaching the risk management in the offshore banks. Also keeping in regards to extend restrictions, onshore banks are still liable for the operations of related offshore branches and subsidiaries as they have a controlling interest in the same.
- For the risk management purposes, the countries shall now look into current supervisory and prudential frameworks instead of being dependent on exchange restrictions. The reason behind the same is that such frameworks have a wider ambit to manage risk efficiently and effectively which can be implemented all over the world. Furthermore, the supervisory authorities need to keep in mind that there is a need for a high degree of coordination between offshore and onshore supervisory authorities. Additionally, the bridge the supervisory authorities along with the seniors accounting standards can cause a negative impact on the consolidated supervision of activities in which an offshore bank engages.

³² Yeva Nersisyan & Flavia Dantas, *Rethinking liquidity creation: Banks, shadow banks and the elasticity of finance*, 40 Journal of Post Keynesian Economics , 279-299 (2017)

³³ Cheick Wague, *FROM TAX BREAK TO TAX HAVEN - Offshore Profit Shifting and Multinational Corporations Tax Avoidance Strategy*, 13 International Journal of Business Strategy , 115-128 (2013)

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