AN OUTSIDE CHANCE:

PROSPECTING FOR FOREIGN CAPITAL

A Report to the Governor
and the
55th Legislature
of the Subcommittee
on the Foreign Investment Depository

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AN OUTSIDE CHANCE:
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Introduction: Suspending Disbelief

Senate Joint Resolution No. 19 (SJR 19) called for an interim study of the feasibility of establishing a new type of financial institution in Montana. The foreign investment depository, as envisioned in the resolution, would be either a state-owned or state-chartered nonbank facility that would attract capital from abroad and produce revenue as well as economic development benefits for Montana.

The resolution was greeted with a superabundance of skepticism but nevertheless survived the 1995 Legislative Session and subsequently won the second-highest number of votes in the poll legislators take among themselves to help determine which interim studies will actually be conducted. What began as an exotic proposal evolved into an intriguing prospect; so intriguing, in fact, that the eight-member bipartisan committee voted unanimously at their final meeting (on September 11) to recommend enabling legislation to the 55th Legislature. Robert Svoboda, a Montana expatriate and early enthusiast for this project, likened the establishment of the depository to landing on the moon. In the closing week of the interim, NASA scientists reported that they had found fossil evidence of microbial life on Mars. Anything can happen.

An interim study resembles a journey of exploration with no certain end. From the time the members of this interim subcommittee* first hailed each other in August 1995, until they said farewell 13 months later, their deliberations were guided by the provisions of SJR 19 and a staff-devised study plan. These map-like devices were helpful, but crude. A number of the "whereas" clauses in the resolution led to vistas almost too vast to

* Hereinafter, referred to as committee.

contemplate, let alone comprehend, and had the committee taken all the side trips recommended in the study plan, the journey would have seemed interminable.

The study plan was prefaced with a set of principles designed to orient the members to the scope and methodology of their endeavor. In abbreviated form, these principles were as follows:

- begin with and maintain positive assumptions and expectations;
- keep a broad scope;
- maximize educational benefits (i.e., learn something);
- honor legislative intent;
- consider alternatives to the depository as originally conceived.

The outcome of the study was not apparent to anyone involved. Members and staff alike resolved early on to treat the venture seriously and to gain as much practical knowledge as possible given limited time, a predetermined budget allocation, and virtually no collective experience in the field of international finance. There were no foregone conclusions about whether the process would result in draft legislation, a set of less formalized recommendations to the Legislature, or simply a final report documenting activities and highlighting a number of educational milestones. As it happens, this report contains both a summary account of the committee's proceedings and a draft bill that incorporates the essential elements necessary to enable one or more foreign capital depositories to obtain a state charter, provide specialized financial services, earn a profit, generate revenue for the state, and operate in compliance with state and federal laws.

During the course of the study, which entailed seven formal meetings (five in Helena, one each in Missoula and Billings), the members heard or received written comments from individuals representing a variety of interest groups, including federal and state regulatory authorities, law

enforcement agencies, Montana banks, other banks and trust companies, law firms, University System affiliates, scholars of international finance, and management consultants. On several occasions, legislators who were not members of the committee also participated in discussions. For the most part, these people fit into one of the following categories. (The parenthetical blurbs typify the outlook of each respective group.)

- Enthusiasts ("Great Idea!")
- Cautious & Conditional Optimists ("Sounds good, IF...")
- Skeptics ("I don't think so.")

- Curious Pessimists ("I'm doubtful, but intrigued.")
- Incredulous Naysayers ("You must be kidding!", or, "No Way!")

At the close of the committee's final meeting, several of the members admitted that their own initial attitude toward the study was comprised of roughly equal measures of doubt and curiosity. The study resolution itself was regarded by some as "a joke" when it was introduced by Senator Mike Sprague in the final weeks of the 1995 Legislative Session. More than one member of the yet to be named committee recalled voting in favor of the resolution in committee in order to get another chance to laugh at it on the floor of the Senate and House--all in all, an inauspicious beginning. Senator Sprague, the sponsor of SJR 19, characterized the committee's later experience and the study's somewhat surprising ending as an example of his "feel, felt, found" approach to preconceived notions and premature cynicism: "I know how you feel [about this issue]; I felt that way myself; but this is what we found."

During the course of this study, members and staff alike discovered a motherlode of information about flight capital, offshore banking, money laundering, and the regulation of financial institutions in a complex and shape-shifting global economic arena, all controversial subjects in their own right, and all relatively unfamiliar to Montana constituencies. Regardless of the reader's snap judgments or well-considered opinions about the advisability (let alone feasibility) of providing special treatment and specialized financial services to wealthy foreigners, the members and staff together urge serious consideration of the draft enabling legislation included in this report. It's no joke--and the issues and opportunities bound up in the proposed depository institution are relevant to Montana's economic development prospects regardless of whether a foreign capital depository or anything like it ever materializes in the Treasure State.

Organization of the Report

This document is a distillation rather than a complete accounting of what

was learned and decided by the committee. The bill itself is a further distillation of concepts, considerations, and compromises, all leading toward a consensus on the purpose, design, and intended functions of the depository.

The Summary Overview highlights key findings that are integral to understanding the shape and content of the enabling legislation. The summary briefly describes the origins and evolution of the study, and then identifies in greater detail the purposes and goals that provide a foundation for the draft bill.

Part One provides the context in which the study was carried out, and it follows a thematic rather than a chronological pathway. The committee's process entailed presentations, testimony, correspondence, and voluminous background reading materials. Because an understanding of the issues and opportunities surrounding the depository required heightened awareness of international affairs, the members and staff were also attentive to what was going on in the world at the time. For example, the interim period was marked by outbreaks of political violence in Mexico, a referendum in Quebec on separation from Canada, China's provocative military maneuvers in the Taiwan Strait, a volcanic eruption on the island of Montserrat (a tax haven in the Caribbean), a $10 million heist of Citibank funds by Russian cybernauts, Congressional hearings on the future of money, various federal agencies' issuance of reports on money laundering, and a profusion of more local stories highlighting the fiscal uncertainties that bedevil the legislative process every biennium. All of this had bearing on the committee's consideration of the prospective depository's niche in an unstable, unpredictable world.

The meeting agendas and official minutes that are part of the committee's official record (but that are not included in this report) trace the committee's linear progression of inquiry, but they do not provide the reader an accurate sense of the more circuitous character of the endeavor. The committee did a lot of doubling back on a number of central topics,

and Part I is intended to reflect that pattern of discovery.

Part Two provides a brief explanation of what is contained in the draft bill, followed by the bill itself, absent those sections that would amend current law. The narratives preceding the text of the proposed legislation address several contingencies and compliance issues that could alter the legislation's context and content. This part also addresses a number of "bottom line" considerations, including revenue projections based on different volumes of anticipated deposits.

The reason for keeping the new sections apart from the requisite amendments to existing statutes is to provide readers with an unobscured view of the depository proposal as a whole. Many of the amendments will be perfunctory and merely mechanical in nature; inserting them in their proper location with respect to the new sections now would result in a dense thicket of seemingly unconnected limbs and branches. A list of the amendments is included in the report as an appendix. The final draft of the bill will contain them in their entirety and in proper order.

Summary Overview

Genesis and Evolution. Senate Joint Resolution No. 19 was triggered by a timely, two-part coincidence. Mr. Robert Svoboda, formerly of Lewistown and Billings, now a California-based developer, suggested to Senator Sprague and others that Montana's banking laws were uniquely archaic, thus presenting a golden opportunity to establish a depository institution that could emphasize customer confidentiality. At about the same time, Senator Sprague had a chance encounter with some Swiss visitors to the capitol. The combination gave rise to visions of a Switzerland of the Rockies, and it also dovetailed with practical questions about how to deal with Montana's perennial shortage of investment capital and tax revenue.

Analysis of the legal and practical feasibility of establishing an institution that would accept foreign deposits culminated in this general understanding: the committee's recommendations must acknowledge and support a three-way balance between the customer's need for privacy, the depository's need to earn a profit, and the state's multifaceted interest in: (1) enhancing its revenue at no cost to taxpayers; (2) stimulating economic development, and (3) assuring itself, the federal government, and the citizens of Montana that the depository would be, as Senator Sprague once put it, "Snow White clean".

The first input the committee received was an unsolicited phone call to staff from the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) in Washington, D.C. "We've picked you up on our radar screen," said a wholly unfamiliar voice, which later characterized the depository as "a financial free-trade zone" and ultimately asked, in the same conversation: "What are you planning to do, secede?" Some months later, officials from the state Departments of Commerce and Justice voiced their concerns about liability, financial risk, the state's reputation, equal protection issues, the public's right to know, and, above all, the ability of bank examiners and law enforcement officers to gain access, when

necessary, to individual customers' financial records. The committee's main response to both federal and state officials was an invitation to help design a workable prototype depository that would ensure its own success without undermining federal and state efforts to keep crooks and critics at bay.

Purposes and Goals. The easiest way to summarize the results of the ensuing multiparty dialogue is to set forth a sequence of illustrative statements drawn directly from the purpose sections incorporated at various junctures in the draft bill:

O It is in the public interest of Montana to attract legally derived foreign capital for investment, revenue enhancement, and other economic development purposes as well as to facilitate tax abatement for residents and businesses in the state.

O A prudent blend of financial privacy, asset protection, and profitability may offer foreign depositors unique opportunities to build and preserve their wealth in Montana.

O The viability of one or more foreign capital depositories in Montana depends to a large extent upon both the secure nature of the depository and the confidential nature of customer accounts and safe deposits in the depository and upon the confidential nature of transactions between a customer and a depository.

O The Legislature...recognizes that asset protection [from frivolous or otherwise illegitimate lawsuits] is a vital component of a depository designed to serve the interests of high net worth individuals who are not American citizens and do not reside in the United States.

O Helping to establish financial links between customers of the depository and products of the precious metals industry is in the economic interest of the state.

O The depository is subject to competitive pressures in the international financial services market. It is therefore in the state's interest to balance revenue expectations with incentives that will enhance the commercial attractiveness and viability of a depository.

O It is the intent of the Legislature to protect state and national interests alike by promoting legal and technical standards and procedures to deter, prevent and detect money laundering and other types of financial crime.

Having set forth these agreed-to general purposes, the draft legislation was further refined to meet a set of more specific goals, which are summarized below. (The full list is included in Part II.)

O Maximize the revenue and other economic benefits (including a profitable connection to Montana's platinum products) that can be derived from foreign capital deposits.

O Balance the customer's need for privacy and asset protection with the state's need to effectively charter, examine, and otherwise regulate the depository.
Comply with federal laws and regulations but also accommodate technological advances that protect privacy, enhance security, and reduce transactions costs.

O Minimize state exposure to risk in the arenas of negligence, fraud, and criminal abuses by establishing clear charter eligibility criteria, requiring due diligence, and including provisions to deter criminal elements from using the depository as a vehicle for money laundering.

It will be up to the Legislature to determine whether these goals have been met in the recommended legislation and, perhaps more importantly, whether they are adequate, genuinely achievable, and fully desirable in light of the

controversial nature of foreign flight capital and the contradictions that are inherent in the combination of financial privacy and public accountability.

Shaping the Study: Several Lines of Questioning. When an interim committee starts from scratch, one result is a sustained barrage of questions, only some of which elicit satisfying answers. The committee began its quest with basic queries and some provisional replies:

What are the state's interests in establishing this type of institution?

Financial: a significant source of revenue to offset taxes.

Economic: a stimulus to foreign direct investment, tourism, entrepreneurship, technological advances, professional services, and other types of high-skill jobs.

Social and Cultural: a means of inspiring innovation in educational programs and curricula and of enhancing public awareness of Montana's multifaceted niche in the global economy.

A second tier of questions focused on legal and ethical issues:

Can we do this? Will "the Feds" allow it? If this is legal, why hasn't it happened somewhere already? How could the state guarantee secrecy? Who would regulate a state-owned or state-chartered bank? Are current state licensing and regulatory processes adequate to the task of ensuring the integrity of this new type of financial institution? Would the federal government or the Federal Reserve system insist on a role?

Does Montana want to be in the business of attracting flight capital? What will other people think? What will we think of ourselves? How will overseas friends and neighboring states react? Would the depository enhance or degrade Montana's image at home and reputation abroad? Would Montana

be open for business of a more sinister nature? How do financial institutions protect themselves against corruption?

Other questions of a practical nature included the following:

Why would foreign investors choose to place their funds here? What are the incentives? How does Montana compare with offshore jurisdictions? What would differentiate the depository from regular banks? Where would the depository be located, and would there be more than one?

To find answers to these questions, the committee looked first over a broad horizon.

Taking Stock of Interests and Influences

In the early stages of the interim study, staff assembled a list of the entities inside and outside of Montana that would likely take more than passing interest in the depository. The list is reproduced below, subdivided into public and private sector categories, with brief annotations that describe the nature and rationale for each entity's attentiveness.

PUBLIC SECTOR

U.S. Congress - especially the Montana Delegation, because their support (tacit or otherwise) could be crucial to the depository's longer-term success. Congress could kill the project by passing preemptive or *post facto* legislation.

Foreign Governments - would probably not take a kindly view of a U.S. state actively enticing foreign citizens (taxpayers in their home country) to transport their capital to a distant and protective jurisdiction.

Federal Reserve System - in its capacity as gatekeeper to and supervisor of foreign banks operating in the United States.

Other States - could be copycats. States like Nevada, California, Florida, even North Dakota! might take the view that anything Montana can do, they could do better.

U.S. Treasury Department - home to both the Internal Revenue Service, which is always interested in other people's money, and the less well-known Financial Crimes Enforcement Network, charged with combatting money laundering on all fronts.

U.S. Department of Justice - investigates and prosecutes crimes involving foreign nationals and carries out law enforcement duties pursuant to tax treaties that the United States has entered into with several dozen countries.

Tribal Governments - because there is a possibility that an Indian-owned depository institution could be established to serve indigenous peoples and other foreign customers from around the world.

Montana Legislature - since it will be present at and largely responsible for the creation of this new, specialized entity.

Commerce Department - charged with responsibility for the prudential supervision of state-chartered financial institutions.

Revenue Department - the agency that will assess and collect the state's "take" in the proper measure.

Governor's Office - promotes and encourages sustainable economic development.

State Auditor - in his capacity as Securities and Insurance Commissioner.

Board of Investments - a key agency if the depository is state-owned (see Roads Not Taken); could still play a role in the event some of the foreign

capital or revenue derived from it is routed to and administered by the board.

University System - where certain faculty and departments, especially those of business, law, and economics, would find opportunity to adopt new curriculum and develop specialized training programs, some of which could attract grant funds, endowments, and gifts from abroad.

PRIVATE SECTOR

Tourism Operators - because customers will come to visit their money. (Just ask the Swiss!)

Private Security Services - to conduct background checks on charter applicants and to design and maintain physical and technological security systems.

Domestic and Foreign Financial Institutions - since they know the business, have established client bases, and would presumably be first in line to seek a charter.

Investment and Accounting Firms - who are presumably always interested in serving new clients and enhancing their presence in the global market.

Mining Companies - the source and supplier of fabricated precious metals, including platinum.

Construction Firms - as the depository will need to have a building, with a vault.

Law Firms - conceivably, every foreign customer would need and retain a Montana attorney, and the depository itself would require a retinue of them.

Telecommunications Providers - to wire the depository to the world.
Public Media - the depository could constitute an important story, off and on, for a long time to come.

Private Insurers - to provide deposit insurance if customers demand it. (Depository accounts would not be federally insured.)

Montana Taxpayers - who have an intrinsic interest in sensible relief from tax burdens.

The committee did not solicit testimony from representatives of all of these groups, but it did hear from many of them. Montana's Congressional Delegation was kept informed of the committee's proceedings. Federal agencies were invited to participate, cooperate, and assist in the review of the draft bill. The U.S. Treasury Department's FinCEN and the U.S. Justice Department sent representatives to the January meeting in Billings. The Federal Reserve and the IRS declined repeated invitations to participate, although both did supply helpful documents. Representatives from the Montana Bankers Association were regular attendees. In Missoula, the committee heard comments from the newly established World Trade Center, the Mansfield Center for Pacific Affairs, the Pacific Northwest Economic Region, and the Law School. In Helena, officials from the Justice Department (including the Attorney General's Office), the Commerce Department, the Department of Revenue, and the Governor's Office all weighed in on the discussion. Several private attorneys and business consultants, as well as a coin dealer, also offered valuable information.

Caveats and Qualifiers. First, a word about a subtle but significant shift in nomenclature: the Interim Subcommittee on the Foreign Investment Depository is recommending a bill that would enable the state to charter a foreign ***capital*** depository. The depository's main purpose is to hold and keep safe foreign capital in the form of currency or various types of valuable personal property. Investment is one of a variety of allowed functions for the depository (a customer may direct the depository to invest in tax-

exempt securities, such as U.S. Treasury bills or municipal bonds), but the institution is not intended to facilitate direct investment in Montana under a veil of secrecy. The name foreign ***investment*** depository could lead some legislators, potential depositors, and perhaps many Montana citizens to misconstrue the new entity as primarily a vehicle for foreign nationals to buy up large chunks of Montana real estate as well as to purchase or invest in existing businesses in the state. This is clearly not what the supporters of SJR 19 intended, so replacing "investment" with "capital" means the bill title and the institution's generic corporate moniker will not be misleading.

The foreign capital depository is not everything it could be; the nonbank institution is purposefully restricted with respect to the services it may provide and the degree of privacy it can offer its customers. The most significant restriction is the prohibition against accepting deposits from any U.S. citizen. This provision is based on the presumption that it is not in the state's interest to involve itself in complicated legal issues surrounding tax evasion, tax fraud, and scurrilous measures to shield dishonest debtors from honest creditors. Even though the members were presented with some evidence that there is significant domestic demand for a semisecret financial shelter on home turf, the committee demonstrated no interest whatever in creating a tax or bankruptcy haven for Americans. Florida and Texas have already captured the fort, as it were, by providing generous homestead exemptions that attract wealthy individuals who are also insolvent. Americans wishing to legally avoid taxes and frivolous lawsuits can take advantage of the well-established trust services and other asset protection programs offered by banks in Switzerland, Bermuda, the Cayman Islands, and elsewhere.

The proposed legislation is informed by extensive research and sustained deliberations, but it still rests on a number of key assertions and assumptions, some of which were identified early on in the study process, some not. One of the first assumptions made and dropped in short order was that the depository would be chartered by the state as an investment company under 32-1-108, MCA. The main purpose of the type of nonbank institution defined in this 1927 statute is "to accept, receive, and hold

money on deposit, payable either on time or on demand, with or without interest, as may be agreed upon with depositors . . .". Interestingly, this statute has never been used; it also seemed to fit, at first glance, the anticipated service structure of the foreign capital depository, which would include the safeguarding of money and tangible assets for a fee, with no interest payments made to or tax liability incurred by the individual depositor. However, in the course of its study, the committee determined that the investment company statute would not be a good vehicle for the depository. For one thing, 32-1-108, MCA, is embedded in Montana's general banking laws, and an investment company would therefore be subject to a broader range of requirements than necessary. The depository would not engage in lending, for example, but under current law it would be treated as a "bank", to which many complicated legal provisions automatically pertain. Furthermore, the existing statute could not be easily or simply amended to reflect the fundamental fact that the depository is meant to serve foreign rather than domestic customers.

Two further, interconnected assumptions, that a state-chartered depository would not be subject to federal regulation and that a foreign customer's account would for all but the most extraordinary intents and purposes be closed off from federal scrutiny, proved to be even more problematic. While it is true that under the United States' dual banking system, some state-chartered financial institutions are examined solely by state regulatory authorities* it is also likely that the legislative niche for a Montana-based depository would be filled by a domestic subsidiary of a European, Canadian, Japanese, or other foreign bank. This means that a federal role is almost unavoidable. Under the Foreign Bank Supervision Enhancement Act of 1991, all foreign banks seeking to establish U.S. offices, whether licensed by state or federal authorities, must first be approved by the Federal Reserve System. Moreover, because the United States has entered into numerous income tax treaties, tax information-sharing agreements, and mutual legal assistance pacts, federal law has in large measure preempted

* When the institution is not a member of the Federal Reserve System, is not a foreign bank, and does not offer federal deposit insurance.

states with respect to offering foreigners sanctuary from their home government's tax authorities. Under the Supremacy Clause (Article VI) of the U.S. Constitution, the provisions of these arrangements take precedence over any conflicting state law, so the depository's ability to shield its customers from the prying eyes of U.S. and home government authorities is both limited and contingent on complicated legal and procedural factors.

Whether or not such qualified but ultimately inescapable exposure to federal scrutiny would actually hinder the marketability of the depository is debatable. Some depository enthusiasts insist that the prospect of Uncle Sam prying into private financial matters of great magnitude will deter foreign depositors from coming to Montana. Others contend that federal oversight could enhance the depository's image and marketability as a "clean" and relatively incorruptible institution and that so long as customers steer clear of all but the most primitive services offered by the Montana institution, their relative anonymity will remain intact. In any event, the committee acknowledged without hesitation the importance of measures designed to effectively deter money launderers and other financial criminals from taking advantage of the depository's services.

In contrast to offshore financial institutions that often amplify their full-service approach with images of exotic, cosmopolitan lifestyles, the proposed Montana depository is "unplugged". It is probable that the success of this prospective enterprise will rest on a relatively quiet, dignified approach to marketing. Excessive hype would almost certainly alarm governments, prick up the ears of bad elements, and turn off the choicest prospective client base abroad. The draft legislation does not address promotional issues--a private sector matter--but one of the underlying assumptions is that the chartered institution would be careful about the signals it sends to the world.

A Feast of Assumptions

The following is a sampling of other important assumptions about the

prospective customers, the depository itself, and the state's regulatory roles and functions, juxtaposed (in italic text) to relevant observations and findings.

Assumption 1. The feasibility of the depository hinges on the concurrence of legal opportunities, commercial viability, and public acceptance, as well as the convergent interests of various private and public sector entities in Montana.

Notwithstanding research findings and revelations still to come, each of these components is laced with ambiguities that cannot be fully clarified unless and until a bill is passed and a charter is issued. On the legal front, federal officials have offered mixed messages. While insisting that money-laundering statutes strictly limit the degree of privacy a state can offer, they also hinted that there are ways to successfully circumvent certain reporting requirements, especially when all deposits would originate outside the United States. As regards commercial viability, fluid conditions in the financial services marketplace indicate that some flexibility is warranted in the structure and operations of the institution. The "menu" offered by the depository could range from primitively attractive (a glorified, fortified vault for the storage of physical treasure) to seductively sophisticated (private accounts accessible by electronic means from almost anywhere in the world). The institution could evolve backwards or forwards in response to regulatory and commercial conditions. Because of its exclusively foreign customer base and its restricted service offerings, the depository would not be in direct competition with Montana banks, large or

small. (A Montana or regional bank could own and operate a depository, however.) Public acceptance is not something easily gauged ahead of time. Perceptions on flight capital and other aspects of international finance vary widely.

Assumption 2. Depositors will not be as concerned about rates of return on their "investment" in this facility as they are desirous of relative confidentiality and isolation, as well as strong measures to secure their assets against liens, theft, seizure, corruption, expropriation, and natural disaster.

Some people have difficulty grasping the sensibilities attached to idle money. The assertion that high net worth individuals will willingly pay the opportunity cost of not making a sizeable return on their capital is alien to ordinary domestic investors and goes against the grain of commonsense financial logic. A typical investment services advertisement in this country reads: "Our efforts are focused on growing your assets." However, the foreign customer is likely to have a different perspective because of uncommonly onerous taxes in the home country, a sincere desire to set aside funds for heirs (and apart from creditors), a cultural aversion to interest income (increasingly common in the Islamic world), or a surfeit of exposed assets already earning high interest and paying ample dividends in places other than Montana. Prospective depositors will view the depository as a hedge, not a garden.

Assumption 3. Some depositors' funds would be invested in tax-exempt instruments, others in foreign currencies or precious metals--such as platinum--to insure customers against depreciation of their monetary assets.

There is a trade-off between privacy and profit; the more a customer needs the former, the less the customer can expect of the latter. While federal law allows nonresident aliens to earn interest on portfolio investments (such as

Treasury bills and municipal bonds) without paying taxes in the United States, they are nonetheless required to file revealing documents with the IRS in order to certify their identity and exemption from automatic withholding. Precious metals purchases do not require the depository and customer to leave so obvious a paper trail. Moreover, platinum and gold maintain their value against inflation more reliably than many foreign currencies. The inconvenience of relative illiquidity and the bypassing of profitable investment opportunities are offset by a reduced risk of disclosure.

Assumption 4. There are wealthy individuals and corporations outside the United States willing to pay a reasonably competitive price for the kind of specialized and limited financial services provided for in the bill.

The members heard repeated assertions to this effect. For example, a Livingston resident who represents Arab investors said he could vouch for $300 million worth of immediately interested capital, and the director of the Platinum Guild International said that he would be willing to invest his own money in a depository--as a shareholder, not a customer--that offered precious metals accounts. Information on Swiss and other offshore banks indicates that some people do indeed pay what amounts to negative interest for the privilege of confidential accounts and investment services. However, nobody from outside the country turned up to testify that they stood ready and waiting to deposit vast sums in a new, unusual, and untested type of financial institution. The depository is designed primarily to maintain and nurture nest eggs rather than grow fortunes.

Assumption 5. The lending, investment opportunities, and brokerage activity stimulated by the depository would take place outside the confines of the depository's walls and charter.

The depository is conceived as a limited-purpose financial institution. Lending is strictly limited to exigencies arising from trust accounts and

credit card-type linkages between a customer and the customer's precious metals account. The depository might well serve as an economic development engine, as it were, because of the likely spinoffs in international trade, foreign direct investment, and related professional services. There may be occasion in the future, depending on what changes Congress is willing and intending to make in the regulation of financial institutions, for Montana to host a full-service international banking entity, similar to those in Switzerland and other countries. The foreign capital depository is not designed, however, to be such a vehicle.

Assumption 6. The most likely candidates for a charter would be: (1) a subsidiary of a U.S. bank; (2) a subsidiary of a non-U.S. bank; or (3) a new, privately held corporation.

The state charter would enable a private firm to provide limited, specialized services; the depository would not be a full-fledged bank. However, large, transnational banks and trust companies already provide many similar services and have well-established clientele, information, and marketing networks. There are currently no international banking operations in Montana, but that may change soon. Institutions that are presumably already well-positioned to take advantage of charter availability in Montana include: the "Big 3" Swiss banks (Union Bank of Switzerland; Credit Suisse; Swiss Bank Corporation); Canadian firms such as Royal Bank and the Bank of Montreal; and a number of British and Japanese banks. Domestic banks that would seem to fit the bill include First Boston (which is affiliated with Credit Suisse), Wells Fargo (recently merged with First Interstate), and Norwest (with expanding overseas connections).*

Representatives from Norwest, First Bank, and First Interstate were invited

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* The State Banking Commissioner received a letter in March 1995, from the president of FINTRADE, U.S. Inc., with an Empire State Building address in New York, requesting information about how to open an international bank in Montana.

to participate in the study, and the Trust Division at Norwest demonstrated considerable interest. In addition, the committee sought input from several other reputable domestic institutions, including the Bank of America (California), U.S. Trust (the Portland, Oregon, office), and Northern Trust from Chicago. The reasons given for not attending ranged from ordinary scheduling problems to a concern that attendance would draw unwanted attention from federal agencies, with frank admissions of a cautious "wait and see" attitude in between.

Assumption 7. The Montana depository will not compete directly with other, well-established offshore tax and private banking havens.

Wealthy foreigners will not substitute a Caribbean account for a Montana one, but they will--so goes the assumption--add Montana to the list of jurisdictions in which they place their treasure. With zero taxes and competitive fee structures, the offshore option may always be a better bargain. The irrefutable fact, however, is that none of the other places that offer privacy and security are inside the United States of America, arguably the world's most stable and secure country. In an expert's words, "Capital preservation through international diversification is a superb hedge against any contingency. The knowledge that a portion of your wealth is waiting for you, where nobody but you can touch it, creates a sense of security and a freedom from fear. That's something you can't put a price tag on."[1]

Montana may be well-positioned to complement rather than compete with the Swiss. Recognition of some of the real and imagined similarities between the state of Montana and the country of Switzerland was and remains a stimulus to go forward with the depository. There are cultural traits that accompany the obvious geosympathy between people who dwell, farm, fabricate things, and otherwise thrive in the Swiss Alps and the Northern Rockies. Montana and Switzerland share certain political traditions (such as the use of citizens' initiatives and referenda) as well as a vaunted respect for individual freedoms, including the right of privacy. Both communities appear to outsiders to be self-centered but nevertheless

attractive and respectable. This virtual kinship may not make any sense to someone in Ekalaka, Plentywood, or Jordan, Montana, but it may be a significant factor in the depository owners' and customers' calculations.

Assumption 8. The state would realize substantial revenue derived from the foreign capital in the depository.

A one-page summary of the potential revenue benefits of the depository that was circulated during the waning weeks of the 1995 Legislative Session looked promising: with a mere 1 percent charge on deposits, Montana stood to gain $1 billion, the equivalent of all the taxes collected in fiscal year 1994. This figure was predicated on $100 billion worth of deposits, a seemingly astronomical sum. During the course of the study, the committee heard some experts suggest that, given the amount of liquid capital in circulation and the intense demand to protect it--as evidenced by the proliferation of offshore tax havens and banking centers--both numbers may in fact be ***underestimates****! There was no way to verify what constitutes realism in this realm; the billion dollars remained the target and staff prepared a spreadsheet that juxtaposes the value of assets on deposit, the rate of assessment (or tax), and the resulting revenue accruing to the state. In addition, based on the assumption that it would take some time for assets to accumulate in the depository (it seemed wholly unrealistic to expect $100 billion to arrive almost overnight), the 1 percent rate was raised to 2.5 percent. The committee was advised by bankers and others that this rate might prove exorbitant, but it was nevertheless adopted as a starting point for the purposes of the enabling legislation.*

At the 2.5 percent rate of assessment included in the draft bill, the state would realize revenue in accordance with this formula.

- *With $100 million on deposit, the revenue amounts to $2.5 million.*
- *At $500 million in the depository, the state stands to collect $12.5 million.*
- *With $1 billion on deposit, Montana gets $25 million.*

- *Five billion dollars yields $125 million in revenue.*
- *Ten billion would generate $250 million.*
- *At $50 billion on deposit, the state clears $1.25 billion.*

Assumption 9. The depository would earn a profit by charging fees to the depositors.

Nobody from the financial services sector volunteered precise details regarding fees and costs pertaining to private banking services. Some numbers were turned up, however, for general consideration. Trust formation fees in the offshore industry are advertised in the $2,500 to $3,500 range. Minimum annual fees charged by banks to administer custodial accounts are based on a fractional percentage of assets (e.g., 0.6 percent) or a set amount (e.g., $3,500). There are portfolio management fees, company formation fees, license renewal fees, and transaction fees of varying amounts. Conventional banking entails standard loan origination fees, credit check and property appraisal fees, mortgage interest "points", and a variety of commercial loan handling charges. In the securities business, a 3 percent front-end "load" or a sales charge amounting to 4 to 5 percent is not unusual. Fees based on gross premiums are also common in the insurance industry. In short, a fee-based rather than an interest-based income stream for the depository appears feasible. Some depository fees would likely be imposed on a monthly, semiannual, or annual basis; others would be directly related to services provided (such as currency conversion, the placement of investments, interbank transactions, and legal services).

Assumption 10. There are financial services sector professionals capable of managing a foreign capital depository in a profitable and rigorously disciplined fashion. Moreover, such expertise will be attracted to Montana from elsewhere in the United States or abroad.

The committee was not provided with hard evidence to confirm this expectation: no warm bodies from Switzerland or the Caribbean turned up

to testify. However, based on anecdotal information from trout fishing guides and other outfitters, as well as the abundant data that describes crowded, crime-ridden, and polluted living conditions in other countries, as well as in New York, L.A., and Miami, it seems a safe bet that a Montana-based depository could go "head hunting" and bag a few choice specimens in metropolitan jungles or in places like London, Zurich, Hong Kong, or Nassau.

Assumption 11. There are ways and means of discerning the character of prospective depository owners and operators as well as the legitimacy of their customers' wealth.

Distinguishing good apples from bad can be expensive, but it is feasible. The procedure would most likely involve contracts with private intelligence gathering firms, such as Burns Security or Kroll Associates, that operate internationally. Background checks, which range in cost from six hundred to several thousand dollars, would be the main tool for determining the motives of a prospective depository owner. Such checks might include research on a person's civil and criminal record going back 7 to 10 years in the city where the applicant has lived the longest, as well as interviews with applicant's banking and other business associates.

Under the draft bill, the depository (not the state) would be responsible for exercising rigorous due diligence in commissioning or conducting investigations of prospective clients to obtain personal references, credit information, and financial history.

There is a wealth of useful, high-quality information from public sources, including Interpol and the CIA (which publishes detailed surveys of international economics and world politics) that would be useful in customer profiling. Some if not many of the customers will be financial refugees. Freedom House, Amnesty International, and Human Rights Watch are just a few of the nongovernmental agencies that collect and disseminate detailed information on political conditions in countries around

the world.

Assumption 12. Once given the responsibility and statutory authority to regulate activity in this fledgling enterprise arena, the Department of Commerce and other relevant state agencies will be willing and capable of doing the job well.

In response to concerns raised by the state Commerce Department's legal staff, the State Banking Commissioner, and officials from the Montana Department of Justice, modifications were made to early drafts of the draft enabling legislation. Agency personnel voiced their apprehension about dealing with foreign customers. The following comments from Justice Department official Wayne Capp exemplify this outlook: "Investigation of the financial resources of a potential customer is extremely difficult and time-consuming. The methods and strategies available to law enforcement officers and regulators in domestic cases simply do not apply to foreign jurisdictions . . . I would offer my opinion that any consideration of a Foreign Depository in Montana should contemplate every possible abuse and subterfuge by domestic and international criminal elements and provide adequate law enforcement and regulatory structures to prevent such abuses."[2] Commerce Department staff echoed Mr. Capp's remarks on several occasions and in several memos submitted to the committee. At the close of the interim, however, it appeared that most if not all of each state agency's main concerns about the bill had been addressed, so that in the event that the enabling legislation is passed, state regulators and others will understand their powers, duties, and responsibilities with respect to the foreign capital depository.

Assumption 13. State regulators and depository managers and employees can be trusted not to breach customer confidentiality and other aspects of the law, given sufficient information and training.

Tough penalties for improper disclosure of customer account information

appear to work well in Switzerland and other reputable offshore tax and banking havens. There are no guarantees, but civil and criminal penalties included in the draft bill should help bolster personal integrity, prevent improper disclosures, and deter the selling of secrets, as well as other types of corruption. There is a deeper and more significant dimension of trust that must be kept in mind. The Swiss have cultivated a culture of privacy and integrity for several hundred years. The depository's prospects for success are rooted in several layers of mutual trust: between the customer and the depository; between the state and the chartered institution; between state and federal agencies; between Montana citizens and their government. Penalties, sanctions, examinations, training programs, and the like are necessary preventive and verification measures, but they alone are not sufficient to engender the respect for privacy that underlies the type of trusting relationships required in order for the depository to operate as intended.*

Assumption 14. This type of financial experiment has not been tried because federal laws and regulations make it very difficult.

In short, Amen to that. The committee did learn about a few failed experiments. For example, the tiny and relatively impoverished Republic of Palau, a U.S. Trust Territory in the Pacific, attempted in July 1982 to implement the offshore banking act it had passed earlier in the year. However, the sections of the act that provided privacy were suspended by the Territory's High Commissioner, acting on authority of the U.S. Interior Department. Similar proposals in the Cook Islands and the Marianas Islands have come to naught; the United States will apparently not countenance banking activity within its jurisdiction that is modeled after offshore centers. At the Billings meeting, an official from the U.S. Treasury put it bluntly: "There's just no way the federal government is going to treat you [the state of Montana] like the Cayman Islands."

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* Staff found no published information quantifying the incidence of system failure or the numbers of convictions.

On the other hand, if the depository does prove feasible, and other states race to mimic it, Montana will have the advantage of being first off the blocks.

An additional, less confident presumption is that if and when the provisions of this bill are subjected to legal challenge, Montana courts will uphold its constitutionality. An equal protection argument could be made by a Montana resident (or another U.S. citizen), since the services offered by the depository are to be rendered exclusively to foreigners. This is the reverse situation found in case law, where, for example, resident aliens have challenged states for alleged discrimination on the basis of their foreign origins and identity. In 1989, the Montana Supreme Court found it permissible for a state to condition access to the full legal redress under Article II, section 16, of the Montana Constitution. (See Meech v. Hillhaven West, Inc., 238 Mont. 21.) The court held in effect that promoting the financial interests of businesses in or potentially in the state to improve economic conditions constitutes a legitimate state goal. The draft bill applies the same reasoning to the financial interests of the depository and its customers insofar as both will contribute (perhaps mightily) to the state's economy.

Some critics of the depository concept are likely to challenge it on the basis of the public's right to know what goes on inside an institution licensed and regulated by the state. Article II, section 9, of the Montana Constitution establishes the public right to know except in cases in which the demand for individual privacy clearly exceeds the merits of public disclosure. The foreign customer's need for privacy seems compelling on its face. A Montana court might view things differently.

Another type of legal challenge might be forthcoming from one of several federal agencies, including the Internal Revenue Service. While the committee and staff made considerable effort to engage the IRS and the Federal Reserve System and had direct contact with officials from the U.S. Treasury Department and the U.S. Justice Department, these friendly

consultations do not guarantee a benevolent or beneficent attitude in the event the enabling legislation is passed. As Jim Springer, a friendly federal witness at the Billings meeting, put it to the committee:

> *[A]ny legislation purporting to grant anonymity to investors and protection against disclosure would contravene any number of these [U.S.] international undertakings, as well as our bilateral agreements, with respect to information concerning the true owners of funds you seek to attract . . . . Many of these [U.S.] foreign policy initiatives and commitments appear to be at cross purposes with the principles underlying your proposed legislation.*[3]

Representatives from the Federal Reserve Bank of Minneapolis and the regional office of the Internal Revenue Service were invited to address the committee on several occasions. The Federal Reserve plays key roles in the regulation of foreign banks in the U.S. and in interbank financial transfers. In accordance with federal laws, the IRS collects data on virtually every cash transaction of $10,000 or more and hence effects strict limits on the anonymity offered to or sought by foreign as well as domestic depositors. Both agencies declined any direct participation in the study; however, both supplied highly useful reports and other documents. Staff was informed by Treasury Department lawyers in Washington, D.C., that local IRS officials would not be authorized to participate in discussions. The committee was surprised and disappointed by these absences.

The type of activity that would most surely provoke federal intervention would be of a criminal nature, and that points directly to another caveat: the depository might attract unsavory characters, including criminals, even though the enabling legislation is replete with deterrent sections, clauses, phrases, and general intent. Establishing a financial institution is inherently risky, and some might argue that a venture designed to attract and serve extraordinarily affluent foreigners is laden with extraordinary risk. In this regard, it is important not to lose sight of the fact that a significant number of the countries with which the U.S. has established tax treaties and information-sharing agreements have governments that are not regarded as free, democratic, or respectful of human rights. The distinction between a

criminal and a victim of tyranny is often a matter of perspective and raw power, rather than highly refined legal principles. As a practical matter, it may be self-evident that few victims of human rights abuses are also high net worth individuals, but this does not obviate or resolve the contradiction between the federal government's advocacy of democratic freedoms abroad (including privacy rights) and its occasional and sometimes clandestine collusion with undemocratic regimes.

A less frightful prospect is the situation in which the Legislature passes enabling legislation but nobody applies for a charter. This is the no risk, no return scenario. Like the unused investment company statute noted above and the recently repealed state credit card*, the depository might never be tested or tried for reasons that may never be clearly understood but that could include such factors as a design flaw, another state's initiative, or simply bad timing.

Why Montana? During the course of six meetings leading to the committee's March 28 decision to request a bill, the most often repeated question at the beginning and end of the day was "Why Montana?" What's so special about Big Sky Country that's going to attract the big fish of international finance who already play in offshore banking and investment markets like Switzerland, Bermuda, and the Cayman Islands? The committee entertained a number of answers to this question, all demonstrably true yet still somewhat lacking in compelling financial logic.

Montana is perhaps the last place on earth someone from a foreign country would think of as a place to deposit billions of dollars. Despite its physical size, Montana does not loom large in a domestic economic setting, ranking 45th in gross state product per capita. With fewer than a million inhabitants and no city with a population in excess of 150,000, Montana

* See Chapter 252, Laws of 1995.

is very much at the outer margin of the national economy. Investment opportunities are relatively scarce. Montana's taxes are not much different from those in many other states; in some respects (such as the optional unitary method of assessing corporate income) they are relatively high and not the least bit inviting to foreign companies. Montana is way off the beaten track of global money traffic. Many rich people will not find Montana's isolation splendid, nor are they likely to find the relative absence of cosmopolitan culture endearing. In addition, Montana lacks experience with international financial institutions, both with respect to regulation and profitable operation.

Nevertheless, Montana has a number of unique attributes, among which are the following:

(1) Montana is located in the center of North America, a long distance from the war-torn regions of the world and far from the madding crowds of major league crooks and scam artists, tax collectors, big-time lawyers, and secret agents.

(2) Montana is securely ensconced in the most stable political space on the planet. So far as we know, nobody is plotting a palace coup or planning to nationalize the banks, mines, and railroads.*

(3) Montana is a beautiful and enjoyable place to visit. Recent trends indicate a growing number of people interested in Montana as a place to "suffer" early retirement.

* Nor is there much prospect for an antigovernment uprising. During the course of this study, the Freemen went to jail.

(4) Montanans are culturally "fit" for private banking. The conservative populism of yesteryear is today liberally laced with a libertarian ethos. Although Montanans have historically taken a dim view of rich outsiders trying to hide things, they nevertheless:

- respect individual liberty;
- respect private property;
- believe people have a right to be left alone--it's in the constitution;
- believe in basic human rights, at home and abroad; and
- believe in minding their own business when it comes to personal financial information.

(5) Montana is not just an exporter of grain, cattle, and wood products, but a major mineral power. The Stillwater Mine on the Beartooth Plateau is the only U.S. producer of platinum group metals and the only significant source of these strategic materials outside of Russia and South Africa.

When all is said and done, Montana is more secure than the Rock of Gibraltar.

Benefits, Risks, and Costs to Consider

In weighing the pros and cons of allowing a foreign capital depository to take root in Montana, the committee considered a number of economic, financial, social, and political factors. The benefits and risks itemized below are indicative rather than exhaustive; in large part they reflect the interests and influences listed above.

BENEFITS

- New, relatively well-paying and sustainable jobs for trained Montana workers
- Stimulus to trade and passive investment via exposure to international financial networks
- Multiplier and spinoff effects (e.g., increased foreign tourism; greater supply of venture capital; higher demand for professional services)
- Positive sectoral impacts on private security firms, high/medium-tech manufacturing; construction trades
- State (and local) revenue enhancement
- Property and income tax relief
- Clean industry, with minimal negative impacts on physical/visible environment
- Stimulus to University System for specialization, innovation, collaboration
- Greater public interest in and awareness of global economy and international relations (a better-informed citizenry)
- Increased exposure to people from foreign countries and cultures, with reciprocal benefits
- Secure basis for long-term development plans and processes

RISKS

- Labor force requirements will compel out-of-state recruiting
- Trade enhancement and spinoff activity could be minimal
- Financial gains may accrue only to small segment of population
- Great expectations of revenue could engender overreliance on volatile funding source
- Arrival of large, transnational banks could result in displaced Montana banks
- Security systems could be compromised, resulting in corruption, theft, failure
- Competition from other states
- Costly litigation involving charter holder, customer, state and federal governments
- The depository could attract unscrupulous and/or criminal syndicates to launder

The major costs to consider would be borne by the private entity that obtains a state charter. These costs were nevertheless of interest to the

committee since they will ultimately influence the commercial viability of the institution. The major types of costs considered involved physical infrastructure--the buildings, vault, security apparatus, etc. The committee took a guided tour of the still relatively new, multimillion dollar Federal Reserve Branch in Helena. In addition, the members were briefed on Norwest Bank's internal security systems. Staff also obtained information on the cost of constructing and outfitting a medium-sized bank facility. Estimates vary in accordance with particular design factors, of course, but it is unlikely that a new facility could be built for under $3 million.*

As far as state obligations are concerned, most of the direct costs of the depository would be in the startup phase, since a number of regulatory functions would likely have to be reconfigured, including the procedures for collecting revenue. The largest component of time and effort would probably be in the rules process, a function of the State Banking Board. The draft enabling legislation includes several provisions that require a charter recipient to meet the state's administrative and regulatory costs.

The foreign capital depository is a speculative venture. There are risks. If the assumptions above prove inaccurate, misguided, or just plain wrong, a number of scenarios might unfold, ranging from the already noted situation where nothing happens (the law is passed, but no qualified applicant steps forward for a state charter) to a more difficult one where too much happens all at once and state regulatory authorities are overwhelmed by a flood of applications, a surfeit of suspicious activity, or both.

In requesting and recommending enabling legislation, the members of the committee in effect determined that the foreign capital depository has an outside chance of political and economic success. In terms of revenue, the payoff is large. With respect to business-related spinoffs and positive

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* According to information gathered via interview with a representative of American Federal Savings Bank in Helena, where the bank's new, 33,000 sq. ft. multistory building is nearing completion, commercial building costs in Montana's urban communities run about $100/square foot. The cost of the vault, safe deposit boxes, surveillance equipment, and alarm systems can easily exceed $200,000. Land prices vary significantly across the state.

cultural consequences, the benefits could be larger still. Prospecting, which always entails a large degree of uncertainty, is not alien to Montana's economic history and cultural traditions. Neither is foreign capital, which has a prominent place in Montana's past and present and may well play an even more significant role in the future.

There are aspects and attributes of Montana that are genuinely unique and highly attractive. Provided the proper signals and incentives, the right people will recognize them. Montana might indeed be the last place people would think of as a haven for flight capital, but it could still turn out to be one of the best in the world.

A View from Afar

The following are excerpts from written submissions to the committee from Professor Ingo Walter, an expert on private international banking, professor at New York University, and author of **Secret Money**.

> *Why Montana? Here the question will be what kind of structure you set up and what sort of combination of confidentiality, political and currency stability, exemption from taxation for non-residents, and professional asset-allocation services you can provide--and then to defend such a position if it is effectively created from imitators.*
>
> _____
>
> *Where does the proposed Montana depository fit into this [theoretical] framework, specifically in meeting the needs of asset holders?*
>
> *1. Safety. A key attraction will be the political and economic stability of the United States. This is also a key attraction of Switzerland, clearly offering the greatest stability of all the world's secrecy havens. The United States may gain at the expense of Switzerland in this dimension if political problems develop in Europe, such as a widened Balkan conflict or a resurgent Soviet Union after . . . elections in Russia. The second element of safety is related to the institutions involved, so it is essential that the depository be professional, well managed, and tightly regulated by people who know what they are doing.*
>
> *2. Confidentiality. It is likely that the proposed legislation will be sufficient to attract the kinds of funds wanted, namely those driven by home-country tax avoidance and by capital flight. Concern will be raised regarding the operation of the U.S. legal system, however. Suppose a foreign government initiates proceedings to force disclosure in U.S. courts. Or suppose foreign residents alleging damage by public officials initiate class-action suits to force insight. Under such circumstances "innocent" depositors may be caught in the web. If they fear this, they will stay away.*
>
> *3. Yield. If as proposed the depository pays no interest, the opportunity cost of*

using it will be very high. Consequently, the only users will be hardcore secrecy seekers and those paranoid about safety, which are not necessarily the best of clients. This can be moderated by allowing the depository to invest in assets with a positive yield, such as U.S. government securities, which would reduce the opportunity costs and greatly broaden the customer base. Or this issue can be largely neutralized by allowing the depository to offer a range of different investments managed for the depository by professional fund managers.

" . . . like water, secret money will always find a way around attempts to control it as long as the underlying incentives are there. It can be temporarily dammed up, diverted and made more costly, but it will invariably resurface."[4]

ENDNOTES

1. Adam Starchild, Using Offshore Havens for Privacy and Profits, Boulder: Paladin Press, 1995, p. 9

2. Wayne Capp, District Supervisor, Gambling Investigation Bureau, in a memo dated December 1, 1995.

3. James P. Springer, Senior Counsel for International Tax Matters, U.S. Department of Justice, in a Memo to the Subcommittee dated January 25, 1996.

4. Ingo Walter, Secret Money: The Shadowy World of Tax Evasion, Capital Flight, and Fraud, London: Allen & Unwin, 1985, p. 238.

PART ONE: THE CONTEXT

I. An Age (and State) of Anxiety

The final 30 years of the 20th century could be labeled many things, some disturbing, some hopeful. In the realm of finance, always an important sector of the global political economy, the age of anxiety seems fitting. The 1970s began with the United States' decision to abandon reliance on gold to underpin the nation's currency and proceeded with the taxpayer-funded bailout of several large banks deemed "too big to fail". The early 1980s were marked by widespread fear that the world's banking system would collapse; later on in the decade there was the 1987 stock market crash dubbed Black Friday. In the 1990s, the Bank of Commerce and Credit International's clandestine attempt to purchase First American Bank opened a can of worms with uncommonly slimy connections to global arms traffickers and money launderers. The BCCI scandal was followed by a spate of unrelated but nonetheless serious allegations, investigations, and revelations about the shakiness of financial institutions at home and abroad. An article in *Foreign Affairs* about these and more recent events includes the following observation:

> *The past year witnessed three of the most dramatic financial collapses since the Third World debt crisis of 1982. The meltdown of the Mexican peso in December, 1994, the failure of the 233-year-old Barings Bank last February, and Daiwa Bank's $1 billion loss in November--apparently at the hands of a single trader--would all seem to point to a financial system that has spun out of control.*[1]

Somewhat less startling signals of economic and financial instability emanate almost daily from the editorial pages of *The Wall Street Journal* and other voices in the international media. Reports of persistent trade deficits, the erosion of the American dollar as the world's reserve currency, and this country's degree of dependence on Middle Eastern oil and Japanese bondholders lend credence to the gloomy prognostications of the doomsday industry.

In geopolitical terms, the end of the Cold War brought only temporary relief to a quarter-century of deep-seated apprehension. It has been followed by an onslaught of smaller, fiercer wars and rumors of wars to come. There is mounting evidence of central governments' inability to control events as countries splinter and electronic networks facilitate transnational webs of terror and intrigue. Many observers predict a Mexican civil war and the dissolution of Canada within the next decade or two. Hong Kong and Taiwan are major financial centers in peril. The breakup of Yugoslavia and the ensuing Balkan wars, Russia's war against Chechnya, and the looming possibility of a second Gulf War are further indications of a seeming slide toward chaos. Some of these conflicts create opportunities for profitable investments, but all of them are inimical to wealth preservation.

Even if the world isn't really coming to an end, it has witnessed of late the end of money and banking as we know it. Approximately $2 trillion worth of financial capital is in motion, 24 hours per day. This is much more money than is required to finance international trade, and the spread between the supply of funds and the demands of commerce is explained by rampant speculation about interest rates, exchange rates, stock prices, bond markets, inflation, deflation, and derivatives. Peter Drucker has observed that 90 percent or more of the transnational economy's financial transactions do not serve what economists would consider an economic function.[2] Money flows are triggered in large part by anticipation of political decisions (regarding government deficits, borrowings, and intervention in currency markets) and diverse assessments of political risk (such as what will happen to Hong Kong's capitalists when Communist China takes over next July). Much of this liquid capital is stateless, beyond the control of governing authorities and detached in different ways from the patriotic loyalties of the people who decides its course and ultimate destination.

While it is rational to assume that most owners of financial capital seek the highest return whenever and wherever possible, some of them are subject to irrational forces, real and imagined. Consequently, a certain number of the superrich are more interested in privacy and security than additional profit. Liquid assets have a tendency to spill into harm's way while

transiting world markets; sometimes they get frozen stiff by the heavy hand of government. There is a need for safe havens, where small fragments of huge fortunes can be brought to ground, as it were, or even literally buried in deep vaults. The list of jurisdictions offering such refuge has grown in recent years, and it includes little known places on the map such as the Isle of Man, the Republic of Palau, and the Netherlands Antilles, as well as more familiar sites like Switzerland, the Cayman Islands, the Bahamas, and Bermuda.

With respect to the influence of foreign affairs on the prospects for the Montana depository, it is important to keep in mind two easily forgotten facts. First, while dramatic and often disastrous events are taking place in places far removed from Big Sky Country and appear to have little if any effect on the way Montanans perceive the world, these same events are really happening to real people in real countries, and the consequences are neither subtle nor contained within national boundaries. The attitudes and expectations of middle-class Montanans who are immersed in the economic mainstream of the United States are going to be different from those of people who find themselves drowning in a sea of troubles. What may sound like unrealistic or even weird forecasts of catastrophe issued by obscure publicists inhabiting the fringes of society often describe what is actually going on somewhere else on the planet. This conjures up the second fact, that every prospective customer of the depository will by law be a nonresident alien.

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There is increasing citizen wariness and concern about the breadth and forcefulness of federal power in America. This is true throughout the West and across much of the country. Some people believe the federal government has overreached its legitimate, constitutional prerogatives in the realm of financial regulation as well as in other sectors of the economy. These attitudes and concerns provided a backdrop to the study, which took place during what seemed a long and drawn-out season of strange activities

in Montana. The members were reminded by unexpected and highly publicized events, such as the arrest of the Unabomber and the standoff between law enforcement agents and the Freemen in Jordan, that people "back East" still regard Montana as part of a wild and wooly West. For example, in several telephone discussions with staff, federal officials couldn't help but make a few gently sarcastic remarks about how the depository project would look in light of such strange goings-on. It did occur to several interested persons that there might be a hidden connection between a quasi-secret depository and the financial interests and needs of antigovernment militia groups operating in Montana and other parts of the Pacific Northwest. The committee found no evidence of this, but they did hear Mr. Svoboda say at their January meeting in Billings, perhaps simply in frank frustration, that the federal government (and most especially the IRS) is "the enemy".

In sum, the foreign capital depository is largely a product of anxiety. The world is a dangerous place, especially for people in unstable countries who have great fortunes at risk. The distrust of governments, and especially central governments, is a worldwide phenomenon, and it contributes to the general climate of apprehension about the future. Shaky political conditions create risk and, therefore, provide an incentive to move capital to safer ground. These situations in turn influence public and private perceptions, even in relatively safe and quiet places like Montana. The committee was neither immune to such influences nor oblivious to their implications, even if no singular event could be said to have a direct or lasting effect on any member's outlook.

ENDNOTES

1. Ethan Kapstein, "Shockproof", Foreign Affairs January/February 1996, Vol. 75, No. 1, p. 2.

2. Peter Drucker, The Ecological Vision: Reflections on the American Condition, New Jersey: Transaction Publishers, 1993, p. 127.

II. Financial Privacy: a Right, Privilege, or Fantasy?

Financial privacy is like Swiss cheese, full of holes. This was the major finding of the committee's inquiries regarding the confidentiality of bank records and monetary transactions. It came as a bit of surprise. Banks routinely promise not to divulge information about their customers' financial affairs. State laws protect the security of electronic fund transfers and prohibit the disclosure of income tax files. The Montana Constitution contains an explicit right of privacy.

Given all this, one might reasonably surmise that personal financial records are sacrosanct, but they're not. Consider the following two items:

O The list of public records on Westlaw, LEXIS-NEXIS, and other commercially available data bases includes business financial ratios, parent-subsidiary information, SEC filings, bankruptcy records, liens and judgments, and more. A typical ad for such services reads: "Know a party's assets before you bring suit . . . There's no better way to uncover relationships among people, businesses and their assets." A casual search in the Westlaw system turned up several nuggets of value to the committee about depository supporter Mr. Svoboda.*

O A standard account agreement between a bank and a customer includes language indicating that as a general rule, the bank will not disclose information to third parties about an individual account, but it may do so under a variety of conditions (e.g., a subpoena or court order) and for a number of reasons, such as: "to verify the existence and condition of your account for a third party, such as a merchant or credit bureau" and "when the bank concludes that disclosure is necessary to protect you, your account, or ***the interests of the bank***" (emphasis added).

Commercial banks customarily apply sanctions against employees who breach client confidentiality. Nevertheless, an agreement between a bank

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* And in a tidbit of delicious irony, a magazine ad for LEXIS-NEXIS shows a thick slice of Swiss cheese beneath this heading: Are There Holes in Your Research?

and an account holder does not constitute a binding, actionable contract. Bank presidents may enter into contracts with select depositors on a case-by-case basis, but such occasions are rare, mostly because of liability concerns.

Early on, after determining that all depository customers would be foreigners and that many of them would come from troubled countries with oppressive governments that may nevertheless maintain fairly close ties to the United States, the committee presumed that a depository customer would value privacy from the Internal Revenue Service, the State Department, and the CIA as well as from state government agencies, other banks, other businesses, creditors, estranged partners or family members (and their lawyers!), and not least, the tax authorities and Ministries of the Interior (a.k.a. the secret police) in their home country. It also seemed reasonable to presume that the customer's primary concern would be the uncontrolled incidence of information sharing between the depository and other private business entities, between the depository and state authorities (other than the regulating agency)*, and between the depository and the federal government. All of these instances would seem to be covered, at first glance, by the right of privacy provision in the Montana Constitution, which states that "the right of individual privacy is essential to the well-being of a free society and shall not be infringed without the showing of a compelling state interest."

Scholars from the University of Montana Law School and several private lawyers** volunteered their time to complement the staff attorney's review

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* Under existing state law (32-1-234, MCA), reports required of financial institutions by the Department of Commerce are not to be shared with any person not officially associated with the Department. However, the Department is large and performs a variety of functions that have nothing to do with banks. Information contained in the reports may be shared with federal regulatory agencies, regulators in other states, with the Montana Legislative Auditor, and potentially many others.

** Professors Larry Elison, Rob Natelson, and Ray Cross; Bruce Mackenzie (Dorsey & Witney) and Steve Brown (via correspondence).

of the relationship between the constitutional right of privacy provision in the Montana Constitution and the desire for anonymity on the part of the depository customer. Their conclusion: The right of privacy in Article II, section 10, does not protect an individual's bank records. Several court cases illustrate the situation. In 1982, the Montana Supreme Court held that telephone company billing records are not private matters and therefore are not protected by Article II, section 10 (Hastetter v. Behan, 196 Mont. 280). The court's reasoning was based on an earlier U.S. Supreme Court finding (United States v. Miller, 425 U.S. at 442-444, 96 S.Ct. at 1623-1624) that a person has no legitimate expectation of privacy regarding information that the same person voluntarily provides to a third party. An agreement between a bank and a customer is just such an instance of voluntary disclosure, *ergo*, the constitutional protection does not extend to an individual's bank records.* The same is true, apparently, in nine other states that have similar right of privacy provisions in their constitutions.**

Customers Vulnerable to Tax Treaties and Other Arrangements

Under the Internal Revenue Code, Congress has required U.S. "payors" of interest to withhold 30 percent (or a treaty-specified amount) from a nonresident alien and to obtain from each payee who is an individual, a trust, or a partnership a form that includes a taxpayer identification number. The withholding tax does not apply to interest income earned by foreign persons on U.S. portfolio investments, including U.S. Treasury bills and state, county, and municipal bonds. The interest income exemption from withholding also applies to any interest paid on bank deposits. Foreign persons are not required to have a taxpayer ID, but the exemption from automatic withholding requires the completion of a Certificate of Foreign

* See at Appendix 2, the David Niss memorandum dated November 30, 1995, for a more complete rendering of the relevant jurisprudence.

** The others are: Arizona, Florida, Hawaii, Illinois, South Carolina, Louisiana, California, Alaska, and Washington.

Status.* Nonresident aliens who fail to provide an exemption form to the U.S. financial institution are subject to withholding at the rate of 30 percent.

In IRS terminology, the depository would be a withholding agent and would be required to file an annual withholding tax return that identifies each foreign person to whom payments were made during the year, the amount paid, and the amount of tax withheld. Various civil and criminal penalties may be charged against the withholding agent (not the customer) for failure to comply with the reporting requirements.

The United States has entered into 45 income tax treaties and 13 tax information exchange agreements (TIEAs) with other countries. Treaty partners include China, Indonesia, Mexico, Japan, the Philippines, and Russia (all countries from which depository customers would likely originate). All but one of the countries with which TIEAs are in effect are in the Caribbean Basin. Both types of agreement have the force of federal law. Under these reciprocal arrangements, U.S. officials are obliged to obtain information about individuals and share it with the relevant foreign government. The IRS is frequently called upon to issue administrative subpoenas to obtain financial and other records in response to requests from treaty and TIEA partners. The U.S. has four income tax treaties (with Denmark, Sweden, France, and the Netherlands) that obligate IRS agents to assist in collecting the other country's taxes (as well as any interest penalties due) that are covered by the treaty. The U.S. has a unique accord with Canada that commits each to assist the other in the collection of all taxes imposed by either country, regardless of whether the specific taxes at issue are otherwise covered by the treaty. The U.S. also requires that any country wishing to enter into a TIEA must be willing to override whatever bank secrecy laws are in effect for purposes of honoring a U.S. request for a person's financial records.

The U.S. Justice and State Departments have "open mutual assistance

* IRS form W-8

channels" with many countries with which the United States has neither a tax treaty nor a TIEA. In addition, the U.S. has concluded mutual legal assistance treaties (MLATs) with 18 foreign jurisdictions, including the Cayman Islands, the Bahamas, Panama, Turkey, and Switzerland. These agreements generally obligate treaty partners to cooperate with each other in criminal matters; some of them have a sufficiently broad scope to include exchange and currency control offenses.[1]

In addition to tax treaties, TIEAs, and MLATs, there is a relatively obscure provision of federal law (28 U.S.C. 1782) that authorizes U.S. district courts to compel the production of testimony or records for use in a proceeding in a foreign or international tribunal. The request for such an order may be made by foreign governments or private litigants.[2] It is uncertain to what extent this legal avenue would or could be used to gain access to customer records in the depository, but the committee was informed about a recent case whereby Haitian government officials requested and obtained bank records from a U.S. institution after alleging that several defendants from Haiti had illegally transferred funds abroad. The District Court ordered the production of the records over objections that the Florida Constitution includes a right of privacy from government intrusion. The subpoena was issued pursuant to 28 U.S.C. 1782, and the Court ruled that it preempted state law.[3]

The provision of 28 U.S.C. 1782 is of particular interest to the committee because it is the only formal mechanism by which law enforcement authorities in Taiwan could request and obtain assistance from the U.S. The U.S. does not recognize Taiwan as a sovereign country and, therefore, may not join with it in a treaty or other binding agreement. Taiwan may be the single most likely source of depository funds, at least in the near term, because Montana already has significant trade links to the island and because the Taiwanese hold enormous capital and gold assets that are vulnerable if the Chinese decide to attack. At the same time, it is important to keep in mind that most if not all anticipated transactions between foreign customers (from Taiwan or any other place) and the Montana depository would be entirely aboveboard and therefore not subject to

disclosure under the circumstances outlined above.

> *In a society awash in computer databases, credit card fraud and crazy lawsuits, it's perfectly rational to be a bit paranoid about who has your name and numbers, and what plans they have for them.*[4]

Legal Limits to Privacy Invasion

The interest of individuals in financial privacy competes with the interest of government in requiring disclosure of financial information to assist in law enforcement. This competition has spawned several pieces of federal legislation and consequent litigation.

The Bank Secrecy Act (BSA) requires that certain records be kept and reports be made that "have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings". (See 12 U.S.C. 1951, et seq., and 31 U.S.C. 5311, et seq.) The BSA's definition of "financial institution" is broad and would apply to the foreign capital depository. The BSA requires all financial institutions to report cash transactions in excess of $10,000 to the Internal Revenue Service by preparing a Currency Transaction Report (CTR).* Reportable transactions include deposits; withdrawals; currency exchanges; check cashing; cash purchases of cashier's checks, money orders, and traveler's checks; and other financial services involving the physical transfer of over $10,000 in cash from one person to another. The CTR must include information describing the nature of the transaction and the identity of the person(s) involved. The Act does allow for exemptions (e.g., for a number of retail businesses that routinely require large cash transactions), but it also imposes strict penalties for noncompliance. Amendments to the BSA, as well as subsequent implementing regulations, require banks and nonbank financial entities to keep records of wire transfers and the sale of various monetary instruments whenever such

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* IRS Form 4789

activities amount to $3,000 or more. These records must be made available to the U.S. Treasury Department upon its request. In short, the federal government has the ability and procedures in place to keep tabs on most types of cash transactions involving virtually every type of financial services provider.

Shortly after the BSA was passed, it was challenged as a violation of the Fourteenth Amendment to the U.S. Constitution.* Certain members of the U.S. Supreme Court acknowledged the revealing nature of financial records. Justice William O. Douglas observed that "the banking transactions of an individual give a fairly accurate account of his religion, ideology, opinion, and interest". Nevertheless, the Court held that the BSA's reporting requirements did not constitute unlawful search and seizure. Congress, largely in response to constituents' complaints that the government enjoyed *carte blanche* access to every bit of information in everybody's bank accounts, passed the Right to Financial Privacy Act (RFPA) in 1978.

In the same manner that the Bank Secrecy Act is a misnomer (since it basically prohibits secret bank accounts), the title of the Right to Financial Privacy Act promises more than its substance actually delivers. The RFPA places some restrictions on the ability of a federal agency to obtain or scrutinize a person's bank records, but it does not apply to inquiries or investigations made by state and local government agencies, nor does it place any restriction on private individuals or entities (such as credit or detective agencies) who might, on occasion, have a pecuniary interest in another person's financial affairs.[5] (For a more complete summary of the RFPA, see at Appendix 2 the David Niss memorandum dated March 22, 1996.)

Amendments to the RFPA's disclosure section permit a financial institution to voluntarily notify the government when it suspects illegal activity. In other words, banks and nonbank entities enjoy "safe harbor" with respect to many potential customer allegations of wrongful disclosure. In a June

* California Bankers Association v. Schultz, 416 U.S. 21.85 (1974).

1996 decision, for example, a federal judge in Texas ruled that neither state nor federal right of privacy laws prohibit a bank from disclosing to government officials cases of potential or suspected money laundering.[6] Interestingly, there is no particular strategy that will ensure that financial institutions are in compliance with the BSA and the RFPA at the same time. A legal expert has asserted that each situation involving an alleged conflict of laws (disclosure versus reporting) would have to be analyzed on a case-by-case basis.[7]

Many of the types of provisions of the federal RFPA are commonly found in state financial privacy laws as well. According to a recent law review article*, seventeen states** have enacted laws similar or nearly identical to the federal RFPA.

At first, the committee's findings regarding the inapplicability of the constitutional right of privacy and the degree of federal preemption via treaties and other arrangements seemed to drain the depository concept of its core vitality. From the outset, a defining characteristic of the foreign capital depository has been the high degree of privacy, relative to other U.S. states, that it could offer to foreign clients. On further reflection, however, the subordination of a state constitutional right to other law limits the degree and scope of what the depository can promise, but Montana can still extend privacy protection beyond current limits to benefit depository customers.

The draft enabling legislation for the foreign capital depository contains

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* Steadman, "Constitutional Law: Kansans Have No Reasonable Expectation of Privacy in Bank or Telephone Records" State v. Schultz, 850 P.2d 818 (Kan. 1993).

** Steadman lists the states of Alabama, Alaska, California, Connecticut, Florida, Louisiana, Maine, Maryland, Missouri, Nebraska, Nevada, New Hampshire, North Carolina, North Dakota, Oklahoma, Oregon, and Tennessee. Steadman notes that Colorado has also interpreted its constitution to reject the holding in U.S. v. Miller. Other states than those listed may also have state RFPA-type statutes. An electronic search by LSD library staff indicates that there is at least one other state, Texas, with right-to-financial-privacy statutes that predate the Steadman article. See Tex. Rev. Civ. Stat. Ann. art. 342-705 (Vernon Supp. 1993).

within it the functional equivalent of a state right to financial privacy act. Federal law prohibits states from offering blanket anonymity or "secrecy" to depositors. However, the combination of the federal RFPA with a complementary state financial privacy law could effectively shield depositors from inquiries other than law enforcement-related inquiries by federal government agencies, state agencies, private individuals, and perhaps most importantly, private commercial entities, such as banks, marketing firms, and competitors.

The privacy provisions in the draft bill echo (albeit somewhat faintly) Swiss bank secrecy laws and anticipate the use of numbered accounts as a practical means of protecting the depository, the customer, and state regulators from wrongful disclosure, but they more fully reflect California law--and hence the federal RFPA--as well as provisions drawn from other states, such as Missouri and North Dakota. This portion of the bill is essential--without it, depository customers would be legally defenseless against successful probes by anyone other than a federal official. It must be noted, however, that the privacy protection offered would only apply to foreigners, not to Montana citizens.

Americans and foreigners alike can obtain a higher degree of financial privacy by going offshore. The "private banking" and trust divisions of transnational financial institutions typically have subsidiary offices in jurisdictions where there are stringent confidentiality laws.[8] In most cases, the confidentiality on offer is not ironclad--criminal investigators can generally gain access to records--but the thousands of customers find thin armor much more comforting than none at all.

Financial Anonymity: Supply and Demand Factors

A review of the available literature on financial privacy produced the following list of respectable and not-so-respectable types of economic demand.

LEGAL & (PROBABLY) LEGITIMATE

- Business confidentiality
- Personal privacy
- Tax avoidance (income, estate, business, etc.)
- Exchange controls
- Political risk (of revolution, expropriation, etc.)
- Social pressures (e.g., envy)
- Varying conceptions of justice and fairness
- Family misfortunes (e.g., divorce)
- Fear of the unknown

ILLEGAL & NOT (NECESSARILY) LEGITIMATE

- Money laundering (drugs, guns, gambling, other)
- Bribery, and other forms of financial corruption
- Tax evasion
- Smuggling
- Insider trading
- Fraud
- Clandestine government operations

ENDNOTES

1. Memorandum to Senator Sprague from James Springer, U.S. Department of Justice, International Tax Division, dated January 25, 1996, p. 3.

2. Unpublished document submitted to the committee entitled "IRS Access to Confidential Financial Information and Assets in Foreign Investment Depositories" (no author listed).

3. Springer, ibid.

4. Janet Novak, *Private Lives*, Forbes, June 19, 1995, p. 139.

5. Charles Taylor Plombeck, *Confidentiality and Disclosure: The Money Laundering Control Act of 1986 and Banking Secrecy*, The International Lawyer, Spring, 1988, Vol.22, No.1, p. 95.

6. Banking Attorney, June 1996, p. 3.

7. Peter Meltzer, *Keeping Drug Money From Reaching the Wash Cycle: A Guide to the Bank Secrecy Act*, Banking Law Journal, May/June 1991, p. 254.

8. The promotional literature from the Bank of America states that "the judicious use of offshore trusts and private investment companies allow for a high level of anonymity in your financial affairs." The Bank of America has facilities in Asia, Europe, the Middle East, and Latin America as well as in a number of U.S. cities; its International Trust Services Offices are located in Hong Kong, Grand Cayman, the Bahamas, and Jersey.

III. Flight Capital and Foreign Clientele

The current state of global affairs is marked by political instability and economic insecurity. On a good day, financial markets clear $2 trillion worth of liquid capital. On a bad day, the whole system seems like a house of cards about to collapse. The world is a rough and tumble place for people who have earned, amassed, or inherited vast fortunes. There are many good reasons, such as inflation, devaluation, and confiscatory taxation, for wealthy people to shift their funds out of their home country and into another. There are some not-so-good reasons too, ranging from criminal tax evasion to innocent but irrational fear of invasion, revolution, depression, or all three combined.

Big bangs scatter cash. When a volcano erupted on the tiny Caribbean island of Montserrat in July 1995, foreign depositors abandoned this offshore tax haven almost immediately, just ahead of half the population. Elsewhere, over $10 billion left Mexico overnight following the explosive devaluation of the peso in December 1994. This was nothing new; hundreds of millions of dollars were sent abroad from Mexico in 1982, amid devaluations and bank nationalization.* Turkey is reportedly facing an imminent, Mexico-style financial crisis: its foreign currency reserves are down, its own money is overvalued, budget and trade deficit are skyrocketing, the economy is shrinking, and there's a war brewing on Turkey's Kurdish frontier.[1] An estimated $30 billion has fled the People's Republic of China in the last year. Russia has exported so much money--an estimated $50 billion over 5 years--that observers have difficulty finding much evidence of the funds provided by the West. There is no reliable statistical measure, but privately conducted analyses estimate that the flows of flight capital amount to $50 to $80 billion annually, an amount that exceeds the yearly total of foreign aid appropriations of Western governments.

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* "Capital flight is as old as Mexican history. Even the Spaniards took their silver out of Mexico." Jose Mantecon, former securities regulator, quoted in "Mexican Dirty Money Finds a Handy Laundry Next Door in Texas", *Wall Street Journal*, August 8, 1996.

Flight capital refers to money and other liquid assets that are shipped, carried, or transmitted outside the political boundaries of a country suffering (or anticipating) political and/or economic instability. Insecurity causes capital flight, and the causes of insecurity are legion. In general, suspicions about the fragility of one's economic environment (or the international financial system as a whole) plus a deep distrust of government constitute a powerful motivation to move money out of harm's way. In many ways, flight capital is fright capital, and recent examples of the trickle-out effects of fear are abundant: Argentina and Haiti in the recent past, Turkey and Zaire today, Hong Kong tomorrow.

Some people have strong, moralistic views on this subject. Flight capital is "arguably the most destructive economic condition hurting low- and middle-income countries", according to journalist Raymond Baker. He continues:

> *Flight capital is hot money from African, Latin American, Eastern European and former Soviet countries surreptitiously passing by collusive and illicit means into New York, Miami, London, Paris, Hamburg, and Swiss banks. In the process, it distorts free trade, negates foreign aid, worsens inflation, diminishes tax revenues, undermines structural adjustment, delays and imperils democracy, and firmly entrenches poverty.*[2]

There is a very dark side indeed to some types and examples of capital flight. Most of what is reported about the holders of Swiss bank accounts is bad news about very bad people--dictators and despots who bilk their respective countries for billions. There is a lighter side to the picture, however, and it tends to suffer from underexposure in the media because it is not associated with mayhem and melodrama. In technical terms, capital flight

> *. . . refers to an unfavorable change in the risk/return profile associated with assets held in a particular country--as compared with a portfolio held in other jurisdictions--deemed to be sufficient to warrant active redeployment of assets. It usually involves significant conflict between the objectives of asset-holders and their governments. It may or may not violate the law. It is always considered by the authorities to be dysfunctional.*[3]

These divergent views underscore an important consideration: flight capital is commonly subjected to a double standard. Large banking institutions have trust departments and offshore subsidiaries that are very aggressively hunting and "capturing" assets abroad. In addition, many Fortune 500 corporations routinely (and legally) take advantage of the tax deferral advantages provided by moving pension fund and investment income through offshore jurisdictions. When individuals engage in the same type of behavior, eyebrows go up and governments crack down.

Capital flight is a daily occurrence, a commonplace event in the expanding cosmos of international finance. In 1971, about 90 percent of all foreign exchange transactions were to finance trade and long-term investments, and only about 10 percent were speculative. Now those percentages are reversed. Daily speculative flows now regularly exceed the combined foreign exchange reserves of the seven advanced industrialized democracies.[4] Governments that attempt to lower domestic interest rates to stimulate employment are likely to suffer crippling outflows of financial capital in pursuit of higher interest rates elsewhere. High levels of capital mobility create a bias toward restrictive monetary policies. Countries that fail to align their interest rates with those of the global economy risk substantial capital outflows and intense speculative pressures on their currencies.[5]

> *Preservation of wealth often involves a timely decision to move capital from one place, or one form, to another. Many times capital would have been lost if it had not been wisely redeployed as circumstances changed. Capital is always under political threat when it is in a minority. The periods of greatest risk are times of public disorder when many are impoverished and only a few are wise enough or lucky enough to preserve their wealth.*[6]

Some Sources and Their Characteristics

There are two different groups of people necessary to make the depository work: those who would own and operate the institution, and those who

would entrust their wealth to it. References to the prospective charter holders are scattered throughout the report; the focus here is on the depositors themselves: their identity, motives, and wherewithal.

Senate Joint Resolution No. 19 refers to political instability in Mexico and Canada, as well as other countries, as a proximate cause for capital to take flight and touch down again in a secure haven such as Montana. SJR 19 was drafted well after the Zapatista rebellion flared in the southern Mexican state of Chiapas but also before the latest devaluation of the Mexican peso and the ensuing financial panic that overnight drove billions into the U.S. as well as to European and Caribbean accounts. Montana remains, for the moment, an unlikely destination for Mexican flight capital, given the state's geographic location and, more importantly, its cultural distance; Colorado has a much more accommodating climate in every way. Still, there is no telling what difference

a new and different depository might make to a Mexican (or some other Latin American) family seeking more than one secure location outside their home country.

Canada is obviously a surer bet than Mexico as a source of deposits. The committee learned that large sums have been transferred into and out of Montana bank accounts in recent years as the exchange value of the Canadian dollar dropped to historic lows and concerns about the breakup of the country reached all-time highs. The narrow margin of victory (1 percent) of the profederalist forces in the October 31, 1995, referendum in Quebec, coupled with the dearth of popular support for the Ottawa government's attempts to placate Quebec sovereignists with worn-out promises and concessions, means
that the Canadian federation will remain tenuous for some time to come. Whether Montanans are comfortable with the prospect of attracting Canadian flight capital and thus indirectly aiding and abetting the possible disintegration of a neighboring country is another question, albeit a relevant

one.

Prospective customers from outside of North America fit into three general categories: refugees, aristocrats, and expatriates. An example of a financial (and political) refugee would be a billionaire from Hong Kong, Taiwan, or Indonesia. Another would be the so-called "astronauts" from Hong Kong, many of whom have landed in California and Vancouver, British Columbia, in recent years to get a firm foothold in North America with a diversified investment portfolio in advance of the Chinese takeover in 1997.* The aristocrats are more likely to be Europeans, fearful of momentous changes to come on that continent, or they represent upper-most classes of the Middle East and even the extended royal families of Saudi Arabia and smaller Persian Gulf countries.

It is also important to consider people in the relatively wealthy classes of a number of countries; they may not be genuine aristocrats, but they are often similarly motivated. Most high-tax countries in the world, according to one author, have reached the "tax wall". Citizens are no longer willing to tolerate increased taxation, so they rearrange their finances to reduce tax liabilities. One well-tested way is to move their capital offshore. This is capital flight of a sort, but it's almost mundane compared with the kind that is precipitated by revolutionary war and other disasters.

The high marginal and average tax rates in advanced industrialized countries partially explain why so much financial capital has been relocated to offshore jurisdictions. In Britain, for example, the average income tax rate is 40 percent. In Canada, it's slightly over 53 percent. France and Germany have income tax rates of 57 percent and 53 percent, respectively. Each of these countries except Germany also tax capital gains; all pay taxes on dividends ranging from 40 to 67 percent. The Japanese pay up to 65 percent tax on income and the same amount, additionally, on capital gains.[7]

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* They are called astronauts because almost immediately after touching down in North America they take off again to go back to continue doing business in Hong Kong, often leaving their school-age children behind during the week, and returning again to North America for weekend stays.

It's no wonder that offshore banking and trust services have come on so strong in recent years. Ingo Walter puts the matter plainly and succinctly in his book *Secret Money*: "There would be no tax havens without tax hells."

Another type of expatriate is the uprooted cosmopolite, the transnational entrepreneur that Jerome Schneider refers to as "the peripatetic capitalist". This kind of individual stands ready to sever ties to home and country in order to shelter and amass great fortunes; they include obscure (to us) Asian manufacturers as well as famous American retailers. Actually, a significant number of potential depositors are nonresident aliens, but not foreigners. There may be hundreds of Americans willing to at least contemplate giving up their U.S. citizenship in order to take advantage of tax haven and bank secrecy jurisdictions. There is considerable interest in the depository and empathy for Montana among Americans. Much of both is rooted in bad experience with the IRS, a need to shelter assets from lawsuits, or both.

Although it is seldom described as such, there is tremendous capital flight **from** the United States. Most of it is motivated by a desire to legally avoid taxation. A measure still pending at the close of the last session of Congress, HR 1812, would end an existing tax provision that allows wealthy Americans to avoid paying taxes by renouncing their U.S. citizenship. The proposed bill would affect fewer than 24 people each year, according to a U.S. Treasury Department analysis, but they are individuals with hundreds of millions if not billions of dollars in assets. Among the American expatriates who have recently renounced their U.S. citizenship to avoid taxes are the heir to the Campbell soup fortune, the creator of Carnival Cruise lines, and members of the Dart family, inventors and purveyors of the ubiquitous plastic foam cup. HR 1812 would assume that any person with a net worth of more than $500,000 and who is expatriated did so with the express purpose of avoiding taxes. For 10
years from the date they leave the country these wealthy expatriates would be required to continue paying taxes on domestic source income, such as dividends from shares of U.S. corporations or capital gains from U.S. real

estate.[8]

It is risky to generalize about the motives and interests of such a disparate group of potential depositors, but here is an attempt at a summary:

1. **Security** - a safe place for cash, treasure, and other financial assets, immune from political instability and economic chaos; a hedge against disaster.

2. **Privacy** - a financial sanctuary and/or a judgment-proof bank account or safe deposit box, far from the search and seizure capabilities of a depositor's home government, from jealous competitors, from estranged business partners and grasping, disaffected family members; a hiding place, under someone else's mattress.

3. **A Tax Haven** - a legitimate, aboveboard means of avoiding excessive, onerous, or confiscatory taxes in their home country.

4. **Investment Opportunity** - a conduit to something tangible or fungible: land, a retirement home, an annuity, a promising business, precious metals.

Promising Targets

Each year *Forbes* magazine publishes an index of foreign billionaires. In the July 14, 1995, issue, there were 19 individuals listed with reported assets of $5 billion or more. Six were from Germany, three were from Hong Kong, and two were from Japan. There was one each from a variety of countries, including Taiwan, Canada, Switzerland, and the United Kingdom. In the category of $2 billion or more, there were nearly 100 names. Among the countries represented were Indonesia, South Africa, Lebanon, and Mexico. There were over 150 persons listed in the $1 billion lineup, a sizeable number of whom come from Brazil, Mexico, and the Philippines. It is evident from this profile that there are extraordinarily wealthy people all over the world, that those with the greatest assets come from advanced industrialized democracies (not Colombia), and that a Montana depository

could target certain groups in certain countries, using a variety of criteria (legal systems, political conditions, human rights records, cultural and religious traditions, etc.) to help ensure that the customer base is truly select and unlikely to include criminals.

The committee briefly considered an additional category of customer, one with familiar motives but an added dimension of concern. According to *The Koran*, the holy book of Islam, paying or earning interest (riba) is sinful.* This does not mean that devout Muslims are averse to making money; OPEC oil has made some of them fabulously wealthy. There is a trend, however, throughout the Muslim world, toward Islamic banking, which utilizes special bonds, equity funds, and predetermined profit-sharing arrangements in lieu of conventional interest payments. Malaysia is the first country to introduce full-fledged Islamic banking that operates parallel to the conventional system, but the phenomena is also spreading to Indonesia and Pakistan as well as to a number of Middle Eastern countries.[9] Noninterest-based financial services appear to be an expanding subsector of the global economy that serves the needs of hundreds of millions of people. It is worth noting that Indonesia is not only an economic powerhouse and the home of many billionaires, but also has the largest Muslim population in the world. What may confound some Montanans and other Americans about the proposed depository--its dearth of interest-bearing investment opportunities--may be what helps attract the foreign customers it is intended to serve.

There are many perspectives on capital flight and enormous personal wealth. As the editor of *Forbes* points out in a recent issue, low profiles are common among the rich of Europe; less so in the United States. There is an old French saying: live happy, live hidden. Donald Trump and Bill Gates don't appear to fit this mold, but many foreigners do. A quiet account in a Montana depository may suit them well.

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* "Allah hath permitted trade and forbidden riba." Chapter Two, *The Koran*.

Attracting flight capital might compromise existing trade relations and obstruct more conventional investment decisions on the part of foreign governments. On the other hand, why not benefit, if possible, from anticipated (if not already abundantly evident) flight of financial capital from Hong Kong prior to the scheduled takeover of the colony by the People's Republic of China in July, 1997? It makes even more sense to attract financial capital from Taiwan, which has the world's second-largest store of foreign currency reserves, billions of dollars worth of gold, well-established trade links to Montana, and an uncertain political future, given China's unpredictability.

The members of the committee found it useful to remind themselves on occasion that for every sensationalized account of a Third World potentate absconding with sizeable chunks of a nation's financial resources and subsequent refuge in a Swiss bank account, there is the earlier and monumental historical fact that if not for the Swiss and their armed neutrality, the Jews of Europe who survived the Holocaust would have lost everything to the Nazi regime. There is good, bad, and ugly flight capital. The committee did not ignore the latter two categories, but focused its sights on the good.

ENDNOTES

1. *Turkish Economy, Hit by Multiple Ills, Sparks Fear at Home, in West,* Wall Street Journal, February 2, 1996.

2. Raymond Baker, Dirty Rivers of Money, Manchester Guardian Weekly, June 18, 1995.

3. Ingo Walter, New York University, fax memorandum dated March 26, 1996.

4. Fred Block, *Controlling Global Finance*, World Policy Journal, Fall 1996, Vol. XIII, No. 3, p. 26. The Group of Seven includes: the United Kingdom, Germany, France, Italy, Canada, Japan, and the United States.

5. Ibid., p. 28

6. Adam Starchild, Using Offshore Havens for Privacy and Profits, Boulder: Paladin Press, 1995, p. 26.

7. Richard Czerlau, Tax Haven Roundup, Toronto: Uphill Publishing, 1995, p. 13.

8. Congressional Quarterly, June 17, 1995, p. 1724.

9. *Banking on Faith*, Far Eastern Economic Review, April 13, 1995, pp. 54-55.

IV. Offshore Banking: High Standards v. Low Regard

The cover of the brochure for Jerome Schneider's seminar entitled "The Secrets of Offshore Wealth Building" features a collage of photos that include: a handsome, youngish man in a tailored suit juxtaposed to a private jet and what looks to be a Lambourgini; a luxury hotel; some Kruggerrands; a stack of paper money; several rows of safe deposit boxes; and a blonde woman in a bathing suit. The 3-inch thick binder provided to seminar attendees contained a multitude of articles, outlines, checklists, and legal forms. The contrast between the contents and the cover is telling--the mystique of offshore banking obscures reality. The use of tax haven and bank secrecy jurisdictions is commonplace for many reputable and well-known corporations as well as wealthy individuals. Many top-flight American companies routinely utilize the services of banks in Switzerland, the Caribbean, and elsewhere.

A tax haven is a political jurisdiction actively making itself available for the avoidance of tax that would otherwise be paid in relatively high-tax countries. The list of tax havens and offshore banking centers has grown in recent years. In addition to the best known jurisdictions, such as Switzerland and the Cayman Islands, there are about 25 others, most of them small island countries (or colonies with few other means of visible support given their relative dearth of population and natural resources). The Channel Islands (between Britain and France), the Netherlands Antilles (in the Caribbean), and the tiny Pacific Ocean Republic of Nauru are all striving to become major intersections of international financial traffic. Most have few or virtually no banking regulations. Typically, there are strict laws governing confidentiality, which encourages banks and trust companies to locate there. License and other revenues (such as stamp duties, but rarely taxes) accrue to the government; businesses are shielded by local law from inquiries about their structure, activities, and financial worth. In many cases, they are also shielded from inquiries by the taxing authorities of other governments.

Successful and reputable tax havens have healthy economies, honest and stable governments, and growing opportunities for investment. It is seldom acknowledged, but the United States has effectively established itself as a tax haven for foreigners by not imposing a withholding tax on interest paid to foreigners on their U.S. bank deposits or portfolio interest and by allowing foreigners to buy, hold, and sell U.S. securities without incurring a capital gains liability.

Not all offshore tax havens and banking centers are the same. A survey of the literature on offshore banking makes it quite clear that there are noble and ignoble places to do business in confidence. The Swiss are the most venerable and upstanding among the bank secrecy jurisdictions; Bermuda and the Cayman Islands are also included in the experts' top ten list for integrity and security. Reputations can change as rapidly as political conditions, however. Panama used to be considered an offshore tax haven with star quality, but lost its luster almost overnight because of former dictator Manuel Noriega's ruinous behavior. Panama's proximity to Colombia and its narcoterrorist troubles has not helped, and even though the government's public relations officers still insist that Panama's low taxes, bank secrecy rules, and location at one of the world's great commercial crossroads make the country "a near-ideal haven for funds", Panama is no longer considered a safe or reputable place to conduct legitimate offshore business.

> *Never keep all your wealth in the country where you live. Keep part of your assets hidden and beyond the government's reach.*[1]

The Swiss Model

A tiny country in geographic measure, Switzerland has the 8th largest economy in Europe and the 16th largest in the world. Much of its modern success has hinged on private banking. Switzerland is well known for keeping customer accounts private. Violations of bank secrecy laws are a

criminal offense. This applies to bank officials and to anyone found guilty of causing a breach in customer confidentiality. In addition, it is illegal for a bank to reveal whether a certain individual is a customer or not.*

The Swiss believe that paying taxes is a civic responsibility, not a legal obligation. The failure to report income or assets subject to taxation is considered a misdemeanor with civil penalties imposed. Because tax evasion is not a criminal offense in Switzerland, Swiss banks are not obligated to provide U.S. or other foreign prosecutors information about depositors who may be suspected of tax evasion.**

Swiss banking practices are often misunderstood, and bank secrecy is not absolute. It can be lifted by court order under two conditions: in the case of a criminal investigation conducted in Switzerland of a Swiss crime committed by a Swiss citizen and under treaty-specified conditions when foreign citizens are under criminal investigation by a foreign government and the alleged crime is also considered a crime under Swiss law. Among the laws for which confidentiality may be breached are the following: larceny, embezzlement, extortion, bribery, forgery, receiving or transporting stolen property, fraudulent bankruptcy, false business declarations, and fraud.[2] In short, criminals are not protected; law abiding citizens are.

Swiss banking has evolved fairly rapidly in the same direction as other national types--toward full service, supermarket-style financial institutions, offering options, futures, derivatives, and other specialized products to their customers. Switzerland has suffered a gradual loss in its competitiveness as a financial center. This has less to do with the proliferation of alternative offshore banking jurisdictions than with the fact that financial transactions have become the target of new taxes, such as

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* Arcticle 28 of the Swiss Civil Code. In addition, Article 47 of the federal Banking Law of 1934 stipulates that banks may not furnish any information to third parties about the financial circumstances and business connections of their customers.

** There is a special provision of the U.S.-Switzerland Treaty on Mutual Assistance in Criminal Matters that provides Swiss legal help to U.S. prosecutors in tax evasion cases when the investigation concerns an organized crime syndicate.

a transactions tax on securities trading and a 6.2 percent tax on individual gold purchases. In addition, Swiss traditions of confidentiality have been eroded by international agreements such as bilateral treaties (e.g., with the United States) on double taxation, which generally include a clause covering the exchange of information.[3]

There are other important aspects of Swiss banking and finance that are congruent with the hopes and visions of depository advocates: the Swiss franc is a gold-backed and convertible currency; Switzerland has a policy of unrestricted capital movement; Swiss banks are keen on adopting new technology without sacrificing hallowed traditions.

Caribbean Gems

As mentioned above, Bermuda and the Cayman Islands also stand out from the pack as examples of reputable havens. Bermuda seems to have it all: political stability, professional capacity, tax advantages, and a beautiful setting. Bermuda has been a British colony for 400 years, and in a 1995 referendum the people voted to keep it that way. The island has well-developed social and physical infrastructure for international banking, including ample expertise in banking and accounting, state-of-the-art fiber optic telecommunications links to the world, and sophisticated hotel and air services. Bermuda imposes no income, capital gains, or transactions taxes. Bermudans acknowledge the importance of maintaining their sterling reputation. "There is sometimes a sense that offshore centers are not always careful, so it is very important to us to know our customers and provide an environment that is credible and first rate", said the Finance Minister in a July 1996 interview.[4] The colonial administration also affirms the strong connection between international business activities and tourism. Bermuda is convenient to the U.S. mainland and accessible from most major cities worldwide.

Grand Cayman ranks as the world's fifth largest financial center, after London, New York, Tokyo, and Hong Kong. Forty-seven of the world's top

50 banks have established branches or subsidiaries in the Caymans. The island colony is host to the world's largest and most prestigious accounting firms: Arthur Anderson, Coopers and Lybrand, Deloitte and Touche, Ernst and Young, KPMG Peat Marwick, and Price Waterhouse. Accounts can be maintained in any currency. There is no exchange control legislation. Fees charged by banks are competitive. In the Caymans, there is no income tax, capital gains tax, withholding tax, gift tax, inheritance tax, death duty, corporation tax, value added tax, sales tax, or property tax.[5]

The Confidential Relationships (Preservation) Law of the Cayman Islands is subdivided into major sections dealing with testimony concerning confidential matters given in public proceedings, making private use of confidential information, and penalties for violations. Confidential information is defined to include information concerning any property that the recipient is not authorized by the principal to divulge. Interestingly, the law does not apply to the divulging of confidential information by a bank to the extent that disclosure is "reasonably necessary for the protection of the bank's interest". The primary provision of the law prohibits disclosure of information in a proceeding unless the witness first applies for direction from the judge concerning the disclosure. Another provision prohibits a person in possession of confidential information from disclosing it for his or her own benefit or the benefit of another without consent of the principal. A penalty of $5,000 and 2 years imprisonment is provided.[6]

Cayman banks subscribe to the "know your client" philosophy and are constantly alert to the danger signals that accompany dubious clients and transactions. A published message from the Financial Secretary exemplifies the kind of efforts made to deter shady characters from the sunnier parts of the Caribbean: "It is my responsibility not just to encourage growth in Cayman's financial sector but, as importantly, to insist upon the right kind of growth. Cayman welcomes all legitimate deposits and investments but has no interest in, and, in fact, will not tolerate questionable transactions."[7]

A Trend Toward Trusts

A noticeable development in offshore banking is that tax considerations are less dominant than before, while trust arrangements designed to protect assets have become more popular. The Caymans have become a major center for offshore trusts, attracting customers from regions where the trust concept is alien, such as continental Europe, Latin America, and the Islamic World. Offshore trusts are no longer viewed simply as a tax avoidance technique but rather a vehicle to preserve or enhance wealth and to provide for its efficient succession, transmission, and management.

A trust is a set of obligations established by an individual (the settlor) binding one or more persons (the trustees) to hold and deal with property (the trust fund or trust property) in such a way that the benefit of the property accrues to other persons (the beneficiaries). The benefits of trusts are rooted in the separation between legal and beneficial ownership.* Since the trust assumes legal title of assets, it provides confidentiality to the beneficial owner. By establishing a trust in an offshore location with favorable tax laws, a person can protect their tax benefits and help offset or mitigate tax liabilities.

Some foreign jurisdictions have enacted laws that protect trust assets to a greater extent than does U.S. law. The Cayman Islands are not a signatory to the Hague Convention on Trusts, thus assuring autonomy in tailoring legislation to local needs and customs. Attorneys and consultants who promote offshore banking advise their clients to establish asset protection trusts in jurisdictions with these characteristics:

- no (or limited) recognition of foreign civil judgments, thereby forcing creditors to litigate their claims in the foreign jurisdiction;

- a requirement that plaintiffs hire attorneys licensed in the foreign

* The beneficial owner is the person or entity that receives the benefits of ownership--such as income--and exercises ultimate control over an asset's holding or disposal.

jurisdiction, thus raising the cost of litigation and discouraging the prosecution of cases;

• prohibition of contingency fee arrangements; i.e., plaintiffs have to finance litigation themselves.[8]

Asset protection strategies are designed to keep the lawyers of estranged business partners, family members and their lawyers, malpractice lawyers, divorce lawyers, bankruptcy lawyers, and just about any other kind of lawyers out of one's bank account.*

There is tremendous diversity within the "community" of offshore banking jurisdictions. Does Montana aspire to become the Switzerland of the Rockies, or Panama North? The question is rhetorical, the choice obvious. Montana shares with Switzerland many political values as well as a similar landscape. "Western Montana is the Switzerland of the United States," declared Dr. Sung Won Sohn, chief economist for Norwest Corporation in a 1995 address to the Montana Chamber of Commerce. This comment had no apparent intentional connection to banking, but it still fits: the draft legislation to enable the foreign capital depository was inspired in part by admiration for venerable Swiss traditions of religious tolerance, political stability, and respect for private property. The Swiss insist on preserving their centuries-old respect for refugees (financial and otherwise) and for foreign investors. The following characterization of the Swiss might be easily adapted to describe Montanans:

> *That's what the Swiss are like: conservative, prudent, independent. And these qualities are exactly those you expect in any company, institution or country where your money is invested.*[9]

Paeans to the Swiss don't wash with everyone. The *Montana Standard*'s

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* The irony is that it takes a sizeable outlay of cash to implement an offshore strategy: tax and trust attorneys don't come cheap.

lead editorial of September 10, 1996, said: "A desire for more tax money and a handful of jobs . . . shouldn't blind state officials to basic moral principles. Montana doesn't want to be compared closely to Switzerland, which some published accounts say has more than its share of government corruption." The committee paid due notice to scattered news reports throughout the interim about Jewish organizations claiming that Swiss banks continue to hold onto many millions of dollars owed to the families and survivors of Holocaust victims. A British Foreign Office report based on recently declassified war records indicated that such claims may be valid, and an internal Swiss investigation reached the same conclusion.[10]

As the title of this section of the report suggests, there is no consensus of opinion on the traditions and contemporary merits of offshore banking. Standards vary, and there appears to be ample opportunity to reap rewards on the high road as well as the lowest rung of this financial endeavor.

ENDNOTES

1. Harry Browne, quoted in Adam Starchild, Using Offshore Havens for Privacy and Profit, Boulder: Paladin Press, 1995, p. 7.

2. Jorg Schwartz, Legal Services Group, Swiss Bank Corporation, *Swiss Banking Secrecy: Not a Legend*, reprinted from Prospectus, October/November 1995, published by Swiss Bank Corporation.

3. Adrian Hamilton, The Financial Revolution: The Big Bang Worldwide, London: Penguin Books, 1986, p. 194.

4. Merelice K. England, *Bright Bermuda Sun Shines on Trusts as well as Tourists*, Christian Science Monitor, July 22, 1996, p. 9.

5. *Financial Services in the Cayman Islands*, government promotional publication, 1995, p. 10.

6. Confidential Relationships (Preservation) Law (1995 Revision), Supplement No. 1 published with Gazette No. 6 of 20th March, 1995, supplied by mail from the Finance Ministry, Grand Cayman.

7. Preface to government publication in note 5.

8. The Washington Lawyer, November/December 1995, p. 40.

9. Jurg M. Lattman, *Money & More*, June 16, 1995.

10. See, for example, Bruce Nelan, The Goods of Evil, Time, October 28, 1996, which includes mention of a U.S.-Swiss Commission headed by former Federal Reserve Board Chairman Paul Volcker to resolve the issue.

V. Dirty Money

"Behind every great fortune is a crime." At times, Balzac's cynical aphorism all but leapt off the pages of articles, reports, and memoranda describing the myriad ways of laundering money without getting caught. During the course of its inquiry, the committee became well acquainted with the taint of secrecy and also with the casual smearing of legitimate financial activity by sometimes overzealous efforts to uncover nefarious plots, schemes, and drug dealers' pipedreams. Some of the most egregious financial crimes get reported in the media, and the often sensational aspect of the stories (Mobutu's crimes in Zaire, Imelda Marcos's fortune in shoes, the Duvaliers' exit to Switzerland after trampling on human rights in Haiti, the depredations of CIA informant and narcoterrorist Manuel Noriega, etc.) tend to sully the reputations of otherwise prestigious institutions and greatly distort public perceptions of what goes on most of the time in most of the offshore tax haven jurisdictions in the world. Nevertheless, financial crime is a fact that the committee did not ignore.

Money laundering involves disguising financial assets so that they can be used without being associated with the illegal activity that produced them. Federal law enforcement officials estimate that between $100 and $300 billion in U.S. currency is laundered each year. This is clearly a lot of money; there is only about $400 billion of U.S. currency in circulation, and according to author Rachel Ehrenfeld, the volume of illicit money traffic dwarfs the earnings of legitimate corporations.[1] Yet the tremendous spread in the estimate is indicative of how difficult it is to measure something as elusive as the darker regions of the underground economy.

> *Secret money is the product of human nature. People lie. People cheat. People commit crimes. People are driven to protect what they regard as theirs. People elect or tolerate governments that foster political and economic adversity and uncertainty. People take advantage of the misery of others. A true international market for secret money is the inevitable result: a market that itself is appropriately cloaked in secrecy. While it may change form and substance over the years, human nature will ensure that this market will continue to thrive.*[2]

Drug trafficking remains the single largest source of illegal proceeds worldwide, and U.S. law enforcement has determined that going after the money is the most effective way of fighting the drug war. Illegal arms trade; bank, medical and insurance fraud; and various activities undertaken by organized crime syndicates are other examples of "dirty" money in search of a Maytag. Some of this country's largest and most reputable financial institutions have been both victims of and accomplices to money laundering offenses. One of the stories that broke during the interim concerned Citibank's relationship to Raul Salinas, brother of former Mexican President Carlos Salinas de Gortari. At issue is whether the bank accepted Salinas' $80 million knowing that it had been acquired by illegal means.

Law enforcement agencies generally view laundering as a three-step process: placement (when cash is actually deposited into a bank, for example), layering (which describes the rapid, multidirectional, transnational, and often confusing movement of the funds after they've entered interbank communication systems), and integration, when the funds are invested in tangible goods, real property, or simply change hands so many times as to become indistinguishable from good clean money. From a law enforcement perspective, it is essential to detect and block incoming funds at the placement stage, before they enter the international banking system and become nearly impossible to track.

For money launderers and other financial crooks, the big problem with cash is its bulk. In hundred dollar denominations, paper money weighs 3 times more than the drugs it can purchase; the much more common $10 and $20 bills generated in narcotics deals are 15-30 times heavier than cocaine. In 1990, U.S. agents made their largest seizure ever: $22 million in cash, $11 million of which was in twenties, and a total of 900,000 paper bills. The cache of cash weighed over 3,000 pounds.[3] The preferred method for reducing the weight and volume of cash is money orders supplied by American Express, Western Union, Thomas Cook, and the U.S. Post Office. For this reason, federal laws and regulations have been put in place to ensure that transactions are recorded and paper trails can be followed.

Similar to the shift of legitimate capital away from banks, there has been a large migration of money launderers to nonbank institutions. The securities sector is susceptible to infiltration by money launderers. Brokerage firms often have offices all over the world, and interoffice transactions are ordinarily conducted by wire transfers from or through multiple jurisdictions.

The globalization of American business makes antimoney-laundering tasks extraordinarily difficult. U.S. banks had over 380 overseas branches located in 68 countries as of August 1995.[4] These branches are subject to host country laws, not U.S. laws concerning money laundering. Foreign banks are under no obligation to inform U.S. bank examiners of the ownership of the accounts they hold. Bank privacy and data protection laws in some countries prohibit U.S. regulators from examining foreign branches. American bank regulators and law enforcement agents have other means of obtaining financial information, however, through tax treaties, tax information sharing agreements, and mutual legal assistance pacts. In addition, the Federal Reserve Board can deny a domestic bank's application to open a foreign branch in a country if the Board does not receive assurance that the branch will have sufficient money-laundering controls in place.

The War Against Financial Laundromats

The heavy artillery in the U.S. arsenal against money laundering is a thick chunk of paper: the Bank Secrecy Act (BSA), formally known as the Financial Recordkeeping and Currency and Foreign Transactions Reporting Act of 1970.* The BSA requires domestic banks and financial institutions to maintain certain records of transactions with their customers. The BSA also requires that individuals and financial institutions must report to the U.S. government certain foreign and domestic financial transactions. Failure

* Public Law 91-508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5330.

to keep records or make required reports can lead to civil and criminal penalties and civil forfeiture.

Implementing regulations of the BSA requires three kinds of reports: (1) a currency transaction report (CTR) must be filed by banks and domestic financial institutions on any currency transaction exceeding $10,000 on any business day; (2) an international transportation of currency or monetary instruments report (CMIR) must be filed by institutions or individuals when moving over $10,000 in currency or monetary instruments into or out of the U.S.; (3) a foreign bank accounts report (FBAR) must be filed annually by individuals who have a financial interest in or signature authority over bank accounts, securities accounts, or other financial accounts in a foreign country. Under its regulations, the Treasury Department may require reports on individual transactions with foreign financial institutions, including check and wire transfers received from or sent to foreign financial agencies. The Treasury Department regulations and administrative interpretations provide numerous exceptions to the BSA's reporting requirements. Transactions involving the use of safe deposit boxes are excluded from the reporting requirements.[5] However, new (in 1996) regulations require financial institutions to keep records on all domestic and international funds transfers amounting to $3,000 or more.

The BSA has been amended several times since its enactment in 1970. Here's how:

The Money Laundering Control Act of 1986 prohibits structuring of financial transactions for the purpose of exempting those transactions from the CTR requirements of the BSA. Structuring entails the purposeful reducing of transaction amounts to under $10,000 so as to not trigger the transaction reporting requirements.* (Structuring includes aggregation in a single business day or over a weekend.) The BSA also requires that

* A person hired to make a series of small (e.g., $2,000) transactions on behalf of a drug dealer or some other person seeking to evade government scrutiny by structuring their deposits is known as a "smurf".

individuals, in addition to institutions, file CTRs and that bank employees more carefully screen depositors to preclude attempts to structure deposits. Finally, the BSA criminalizes the willful dealing in or transporting the monetary proceeds of specified criminal offenses.

The Money Laundering Prosecution Improvements Act of 1988 specifies that financial institutions may not issue a bank check, cashier's check, traveler's check, or money order in an amount over $3,000 unless the customer has a verifiable transaction account with the bank or the bank obtains identification from the customer. Administrative regulations adopted under the Act authorize the Treasury Department to require reporting of monetary transactions under the usual $10,000 threshold for a limited periods of time and in a limited geographic region.*

The Annunzio-Wylie Anti-Money Laundering Act of 1992 requires the Treasury Department to adopt regulations requiring depository institutions to identify their nonbank customers and report specified information about those customers to the Department, under threat of civil and criminal penalties. This Act also authorizes the Department to require that any director, officer, agent, or employee of a financial institution report suspicious transactions relevant to a possible violation of law or regulations and prohibits the person making the report from notifying the customer about the report. The Act provides protection from civil liability to the person or institution making a report of any suspected violation of federal or state statutes or regulations. This "safe harbor" provision is not limited to reports required by the BSA, but applies to reports of any possible violation of federal or state law or regulation. The Act authorizes disclosure of CTRs to state agencies supervising financial institutions. The 1992 amendment also added a "death penalty" provision: institutions convicted of BSA violations may have their charters terminated.

The Money Laundering Suppression Act of 1994 provides for electronic compiling and transfer of CTRs and other records required by the BSA,

* This is known as "targeting".

provides for the publication of written rulings interpreting the BSA, and extends the exemptions for filing of routine CTRs. All of these most recent amendments are designed to reduce the burden placed upon financial institutions by the BSA by 30 percent.[6] The 1994 Act also modified the burden of proof necessary to convict a defendant of the antistructuring provisions of the BSA.

Under sentencing guidelines, money laundering offenses are treated more harshly than most federal crimes. Willful violations of the BSA reporting requirements are subject to civil penalties of up to $100,000 or $25,000 per violation, whichever is greater. Criminal penalties for willful violations range from 1 year imprisonment and a $1,000 fine to 10 years in jail and a $500,000 fine. Amendments to the BSA prohibit structuring transactions to avoid reporting.

FinCEN and FATF: Treasury Cops at Home and Abroad

The Financial Crimes Enforcement Network (FinCEN) is the U.S. Treasury Department's cloak and modem outfit in the global antimoney-laundering campaign. FinCEN administers the Bank Secrecy Act and provides intelligence backup to other federal agencies, including the IRS and the Justice Department. FinCEN's mission is "to provide world leadership in prevention and detection of the movement of illegally derived money and to empower others by providing them with the tools and the expertise needed to combat financial crime." In its efforts to fulfill this mission, FinCEN enters into information-sharing agreements with other agencies, and it takes the lead in representing U.S. interests on the Financial Action Task Force (FATF), a coalition of law enforcement agencies from several dozen countries actively engaged in attempts to hang money launderers out to dry.

FinCEN gleans information from a variety of sources. Its financial data base includes currency transaction reports, (CTRs), reports of international transportation of monetary instruments (CMIRs), reports of foreign bank

and financial accounts (FBARs), and, in consequence of recent developments, CTRs from casinos. All of these documents are filed by financial institutions (and casinos) in accordance with the BSA.

All U.S. depository institutions have traditionally been required to file criminal referral forms with federal regulatory agencies whenever they became aware of or suspected criminal activity. When a customer opens a number of accounts in amounts of less than $10,000* or converts large amounts of currency from large to small bills or when a bank employee notices a sudden surge in a customer's cash flow through the institution or a fellow employee's sudden adoption of a lavish lifestyle, these are some of the telltale signs of a money laundering operation. As of February 1996, banks and other depository institutions must file a new form with FinCEN, the suspicious activity report (SAR) for certain suspect transactions involving $5,000 or more.[7]

A financial institution must file the SAR following the discovery of: (1) suspected insider abuse involving any amount; (2) transactions aggregating $5,000 or more where a suspect can be identified; (3) transactions aggregating $25,000 or more regardless of potential suspects; and (4) transactions aggregating $5,000 or more that involve money laundering, suspicious financial transactions, or violations of the BSA.[8] As previously noted, the BSA prohibits a financial institution from notifying any person involved in a suspicious transaction that the transaction has been reported.

FinCEN also accesses federal, state, and local law enforcement data bases through written Memorandums of Understanding (MOUs). Currently, an MOU between the Montana Department of Justice and FinCEN is in the works, pending the resolution of some intergovernmental cost-sharing issues.** In past years, Montana has been a participant in a cooperative

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* Not a possibility with the foreign capital depository, which would require minimum deposits of $200,000.

** Draft MOU on "Suspicious Activity Report Access for Montana Department of Commerce", received at Montana Department of Commerce June 10, 1996.

program called Project Gateway that allows designated state officials access to the IRS's main computing center in Detroit, Michigan, where all CTRs are stored and processed. State and local government agencies are required to submit information requests through their State Coordinator. (In Montana, the Coordinator is located in the Justice Department's Law Enforcement Services Division.)*

Under Project Gateway, state analysts must use a specific name to search the data base and access only those reports filed on the individual or business named. The program does not accommodate fishing expeditions. States can only use the data on a reactive basis--when they already have the name of a suspect. According to a 1993 Government Accounting Office survey, 15 states require financial institutions to report suspicious transactions to state officials as well as to the IRS. Some states, including Arizona, Florida, and New York, require separate forms and use this information to initiate criminal investigations.[9]

The Financial Action Task Force (FATF) was established in 1989 by the members of the Group of Seven (or "G-7") advanced industrial democracies.** The membership of this international organization has swelled to include representatives of the financial, regulatory, and law enforcement communities from 26 nations around the world. Its primary purpose is to promote effective means of combating money laundering. The organization has adopted standards for member countries to meet, known as the 40 Recommendations.

FATF is endeavoring to effectively detect a difficult thing to measure. The vast majority of Task Force members lack sufficient data to support credible estimates of money laundering. The mere registering of a report of suspicious activity does not necessarily establish that money laundering

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* Project Gateway headquarters can be reached directly by dialling 1-800-SOS-BUCK.

** The Group of Seven (G-7) includes: the United States, the United Kingdom, France, Germany, Italy, Canada, and Japan.

has in fact occurred. U.S. estimates combine official crime statistics and anecdotal evidence, amounting to approximately $4.55 billion per year.[10] Compared to the volume of legitimate transactions, this is a drop in the bucket.

FATF must contend with two fundamental problems: the lack of universality, and the lack of a tough international enforcement mechanism. Some money laundering operations involve literally scores of transactions going to and from dozens of countries in a single day. It is not in the economic interest of many countries, especially those that are not members of FATF, to cooperate fully and routinely with outside law enforcement. A good example of this problem is the Economic Development Act passed in early 1996 by the government of the Seychelles.* Under the Act, investors who place $10 million or more in approved types of businesses and programs obtain immunity from prosecution for all criminal proceedings and also have their assets protected from compulsory acquisition or sequestration, unless the investor has committed acts of violence or drug trafficking in the Seychelles itself. FATF condemned this law as an open invitation to international criminal enterprises.[11]

Regulatory Overkill?

A FinCEN official admitted to the committee members that accessing information in the Project Gateway data base is like looking for a needle in the proverbial haystack. Of the approximately 12 million CTRs filed in 1995, only a tiny fraction were associated with any kind of illegal activity. The Government Accounting Office conducted a national survey and found that a little more than 35,000 institutions filed CTRs in 1993. Less than 1 percent of the 10.2 million CTRs filed that same year were marked suspicious, and many of those were marked or filed erroneously. Prior to the adoption of a new Suspicious Activities Report, bank employees could mark CTRs as suspicious on a voluntary, discretionary basis. The result was

* A small, archipelagic country in the Indian Ocean.

a great mass of inconsistent, unreliable data.[12]

A related issue is the cost to the U.S. financial services industry of laying such a carpet of records and reports. CTR compliance costs at different-sized and variously configured institutions range from $3 to $15 each.[13] A 1993 estimate
placed the cost of compliance with BSA requirements on a national basis at nearly $200 million annually, and this figure does not take into account the cost of enforcement bureaucracies, prisons, or courts involved in money laundering enforcement. Another major cost to the economy is the tax revenue foregone when criminal organizations are prevented from laundering their money into legitimate businesses that pay taxes and create honest jobs.[14]

The BSA can be read to permit the prosecution of a person who handles funds that the person believes to be derived from violations of foreign laws, including foreign currency control laws. The prosecutor would most likely have to prove culpable intent in such cases. It must be remembered nonetheless that exchange controls are inimical to individual freedom (even if they can be justified on other grounds, such as the exigencies of war) and also often presage more draconian economic measures; as such, they are a cause of capital flight.

Know Your Customer!

Even though filing currency transaction reports and keeping innumerable records may be costly, burdensome, and wasteful, they are also an unavoidable legal responsibility. Another approach to combating financial crime that is still voluntary is known generically as Know Your Customer, or KYC. Regardless of whether transaction reporting remains the law, experts concur that bank employees must be trained to look for unusual patterns of transactions in order to detect criminal activity. To determine what is unusual, they have to know something about their customers' businesses. Two of FATF's 40 Recommendations concern customer

identification and serve as an introductory overview of KYC principles:

> *Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names: they should be required (by law, by regulations, by agreements between supervisory authorities and financial institutions or by self-regulatory agreements among financial institutions) to identify, on the basis of an official or other reliable identifying document, and record the identity of their clients, either occasional or usual, when establishing business relations or conducting transactions (in particular opening of accounts or passbooks, entering into fiduciary transactions, renting of safe deposit boxes, performing large cash transactions).*
>
> *Financial institutions should take reasonable measures to obtain information about the true identity of the persons on whose behalf an account is opened or a transaction is conducted if there are any doubts as to whether these clients or customers are not acting on their own behalf, in particular, in the case of domiciliary companies (i.e. institutions, corporations, foundations, trusts, etc. that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located).*[15]

These suggestions complement and reinforce voluntary guidelines issued by the American Bankers Association and the Federal Reserve System.[16] According to the ABA, most U.S. banks have adopted KYC policies to help them identify suspect customers and transactions. Under these voluntary provisions (which may be made mandatory via forthcoming regulations), financial institutions verify the business of a new account holder and report any activity that is inconsistent with that type of business.

Establishing a foreign capital depository entails a certain risk--albeit unmeasurable by any reliable means--that financial criminals will take notice and seek to take advantage of a fresh opportunity. This would not be unusual, especially if the charter is issued to a large, transnational bank, and even if the institution has a sterling reputation. Merrill Lynch, First Boston, and E.F. Hutton are just a few of the well-known institutions that have been charged with aiding and abetting money launderers. "Banks all over the world, including some of the most influential, have been witting

and unwitting partners in crime, either by quietly standing by or by direct complicity," writes journalist Rachel Ehrenfeld.[17] Banks are rarely prosecuted, even when illicit activity has been detected and monitored.* As another expert put it, "Money laundering techniques are mercurial--as soon as the bank learns to watch one type of transaction, the "bad guys" devise new ways to carry out their schemes."[18] In a recent *Foreign Affairs* article, David Andelman presents a worst-case scenario of such risks:

> *Each time the international cartels and their money launderers pour their money into a particular country's banks, they want to make sure that not only the banks themselves but the environments where the banks do business and the operations of the banks fall under their narcotic spell. So there are often horrific social and political costs for nations that succumb to the seduction of billions of dollars in drug funds following into their coffers--corruption of judicial, police and governmental officials at the highest levels, bribery of entire parliamentary blocs and ultimately the corpses of judges, prosecutors, and journalists.*[19]

It is difficult to imagine this sort of torrid scene unfolding in Montana, although an unmeasured amount of money laundering probably takes place already. Nevertheless, there are a number of provisions in the draft bill designed to deter money launderers from taking any serious interest in the Montana foreign capital depository. These features are outlined in Part II of the report, but in general terms they include mandatory suspicious activity reports (to inform state officials as well as comply with the BSA and federal regulations), mandatory KYC policies, and a number of restrictions on the liquidity of funds once they've been deposited. An additional failsafe factor is that the Federal Reserve or the Treasury Department may impose a cease

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* In a private communication, an official from the New York Federal Reserve Bank remarked to staff that an enormous amount of legally questionable activity involving foreign capital takes place every day, that the cost of policing it would be outrageously high, and that the damage to the U.S. economy from an overzealous effort to clean up New York City banks would probably be devastating.

and desist order on any bank that either fails to adopt a BSA compliance program or fails to correct a program to the agency's satisfaction. The foreign capital depository would be subject to such an order and could also be shut down by state regulators for the same offense, with or without federal concurrence.

Dirty money is a mixed bag. The BSA requirements inundate government officials with information that may not be used very effectively. Several countries, including Canada, Australia, and the United Kingdom, have reviewed the U.S. approach to transaction reporting and have found them unwieldy, costly, and unnecessary. There is mounting pressure within the United States to modify the system. The Suspicious Activity Report is partly an acknowledgment of the need to reduce paperwork and all the problems associated with information overload. Industry analysts are recommending various methods of enforced self-regulation, and the still voluntary KYC guidelines evidence this trend. In view of the difficulties inherent in detecting, measuring, monitoring, and ultimately prosecuting financial crime and recognizing the endemic inefficiencies in a blanket approach to recordkeeping and reporting, the committee sought to establish state-level measures that would protect the institution and the state from harm and assist federal law enforcement even when transactions do not fall under the broad and heavy cloak of the BSA.

ENDNOTES

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13. John Byrne, *The Bank Secrecy Act: Do Reporting Requirements Really Assist the Government?*, Alabama Law Review, Vol. 44:3, 1993, p. 818.

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1994, p. 103.

VI. Electronic Money: D-Basing the Currency

"Cash is dying," declares James Gleick in a recent *New York Times* article. A panoply of public, private, bank, and nonbank institutions are starting to replace paper money with coded strands of bits and bytes that can be backed by any currency or by any other asset that engenders the public's confidence. This nascent electronic money industry, which combines recent advances in communications, computing, and cryptography, could bring significant efficiencies and related cost savings to consumers and institutions alike.

Interbank payment systems involving checks are costly and inefficient. One estimate puts the price at $150 billion per year, much of it tied up in labor and infrastructure that could be much reduced by electronic banking.[1] Another beneficial aspect of electronic commerce is that it provides instantaneous access to banking services from remote locations. The financial services industry has been developing and testing an array of new products, generally referred to as "cyberpayments". Bitbux, E-cash, Netchex, Cybercash, Netbills, and Digicash are just some of the trademarks ascribed to these new forms of payment and exchange, all of them designed to serve as surrogates for cash.

Most cyberpayment systems entail the use of "smartcards" also known as debit cards. Smartcards are credit card-like devices containing a microchip on which monetary value is encoded. The cards can be read by vending machines or terminals that deduct the amount of each transaction from the total stored value. When the stored value has been used up, it can be recharged via ATM, telephone, or personal computer, or it may be discarded. Smartcards are already quite popular in France and Germany, and in 1995, 400 million smartcards were shipped to Asia.[2]

Another type of cyberpayment used in electronic banking allows value to be stored in a personal computer and transferred electronically over the Internet. The Internet is the unanticipated outgrowth of an experimental network developed by and for the U.S. Defense Department in the 1960s.

The Internet now connects some 4.3 million computers (three quarters of which are in North America) and 20 to 30 million users worldwide via a mesh of phone lines, fiber optic cables, satellite transponders, and computer servers that can route mountains of data over long distances in very short periods of time. There is no industry standard as yet for Internet transactions. Visa, Mastercard, and Microsoft are attempting to create one, while AT&T is joining forces with Sprint and MCI to sell Internet services globally. The liberalization of telecommunications policies in fast-emerging markets of Asia, Eastern Europe, and South America will likely increase the availability of transnational electronic networks. Many large banks are not prepared to use the Internet for transactions because it is not secure enough against intruders, be they innocent computer hackers or sophisticated cybercrooks. In 1995, for example, student programmers in California discovered flaws in Netscape Navigator, the most popular search engine on the Internet.

Perhaps the most advanced cyberpayment system is Digicash, an invention of David Chaum, an American cryptographer based in the Netherlands. Digicash relies on a "public key" encryption technique that uses purportedly foolproof digital signatures to guarantee both the authenticity of the electronic coins and the anonymity of the person spending them.[3] Sweden's national bank and Finland's largest private bank are experimenting with the Digicash system, allowing account holders to visit a virtual ATM on the World Wide Web, withdraw funds into a electronic purse, and use this money to make purchases from and payments to participating merchants.

Mark Twain Bancshares, Inc., a regional bank holding company based in St. Louis, Missouri, is currently the only domestic institution using Digicash on a trial basis. The arrangement requires merchants and buyers alike to hold accounts with the bank and to pay a fee for electronic cash privileges. Participants deposit money by wire or check into special accounts, after which special software is downloaded to their personal computer hard drives. The bank "mints" electronic coins (encoded strings of symbols), which can be expended within a closed circuit of participating businesses.

> *The U.S. is built upon a U.S.$7 trillion economic engine, only [about] $300 billion of which is in cash, and less than 40 percent of which is even transacted within the U.S. The wealth of this nation is embedded in our electronic infrastructure.*[4]

The digitization of money is not altogether new. Several conventional payment systems enable banks to transfer and settle international payments more quickly by replacing official bank checks with electronic bookkeeping entries.

Fedwire is a broad-based domestic network maintained by the U.S. Federal Reserve System that enables financial institutions to complete final payments on behalf of their customers at any time during the business day. Fedwire links the 12 Federal Reserve Banks to more than 11,000 depository institutions nationwide. On an average day in 1994, the Fedwire funds transfer system processed 287,000 transactions valued at $841 billion.[5]

The Clearing House Interbank Payment System (CHIPS) is a private sector computerized network for the transfer of *international* dollar payments. CHIPS links 135 depository institutions that have offices or subsidiaries in New York City. The system finalizes payment orders only at the end of the day, when net settlement transactions are executed through Fedwire. CHIPS serves fewer banks than Fedwire, but nevertheless handles about 95 percent of all international interbank dollar transfers, which in the aggregate amount to over $1 trillion each day.

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) is a bankers' cooperative that facilitates the exchange of payment and other financial messages between financial institutions (including broker-dealers and securities companies) throughout the world. A SWIFT payment message is an instruction to transfer funds; the transfer itself takes place subsequently, over a settlement system like CHIPS or through correspondent banking relationships.

The foreign capital depository would probably be linked to both Fedwire and the CHIPS systems and might also make use of SWIFT in connection with an offshore affiliate or correspondent institution. The Digicash system, once tests have been completed and if it comes online in the financial services marketplace, may provide a means of enhancing customer privacy, but for the time being the practical applications of electronic money to the depository have not been determined.*[6]

A Gray Area for Policymakers

The advent of electronic commerce raises a number of public policy issues, including the government's loss of seignorage** and the potential for consumer fraud, money laundering, and counterfeiting. There is at least a possibility that someone will figure out how to make a perfect copy of someone else's digital money, thus creating counterfeit access to a theoretically endless source of purchasing power. At present there is no specialized legal framework for stored-value transactions, nor is there any established means of taxing them. So far, there has not been any overarching federal response to the cyberpayments revolution; the government's message is mixed. On the one hand, the Comptroller of the Currency is studying the advisability of the U.S. government becoming the major (if not the sole) issuer of smartcards; on the other, the Treasury Department is conducting and compiling research on the implications of electronic commerce for existing methods of combatting financial crime. On yet another hand--that of the quasi-governmental and seemingly omnipotent Federal Reserve System--there appears to be a strong reluctance to intervene, at least for now. "On behalf of the entire Board," said Fed Vice

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* The Marketing Vice President for Mark Twain Bank was invited to attend a committee meeting to discuss the potential applications of Digicash to the depository, but he did not make it to Montana.

** Seignorage is the difference between the face value of coins and currency and the cost of producing it. The term also applies to the interest-free lending to the government effected by Americans (and others) holding U.S. currency. In 1994, much of the $20 billion the Federal Reserve returned to the U.S. Treasury was derived from seignorage.

Chairman Alan Blinder in a recent statement to a Congressional committee, "I want to state clearly at the outset that the Federal Reserve has not the slightest desire to inhibit the evolution of this emerging industry by regulation, nor to constrain its growth."[7]

While the direction federal regulators intend to take may be difficult to discern, there is no question that cyberpayments will attract financial criminals. Electronic money poses no weight and concealment problems. It can move through computer networks undetected, at a keystroke, thus facilitating money laundering, tax evasion, and other illicit activities. Smartcards, or an online equivalent, could be made even less traceable than cash. All of this poses a new challenge to law enforcement agencies, who have labored long and hard to raise the cost of laundering dirty money by imposing strict transaction reporting and recordkeeping requirements on banks and virtually every type of nonbank financial institution.*

Some observers foresee the extension of BSA restrictions to the electronic payments arena. "Having finally made life difficult for drug smugglers with heavy cash suitcases," Gleik writes, "[the federal government] will not casually allow the manufacture of half-ounce chips that could make possible blind transfers of hundreds of millions of dollars, a money launderer's dream." So far, neither the Treasury Department nor the Federal Reserve have turned up evidence that cyberpayment technologies are being manipulated by criminal interests. Nevertheless, FinCEN and other members of the multilateral Financial Action Task Force are adamant about taking a proactive stance, working with vendors and users to identify vulnerabilities and build appropriate safeguards.[8]

From the consumer's (or depository customer's) perspective, digitized currency is double-edged; it offers extraordinary privacy, when encryption is part of the package, and equally extraordinary opportunities to invade

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* In April 1996, FinCEN's and the Federal Reserve Board's final regulations requiring U.S. financial institutions that initiate, transmit, or receive wire transfers to obtain, keep, and transmit specified information about the sender and recipient of funds came into effect. This recordkeeping rule applies to most wire transfers of $3,000 or more.

financial privacy, since most forms of electronic conveyance entail records and leave an audit trail.

Encryption is a means of protecting the integrity and privacy of telecommunications signals through electronic codes. Many computer network system administrators use encryption to defend against hackers and cyberthieves. The Communications Assistance for Law Enforcement Act, signed into law by President Clinton in 1994, provides online service providers the ability to monitor keystrokes of people communicating over their systems. Notwithstanding its value to the tracking of intruders, this law has spurred the development of new encryption methods and devices. To safeguard privacy, one proposal supported by the National Institute of Standards and Technology is called "commercial key escrow", wherein private entities (not government agencies) would hold decryption keys in escrow, making them available to law enforcement agencies following the seizure of encrypted communications.*

> *Much will turn on the value which users of e-cash prove to attach to its convertability into other forms of money. And here, one confronts questions that are related not merely to the Internet alone, nor indeed to electronic money alone, but are new-age cousins of the questions people asked when the first coins were struck, and when the first paper money was circulated, and when the first current accounts and credit cards were offered. The particular excitement of electronic money is that it poses the questions afresh in a pure, almost conceptual form: electronic money promises no intrinsic value, and barely even the trace of a physical existence. The Internet is about to push to the limit the question of what makes money worth what it is deemed to be worth.*[9]

To summarize, it appears that electronic commerce and the virtual money that goes with it are here to stay, but the cyberpayments industry is still in

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* For a detailed description of such systems, see: *How to Make a Mint: The Cryptography of Anonymous Electronic Cash*, L. Law, S. Sabett, J. Solinas, National Security Agency, Office of Information Security Research and Technology, Cryptology Division, June 18, 1996, available by phone at (202) 639-7200 or at http://www.ffhsj.com/bancmail/21 starch/961017.htm

its infancy. The basic vulnerability of electronic commerce is that it depends on software, and software always has bugs. Many cyberpayment systems are also susceptible to "bugs" of a different sort; some are actually designed to leak information about their users to unseen network monitors. Federal regulators are likely to enter the picture soon, for better or worse. Moreover, electronic commerce still commences with cash payments or credit card charges--in other words "real" money. This may limit the commercial appeal and practicality of even those encrypted systems that can guarantee the privacy of transactions.

And yet . . . money is in essence merely information about value and wealth. Money is the current liability of any bank or of all banks put together; it is not backed by dollars or by gold or anything else that is tangible. Even though roughly half the nearly $4 trillion total money supply in the U.S. is in motion every business day in the form of electronic impulses traveling between banks over Fedwire and CHIPS, only about one-tenth of the total exists as currency.
Ultimately, as Gleik and others point out, money is backed by nothing but confidence, habit, and faith. A salient exception is the Swiss franc, which is still as good as gold.

The draft bill to enable the foreign capital depository in Montana does not define or specify any particular use of electronic money or its conveyance over the Internet. It does, however, anticipate, in a general sense, the evolution of cyberpayments and an eventual, Digicash-like encrypted transaction system of significant value to depository customers. Certain sections of the bill provide for the use of smartcards or debit cards to access precious metals accounts. This is a strange marriage, in a way, since it brings together advanced technology and all the faith required to sustain virtual money with the primitive, rock solid reality of high-value, multipurpose products of the earth.

ENDNOTES

1. James Gleick, *The End of Cash*, New York Times Magazine, June 16, 1995, p. 35.

2. Walter Wriston, *The Future of Money*, Wired, October 1996, p. 142.

3. For a fascinating profile of Chaum and the Digicash system, see Alan Deutschman, *Money Wants to be Anonymous*, Worth, October 1995, pp. 95-104.

4. S. Venzke, Wired, August 1996, p. 137.

5. Federal Reserve Bank of New York: *Fedwire: The Federal Reserve Wire Transfer Service*, Monograph prepared by the Payments System Studies Staff of the Research and Market Analysis Group, March 1995, p. 1.

6. Staff was informed by a FinCEN official that in 1994 the Treasury Department charged Mark Twain Bank $750,000 in civil fines for violations of the Bank Secrecy Act. None of the illegal activity was connected in any way to the bank's use of and association with Digicash, however.

7. Statement by Alan Blinder, Vice Chairman of the Board of Governors of the Federal Reserve System, before the Subcommittee on Domestic and Monetary Policy of the Committee on Banking and Financial Services, U.S. House of Representatives, October 11, 1995, obtained from the Internet site of the Federal Reserve Bank of Minneapolis (http://woodrow.mpls.frb.fed.us.).

8. United States Department of the Treasury, FinCEN Advisory, Vol. 1, Issue 4, August 1996, with attached *FATF-VII Report on Money Laundering Typologies*, June 28, 1996, p. 6. Also, according to Alan Blinder, op. cit., "the menu of new products proposed for distribution in the United States holds little appeal for illicit activities due to their relatively low balance limits, the potential audit trail, and the limited acceptability as a means of payment--at least in the near term."

9. The Economist, November 26-December 2, 1994, pp. 22-23.

VII. Treasure State Redux: Oro y Plata y Platinum?

There is something altogether unique about Montana when compared with any offshore jurisdiction or any other state of the Union for that matter: Montana produces platinum, the world's rarest precious metal.

Even though all the platinum mined to date in the world would fit into one large shipping container, more than 20 percent of all manufactured goods contain platinum or require its use in the production process. Demand is rising, supplies are limited. While platinum use has risen by 50 percent in Europe, Japan, and North America in the past decade, its use has risen by over 300 percent in the rest of the world, most notably in China and other emerging markets in Asia. Over 95 percent of the world's platinum is mined in South Africa and Russia, both of which are susceptible to disruption caused by strikes, transportation bottlenecks, capital shortages, and technical breakdowns associated with antiquated machinery and infrastructure. It takes 10 tons of ore to produce a single ounce of the metal, a complex process that requires capital, expensive machinery, and a highly skilled work force. Bringing a new mine into operation takes from 5 to 10 years. In short, there is little doubt that platinum will continue to increase in value. What is not certain is whether the proposed depository will provide a commercially viable link between the deep pockets of foreign investors and the highly refined product of a big hole in the ground in south-central Montana.

The Stillwater Complex in the Beartooth Plateau contains a considerable number of "platiniferous orebodies" embedded in some of the oldest rock on the planet. The Complex includes an extensive mineralized zone known as the J-M Reef, which has been traced on the surface for approximately 28 miles and which extends over one mile to unknown depths. The Stillwater Mining Company currently owns or has the rights to nearly 1000 claims covering substantially all of the presently identified ore-bearing zone. The preface to the company's 1995 annual report explains the economic significance of this geologic happenstance:

Platinum and Palladium are rare precious metals with unique physical and chemical properties which make then vital to modern society. Stillwater Mining Company is the only U.S. producer of these strategic metals and the only significant primary source of platinum group metals (PGMs) outside South Africa. Stillwater's vast ore body in southern Montana is the richest known depository of PGMs in the world, and contains sufficient reserves to make Stillwater one of the largest precious metals companies in North America on a reserve basis.

The Stillwater mine sold 55,000 ounces of platinum in 1995. Milling and concentrating facilities at Nye are undergoing expansion. A base metals smelter is being constructed at Columbus. Annual platinum production is expected to exceed 125,000 ounces beginning in 1998. A second mine is planned at East Boulder, which could double or even quadruple production in the future. Within a decade, it seems, investment-grade products will be refined in Montana.

As Good as Gold, Only Better

Platinum is similar to gold in that it is widely regarded as a store of value. The available supply of platinum is far less than gold; however, there is at least 20 times more gold than platinum mined each year and there is far more gold than platinum in the commercial and strategic stockpiles of the world. Platinum generally trades at a substantial premium to gold. For example, in 1993 platinum prices exceeded gold prices by $40 an ounce. In the 1980s, the spread exceeded $100 an ounce. When gold reached $859 in 1980, platinum broke through the $1,000 mark. Platinum has increased in price by over 150 percent in the past decade. (The current price of platinum is just under $400 an ounce, which is about $20 an ounce more than gold.)

Platinum has remarkable physical characteristics: a high melting point (3,125 degrees F), great tensile strength, high resistance to corrosion and oxidation, excellent conductivity, and unmatched catalytic properties (that

is, the ability to alter and/or accelerate beneficial chemical reactions). Nearly half of all the platinum produced today is used in catalytic converters for automobiles. The metal is irreplaceable in some petrochemical processes as well as in assorted defense and high technology applications, including space shuttle components. It is also used in catheters, pacemakers, mass spectrometers, dental equipment, surgical instruments, and certain anticancer drugs.

Platinum is also what's known as a prestige jewelry metal, and jewelry accounts for nearly 40 percent of commercial demand. This type of jewelry is especially popular in Japan, which alone accounts for 85 percent of the market for platinum jewelry. Platinum is a hypoallergenic metal compatible with skin types. It does not tarnish or discolor, and it is used widely as a setting for precious stones. In addition, platinum jewelry is usually 90 to 95 percent pure, while much of gold jewelry contains only 50 percent pure gold.

Platinum group metals comprise an increasingly important element in efforts to restore and conserve clean air and water. Besides their use in the fabrication of automotive catalysts in the U.S., Japan, and Europe, platinum-based fuel cells may power cars when zero-emission standards come on line. Platinum is a key ingredient in pollution prevention technologies in dry cleaning, power plants, oil refineries, and assorted factory operations. There is also a growing market for recycled platinum recovered from abandoned cars and machinery. Palladium is a vital constituent of hydrogen peroxide, which is now being used in lieu of chlorine in a number of industrial processes.

There are no known substitutes for platinum and palladium, although the Stillwater Mining Company includes in its reports a caveat about the possibility that a less expensive alloy or synthetic material that could serve the same purposes might be developed in the future.[1]

The Enduring Appetite for Metal

"Investment in precious metals has always been a reflection of what people expected--feared!--would take place in national and world events." This is the opening line in a 1996 booklet written by Jacques Luben, President of the Platinum Guild International.[2] Precious metals are a remarkably respected and effective hedge against disaster. As Charles de Gaulle observed in mid-century, gold is still the universally accepted medium of exchange for governments and individuals alike, and as a marketing pamphlet for a precious metals investment program offered by California-based Monex Deposit Company puts it, "many experts believe that the financial markets and the mutual funds that invest in them are overvalued. [Precious metals] offer an excellent alternative and should benefit if there is a flight to tangible assets." According to Luben and others, bullion offers other advantages: commissions on purchase and sale are minimal; resale is relatively easy (provided the bars bear the stamp of a trustworthy refiner); market prices are quoted uniformly across the world; and purchases can be made at many different outlets, including banks, brokerage firms, and metals exchange companies. Paraphrasing de Gaulle, Luben writes that "whether a country has or lacks sufficient gold reserves (or their equivalent), may decide the fate of nations in war and peace". The focus here and now is on the parenthetical "equivalent", which for our purposes means platinum.

Notwithstanding all the above, history records a perennial return to--rather than departure from--precious metals. Gold, silver, and platinum are not generally regarded as good investments. Prices are, on occasion, volatile. Platinum and gold pay no interest or dividends. Their value has failed to keep pace with stocks, money market accounts, and mutual funds. There is always a risk that governments will succeed in their pursuit of balanced budgets, balanced trade, low inflation, and other aspects of a sound money policy, all of which tend to diminish the allure of precious metals.

From a purely financial point of view, these are all disadvantages. But from the vantage point of someone who is wealthy, skeptical about the resiliency

of currency markets, and fearful of a worldwide financial crash and all the misery that would entail and who is perhaps a devout, orthodox Muslim (for whom earning interest is a sin), a sizeable investment in precious metals is a genuinely attractive proposition. The possibility that the metal might be stored in a secure vault in the heart of North America--far from pirates and plunderers of all sorts, including tax collectors--presumably adds luster to the prospect.

A Scenario, Likely or Not?

The platinum angle hinges on a mixture of primitive and sophisticated factors: the psychological desire for "real" money and the use of cutting-edge telecommunications and security technologies. Picture this: a Taiwanese business executive guided by entrepreneurial instincts and mounting evidence that the People's Republic of China intends to squelch the island's independence movement as well as sit down hard on the golden goose egg complex known as Hong Kong decides to hedge a little and buy into whatever the Wild West nonbank depository of Montana has to offer. The customer deposits $25 million in New Taiwan dollars* at the branch office in Taipei. The deposit is transmuted into a purchase order and wire-transferred to the home office in Montana, where it automatically summons up the appropriate number of made-in-Montana platinum bars, which are promptly shipped to the privately insured depository vault. The overseas customer receives a warehouse receipt or delivery order confirming ownership of the metal and, under special arrangements with the depository, also receives a smartcard with a daily ATM limit that is less than $10,000 and an annual withdrawal limit that does not exceed 20 percent of the market value of the metal on the date of initial purchase.

These details beg numerous questions, but in this sequence of events, the customer has: (1) retained financial privacy (the cash transaction takes place offshore, and other features of state law shield the platinum assets

* Approx. $1 million U.S.

from scrutiny); (2) traded conceivably imperiled currency for a valuable physical asset; (3) acquired a new nest egg for heirs (or for retirement in exile); and (4) obtained and established a solid hedge against the potentially disastrous consequences of a Communist Chinese takeover. The state of Montana gets a proportionally small yet financially significant cut, in that a semiannual tax assessment based on the total value of assets in the depository generates general fund revenue that might in turn engender tax reduction. Montanans' interest in deterring money launderers and other crooks from abusing the state's "open for business" mentality is protected by rigorous statutory and regulatory controls that restrict the liquidity of the customer's assets. Early withdrawal (say, before 3 years have expired) from the platinum account entails a hefty financial penalty and an automatic partial loss of financial privacy via a suspicious transaction report submitted to both state and federal government law enforcement authorities.

Barring some huge calamity, precious metals prices are probably going to stay within a narrow price range. The ownership of platinum or gold is less an investment than first, a hedge, and second, a speculation. Still, it is not difficult to make a strong theoretical case for the purchase of precious metals. All that's really needed is a sufficient degree of anxiety about the course of world events and a sure-fire method of assuring investors that their hoard is safe from theft and seizure. Given the location of the Stillwater Mine, the dearth of secure storage facilities equipped to handle metals (there are only a few, such as in Zurich, Switzerland, and Wilmington, Delaware), the possibility that mine products could be refined in Montana (instead of being shipped to Belgium, as they are presently), the growing worldwide demand for platinum and palladium for a variety of industrial and investment purposes, political instability in Russia and South Africa, and a superabundance of worrisome economic conditions in certain countries in Asia and the Middle East, not to mention North and South America, the platinum angle can be made to look very promising.

Precious metals fabricated into bars and wafers of standard sizes and weights are commodities in a world market. A 50-ounce bar of 0.995 pure

platinum mined, refined, and stamped in South Africa costs virtually the same as a bar similar in all respects that originates in Montana. The price of platinum bullion bars and coins is a factor of the spot price on commodity exchanges plus a modest premium for the cost of fabrication, packaging, and delivery. What are these costs? Would the relative proximity of production to a storage bank vault create a measurable price advantage for Montana-made bars? The "inventors" of Black Hills Gold (which has been chemically treated to render its distinctive coloration) figured out a way to distinguish it from run of the mill gold produced elsewhere in the world. Could Montana platinum be similarly marked and marketed?

What is a reasonable profit on our prospective platinum-based depository account? In general, storage, handling, and insurance costs run about 1 percent per year for existing metals depositories. The few banks that offer metals services charge fees as high as 5 percent on purchases and up to 2 percent on sales. The fees and commissions charged by the Montana depository would need to add up to a figure that is almost always less than the amount of platinum's appreciation value; otherwise, the depositor would end up paying the financial institution to safeguard a depreciating asset.

Is there enough platinum to meet anticipated demand? About 140 tons of platinum reach world markets each year. Total demand in 1995 was 4.79 million ounces; total supply amounted to 4.98 million ounces. Montana is still a marginal producer. In 1998, total platinum output from the Stillwater Mine is anticipated to be 125,000 ounces. At $400 an ounce, a million dollars would buy something close to 2,500 ounces. Unless prices go up appreciably or a great deal more platinum is produced, the depository will be unable to accommodate a large number of million dollar accounts.

There may be something fundamentally wrong with this picture, either from a technical, legal, or commercial point of view. Connecting platinum products to the proposed depository's specialized financial services may turn out to be farfetched. On the other hand, the lure of platinum may be the best answer yet to why wealthy foreigners would hedge a portion of

their fortune in Montana. The sections in the draft bill for the foreign capital depository that provide for precious metals accounts anticipate the latter conclusion.

ENDNOTES

1. Most of the technical information contained in this part of the report has been gleaned from the 1994 and 1995 annual reports of the Stillwater Mining Company, materials provided to staff during a tour of the mine on August 28, 1996, and Platinum 1995: Interim Review, published by Johnson-Matthey, London.

2. Jacques Luben, Profits in Gold, Silver and Platinum, New York: Platinum Guild International, 1996.

VIII. Financial Federalism: Trends and Developments

From a regulatory perspective, financial institutions in the United States fall into two major categories, those with national charters and others with state charters. These categories are not hierarchical, but rather reflect the bottom-up historical evolution of the American banking system and various events and circumstances that prevented truly interstate banking and branching from taking place until quite recently. This legacy has resulted in a situation where over two thirds of the banks in the U.S. hold state rather than national charters. The distinction is still important for a variety of business reasons; with respect to the foreign capital depository the difference is especially significant for regulatory purposes.

National banks (including branches and agencies of foreign banks) report to the Office of the Comptroller of the Currency (OCC). State-chartered banks that are also members of the Federal Reserve System (the minority) are supervised and examined by the state and the Fed, sometimes jointly. Nonmember state banks that offer deposit insurance (most do) are regulated by the Federal Deposit Insurance Corporation (FDIC) and the state. The Montana foreign capital depository would not fit into any of these standard molds: as a state-chartered, nonmember, noninsured nonbank it would be subject solely to the regulatory authority of the state banking board and the Department of Commerce--unless, as is likely, the entity seeking the charter is a subsidiary of a foreign bank, in which case the depository would come under Federal Reserve as well as state examining authority.[1]

A Relevant Aside: "The Fed"

The Federal Reserve is the central bank of the United States. It is responsible for conducting monetary policy, maintaining the stability of financial markets, providing services to financial institutions and government agencies, and regulating financial institutions. All checks drawn on the treasury of the U.S. are paid at Federal Reserve Banks; as such, "The

Fed" maintains the world's largest bank account. The Federal Reserve is a self-financing entity. It earns income through interest gained from its holdings of U.S. government securities and from fees for services (e.g., check clearing) that it provides to commercial banks; after deducting operating expenses, the Fed returns revenue to the U.S. Department of the Treasury. The Fed is not, however, part of the Executive Branch of government, and it receives no appropriations from Congress. It is still accountable to Congress, which can amend the 1913 Federal Reserve Act at any time.

The Federal Reserve system has always been controversial, at least among Americans who distrust federal anything and remain unconvinced of the Fed's legitimacy. As the quasi-governmental agency has become more powerful, both in national and international terms, it has also come under closer, more critical scrutiny by mainstream observers. Some take issue with the Fed's emerging role as chief guardian of global (not just American) economic security and wonder aloud why this institution should be allowed to dispense taxpayer funds to prop up Mexican, Japanese, and other foreign banking systems without having to gain Congressional approval. The Government Accounting Office completed a 2-year study of the Fed banks and concluded that "there are serious, long term questions about their mission and structure".[2] A recent article in the Wall Street Journal suggests that rapid changes in technology, commercial bank consolidation, and rising competition in check clearing and other payments services threaten to make the Fed's 12 regional banks "costly relics".[3] The New York Federal Reserve Bank is generally excluded in such projections, since it provides vital linkage between the U.S. financial system and world markets.

Under recently adopted legislation (see FBSEA below), the Fed has the ultimate authority to terminate the operations of a foreign bank in the United States, regardless of whether the bank is a system member and has a national or state charter. After providing notice and the opportunity for a hearing, the Federal Reserve may issue a "death sentence", but there must be evidence that the foreign bank has violated the law or engaged in unsafe or unsound banking practices. The termination order may come even

without notice or a hearing if the Fed determines that public interest is threatened. Foreign banks ordered to cease their activities in the U.S. must follow federal and state laws governing the closure and dissolution of financial institutions.[4]

The depository proposal arrives at a time when major shifts are occurring in the national and international financial services industry. In many ways, the depository is a throwback to earlier times, when savings accounts were regarded as prudent investments and money was backed by metal. In other ways, the depository fits easily into a pattern of developments that seem to point toward larger, more efficient financial services organizations offering a multitude of services to a panoply of market segments across the globe. A few items illustrate this trend.

Mergers and acquisitions. There is a steady trend toward consolidation in the banking sector. In 1994, for example, there were 14,500 banks in the United States; today, there are fewer than 10,000. The 1995 merger of Chase Manhattan and Chemical Bank resulted in the largest bank in the United States.* Of the 20 largest deals in U.S. banking history, 10 occurred in 1995.[5]

Declining market share. At the same time banks are ballooning in size and decreasing in number, their relative importance is shrinking. Banks used to hold about 70 percent of the world's financial assets. Now they control half that. Banks hold only a quarter of the total $12.9 trillion credit market debt outstanding today, and bank debt is growing at a compound annual growth rate of less than 7 percent, compared to a 10.5 percent growth rate for all nonbank credit providers. Nonbank financial intermediaries are flourishing. In 1980 there were about 350 finance companies, mutual funds, and money market mutual funds operating in the U.S.; today, there are eight times that number. The assets of firms like Fidelity and General Electric Credit Corporation far exceed those of most banks. Mutual funds, pension funds,

* Interestingly, no U.S.-based bank ranks in the top 10 worldwide; those positions are occupied by Japanese and German banks.

and insurance companies constitute a largely unregulated parallel banking system that is putting intense competitive pressures on banks.[6]

Electronic commerce. Advances in computer technology are facilitating rapid, voluminous, and complex transactions. In the United States alone, there were nearly 700 million automatic teller machine transactions per month in 1994. ATMs are gradually replacing bank tellers. In less than a decade, some experts predict, half the remaining teller jobs will be eliminated and the remainder will be part-time. According to a recent NBC news broadcast, some 15,000 bank branches are destined to close in the next few years, mainly because their overhead costs far exceed the cost of maintaining vast (even global) networks of ATMs. Many large institutions offer their customers home banking, which relies on phone lines and portable computers; a few are experimenting with electronic forms of money.

Foreign bank penetration. The dual banking system and related restrictions placed on banks following the Great Depression have put U.S. financial institutions at a competitive disadvantage in global markets. Foreign banks have grown bigger and more diversified than American banks and, until the late 1970s, enjoyed certain privileges not afforded to their U.S. counterparts while doing business on American soil. Still, various regulatory parameters have kept foreign banks from "invading" the country and displacing domestic banks from their traditional market territory.

In 1995 there were over 375 foreign banks operating nearly 1,000 offices in the United States. The total assets of these branches, agencies, and subsidiaries amounted to approximately $974 billion.[7] Nearly three quarters of foreign bank activity in the U.S. is regulated by the New York state banking authority and the Federal Reserve Bank of New York. Foreign banks play an important role in the nation's finances. They are believed to supply more funds to the United States than they raise from it; that is, a net inflow of liquid capital for investment. Foreign banks have attained a sizeable share of the U.S. market: 22 percent of assets held in 1995 and a third of all business loans.[8] At the same time, foreign institutions hold a

tiny fraction (less than 1 percent in 1994) of the total retail deposits in this country. Foreign banks also offer services to U.S. customers through offices located outside the U.S. Offshore shell branches of U.S. banks, including foreign-owned U.S. chartered banks, are subject to U.S. laws, but shell branches of foreign banks are subject to U.S. regulation only for those activities that are managed within the United States.[9] A 1994 study by the OCC concluded that although the market share of foreign banks in the U.S. grew during the 1980s and early 1990s, these banks consistently fared worse than domestic banks as measured by profitability, efficiency, and credit quality. Most foreign banks that have established operations in the U.S. have done so to accommodate the international business activities of their home country customers.[10]

Shifting Legal Parameters

In addition to marketplace trends, a number of recent, complementary changes in federal law structure the environment in which the depository would operate.

The International Banking Act of 1978 (IBA) brought foreign banks under federal regulation and adopted the policy of national treatment, which accords foreign banks the same opportunity to compete in the U.S. as domestic banks, including under national charters. Before the IBA, only states could license, supervise, and regulate foreign banks. The goal of national treatment is to allow foreign banks to operate in the United States without incurring either significant advantage or disadvantage compared with U.S. banks.

The Foreign Bank Supervision Enhancement Act of 1991 (FBSEA) amended the IBA and authorized the Federal Reserve to oversee all foreign bank operations in the U.S. The FBSEA established uniform standards for U.S. offices of foreign banks, requiring them to meet financial, management, and operational standards equivalent to U.S. institutions. The FBSEA requires the Fed to approve all applications for entry or expansion in the U.S. market

and prohibits approval of such applications unless the agency determines that the applicant bank is engaged in banking outside the U.S. and is subject to comprehensive supervision on a consolidated basis by home country authorities.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 phases out pre-existing barriers that prohibited banks from expanding nationwide. Effective June 1, 1997 (unless already authorized by previous state legislation), banks are allowed to merge across state lines, subject to longevity requirements and provided that the home state of the bank seeking to merge across state lines has not opted out of interstate bank mergers by enacting legislation that expressly prohibits interstate branching by all out-of-state banks.* The Riegle-Neal Act also authorizes a foreign bank to establish interstate branches or agencies outside its home state, either by acquisition or *de novo*, to the same extent permitted a national or state-chartered bank. Previously, bank mergers were governed by a patchwork of state laws that effectively ruled out the emergence of a genuinely national bank. (Even with a "national" charter, U.S. banks have not been allowed to establish branches outside their home state.) The Riegle-Neal Act also attempts to achieve more parity in the scope of permissible activities of foreign and domestic banks. Under Riegle-Neal, states may not pass interstate banking or branching legislation that discriminates between U.S. and foreign banks; that is, neither type can gain preferential treatment. A foreign branch operating in the U.S. and also managing an offshore facility may not conduct any business that a domestic competitor with a similar setup may not under U.S. law.

The draft enabling legislation would allow a subsidiary but not a branch of foreign bank to obtain a charter for a foreign capital depository. This requirement would, arguably, provide greater assurance of accountability. Subsidiaries require a separate board of directors and also their own capital base. There are fewer subsidiaries than branches in the U.S. mainly because

* In the 1995 Session, the Montana Legislature passed a bill (HB 428) bringing state banking laws into conformity with the Riegle-Neal Act.

branches (and agencies, which may not accept domestic retail deposits) are less costly to operate. Foreign bank subsidiaries in the U.S. are subject to the same interstate rules as U.S. banks.

Finally, there is considerable interest in streamlining the regulatory processes governing U.S.-based financial institutions. The Bank Administration Institute and the global corporate consultant McKinsey & Co. recently published a report outlining a set of bold reforms that would, if adopted, dramatically alter the policy environment in which the foreign capital depository and other, more conventional institutions conduct their business.[11] Among the proposed changes is a general recommendation for performance-based regulation that would reward well-managed institutions and impose penalties on those that did not meet high standards set by the industry itself. The report contains 34 specific proposals aimed at achieving the following objectives:

- institute risk-based supervision;
- empower full corporate governance, strategy, and structural freedom;
- liberate customer service capabilities; and
- eliminate outmoded compliance burdens.

The committee did not have the time or opportunity to look into any one of these goals, but it did gain a strong sense of why such reforms might have beneficial consequences for the financial services industry in general and for the foreign capital depository in particular.

One of the underlying objectives of the depository is to minimize the role of federal agencies in its supervision. The rationale for this purpose is mixed and not altogether clear, but it reflects a generally unfavorable attitude toward the federal government's sometimes obtrusive or overbearing presence in so many aspects of public and private life. Foreign customers are presumed not to trust the United States with sensitive information about their financial affairs. The issue is privacy, not competence; wealthy individuals outside the United States seem to be at least as averse to their

central government's capacity to snoop and meddle as a growing number of we Americans are to our own. Moreover, customers of the depository are likely to be concerned about the ties, official and unofficial, between U.S. government authorities and much-feared authorities in their home country. This issue is addressed in the Financial Privacy section of this report, but it touches almost every aspect of the depository.

On the other hand, the expertise of U.S. federal regulatory and law enforcement agencies exceeds that of most state-level counterparts. This is certainly the case in Montana, at least for now. It is difficult to say with confidence that the institution (foreign or domestic) seeking a charter and the customers of the depository would be comfortable with no federal oversight or regulatory function whatsoever. It's a moot point at this juncture: the draft legislation acknowledges the role of the Federal Reserve in the event that a foreign institution obtains a charter and mandates the depository's compliance with U.S. Treasury Department reporting and recordkeeping requirements.

Apart from a desire to "keep the Feds at bay", as it were, or at least in their proper place, the depository concept is also a reflection of concurrent trends (including a move toward performance-based regulation) in the financial services industry and the way these trends manifest themselves in the thoughts and actions of state policymakers.

ENDNOTES

1. As soon as the committee realized that the Federal Reserve might have an important role in the depository picture, it invited the Fed to participate in the study. Federal Reserve officials declined to take part in any formal way (no representative ever attended a meeting), but the committee was provided with an informative tour of the Helena branch facility that included an informal question period. Different offices of the Fed also supplied highly useful background materials to staff through the Board of Governors in Washington, D.C., the New York Federal Reserve Bank, and the Minneapolis Federal Reserve Bank ("parent" to the Helena branch).

2. Government Accounting Office, Federal Reserve System: Current and Future Challenges Require Systemwide Attention, June 1996.

3. *The Fed's Empire: Costly and Inefficient*, Wall Street Journal, September 12, 1996, p. 1 and A10.

4. Daniel B. Gail, Joseph J. Norton, and Michael K. O'Neal, *The Foreign Bank Supervision Act of 1991: Expanding the Umbrella of "Supervisory Regulation"*, The International Lawyer, Winter, 1992, Vol. 26, No. 4., pp. 998-999.

5. Chris Bohner, *The Brave New World of the Mega-Bank*, Dollars and Sense, January/February 1996, p. 9.

6. Bank Administration Institute (BAI) and McKinsey & Company, Building Better Banks: The Case for Performance-Based Regulation, 1996, pp. 11-19.

7. Government Accounting Office, Foreign Banks: Implementation of the Foreign Bank Supervision Enhancement Act of 1991, September 1996, p. 3.

8. Price Waterhouse, LLC., A Regulatory Guide for Foreign Banks in the United States--1996 Edition, Washington, D.C.: Price Waterhouse, June 1996, p. 2.

9. Government Accounting Office, Foreign Banks: Assessing Their Role in the U.S. Banking System, February 7, 1996, p. 2.

10. Mayer, Brown & Platt, *The Financial Services Regulatory Report*, Vol. 2, No. 8, June/July 1995, p. 3.

11. See Note 6.

IX. Roads Not Taken

The committee took several preplanned detours from the main track. This section of the report will not dwell on any one of them, but as possible alternatives to the foreign capital depository "down the road", all are worth brief mention.

1. **A State-Owned Depository.** Senate Joint Resolution No. 19 called for a feasibility study of a "state-owned" or a "state-chartered" depository. The concept of a state bank is unusual, but not new or unprecedented, as we will discover momentarily. A general rationale for a publicly-owned financial enterprise is twofold. First, in theory, it would provide a direct stimulus to the state economy, with no profit-motivated private sector entity sandwiched between foreign depositors and Montana taxpayers. Second, state ownership would allow the institution to enjoy sovereign immunity from lawsuits emanating from federal agencies and foreign governments as well as private entities. Representatives from the Montana Bankers Association recognized other merits in this option, including a new source of capital for the Board of Investments to manage for the public's benefit.

Offshore banking expert Jerome Schneider arrived at the committee's Billings meeting prepared to advocate this approach because he thought it would strengthen the state's hand *vis a vis* the Internal Revenue Service and other federal authorities. Mr. Schneider backed away from state ownership when it became apparent that committee would have difficulty supporting and selling, in political terms, what would be characterized as a socialist construct.

The committee did receive and review information describing the origins and operations of the Bank of North Dakota (BND), the only institution of its kind in the United States. The BND was created by the state legislature in 1919. Since its inception, its primary purpose has been to encourage and promote agriculture, commerce, and industry. In recent years, BND has helped to finance economic diversification initiatives. The Bank also provides financial assistance to individuals to further their postsecondary

education, participates directly in Small Business Administration loan programs, and is in partnership with a private venture capital fund. The BND's deposit base is composed primarily of state funds and has been relatively static. In 1995, the Bank's total assets were approximately $1 billion.[1] If the Montana Legislature ever decides to take another, longer look at state ownership options, the Bank of North Dakota is a well-developed and apparently successful model.

2. **The Tribal Option.** Prompted in part by the fact that Montana has the only fully Indian-owned bank in the United States, Blackfeet National, and also by a brief but intriguing run of news stories in *Indian Country Today* about a Saudi Arabian proposal to shift hundreds of millions of dollars worth of gold to an Oglala Sioux facility in South Dakota,* the committee briefly considered a reservation-based depository. The need for innovative economic development projects in Indian Country was noted, as was the possibility that a tribally owned and managed operation might be able to attract funds from indigenous peoples around the world. Like the famed Mohawk steel bridge builders in the East, it is conceivable that a Western tribal nation could specialize in private international banking, especially in a high-profile tourist destination such as the Flathead Valley.

As in the case of a state-owned depository, sovereign immunity was also a consideration. The thought was that tribal sovereignty could provide a means of insulating foreign depositors from federal, state, and private inquiries. Sovereign powers include the power to enact civil and criminal laws, regulate and prohibit conduct, levy taxes, and conduct relations with other sovereigns on a government-to-government basis.[2] The committee learned, however, that under U.S. law, tribes are considered "domestic dependent nations" whose sovereignty is circumscribed by the plenary powers of Congress. Consequently, a financial institution like the foreign

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* In July 1995, the Oglala Sioux Tribal Council defeated by an 8-7 vote a proposal for an "Electronic Data Interchange" system between a tribal "central bank" and the "Capital Performance Guaranty International Co." of New York as represented by Mr. Ibn Al Ishtari, who purported be part Native American and also related to the Saudi royal family. The proposal was revealed to be an elaborate scam.

capital depository would come under the jurisdiction of federal regulatory agencies; with respect to banking, tribal nations have less autonomy than states.

3. **The Coin Repository.** The committee heard testimony on two occasions from a Helena-based coin dealer affiliated with the Industry Council for Tangible Assets (ICTA). The ICTA is lobbying Congress to modify the Internal Revenue Code to remove certain restrictions on the use of collectibles (including precious metals bullion and legal tender coinage) in Individual Retirement Accounts (IRAs) and other self-directed or otherwise qualified retirement plans. The Tax Reform Act of 1986 excluded gold and silver U.S. American Eagle coins from the definition of collectibles, thus allowing them as investment vehicles in IRAs and other accounts without penalty. A further change--still pending in Congress--would extend this exemption to any gold, silver, platinum, or palladium coin that has been issued by a state (or another country) and has undergone certain tests for fineness by a qualified third party.[3] If ICTA succeeds in getting this measure passed, there will probably be an immediate surge in demand for coins and, more importantly, for a place to store them. At present, there are only two facilities in the United States (in Wilmington, Delaware, and Winchester, Indiana) that have the capacity to handle the enormous bulk of large stocks of graded coins encased in plastic.

Discussion of this matter centered on the possibility that a portion of the foreign capital depository could be designated (and physically sequestered) as a coin repository. It is plausible that this relatively simple and mundane feature could generate more immediate interest--and more revenue to the state--than the more exotic services offered to foreign depositors. Another advantage is that the coin repository would not cause the same type or degree of concern on the part of federal officials. A coin repository would not come under the strictures of the Bank Secrecy Act, for example.

The committee walked away from this option, not because it lacked merit, but because it is fundamentally different from the foreign capital depository in several respects, the most important of which is that the principal

demand for the coin warehouse would be domestic, not foreign. The carefully engineered and strictly controlled mixture of services provided exclusively to nonresident aliens with a facility that could be used by Montanans and all Americans might be legally and technically feasible, but the committee did not plumb these problematic depths.

4. **An International Banking Facility.** International Banking Facilities (IBFs) enable depository institutions in the United States to offer deposit and loan services to foreign customers and companies free of the Federal Reserve System's reserve requirements and interest rate regulations and also without having to pay deposit insurance premiums or state and local taxes. The purpose of this structure is to provide U.S. banks with competitive funding opportunities in international markets without having to establish a foreign branch. IBFs were first established in New York in 1981 as a means of bringing back business from offshore centers, particularly London and the Caribbean. In the late 1970s,

many financial institutions migrated to these locations to get around U.S. domestic restrictions (such as the Glass-Steagall Act) and interest rate limits, as well as to take advantage of tax differentials.

IBFs permit U.S. banks to use their domestic offices to provide services that formerly could only be delivered competitively from their foreign branches and subsidiaries. In practical terms, an IBF is a set of accounts segregated on the books and records of a U.S. depository institution, not a separate bank building. IBFs may accept time deposits and international loans only from foreign customers or other IBFs.

Most IBFs are in New York, but they've also been established in Seattle, San Francisco, and Los Angeles. Vancouver, British Columbia, hosts analogous Canadian entities, known as International Banking Centers. Scholars and financial specialists recently studied the feasibility of an IBF in Anchorage, Alaska. The main motivation was economic diversification away from oil, combined with a need to generate jobs and revenue

following the recession in the 1980s. The study indicated that a massive amount of infrastructure spending on service systems and telecommunications would be required to compensate for Alaska's geographical isolation, harsh climate, and high cost of living and doing business. In addition, Anchorage and the state would have to undertake an extensive regulatory overhaul to compete with long-established money centers on the West Coast and offshore.[4]

The committee spent no time analyzing the feasibility of an IBF, primarily because this type of arrangement is more in tune with conventional banking than with the type of private, nonbanking activities envisioned for the foreign capital depository. Still, there may be unrealized opportunity within the existing banking sector in Montana to establish an International Banking Facility.

Finally, while it did not stop to consider them in detail, the committee also became aware of other paths toward economic development built on a base of foreign capital. For example, in light of the Riegle-Neal Act's purpose and trajectory, it may not be long before foreign banks establish branches throughout the western states, including Montana. There is always a possibility of a surge in foreign direct investment in the state. Currently, most of this activity is concentrated in the mining sector, where several Canadian firms are prominent, but there are other, more isolated instances of Japanese, Taiwanese, and other foreign ownership of industrial properties as well as trade-related investment activity.

ENDNOTES

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2. Mark Jarboe, Dorsey & Witney, *The Nature of Tribal Sovereignty*, unpublished monograph, 1995, p. 1.

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4. Anindya K. Bhattacharya, *The Costs and Benefits of Establishing an International Banking Center*, in International Banking and Financial Centers, Yoon S. Park and Musa Essayyad, editors, Boston: Kluwer Academic Publishers, 1989, pp. 138-139.

X. FURTHER INFORMATION

The following committee file materials are available to any interested persons for a nominal photocopying charge:

• Transcribed and printed summary minutes supply a more complete record of the proceedings of each meeting.

• Meeting agendas provide information about discussion topics and a list of persons invited to provide informal comments or testimony.

• Correspondence between staff and members and other interested persons documents the type and substance of communication and sometimes includes valuable details about expectations, understandings, and the law.

• An audiotape summary of the draft bill was produced by staff at the request of the chairman. Copies were distributed to each member. A copy of the tape and the accompanying text may be borrowed from the Legislative Services Division Library.

• There is a videotape version of the minutes from the January 25-26 meeting that is also available through the Library.

The remainder of this part is a select bibliography of information sources consulted during the course of the interim study. The books, articles, and reports listed are those the author of this report considers most relevant to the draft enabling legislation and most accessible to general readership. Please note that some of the sources cited in the endnote sections of the report are not listed below, but are nonetheless valuable sources of information, analysis, and opinion.

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PART TWO: THE DETAILS

I. Factors in Focus: Compliance and Contingencies

This part of the report points to provisions of the draft bill that illustrate the committee's desire to comply with both the letter and spirit of federal law, albeit with a few twists here and there that manifest a shared sensitivity to sensible assertions of states' rights. This part also touches briefly on a number of contingencies (a few possible, some anticipated, and others omnipresent) that could alter the policy environment in which the foreign capital depository would function.

First, to recapitulate some key considerations that shaped the committee's dialogue and recommendations, its aim in building the statutory framework for the depository is to create a synergistic blend of legally sound, commercially attractive, and culturally appropriate features that compose a unique package, even if it can be imitated (just as legalized gambling has spread from Nevada to other states). Prudence is the underlying value. The draft enabling legislation is suffused with attempts to address and resolve these main areas of concern:

> (1) **legality**, meaning compliance with federal reporting and recordkeeping requirements and conformity with well-established international principles, coupled with a dual acknowledgment that the new law may be tested in litigation and that there is no discernable pattern in the recent decisions of Montana or federal courts to suggest any certain outcome, favorable or not;
>
> (2) **propriety**, which entails both the state's capacity to exercise due

diligence (or even extraordinary diligence)* in the screening, supervision, and regulation of a new type of chartered institution and the depository's ultimate compatibility with Montanans' attitudes and expectations as well as U.S. norms; and

(3) **commercial viability**, which pertains to product differentiation, specialization, and other factors of economic competitiveness that would influence the depository's success in blending elements of financial privacy, asset protection, and profit.

Compliance With National and International Legal Norms

The enumerated items that follow will provide specific references to sections of the draft bill, most of which will manifest a "procompliance" mentality *vis a vis* FinCEN regulations and FATF recommendations. Readers must be warned, however, that the specific section numbers associated with the various elements of the bill are pertinent to the enclosed draft only. These numerical reference points will change in the final version of the bill.

1. The bill applies Know Your Customer (KYC) principles in two dimensions. Section 8 says that a potential chartered depository shall file a KYC policy with the Department of Commerce prior to obtaining a charter. The charter seeker must demonstrate to the state licensing authority how it will routinely check the identities of its clients. Section 13 requires that the Department's rules require details of that same KYC policy in the depository's mandatory annual report.

2. Section 9 allows the Department of Commerce to conduct background

* Black's Law Dictionary defines due diligence as "such a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case". Extraordinary diligence refers to that extreme measure of care and caution that persons of unusual prudence and circumspection use for securing and preserving their own property or rights.

checks on owners, directors, officers, and managers of a depository.

3. Section 9 also includes a good character test. Under this provision, the State Banking Board is required to refuse a charter to someone who's been convicted of a crime, who's lost a professional license, or who's been misleading or lying to the state. (The Board can turn up its nose whenever it smells a rotten egg or gets wind of a bad apple.)

4. A depository also has a right of refusal. Section 22(2) allows the depository to turn away any customer for any reason.

5. Section 23 says that a depository may not accept money from anyone convicted of a crime in the United States.

6. Section 15 calls for examinations twice a year and Section 16 allows the Banking Commissioner to carry out *ad hoc* inspections of the depository's books at any time.

7. Section 13 requires a depository to monitor and report to the state on request any cash transaction of $10,000 or more when it departs the institution. This is equivalent to the CTR that the federal Bank Secrecy Act mandates, but in reverse. With this provision, a deposit that circumvents the BSA by one legal means or another would remain confidential until a customer decides to move cash out of the depository. In this way, the state guards the back door against money laundering instead of robbing a customer's privacy at the front gate.

8. Section 19 addresses a depository's obligations to comply with federal law regarding suspicious transactions. The bill goes a step further, however, and requires in the same section that a depository also report suspicious activity to the state.

9. Sections 67 and 68 detail the civil and criminal penalties that a depository faces if it breaks the law. If the depository violates certain federal laws, the state is authorized to prosecute the violators separately.

10. Money launderers rely on liquidity; they deliver their dirty money to a clean institution and expect it back figuratively pressed and neat, pronto. Section 27, which deals with precious metals accounts, restricts a customer's ability to withdraw its funds or cash out its platinum holdings for 3 years. Bad guys are not going to wait that long--they will seek other avenues and establishments somewhere else.

Relevant Contingencies

The following list of possible changes in the legal and political climate includes eventualities that could enhance or undermine the efficacy of the depository by affecting its ability to provide privacy and asset protection to its customers. None of these items is a sure bet, but all of them are worthy of the Legislature's consideration.

• The United States may enter into an income tax treaty or a TIEA with a country (or countries) from which customers might be coming as well; either event could dampen these customers' enthusiasm for the depository.

• The U.S. Treasury Department was authorized in 1992 to issue formal regulations governing KYC policies and procedures and will likely do so in the near future. When the regulations materialize, the depository will have to comply with them.

• Federal rules could get even more burdensome than they are now. As an observer from the ABA remarked recently, "The Bank Secrecy Act is one of the most fluid areas in banking today. The statute itself as well as a number of other statutes which relate in some way to money laundering offenses are constantly being amended, whether to close loopholes, create new fines and penalties, or stiffen existing sanctions."[1]

• Innovations in electronic commerce could open up new channels through which deposits could be made without triggering federal reporting and recordkeeping requirements.

• The depository could be let off the federal "hook" insofar as reporting to the IRS is concerned. The 1994 Riegle-Neal Act permits the Treasury Department to exempt classes of transactions within a state from the Bank Secrecy Act if the transactions fall under state requirements that are substantially similar to federal ones.[2]

• Congress or a federal agency could preempt state-enabling legislation for the foreign capital depository. New regulations might be issued in direct response to response to new structures, new technologies, and new developments.* As a member of Senator Max Baucus' staff put it at an early stage of the interim process, "Even if the committee could get comfortable that current legislation and regulations . . . would not jeopardize the relationship of the Montana entity with its foreign depositors, there can be no assurances that legislation passed by Congress at a future date (or even more importantly, regulations issued by any number of federal bureaucrats at a future date) won't jeopardize that relationship."[3]

• Key agencies of state government could become more apprehensive or skeptical about the depository than they have revealed to date. Department of Commerce personnel, for example, evidenced at the committee's final meeting a strong reluctance to embrace certain concepts and principles underlying the draft bill.

• The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (the federal welfare reform bill) requires financial institutions to provide confidential information and impose liens on individual bank

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* The Foreign Bank Supervision Enhancement Act of 1991 was, according to its critics, an overreaction to the scandal associated with the Bank of Commerce and Credit International (BCCI).

accounts in response to inquiries concerning persons who owe past-due child support. It is premature to say how this provision might blunt, dent, or otherwise damage the asset protection features of the depository, but conceivably, a foreign litigant could demand access to customer data pursuant to this provision of domestic welfare reform legislation.[4]

• The United States is involved in protracted multilateral negotiations at the Hague in the Netherlands, aimed at achieving an international convention on civil judgments. It is unlikely that the treaty will be completed before the year 2000, but in the event that it enters into force shortly thereafter (and the U.S. is a signatory), the treatment of foreign civil judgments in the enabling legislation could be rendered void.

• An overarching factor is the degree of public interest in and understanding of the actual provisions in the draft bill, as well as the public's general concern about propriety and the appearance of propriety. The depository could be easily misconstrued and automatically rejected by persons who have an inherent aversion to risk and voice blanket disapproval of flight capital in all forms.

II. The Formula: P^3

So far, to the staff's and committee's knowledge, no U.S. state has combined privacy, protection, and profit potential--"P cubed"--in the manner outlined below and provided in the draft bill. Eight states have a privacy provision similar to Montana's in their respective constitutions, and 17 states have enacted right to financial privacy statutes. Twenty states have not passed the Uniform Act on the Recognition of Foreign Civil Judgments, although not for the express purpose of impeding access to foreign assets in domestic depositories. New York, Los Angeles, San Francisco, Seattle, and Puerto Rico are all host to international banking facilities, which allow U.S. banks to make loans and to accept deposits from nonresidents, free from state and local taxes as well as from reserve requirements and interest rate regulations. A number of states have passed legislation to attract

foreign bank subsidiaries. The Montana foreign capital depository would be something different, and its basic formula is configured as follows:

1. PRIVACY . . .

L For the nonresident alien depositor/investor via a state right to financial privacy statute that complements federal law, protects against unwarranted inquiries by state agencies and private entities, and provides for severe penalties for the wrongful disclosure of private financial information.

Sections 29 through 46 of the draft bill would protect the financial privacy of customers from the prying eyes of state agencies, local governments, and private individuals or organizations. The federal Right to Financial Privacy Act of 1978, as noted in Part One, does not prohibit the disclosure of a person's financial records when a federal law enforcement agency wants to get a look at them. It does require, however, that the individual be informed whenever an inquiry has been made and the information is released. The federal Act does not apply, however, to state and local government activities, nor to any inquiry that might be made by a private investigator, a business competitor, a prying journalist, a prying attorney, or anyone else. While commercial banks insist that they treat their customers' financial dealings with the utmost confidentiality, there is no state law that mandates privacy protection.* The right of privacy contained in Article II, section 10, of the Montana Constitution does not apply directly to financial matters, so customers of the depository need statutory shelter.

Paradoxes of Privacy

> *• One can argue--and many people do--that federal reporting requirements under the Bank Secrecy Act are onerous, inefficient, and largely ineffective. The current federal regulatory environment is paradoxical in that financial institutions are required to submit reports whenever transactions involve currency and monetary instruments of a certain value, but the most serious, high-value money laundering operations use wire*

* It is important to remember that the privacy provisions of the bill do not apply to any financial institution in Montana, other than a foreign capital depository.

transfers originating outside the United States. One of the challenges facing the state is to propose an alternative means of combatting financial crime that achieves a paradoxical result: greater confidentiality for depositors and more deterrence against money laundering. The draft bill attempts to do this by requiring reports analogous to a currency transaction report when funds exit instead of when they enter the depository.

• The draft bill requires a charter seeker to have a KYC policy and to apply it rigorously. To fulfill this requirement, the chartered institution is going to have to obtain the services of an international investigative service or rely on the private intelligence gathering capabilities of its parent financial institution. In other words, the depository is required to do a bit of snooping. Once that bit of "dirty work" is done--which is intended to keep the nose and the reputation of the depository clean--the most important task remaining is to protect the customers of the depository from the very same kind of snooping by other parties. This is the paradox of financial privacy in a regulated environment.

• A chartered institution must have an effective KYC policy, but the state, absent evidence of criminal behavior or a qualified inquiry from a federal law enforcement agency, does not need to know the identity of the customer nor the type or amount of the customer's assets in the depository. In effect, the depository's upper management must say to its customers: "We know you are who you say you are. They (meaning the state, and almost everybody else in the world) do not know who you are or what you've placed in our secure establishment."

2. PROTECTION . . .

L To depositors/investors from foreign creditors and other litigants seeking to exercise civil judgments against assets held in the Montana foreign capital depository.

This is perhaps the most complicated portion of the bill in that it reflects a necessarily convoluted logic. Readers are strongly advised to refer to David Niss's March 22, 1996, memo at Appendix 2 to help clarify and substantiate the brief summary that follows.

"Who needs asset protection?" queries Richard Czerlau, author of a guide to offshore financial centers. In his view, the answer is obvious to anyone with lots of money:

> *If you have debt-free assets, you are the prime target of frivolous lawsuits. As a successful individual, you may find yourself as a defendant in one of over 20 million civil lawsuits filed every year. Many of these lawsuits, although frivolous, result in judgments that can reduce a substantial net worth to virtually nothing. By properly structuring the ownership of your assets, a potential plaintiff may be dissuaded from commencing costly litigation.*[5]

From a perspective more closely aligned with the depository, all prospective customers will need some degree of protection in order to be attracted to Montana. Respectable asset protection involves the drawing of fine distinctions between frivolous or malevolent lawsuits and legitimate ones. The status and force of current state and international law compel Montana, for the purpose of providing a modicum of asset protection to depository customers (and for no other purpose), to clearly establish that illegitimate lawsuits pursued and tainted judgments rendered in a foreign country will not be recognized and enforced.

For the moment, there is no federal legislation or treaty that requires an American state to recognize a judgment rendered in a foreign country. The U.S. Supreme Court has also made it clear that, unlike judgments of sister states, judgments of courts of foreign countries are not subject to the Full Faith and Credit clause.* Moreover, the "comity of nations", a well-recognized principle of international relations that affirms that nations ought to extend to each other the recognition of judicial acts, is not binding on any country and does not automatically apply to relations between a sovereign nation and a subnational unit such as a state. For these reasons, the enforcement of judgments rendered by courts of foreign countries is a matter of state, not federal law.** In other words, an Indonesian court's decision is not entitled to the same consideration in Montana as a court in, say, North Dakota.

In 1989, the Montana Legislature adopted the Uniform Enforcement of

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* Hilton v. Guyot, 159 U.S. 113 (1895).

** Erie Railroad Co. v. Thompkins, 304 U.S. 64 (1938).

Foreign Judgments Act ("Enforcement Act") as Title 25, chapter 9, part 5, MCA. The Enforcement Act was proposed by the National Conference of Commissioners on Uniform State Laws as a method of implementing the Full Faith and Credit Clause of the U.S. Constitution* and provides for the filing of judgments from other states, and their subsequent enforcement, as if those judgments were the judgments of Montana courts. In 1993, the Montana Legislature adopted at Title 25, chapter 9, part 6, MCA, the Uniform Foreign Money-Judgments Recognition Act ("Recognition Act").

The Recognition Act includes requisite conditions for recognition of a foreign civil judgment, which are listed in abbreviated form below. (The condition in boldface type is of particular importance, as will be made clear shortly.) A judgment:

(1) must be a result of judicial or quasi-judicial action;
(2) must be based on civil or commercial matters (usually a debt or fixed sum);
(3) must be issued by a court of competent jurisdiction;
(4) must emanate from an impartial court;
(5) must be valid according to the law of the court that delivered it;
(6) must be final;
(7) must have disposed of the controversy on its merits;
(8) ***may not be contrary to public policy or the canons of morality of the place where it is sought to be recognized or enforced;***
(9) should not have been obtained by fraud;
(10) must not constitute a clear mistake of law or fact.

Because Montana has enacted both the Enforcement Act and the Recognition Act, it is easier in Montana than in some other states to enforce a money judgment of a court of a foreign country. Taking some cues from some of the more reputable offshore tax havens, where laws

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* Article IV, section 1, of the U.S. Constitution provides that "Full faith and credit shall be given in each state to the . . . judicial proceedings of every other state."

facilitate the formation of asset protection trusts, the committee considered a number of impediments, or "speed bumps", that would slow down if not stop altogether the recognition and enforcement process by making it more difficult and expensive for a foreign plaintiffs to discover the assets of the debtor in the depository and levy upon those assets. The committee paid due regard to the fact that the existing laws are uniform acts as well as to the requirements of due process and equal protection and to the administration of justice* provisions of the state and federal constitutions. The resulting sections of the bill that concern asset protection set forth some "speed bumps" without tearing up the pavement laid by these uniform laws.

• Section 49 fixes an obligation on the depository to defend a customer against civil judgments rendered in the customer's home country. The depository may charge fees for this service (section 22) and recover its costs.

• Section 50 imposes a filing fee for registering a foreign judgment with a Clerk of the Court in the amount of $2,500. (The existing fee is $60 and remains in place for all registrations except for those pursuant to a judgment aimed at a depository customer's assets.)

• Section 51 is a strongly worded policy statement that includes a provision to deter bad faith lawsuits originating in a depository customer's home country. The section as a whole is built upon a provision of the Recognition Act that allows consideration of public policy norms as a criterion for nonrecognition (the boldface item above). The five subsections in section 51 articulate such norms, and they are key to the effectiveness of this part of the bill. In a nutshell, four of the five subsections in section 51 declare that of the legal and political conditions in perhaps many of the unnamed countries from which the customers may come, many are

* Article II, section 16, of the Montana Constitution provides: "Courts of justice shall be open to every person, and speedy remedy afforded for every injury of person, property, or character . . . . Right and justice shall be administered without sale, denial, or delay."

repugnant to Montana citizens as a civilized community. The fifth holds that the mere threat of a foreign judgment being levied against a customer's assets in a Montana depository is tantamount to a threat against the state's economic well-being.

• In section 52, the burden of proof in gaining recognition or protection against such recognition is shared between the litigants.

• Section 54 prohibits contingency fee arrangements between the person(s) seeking to enforce a foreign judgment and attorneys. This is likely to be an effective disincentive to press an action in Montana courts, but it may also be a controversial element of the bill because it infringes on the normal scope of attorney practices in the state.

In an earlier draft of the bill, there was a section establishing an attorney-client privilege between the customer and the depository. This would have provided even greater protection to the customer because the depository could not be called upon to testify about the customer's assets in the course of a civil proceeding. This provision was dropped, however. As committee Vice Chairman Jon Ellingson reasoned, "We must be mindful that all civil litigation is not frivolous. I do not like the creation of a new category of privileged communication without a compelling need for it."[6] This perspective, along with a provision in section 13 that places the bill's asset protection features outside the purview of the state Department of Commerce, exemplifies the committee's recognition that raising barriers to civil processes is as delicate and challenging as it is indispensable to the depository's functions.

Finally, it's important to keep in mind that the asset protection portion of the bill applies only to civil cases. Tax judgments are not affected; their enforcement depends on the relationship between the home country of the customer and the United States. If there's a tax treaty in place, the customer won't enjoy any protection, although he or she may still successfully avoid taxes. On the other hand, since there are many countries where the government plays a hyperactive role in the economy, it's

plausible that a customer might be hounded and abused via civil processes commandeered by a foreign government agency.

3. PROFIT . . .

L For the customer by means of tax avoidance, tax-exempt interest earnings from U.S. Treasury bills or Montana municipal bonds, access to Montana platinum bars and bullion at a discount, and the appreciation in value of tangible assets (platinum bars, gold-backed Swiss francs, other coins, art, jewels, etc.); and for the financial institution via fees for services rendered and its own investment earnings not related to customer deposits.

The depository customer is likely to come from a high-tax country where marginal income tax rates for wealthy citizens may exceed 50 percent. The normal rates of return on municipal bonds in the U.S. are around 4 percent over a 3-year period, a little over 7 percent over 10 years. Ninety-day U.S. Treasury bills provide a return of approximately 4.5 percent over 3 years, 5.5 percent over 10 years. These rates do not compare favorably with top performing domestic stock funds in the United States in recent years (many investors made 30 to 40 percent in 1995), nor do they measure up to the less stellar performances of other domestic stocks (about 15 percent on average) and international stocks (12 percent).[7] The value of tax avoidance may far outweigh the profit potential for depository customers.

The committee acknowledged the abundance of uncertainty in this important arena of consideration. Considering that the customer would ultimately bear the cost of the state's 2.5 percent "tax" on total assets in the depository (although quite indirectly) and assuming an annual rate of inflation of 2.5 percent, the implication is that a customer who requested the depository to invest in U.S. Treasury bills would only enjoy an increase in purchasing power of between 2 and 3 percent annually.[8] Is this enough? A customer who chooses to retain maximum privacy by allowing funds to remain idle in a custodial or safe deposit account would, of course, face the real prospect of a net loss in purchasing power over time. To hedge against

this outcome, the customer could have the depository exchange one currency for another, more stable one (such as Swiss francs) and thereby enjoy a modest appreciation in the value of the customer's holdings over time. The same reasoning would hold for platinum and other precious metals.

It bears repeating that customers are not placing funds in a Montana foreign capital depository to make more money--most if not all of the customers are presumed to be earning healthy investment returns elsewhere. Their primary motive is to preserve a portion of their total wealth by keeping it private and in a safe place.

It also bears repeating that a Montana foreign capital depository would not be in a position of direct competition with offshore tax havens and banking centers where customers typically pay very low fees * and often enjoy more secrecy than any state can offer under federal law. Typically, offshore banks pay lower income, property, and payroll taxes than U.S. or European banks, or no tax at all, and consequently pay depositors 10 percent or more interest than banks can afford to pay in high-tax jurisdictions. Most of the Caribbean jurisdictions are tax havens for banks as well as depositors. Financial institutions in the Cayman Islands are guaranteed exemption from direct taxation for 30 years; in Bermuda, a similar exemption has been provided for in law until the year 2016. Still, some banks in tax haven jurisdictions pay little or no interest, and places like Switzerland and Hong Kong impose higher taxes than those in the United States.[9]

The depository would earn a profit by charging fees to the depositors. Some fees (such as custodial account and safe deposit charges, investment services, and retainers for asset protection lawyers) would be imposed on a monthly, semiannual, or annual basis; others would be directly related to services provided (such as currency conversion, metals purchases, and other

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* A cursory review of recent guidebooks to offshore banking indicates that governments manage to capture--through stamp duties on documents, customs duties, special license fees, and other ancillary charges--between 0.1 and 1 percent of the total value of financial institutions' assets.

transactions). Although no precise calculations could be made given the dearth of reliable numbers to consider, the committee and staff figured that the depository, in order to meet its own overhead and the 2.5 percent on total assets owed to the state, would likely need to charge its customers between 5 and 7 percent of deposits--a very steep amount in conventional terms, but perhaps not inordinately so given the value of tax avoidance and asset protection provided. Swiss banks are known to charge their depositors negative interest on certain types of accounts, although the rates remain unknown to the committee.

The depository may also derive some income from short-term interest payments by customers for use of an account-related debit or credit card. Other possible income-generating activities not addressed directly in the draft legislation include activities in the foreign exchange and commodities markets, as well as investment earnings on the depository's own portfolio.

Another possibility to consider is that the depository would be a subsidiary of a large, transnational, full-service financial institution, such as Citibank or Swiss Bank Corporation. As a small but unique component in a global network, the depository may not be required to be profit generating at all. The parent company may enjoy some tax advantages if the depository does not make money, while at the same time, the Montana depository may capture a vital share of the global market for private international banking.

ENDNOTES

1. Peter Meltzer, *Keeping Drug Money From Reaching the Wash Cycle: A Guide to the Bank Secrecy Act*, Banking Law Journal, May-June 1991, p. 255.

2. Congressional Quarterly, December 3, 1994, p. 3467.

3. Roger Blauwet, fax memorandum dated January 15, 1996.

4. Mary Ann Wellbank, Administrator, Child Support Enforcement Division, Department of Public Health and Human Services, memorandum dated August 29, 1996.

5. Richard Czerlau, Tax Haven Roadmap, Toronto: Uphill Publishing, 1995, p. 16.

6. Letter from Rep. Ellingson dated September 17, 1996.

7. Christian Science Monitor, July 12, 1996.

8. Comments to staff in letter from Paul Siebrasse, Degroot Commercial Corporation, dated October 17, 1996.

9. Richard Czerlau, op. cit. p. 29.

III. The Bottom Line: State Revenue Projections

Among the most important goals of the enabling legislation is the creation of a new stream of revenue for the state. Early on, the committee surmised that a steady source of revenue would be preferable to a volatile one. They looked at the types and rates of state taxes that are currently applicable to financial institutions in Montana, how Montana rates compare with other states, and how banks are taxed in offshore jurisdictions. In view of all these factors, summarized briefly below, the members considered several options:

- the status quo: the depository would pay corporate income tax at an annual rate of 6.75 percent (or 7 percent under the "water's-edge" application of the unitary tax*);

- a new transactions tax applicable to some or all of the transactions between a customer and the depository;**

- a tax credit predicated by investments in certified Montana capital companies;

- an exemption from corporate income tax as an incentive to attract prospective charter holders, combined with some other form of tax or fee based on the value of assets in the depository.

Three things must be borne in mind when considering the prospective revenue gains. First, in order to maximize the amount of personal financial privacy offered by the depository under state law, it is essential that the customer incurs no tax liability in the state and also none, preferably, in the

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* See 15-31-322, MCA.

** This transactions tax would be conceptually similar to the "Tobin tax", a recently proposed charge on all international financial transactions recommended by economist James Tobin.

United States as a whole. For this reason, no forms of direct taxation of the individual customer were considered at all. The committee did not inquire into the details of how the state treats interest earnings or other income derived from financial activity in Montana by nonresident aliens.

Secondly, the committee had its speculative sights set on a "prize", as it were, somewhere in the vicinity of $1 billion. This figure was used to advocate passage of SJR 19, and it remained the target. The formula from which the $1 billion was derived was based on a 1 percent charge on $100 billion worth of assets on deposit. Given the volume and value of international capital flows, this rough guesstimate seemed plausible. Jerome Schneider, an expert on offshore banking, presented his own calculations at the January meeting to demonstrate how the billion could be assessed and collected (through a combination of charter and renewal fees, transactions taxes, and a special 20 percent tax on depository profits). Schneider also suggested, quite vigorously, that with the tax treatment he advocated and a depository structured in accordance with his recommendations $1 billion of revenue per year was aiming too low.*

This leads to the third consideration, the magnitude of the dollar figures being contemplated. In both a relative and an absolute sense, the committee was dealing with very large sums indeed. A few comparisons draw this out.**

• $3 trillion / the total amount of money invested in mutual funds worldwide

• $725 billion / the total assets of the world's largest bank,

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* Schneider's numbers, on second look, didn't add up. His formula did produce, hypothetically, half a billion dollars (no mean sum), and his points regarding unforeseen revenue potential were well taken.

** All figures are approximate (/) and were gleaned from various periodicals such as *Time*, *Business Week*, *Christian Science Monitor*, and *The Wall Street Journal*.

Mitsubishi/Bank of Tokyo

• $450 billion / the amount invested with the Fidelity family of companies; also the amount in the Federal Reserve System's accounts

• $244 billion / the amount invested in municipal bonds in the U.S.

• $100 billion / the value of U.S. gold reserves; also of Taiwan's foreign exchange holdings

• $7 billion / the estimated current value of Jewish assets stolen by the Nazis and still held in Swiss accounts

• $5.7 billion / the total assets under management of the D.A. Davidson Company

With the help of state Department of Revenue experts, the committee did briefly consider a variety of different ways to impose an indirect tax on deposits: at the time of the transaction deposit, on withdrawal, or whenever funds were shifted from one type of account to another, for example. It seemed reasonable that a graduated schedule of rates, the lowest of which would be applied to the comparatively largest (most valuable) volume of deposits, would provide additional incentive to customers to: (1) put a lot of money into the depository; and (2) leave it there for a long time. This approach was interesting, but it appeared to undermine the principle that a customer would incur no tax liability in Montana. The transactions tax approach was also passed over because it looked to be inordinately complicated. How the property tax on business equipment would affect the depository was also not discussed, although an exemption was among several creative recommendations from interested persons near the close of the study period.[1]

The standard rate of corporate income tax, applied against the profits of the institution (rather than on the value of deposits), would almost certainly not generate sufficient revenue to compensate for the risks involved in

establishing the depository. First of all, precise information on the profitability of conventional banks is not readily obtainable. According to statistics compiled by the Federal Reserve Bank of Minneapolis,[2] most banks in Montana earned a little over 1 percent on assets* and a return on equity of about 15 percent** and enjoyed net interest margins averaging about 5 percent.*** In fiscal year 1994, total corporation license (income) taxes collected in Montana amounted to approximately $60.5 million. (For the fiscal 1996-97 biennium, anticipated collections of the same tax are $129 million.) Corporate income taxes constitute about 10 percent of total general fund revenue, which is estimated to amount to $1.95 billion in the fiscal 1996-97 biennium.[3] As one would expect, while the corporate income tax rate has remained unchanged over the past decade, the revenue from corporate income taxes goes up and down from year to year. In 1988, it amounted to a little over $46 million; in 1990, it exceeded $80 million. In fiscal year 1994, the amount of corporate income tax collected from the finance, insurance, and real estate sector of the Montana economy was a little over $14 million, nearly three quarters of which came from financial institutions.[4]

The committee was able to draw several general and interconnected conclusions from this information. First, the state could not hope to gain more than a small fraction of a billion dollars from the standard rate of corporate income tax applied to a foreign capital depository. Moreover, since the depository is not a bank and would have few of the standard means of generating profits, even good data that is pertinent to financial institutions currently operating in Montana would not provide good indications of the depository's profitability, so there was no discussion of

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* The return on average assets is the bank's net income divided by its assets. It's an indicator of asset management expertise.

** This performance ratio varies widely from bank to bank. It represents a bank's income divided by shareholders' equity; i.e., it tells what a bank is earning on its shareholders' equity.

*** The net interest margin is roughly analogous to a profit margin. It constitutes the spread between a bank's interest income and its interest expense.

establishing a different rate of tax.*

In the end, the committee favored a 20-year exemption from corporate income tax and a permanent exemption from sales tax (mostly in consideration of precious metals accounts).** The exemption in section 57 of the draft bill compares favorably with main offshore competitors, where banks pay no taxes. In lieu of any direct tax on the depository or the customer, the draft bill calls for a semiannual assessment on the depository that is based on the appraised value of all the monetary assets on deposit and the tangible assets in the institution's vaults. The annual rate of assessment in the bill (at section 59) is 2.5 percent. The members acknowledged at their final meeting that this may be too high. Several current and former representatives from the financial services industry indicated, through testimony, correspondence, and informal conversations, that banks and investment companies rarely deal in full percentages; rather, profit margins are determined by cumulative charges measured in basis points (hundredths of a percentage). At the same time, however, information on Swiss banking practices and brief analyses of roughly analogous charges common to domestic and offshore institutions seemed to indicate that 2.5 percent may be at the high end of plausibility, but not necessarily too high.

With the goal of revenue enhancement in mind, the committee voted to leave the rate at 2.5 percent; any reduction would come, if necessary, as the result of informed discourse in legislative hearings. The committee recognized the fact that the revenue assessments, while not constituting a direct tax on customers or the depository's profits, would nevertheless

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* Montana's 6.75 percent rate of corporate income tax is slightly higher than Oregon's (6.6 percent), more significantly higher than Utah's 5.5 percent, and way above the zero rates in Wyoming, South Dakota, Nevada, Washington, and Texas. Idaho's rate is 8 percent; North Dakota's is 10.5 percent. The rates in New York (10.35 percent) and California (9.3 percent) are significantly higher than Montana's.

** Some U.S. states and Switzerland impose sales tax on gold and other precious metals purchases. Exemption would maintain for Montana a thin yet potentially significant competitive advantage.

be a cost of doing business that would ultimately be borne by the customers through the depository's fee structure. It is important nonetheless to keep in mind that the customer is not paying the assessment charge **directly** and that the state does not need or want to know who owns what in order to assess and collect its money. This is where numbered accounts may enter the picture, as a tested means of protecting privacy but still providing the state with what it wants--a stable and substantial source of revenue.

Unlike the distribution of corporate income tax from a financial institution (80 percent of which is allocated to the local government in which the institution is domiciled), all of the revenue generated from a foreign capital depository would go to the state general fund. An earlier draft directed 85 percent of the depository revenue to the general fund. The remaining 15 percent was directed in different proportions to three preexisting statutory economic development programs: the Job Investment Act (17-6-501, et seq.), the Science and Technology Development Fund (90-3-301, MCA), and the Agriculture Seed Capital Account (90-9-301, MCA). At their last meeting, the members voted to redirect all the revenue to the general fund, which is in keeping with the "de-earmarking" approach to state budgeting and would allow for competing opinions over alternative distribution schemes to take place in the legislative process.

The spreadsheet on the following page illustrates different ways of achieving the $1 billion goal. With the 2.5 percent rate of assessment, nearly $50 billion worth of assets are required to be on deposit and in storage. If the rate were dropped to 1 percent, the depository would have to "house" $100 billion--the equivalent, as noted earlier, of the total value of official U.S. gold reserves.

The state Department of Revenue is charged with the duty to assess and collect revenue from a foreign capital depository. The portions of the draft bill specifying the methodology for assessment (see sections 60 and 61) may prove to be problematic. For example, there may be a simpler (and more confidential) way of determining the value of tangible assets than by

periodic appraisal.

insert spread sheet

Escheatment

The committee also considered another, more somber source of revenue--abandoned assets. Since many of the depository customers would be from troubled areas of the world, it is a sad fact that some of them may be killed or might otherwise "disappear" without having made arrangements for the disposition of their assets in Montana. Swiss banks have earned many millions of dollars in this fashion.

Under current Montana law* abandoned property "escheats" to the state after 5 years of inactivity. The Abandoned Property Section of the Department of Revenue collects the proceeds from abandoned stock certificates, dividends, insurance payments, royalties, and other financial properties and deposits the money into a state school trust fund managed by the Board of Investments. The cumulative value of abandoned assets is unknown, but the current estimate is $13 million. In 1994, approximately $1.7 million was deposited into the trust fund.[5] This fund keeps growing because the principal remains inviolate. Current state law is based on a uniform act first recommended in the 1950s and adopted in Montana in 1963.[6] The law allows state government to spend the interest earnings on the cashed-in value of abandoned property but not to acquire title to the principal amount.

Section 65 of the draft bill comports with existing statutes and with several anticipated changes recommended by the Department of Revenue for general purposes, except that the property abandoned by depository customers would not be subject to the public notice and public inspection provisions. It is important that the customer's privacy be protected even in the event of the customer's untimely death or disappearance. In addition, section 65 of the draft bill allows the depository to deduct a charge for the cost of administering the abandoned property so long as there is a pertinent contract between the customer and the depository. The other major difference between current practices and the treatment of abandoned

* See Title 70, chapter 9, of the Montana Code Annotated.

assets in the depository is that all revenue derived from depository-related escheatment would go to the general fund.

Last Words

Finally, a few observations regarding the anticipated fiscal impact of the draft bill: (1) it depends on how many institutions apply for a charter all at once; (2) the lion's share of the state's routine administrative and regulatory costs would be borne by charter holders; (3) most of the immediate cost of implementing the enabling legislation would be time and effort on the part of the state Banking Board and the Banking and Financial Division's 25-member staff in the Department of Commerce.

The bill establishes in section 17 an account into which funds generated by the application fee ($5,000, at section 8), the initial charter fee ($50,000, at section 12), annual charter renewal fees (not to exceed $10,000; also section 12), and fees for routine as well as special examinations (not to exceed $400 per day per examiner; see sections 14 and 16) would be placed in order to meet the Department of Commerce's costs of regulation and examination. A chartered depository would also pay the Department of Revenue for the cost of conducting each audit. The depository is also held responsible for the cost of establishing and maintaining its Know Your Customer policy. In sum, the draft bill is designed to minimize the state's outlays and, in effect, make the regulation of foreign capital depositories part of the institutions' cost of doing business in Montana.

The profitability of the foreign capital depository and the amount of revenue it could generate for the general fund are tightly interwoven factors of great importance to the proposal's prospects in the Legislature. These "bottom line" considerations are still, by and large, gray areas. By force of circumstance, the staff and committee alike had to grope in the dark when it came to projecting how much money could come into the depository and how much the depository would need to keep to cover its own costs.

Notwithstanding the draft bill's rate and method of taxing the assets held by the depository, how much the state stands to gain in the event one or more foreign capital depositories open for business remains a billion dollar question.

ENDNOTES

1. Letter to staff from attorney John Oitzinger dated September 27, 1996.

2. Data derived from the Bank Directory, a feature of fedgazette, the regional business and economics newspaper of the Federal Reserve Bank of Minneapolis, July 1995, p. S-4.

3. Combined General Fund/SEA Revenue Estimates, *Legislative Fiscal Report: 1997 Biennium*, Vol. 1, Office of the Legislative Fiscal Analyst, June 1995, Revenue p. 17.

4. Revenue figures drawn from the Legislative Fiscal Report: 1997 Biennium (Overview), published by the Office of the Legislative Fiscal Analyst, Helena, June 1995, and from the Montana Department of Revenue's 1995 Annual Report.

5. John Stomnes, *Yours, again, for the asking*, The Missoulian, October 25, 1995.

6. Other states have amassed large amounts of abandoned property. For example, in fiscal 1994, California had $278 million ($81 million claimed) and Washington had $24 million ($7 million claimed). *Should You Revise Your Unclaimed Property Law?*, State Legislatures, March 1996.

IV. The Bill

The draft bill incorporates a number of elements, each of which is integral to the profitable operation of a foreign capital depository that is under prudential supervision by the state and that provides both revenue and economic spinoff opportunities to Montana.

If passed by the Legislature and signed into law by the Governor, these different elements may be codified separately, thus fulfilling organizational requirements of Montana's code, but removing the opportunity to view the proposal in its entirety (including shortcomings or areas in need of further development before the whole thing can work). The draft includes several definition sections, one for general purposes, the others geared to more specialized areas. The major categories of sections in the draft are: financial privacy, regulatory procedures, asset protection (via modifications to existing statutes), revenue collection and distribution, and enforcement.

While prolonged and sincere efforts have been made to paint a clear picture in statutory language, only careful reading of the whole will allow the reader to see how different portions of the bill relate to each other. For example, in the crucial arena of financial privacy and to the extent to which it can be protected from federal and state agency inquiries, the reader must refer to sections other than the obvious ones.

Creative Suggestions

In the period between the committee's final meeting and the completion of this report, including the text of the bill that follows, several interested persons came forward and offered suggested improvements to staff.

• Reduce the rate of assessment on deposits and tangible assets from 2.5 percent to 1.5 percent or less.

• Offer customers more investment opportunities.

• Exempt the depository from property tax and/or the tax on business equipment.

• Include the State Auditor as a supervisory agency with regard to trading in precious metals.

• Provide the state immunity from legal challenges pertaining to the depository. This would require a two-thirds vote in both chambers of the Legislature.

Finally, before the reader is invited to delve into the provisions of the draft enabling legislation, it is worthwhile to reiterate the goals that were used to guide the drafting process.

GOALS

T Maximize individual financial privacy within parameters of federal law.

T Require chartered depository to provide prudent degree of asset protection to customers.

T Ensure reasonable profitability for depository via allowable fees and a favorable tax regime.

T Establish clear eligibility criteria for depositories and their customers.

T Minimize state liability and risk in arenas of negligence, fraud, and criminal abuses.

T Maximize economic benefits to Montana of foreign capital on deposit.

T Accommodate technological advances involving privacy, security, and costs of transactions.

T Deter criminal elements from using the depository as a vehicle for money laundering.

T Delineate & assign regulatory functions/responsibilities in a coherent, cost- effective way.

T Minimize federal involvement without foregoing essential benefits of oversight.

T Structure a functional relationship to platinum bullion and other tangible assets.

T Provide for methods of revenue assessment, collection, and distribution.

T Amend existing statutes to except, exempt, or include foreign capital depositories.

DRAFT BILL (LC 0040)

DRAFT BILL (LC0040)

**** Bill No. ***

Introduced By **********

By Request of the Subcommittee on the Foreign Investment Depository

A Bill for an Act entitled: "An Act authorizing the chartering of foreign capital depositories; providing for the rights of financial privacy, asset protection and specialized services to nonresident aliens who are depository customers; establishing the department of commerce as the regulating authority; mandating compliance with certain federal banking laws; providing for a new source of state revenue derived from an assessment based on the value of assets on deposit; amending (statutes to be specified here); and providing an effective date; and providing a termination date."

STATEMENT OF INTENT

A statement of intent is required for this bill because the bill gives the state banking board and the department of commerce authority to adopt administrative rules to effectuate the purposes, policies, and provisions of this chapter. The legislature intends that rules shall be adopted by the state banking board to govern the processes and procedures for both issuing a charter and for suspending or revoking a charter for a foreign capital depository. Because the department of commerce bears responsibility for the regulation and supervision of a foreign capital depository, the legislature finds it prudent to delegate rulemaking authority to that department with respect to the conduct of examinations and inspections, for mandatory reports, and for other related administrative matters. Because the financial privacy of depository customers must be afforded the highest protection possible within the parameters of state and federal law, and because an applicant for a depository charter must be provided a readily discernable combination of certainty and flexibility with respect to the services provided by a depository, no blanket delegation of rulemaking authority is granted to either the board or the department.

Be it enacted by the Legislature of the State of Montana:

NEW SECTION. **Section (1) Purpose.** The legislature finds and declares as follows: (1) Political instability, economic insecurity, and financial risk outside the United States create incentives for the transfer and investment of foreign capital derived from legitimate estates and business activities to relatively safe places such as Montana.

(2) Political conditions in some countries are inimical to the fundamental freedoms and individual liberties codified in international human rights law and enshrined in the Montana Constitution.

(3) It is in the public interest of Montana to attract legally derived foreign capital for investment, revenue enhancement, and other economic development purposes as well as to facilitate tax abatement for residents and businesses in the state.

(4) The legislature has the authority, in connection with its effort to improve economic conditions in the state, to treat foreign persons differently than it does Montana citizens with respect to equal protection of the law.

(5) Insofar as the United States internal revenue code prohibits Montana from offering the type of tax shelters to American citizens that are available to them in foreign jurisdictions, and since few of the conditions prevalent in other countries that give rise to capital flight are extant in the United States, Montana is both compelled and rationally motivated to offer specialized private financial services exclusively to foreign customers.

(6) The state has the competence, capacity, and legitimate authority to charter and regulate financial institutions under the dual banking system of the United States.

(7) A prudent blend of financial privacy, asset protection, and profitability may offer foreign depositors unique opportunities to build and preserve their wealth in Montana.

(8) It is the intent of the legislature to protect state and national interests alike by promoting legal and technical standards and procedures to deter, prevent and detect money laundering and other types of financial crime.

NEW SECTION. **Section (2) Short title and scope.** (1) [Sections 1 through 68] may be cited as the Montana Foreign Capital Depository Act.

(2) [Sections 1 through 68] set forth the terms and conditions under which a foreign or domestic financial institution may enter and do business in Montana as a state-chartered foreign capital depository.

NEW SECTION. **Section (3) Definitions.** As used in [sections __ through __], unless the context requires otherwise, the following definitions apply:

(1) "Bank holding company" means a bank holding company registered under the federal Bank Holding Company Act of 1956, as amended.

(2) "Board" means the state banking board provided for in 2-15-1803.

(3) "Capital" means currency that is convertible to U.S. dollars or personal property, including tangible personal property.

(4) "Cash" means currency, cashier's checks, money orders, and other monetary instruments as defined in the Bank Secrecy Act of 1970 (Public Law No. 91-508).

(5) "Charter" means a certificate issued by the state banking board through the commissioner of financial institutions to a corporation verifying that the corporation is authorized to conduct business in Montana as a foreign capital depository.

(6) "Commissioner" means the commissioner of banking and financial institutions provided for in 32-1-211.

(7) "Controlling person" means a person who holds 5 percent or more of the equity in a depository or is otherwise determined by the board to exercise controlling authority over decisions affecting the management and operation of the depository.

(9) "Customer" means a person who is using or has used the services of a foreign capital depository or for whom a foreign capital depository has acted as a fiduciary.

(10) "Department" means the department of commerce established in 2-15-1801.

(11) "Foreign bank" means a bank that has its primary office outside the jurisdiction of the United States and is licensed under the laws of a foreign country or a political subdivision of a foreign country.

(12) "Foreign capital depository" or "depository" means a financial

institution incorporated in Montana and chartered by the board to conduct business as a foreign capital depository in accordance with [sections 1 through 68].

(13) "Money laundering" is the process through which the existence, illegal source, true ownership or unlawful application of illicitly derived funds are concealed or disguised to make such funds appear legitimate, thereby helping to evade detection, prosecution, seizure, or taxation.

(14) "Non-resident alien" means a person who is neither a citizen nor a resident of the United States.

(15) "Person" means an individual, corporation, limited liability company, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two or more persons having a joint or common interest, or any other legal or commercial entity.

(16) "Supervisory agency" means any of the following:

(a) the attorney general and the department of justice, established by 2-15-2001, for the purpose of the enforcement of all criminal laws of the state.

(b) the department of commerce, established by 2-15-1801, for the purposes of the administration and enforcement of the state laws relating to the chartering and supervision of a foreign capital depository.

(c) the commissioner of banking and financial institutions, appointed pursuant to 32-1-211, for the purposes of the administration and enforcement of the state laws relating to the chartering and supervision of a foreign capital depository.

(d) the banking board, provided for in 2-15-1803, for the purposes of chartering and regulating a foreign capital depository.

(e) the federal reserve system, when the chartered depository is a subsidiary of a financial institution domiciled outside the jurisdiction of the United States, for the purposes of examining a foreign capital depository.

(f) the legislative audit division, established by 5-13-301, for the purposes of the administration of state laws relating to the audit of state agencies and the collection and disbursement of public funds.

(g) the department of revenue, established by 2-15-1301, for the purposes of the administration and enforcement of laws relating to the

collection of taxes or fees from a foreign capital depository.

(h) the insurance department and the commissioner of insurance, established by 2-15-1902 and 2-15-1903, respectively, for the purpose of the administration and enforcement of state laws relating to the regulation of an insurer of accounts in a foreign capital depository.

(17) "Tangible personal property" includes platinum, palladium, gold, or silver bullion or coins, precious stones, jewelry, works of art, furnishings, and other objects of value that are not legal tender.

NEW SECTION. **Section (4) Charter required -- misrepresentation cause for disqualification.** (1) A person may not operate or conduct business as a depository in this state without a charter issued by the board.

(2) A depository shall post the charter certificate in a conspicuous place. (3) A person who is found by the commissioner to have falsely represented to a customer that a charter had been obtained is permanently disqualified from obtaining a charter.

NEW SECTION. **Section (5) Protection of appellation.** A person or corporation that has not been issued a charter under the provisions of [section 8] may not transact business under a name or title that contains the words "foreign", "capital" and "depository" in any combination.

NEW SECTION. **Section (6) Applicability of banking laws.** (1) Except as provided in subsection (2) the provisions of Title 32, chapter 1 do not apply to a foreign capital depository.

(2) The provisions of 32-1-107, 32-1-301, 32-1-461, 32-1-462, 32-1-464, 32-1-468, 32-1-473, 32-1-491, 32-1-492, 32-1-501 through 32-1-506, 32-1-508 through 32-1-565, and 32-1-901 through 32-1-921 apply to a foreign capital depository unless a section in this chapter or a rule or order issued under this chapter is inconsistent with any of the sections in Title 32 listed in this subsection.

NEW SECTION. **Section (7) Rulemaking authority.** (1) The board shall adopt rules to implement [sections 8, 9, and 12].

(2) The department shall adopt rules to implement [sections 13, 14,

and 18], and to specify the conditions under which a depository may be found to be operating in a manner that unsafe or unsound.

NEW SECTION. **Section (8) Charter eligibility and application requirements.** (1) In order to lawfully conduct business in Montana as a foreign capital depository a person intending to own and operate a depository shall:

(a) obtain a state charter from the board through an application process established by the commissioner and administered by the department;

(b) make and file articles of incorporation in accordance with 32-1-301;

(c) submit an application to the board on a form provided by the commissioner. An application must be accompanied by:

(i) documents certifying that the identity of each director, controlling person, officer and manager of the proposed depository has been verified by means of a background check;

(ii) a written copy of the applicant's Know Your Customer policy and a written description of the implementation method for the policy;

(iii) a detailed written description of the applicant's personnel training and pre-employment screening programs, physical and technological security systems, and methods of compliance with applicable federal recordkeeping and reporting laws;

(iv) a business plan that includes projections of costs, profitability, and relevant changes in financial markets;

(v) the intended location of each depository office in the state;

(vi) a document from a certified public accountant confirming that the applicant has financial assets in excess of liabilities in an amount established by board rule;

(vii) A nonrefundable charter application fee of $5,000, to be paid into the account established in [section 17].

(2) A foreign capital depository may be a subsidiary of a foreign bank that has obtained approval from the federal reserve system to operate in the United States in accordance with the Foreign Bank Supervision Enhancement Act of 1991.

NEW SECTION. **Section (9) Charter application -- grounds for denial.** (1) To safeguard the interests and the reputation of the state, the board shall deny a charter application if it finds that the person planning to operate the depository is not of good character or that the applicant is not financially sound. (2) The board may find that the person planning to own, operate, or manage the depository is not of good character or financial integrity if a director, an executive officer, or a controlling person of the depository has:

(a) been convicted of, or has pleaded guilty or nolo contendere to, any crime involving fraud, theft, conspiracy, racketeering or money laundering;

(b) consented to or suffered the suspension or revocation of a professional or occupational license based on conduct involving an act of fraud or dishonesty;

(c) willfully made or caused to be made in an application or report to the commissioner false or misleading statements, or has willfully omitted salient facts required in the report;

(d) willfully violated a provision of [sections 4 and 8], or aided, abetted, counseled, commanded, induced, or procured the violation by another person of a provision of [sections 4 and 8].

(3) Subsections (1) and (2) are not exclusive of other grounds on which the board may determine that an applicant for a depository charter is not of good character and therefore may not receive a charter.

(4) The board may authorize the commissioner to conduct or obtain from a private investigative service a background check on any director, executive officer, or controlling person of the depository for the purposes of determining whether an applicant is of good character.

(5) The board shall adopt rules concerning the method and process for determining whether an applicant for a charter is financially sound.

NEW SECTION. **Section (10) Suspension, revocation and restoration of charter.** (1) The board may suspend or revoke the charter of a depository if the board finds that the depository or any officer, director, or controlling person of the depository has:

(a) violated a provision of [sections 1 through 68], a rule of the department established pursuant to this act, the Bank Secrecy Act of 1970 or any implementing regulation of the Bank Secrecy Act of 1970;

(b) failed to comply with an order of the commissioner;

(c) operated in a manner or condition that is unsafe and unsound;

(d) become insolvent in that it has ceased to pay its debts in the ordinary course of business, is unable to pay its debts as they come due, or its liabilities exceed its assets;

(d) filed a petition for an adjudication of bankruptcy;

(e) knowingly made a false statement or report to the department;

(f) failed to pay the department of revenue the fee, penalty, or interest owed pursuant to [sections 59 through 61] before 5 p.m. on the last day of the 11th month after the date a deficiency assessment is mailed;

(g) if it is a subsidiary of a foreign bank holding company or another type of financial institution, suffered the suspension or revocation of its operating license in the country where the parent company is domiciled;

(2) Before suspending or revoking a charter the board shall conduct a hearing in accordance with the Montana Administrative Procedure Act relating to a contested case.

(3) On the recommendation of the department the board may reinstate a charter that has been suspended or revoked if the board finds that the depository has restored its integrity and financial soundness.

(4) At no time during or following the suspension, revocation, or reinstatement of a charter may a financial record pertaining to an individual account be disclosed except in accordance with rules for the conduct of examinations in [section 15] or in accordance with [sections 29 through 46].

NEW SECTION. **Section (11) Administrative orders by commissioner.** (1) In addition to or in lieu of the board's suspending or revoking the charter issued to a foreign capital depository, the commissioner may:

(a) issue a cease and desist order that specifies the activity the

depository may not undertake for the duration of the order;

(b) require a depository to take action as determined by the commissioner; or

(c) order the depository to pay a civil penalty in an amount not to exceed $10,000 for each violation or, in the case of a continuing violation, $10,000 for each day during which the violation continues.

(2) Orders issued by the commissioner pursuant to this section must be issued in compliance with the contested case procedure of the Montana Administrative Procedure Act.

NEW SECTION. **Section (12) Charter and renewal fee.** (1) A successful applicant for a state charter shall pay to the department an initial charter fee of $50,000.

(2) A depository shall pay an annual charter renewal fee in an amount set by the board by rule but not to exceed $10,000.

(3) Fees collected pursuant to subsections (1) and (2) shall be deposited in the foreign capital depository account established in [section 17].

NEW SECTION. **Section (13) Regulation and supervision -- rules.** (1) To ensure that the department meets its responsibility for the prudential supervision of a foreign capital depository, the department shall adopt rules that:

(a) determine the processes and procedures necessary to ensure that the managers, employees, and procedures of a depository are in compliance with [sections 1 through 46] and [sections 56 through 68];

(b) establish the procedures for the conduct of examinations of a depository by the department, including the means by which the commissioner will verify that the depository's Know Your Customer policy has been implemented;

(c) establish the form of suspicious activity reports and the conditions under which a suspicious activity report must be filed with the department;

(d) require a depository to submit to the department on request a written or electronic record of any transfer or withdrawal of cash from the

depository in an amount equal to or greater than $10,000.

(e) require a depository to file an annual report with the department detailing the depository's:

(i) security measures designed to deter and prevent theft, fraud, and corruption;

(ii) procedures for filing suspicious activity reports with the U.S. department of the treasury and for keeping records and filing reports of transactions as required by federal law and regulation to combat money laundering and other criminal activities;

(iii) employee training programs regarding disclosure and other aspects of customer financial privacy; and

(iv) fulfillment of the Know Your Customer policy recommended by the American Bankers Association or prescribed by federal regulation.

(2) With respect to an action concerning the issuance, suspension, or revocation of a charter, or an action pursuant to enforcement in [sections 66 through 68], the department shall adopt rules to determine prehearing discovery procedures, including the taking of depositions and the production of documents.

(3) In adopting rules for hearings, the department shall provide for the issuance of subpoenas and for the administration of oaths to witnesses and parties or their representatives, to apply both to discovery procedures and to hearings.

NEW SECTION. **Section (14) Costs of regulation -- supervision.** A depository shall pay to the department an annual fee established by rule and that is commensurate with the cost of conducting examinations of a depository by the department. The proceeds of the fee established by the department must be deposited in the foreign capital depository account created by [section 17].

NEW SECTION. **Section (15) Examinations.** (1) Except as provided in subsection (5), the department shall:

(a) examine, at least once every 12 months, each depository to:

(I) verify the assets and liabilities of each;

(II) ascertain the accuracy of the depository's books and records; and

(III) determine whether the depository's methods of operation and conduct of business are in compliance with applicable laws and rules; and

(b) submit in writing to a depository examined in accordance with subsection (a) a report of the examination's findings no later than 60 days after the completion of the examination.

(2) An officer or employee of a foreign capital depository shall exhibit to the department or an examiner from the federal reserve system on request the books, records, and accounts of the depository, except that the identity of a customer may not be disclosed to the department or any examiner unless the disclosure is necessitated by the department's procedure for verifying that the depository's Know Your Customer policy has been implemented effectively.

(3) The department may issue subpoenas and administer oaths to any director, executive officer, controlling person, or employee of a foreign capital depository. In case of a refusal to obey a subpoena issued by the department, the refusal may be reported to the district court of the district in which the depository is located. The court shall enforce obedience to the subpoena in the manner provided by law for enforcing obedience to the process of the court.

(4) If a depository charter is issued to a foreign bank the department may conduct an examination of the depository:

(a) in conjunction with supervisory personnel from the federal reserve system, or;

(b) without the assistance of federal reserve system personnel.

(5) The department may accept as the examination of a depository required by this section the findings or results of an examination conducted by the federal reserve system.

(6) A foreign capital depository shall keep its corporate records, financial records, and books of account in words and figures of the English language, in Montana, and in a form satisfactory to the department.

(7) If a foreign capital depository is issued a charter to maintain two or more offices in the state, the depository shall designate one of its offices as its primary office for the purposes of keeping consolidated records and facilitating examinations by the department.

NEW SECTION. **Section (16) Special examinations -- costs.** (1) Whenever in the judgment of the commissioner the condition of a depository or the actions of a customer necessitate an examination beyond that required by [section __], the department may conduct additional examinations determined to be necessary and in connection with the additional examinations charge the depository:

(a) an amount not exceeding $400 a day for each examiner engaged in the examination of the depository;

(b) the actual cost of travel expenses of the examiner in the event travel outside this state is determined necessary by the commissioner; and

(c) a reasonable amount to recover the actual costs of counsel and other department resources.

(2) The money collected by the department pursuant to examination fees shall be deposited in the account established in [section 17].

NEW SECTION. **Section (17) Foreign capital depository account.** (1) There is an account in the state special revenue fund. Except for revenue derived in accordance with [sections 59 through 61], money from the foreign capital depository must be deposited in the account.

(2) The money in the account is appropriated, as provided in 17-7-502, to the department of commerce for the department's use in meeting its supervisory and regulatory obligations established in [sections 12 through 16].

NEW SECTION. **Section (18) Reports -- contents and restrictions.** (1) A depository shall make a report to the department in the manner and at the time required by the commissioner.

(2) A report filed with the department must:

(a) contain the information required by rule; and

(b) be verified by two of the depository's principal officers. The verification must state that each of the officers making it has a personal knowledge of the matters in the report and that each of them believes that

each statement in the report is true.

(3) A depository may not include any financial record as defined in [section 30] of any customer in the report.

(4) The department may provide a copy of the report to another supervisory agency.

NEW SECTION. **Section (19) Recordkeeping and reporting -- suspicious activity.** In addition to compliance with applicable provisions of the Bank Secrecy Act, a foreign capital depository shall:

(1) keep a written or electronic record of each wire transfer or other electronic means of transferring capital to the depository for at least 5 years when the transfer involves $3,000 or more; and

(2) comply with federal regulation and rules of the department concerning the form of a suspicious activity report and the conditions under which a suspicious activity report is required to be reported to a supervisory agency or to the U.S. department of the treasury.

NEW SECTION. **Section (20) Sale or transfer of charter prohibited -- penalty.**

(1) A charter issued by the board may not be sold, traded, transferred or otherwise assigned to another controlling person.

(2) a person who attempts to sell, trade, transfer, or who knowingly accepts a depository charter in violation of subsection (1) is subject to civil and criminal penalties pursuant to [sections 67 and 68].

NEW SECTION. **Section (21) Dissolution -- closing.** (1) The board may, upon a finding of negligence, misconduct, or any of the conditions specified in [section 9] dissolve the charter of a depository, and remove any or all directors, officers and employees prior to the dissolution in accordance with the provisions of Title 32, chapter 1, part 9.

(2) The department may close a depository and take possession of the books, records, and assets of the depository and hold them until the depository is authorized by the board to resume business or its affairs are liquidated in accordance with
32-1-502 through 32-1-565.

(3) Except in accordance with the provisions in [sections 29 through 46], an individual financial record must not be disclosed in the process of dissolving or closing a depository, and the penalties for wrongful disclosure in [sections 29 through 46] apply to the board, the department, and the depository.

(4) A foreign capital depository may not close its primary office or cease operations without the written approval of the department.

(5) Voluntary dissolution of a depository must comport with the provisions of 32-1-501.

NEW SECTION. **Section (22) Depository services -- allowed and mandated.** (1) A depository may:

(a) accept deposits in any currency or electronic form convertible to U.S. dollars;

(b) provide safe deposit and other storage services for the purpose of protecting the security of a customer's tangible personal property;

(c) convert cash deposits to purchase orders for platinum, palladium, or gold bullion on behalf of or at the direction of a customer;

(d) purchase, sell and pay interest to the customer derived from tax-exempt federal, state, county and municipal bonds on behalf of or at the direction of a customer;

(e) provide a customer with foreign currency in exchange for U.S. dollars in an equivalent monetary amount;

(f) perform trust and related fiduciary services as provided in 32-1-107, but only if the depository has obtained a certificate from the department authorizing the depository to act as a trust company or the subsidiary of a trust company prior to engaging in trust activities;

(g) issue a debit card or an automatic teller machine card to a customer;

(h) charge interest in relation to a customer's use of a debit or automatic teller machine card;

(i) establish different types of deposit accounts for customers;

(j) offer deposit or safe deposit insurance provided under contract with a financial guaranty insurer approved by the insurance commissioner;

(k) charge fees related to the opening, management and insuring of

deposit accounts, the storage and maintenance of tangible personal property assets, the establishment and administration of trust accounts, and other lawful investment, legal, or financial services;

(l) set underwriting standards for each type of account it offers to a customer;

(m) establish a minimum deposit amount for any type of account so long as the minimum is not less than $200,000.

(2) A depository may in its discretion refuse an applicant for an account of any type.

(3) A depository shall:

(a) exercise extraordinary diligence in determining the genuine identity of a customer;

(b) protect the privacy of each customer as provided in [sections 29 through 46];

(c) in accordance with [sections 47 through 55], provide legal defense of a customer at the customer's request or on the request of the customer's legal representative in the event a civil judgment rendered against the depositor in a jurisdiction outside the United States is registered in Montana;

(d) with respect to precious metals accounts in [sections 25 through 28], comply with the statutory protections against securities fraud under Title 30, Chapter 10;

(e) comply with federal reporting and recordkeeping requirements as provided in the Bank Secrecy Act of 1970, the Money Laundering Control Act of 1986, the Annunzio-Wylie Act of 1992 and implementing regulations of each of these acts of Congress concerning money laundering and other financial crimes.

NEW SECTION. **Section (23) Depository services -- restrictions and prohibitions.** (1) a depository may not accept a deposit:

(a) from an individual who is a citizen or a resident of the United States;

(b) from a corporation, trust, or partnership if any shareholder, settlor, member, beneficiary or partner is a citizen or a resident of the United States;

(c) in an amount valued at less than $200,000 U.S. dollars.

(2) A depository may not:

(a) engage in lending or any related commercial banking services as defined in the Bank Act, except:

(i) in a case where fiduciary lending is necessitated by a trust obligation and the depository has obtained a certificate from the department authorizing the depository to act as a trust company or the subsidiary of a trust company; or

(ii) in relation to a precious metals account as provided in [sections __ through __.]

(b) transfer $10,000 or more of a customer's cash on deposit to another financial institution inside or outside the jurisdiction of the United States, without submitting a record of the transaction to the commissioner and the attorney general that includes the customer's name, last-known address and, if the customer is an individual, passport number;

(c) accept a deposit from a customer who has been convicted of a state or federal crime in the United States or from a corporation of which a controlling person has been convicted of a state or federal crime in the United States.

NEW SECTION. **Section (24) Sale or trade of deposit accounts prohibited -- transfers allowed.** (1) The legislature does not intend to create or facilitate the creation of a secondary market for depository accounts. Therefore, except for the condition set forth in subsection (2) the sale or trade of a deposit account by a depository is prohibited.

(2) A depository may permit the legal transfer of a deposit account from a customer to the customer's heir, spouse, or designated next of kin for the purposes of estate preservation and maintenance.

NEW SECTION. **Section (25) Precious metals accounts -- purpose.** (1) The legislature acknowledges that:

(a) Montana is both a major gold producer and the only domestic source of commercially significant amounts of platinum and palladium, precious metals that have diverse uses in addition to serving as a store of value;

(b) many non-resident aliens and foreign corporations place great value in the security inherent in precious metals as a hedge against currency depreciation, currency devaluation, and general inflation, and prefer precious metals over other types of investments that may offer a higher or more certain rate of return;

(c) the expansion of the processing and refining capacity of the platinum and palladium mining operations in Montana's Stillwater complex may provide unique investment opportunities for non-resident aliens and a significant stimulus for economic development in the state; and,

(d) helping to establish financial links between customers of the depository and products of the precious metals depository is in the economic interest of the state;

(2) The legislature further recognizes its responsibility to help deter money laundering and other financial crime, and therefore acknowledges that restricting the liquidity of a precious metals account will reduce significantly any incentive there may be for a person to use a precious metals account for illicit purposes.

NEW SECTION. **Section (26) Definition.** For the purposes of this chapter, a precious metals account is a depository account in which the depository, upon instructions of a customer exchanges cash for a commensurately valued amount of gold, silver, platinum, or palladium bullion procured by the depository for the primary purpose of safekeeping over an extended period of time.

NEW SECTION. **Section (27) Account requirements -- provisions.** (1) An agreement between the depository and a customer to establish a precious metals account must include the following provisions:

(a) a term of maturity that is not less than 36 months;

(b) a penalty for early withdrawal of an amount of precious metals that exceeds 20 percent of the monetary value of the total amount of precious metals in the account, the monetary value to be equivalent to the spot market price of the precious metal listed in The Wall Street Journal on the date of the withdrawal;

(c) a requirement that the precious metals purchased by a customer

be delivered to the depository within 7 days of payment in good funds of any part of the purchase price.

(2) A precious metals account may provide for limited withdrawal from the account by means of a debit card or an automatic teller machine card, so long as the total amount withdrawn from the account prior to the maturity date established in subsection (1)(a) does not exceed 20 percent of the total monetary value of the precious metals in the account on the date of the withdrawal.

(3) A depository may charge a customer interest and a fee in relation to a cash withdrawal made in accordance with subsection (2).

NEW SECTION. **Section (28) Termination -- settlement.** (1) Upon termination of a precious metals account, whether at or before the date of maturity, the terms of settlement must allow:

(a) the depository to convert the precious metals to currency at the spot market rate on the day of settlement, and:

(b) the depository's right to delay settlement for not more than five business days.

NEW SECTION. **Section (29) Financial privacy -- purpose.** The legislature finds and declares as follows:

(1) The viability of one or more foreign capital depositories in Montana depends to a large extent upon both the secure nature of the depository and the confidential nature of customer account and safe deposits in the depository and upon the confidential nature of transactions between a customer and a depository. Therefore, the purpose of [sections 29 through 46] is to clarify and protect the confidential relationship between foreign capital depositories and their customers and to balance a customer's right of privacy with the governmental interest in obtaining information for specific purposes and by specified procedures as set forth in [sections 29 through 46]. The confidential relationship between a foreign capital depository and its customers is to be protected by restrictions on the disclosure of financial records to supervisory agencies and a prohibition against disclosure of financial records to other state and

local agencies and to private individuals except under specified conditions.

(2) At the same time, however, a state offering secure and confidential depository services to its customers must be mindful that significant amounts of capital are derived from or moved for illegal purposes and that the United States and other jurisdictions have passed laws and worked diligently to prevent money laundering and other offenses from being conducted as part of otherwise lawful transactions.

(3) In licensing and supervising the operation of one or more foreign capital depositories, Montana must enforce its own criminal laws vigorously. It is also imperative that Montana cooperate with United States law enforcement and other authorities to effectively deter and, when deterrence fails, detect, investigate and prosecute perpetrators of financial crimes.

(4) To these ends, the purpose of [sections 29 through 46] is not to avoid the application of the Bank Secrecy Act of 1970, the Right to Financial Privacy Act of 1978, the Money Laundering Control Act of 1986, and the Annunzio-Wylie Act of 1992, which are intended to prevent or deter money laundering and other financial crimes while maintaining a degree of secrecy of customer bank accounts from federal agencies, but rather to apply state law in those areas unregulated by these and other relevant federal laws. [Sections 29 through 46] have therefore been carefully written to augment and not conflict with federal laws intended to deter financial crimes. However, it is the intent of the legislature that if there is a clear and direct conflict between [sections 29 through 46] and applicable federal statutes, treaties, or regulations that cannot be resolved by other means, then the state law should be preempted in order to maintain the efficacy and integrity of United States laws intended to combat financial crimes.

NEW SECTION. **Section (30) Definitions.** Unless the context requires otherwise, in [sections 29 through 46], the following definitions apply:

(1) "Customer" means a person who is using or has used the services of a foreign capital depository or for whom a foreign capital depository has acted as a fiduciary.

(2) "Financial institution" includes state and national banks, state and federal savings and loan associations, trust companies, investment companies, and state and federal credit unions. The term does not include a title insurer while engaging in the conduct of the business of title insurance, an underwritten title company, or an escrow company.

(3)(a) "Financial record" means:

(i) an original or copy of a record or document held by a foreign capital depository that directly or indirectly pertains to a customer of the depository;

(ii) information contained in the original or copy of the record or document; or,

(iii) the name of a customer.

(b) A record or document may, for the purposes of this subsection, be in a paper, electronic, or other format.

(4) "Foreign capital depository" or "depository" means a financial institution chartered by the commissioner in accordance with [sections 1 through 68].

(5) "Investigation" includes an inquiry by a peace officer, as defined by 46-1-202, sheriff, or county attorney, or an inquiry made for the purpose of determining whether there has been a violation of a law enforceable by imprisonment, fine, or monetary liability.

(6) "Local agency" includes a county, city, town, school district, special use or special taxing district, or an office, bureau, committee, commission or other entity of any of those entities.

(7) "Person" means an individual, partnership, corporation, limited liability company, association, trust, or other legal entity.

(8) "State agency" means an office, officer, department, division, bureau, board, or commission of state government that is not a supervisory agency, including the legislature.

(9) "Subpoena" includes subpoena duces tecum.

NEW SECTION. **Section (31) Request or receipt of records and information prohibited -- exceptions -- records to be maintained.** (1) Except as provided in this section and in [sections 39 and 40], an officer,

employee, or agent of a state or local agency may not request or receive a copy of a financial record from a foreign capital depository unless the financial record is consistent with the scope and purpose of any investigation by the state or local agency, is described with particularity, and:

(a) the customer has authorized disclosure of the financial record in accordance with [section 34];

(b) the financial record is disclosed in response to an administrative subpoena meeting the requirements of [section 35];

(c) the financial record is disclosed in response to a search warrant meeting the requirements of [section 36]; or

(d) the financial record is disclosed in response to a judicial subpoena meeting the requirements of [section 37].

(2) The burden of proving that a required disclosure of a financial record is consistent with the scope and purpose of an investigation is upon the state agency or the local agency requiring disclosure of the financial record.

(3) Nothing in this section or in [sections 34, 35, 36, or 37] requires a foreign capital depository to inquire or determine whether a person seeking disclosure of a financial record has complied with the requirements of those sections if the customer authorization, administrative subpoena, search warrant, or judicial subpoena served upon or delivered to the depository pursuant to any of those sections shows compliance on its face.

(4) A foreign capital depository shall maintain for a period of five years a record of all disclosures by a depository of the financial records of a customer pursuant to [sections 29 through 46], including the identity of the person examining the financial records, the state or local agency that the person represents, and a copy of the customer authorization, administrative subpoena, search warrant, or judicial subpoena providing for examination or disclosure. A record of disclosures maintained pursuant to this subsection must be available, within five days of request, during normal business hours of the depository for review by the customer at the office or branch of the depository where the customer's account or safe deposit was located when examined or disclosed. A paper or electronic copy of the record of disclosures must be furnished by the depository to

the customer upon request by the customer.

(5) This section does not prevent a state or local law enforcement agency from initiating contact with a foreign capital depository if there is reason to believe that the depository is a victim of a crime perpetrated by a customer. After contact by a law enforcement agency, if the foreign capital depository reasonably believes it is a victim of a crime, it may, in its discretion, disclose relevant financial records pursuant to [section 32(2)]. Conviction of or admission by a customer of a crime against the depository is conclusive on the issue of the reasonable belief of the depository.

NEW SECTION. **Section (32) Disclosure of record to agency prohibited -- exceptions.** (1) Except as provided in this section and in [section 40], a foreign capital depository and a director, officer, employee, or agent of a foreign capital depository may not provide or authorize another person to provide a financial record to an officer, employee, or agent of a state or local agency.

(2) This section does not preclude a foreign capital depository, in its discretion, from initiating contact with and disclosing a relevant financial record to a supervisory agency concerning a suspected violation of state or federal law if the depository reasonably believes that a violation of law has been committed. Conviction of or admission by a customer of a crime is conclusive on the issue of the reasonable belief of the depository.

NEW SECTION. **Section (33) Disclosure of record to private individual prohibited -- exceptions.** (1) Except as provided in this section and in [section 40], a foreign capital depository and a director, officer, employee, or agent of a foreign capital depository may not provide or authorize another person to provide a financial record to an individual who is not an agent, officer, or employee of a state or local agency acting pursuant to Montana state law or local ordinance, or an agent, officer, or employee of the United States acting pursuant to federal law.

(2) This section does not preclude a foreign capital depository, in its discretion, from initiating contact with and disclosing a relevant financial record to an appropriate state, local, or federal agency concerning a suspected violation of state or federal law if the depository reasonably

believes that a violation of law has been committed. Conviction of or admission by a customer of a crime is conclusive on the issue of the reasonable belief of the depository.

NEW SECTION. **Section (34) Customer authorization -- form -- notice to customer.** (1) A director, officer, agent, or employee of a foreign capital depository may disclose or authorize another to disclose, and an officer, employee, or agent of a supervisory, state, or local agency may obtain, a financial record if the customer to whom the record relates has authorized disclosure of the record on a form provided by the depository that:

(a) is signed and dated by the customer;

(b) authorizes disclosure for a period set forth in the authorization statement;

(c) specifies the name of the person, state agency, or local agency to whom or to which disclosure is authorized and, if applicable, the statutory purpose for which the information is to be obtained; and

(d) identifies the financial record authorized to be disclosed.

(2) A foreign capital depository may not require a customer authorization to be signed by a customer as a condition of doing business with the depository.

(3) A customer may revoke an authorization by written notice to the foreign capital depository. The notice must contain a copy of the authorization to which it relates or contain the information originally required in the authorization to which it relates, be signed and dated by the customer, and must contain a clear statement revoking the previous authorization.

(4) (a) A state or local agency obtaining a financial record pursuant to a customer authorization shall notify the customer in writing of the receipt of the financial record within 30 days of the agency's receipt of the financial record. However, by application to a judge of a court of competent jurisdiction in the county in which the financial record is located and upon a showing of good cause to believe that disclosure would impede the investigation, the notification requirements of this subsection (4)(a) may be extended for two additional 30-day periods. Thereafter, by application to a court upon a showing of extreme necessity for nondisclosure, the notification requirements of this subsection (4)(a) may

be extended for three additional 30-day periods. At the end of that period or periods, the agency shall inform the customer that the customer has the right to make a written request as to the reason why the agency obtained the record. The notice must specify the financial record that was obtained and, if requested, the reason why the record was obtained.

(b) Whenever practicable, an application for an additional extension of the notification time provided in subsection (4)(a) must be made to the judge who granted the first extension of notification time. In deciding whether to grant an extension of the notification time, the judge shall provide the customer with prompt notification, consistent with the purpose of [sections 29 through 46], and on the presumption that prompt notification is the rule and delayed notification the exception.

NEW SECTION. **Section (35) Administrative subpoena.** (1) A director, officer, agent, or employee of a foreign capital depository may disclose, or authorize another to disclose, and an officer, employee, or agent of a supervisory, state, or local agency may obtain, a financial record under [section 31(1)(b)] pursuant to an administrative subpoena otherwise authorized by law and served upon the foreign capital depository only if:

(a) the person issuing the administrative subpoena has served a copy of the subpoena on the customer pursuant to rule 4D of the Montana Rules of Civil Procedure;

(b) the subpoena includes the name of the agency in whose name the subpoena is issued and the statutory purpose for which the record is to be obtained; and

(c) ten days after service of the subpoena have passed without the foreign capital depository or the customer moving to quash the subpoena.

(2)(a) The supervisory, state, or local agency issuing the administrative subpoena may not shorten or waive the requirements of subsection (1). However, the agency may petition a court of competent jurisdiction in the county in which the record is located, and the court, upon a showing of a reasonable inference that a law enforceable by the petitioning agency has been or is about to be violated, may order that service upon the customer pursuant to subsection (1)(a), or the 10-day period provided for in subsection (1)(c), be waived or shortened. For the

purpose of this subdivision, an "inference" is a deduction that may reasonably be drawn by the Attorney General or the county attorney from facts relevant to the investigation.

(b) The petition may be presented to the court in person or by telephoned oral statement which must be recorded and transcribed. In the case of telephonic petition, the recording of the sworn oral statement and the transcribed statement must be certified by the judge receiving it and must be filed with the clerk of the court.

(3) Except as provided in subsection (2) and this subsection, a foreign capital depository shall immediately notify a customer of the receipt of an administrative subpoena for a financial record of that customer. A court may order a depository to withhold notification to a customer of the receipt of an administrative subpoena when the court issues an order pursuant to subsection (2) and makes a finding that notice to the customer by the financial institution would impede the investigation.

NEW SECTION. **Section (36) Search warrants.** A director, officer, employee, or agent of a foreign capital depository may disclose, or authorize another to disclose, and an officer, employee, or agent of a state agency or local agency may obtain, a financial record under [section 31(1)(c)] only if the officer, employee, or agent obtains a search warrant pursuant to Title 46, chapter 5, part 2. Examination of a financial record may occur as soon as the warrant is served upon the foreign capital depository. A foreign capital depository shall notify a customer of the receipt of a search warrant, unless a court orders the depository to withhold notification to the customer upon a written finding that notice would impede the investigation.

NEW SECTION. **Section (37) Judicial subpoena.** (1) A director, officer, employee or agent of a foreign capital depository may disclose, or authorize another to disclose, and an officer, employee, or agent of a supervisory, state, or local agency may obtain, a financial record under [section 31(1)(d)] pursuant to a judicial subpoena only if:

(a) the subpoena is issued as otherwise authorized by law and served in compliance with Rule 4D of the Montana Rules of Civil Procedure, and

the requirements of subsections (1)(b), (c), or (d) have been met. In the event actual service on the customer is not prohibited but has not been made prior to the time the financial record is required to be produced in response to the subpoena, the court shall, prior to turning over a record to the agency, and upon good cause shown, make a finding that due diligence has been exercised by the agency in its attempt to effect service upon the customer; and

(b) ten days after service of the subpoena on the customer and the depository have passed without the customer or the depository having moved to quash the subpoena;

(c) the subpoena has been served upon the customer and the depository and a judge in a judicial proceeding to which the customer or the depository is a party rules that the subpoena should not be quashed. Nothing in this paragraph is intended to preclude appellate remedies that may be available under existing law; or

(d) the subpoena has been served upon the depository and a court orders that service of the subpoena upon the customer be delayed in accordance with this section. Service may be delayed for up to 30 days from the date of issuance of the judicial subpoena after the court makes a finding upon a written showing that service upon the customer would impede the investigation. The withholding of notification may be extended for additional 30-day periods if a court makes a finding upon a written showing, at the time of each extension, that service upon the customer would impede the investigation. Whenever practicable, an application for an extension of time shall be made to the judge who issued the judicial subpoena. In deciding whether to grant an extension of the notification time, the judge shall endeavor to provide the customer with prompt notification, consistent with the purpose of [sections 29 through 46], and on the presumption that prompt notification is the rule and delayed notification the exception.

(2) If testimony is to be taken concerning a financial record or if a financial record is to be produced before a court, the 10-day period provided for in subsection (1)(b) may be shortened by the court upon a showing of good cause. The court shall direct that all reasonable measures be taken to notify the customer within the time so shortened. The motion to quash the

subpoena must be made, whenever practicable, in the judicial proceeding pending before the court.

(3) (a) A grand jury, upon resolution adopted by a majority of its members, may obtain financial records pursuant to a judicial subpoena that, upon a written showing to a judge that there exists a reasonable inference that a crime within the jurisdiction of the grand jury has been committed and that the financial record sought is reasonably necessary to the jury's investigation of that crime, is personally signed and issued by a judge in accordance with 46-4-301, and otherwise complies with the requirements of this section.

(b) For the purpose of this subsection (3), an "inference" is a deduction that may be reasonably drawn by the grand jury from facts relevant to the investigation.

(4) A showing required to be made pursuant to this section, as well as the court record of any finding made pursuant to the showing, must be sealed until one person named in the indictment to which the showing related has been arrested, or until the end of the term of the grand jury, if no indictment to which the showing relates has been returned. However, a court may unseal the showing and the court record relating to the showing on a written showing of good cause.

NEW SECTION. **Section (38) Grounds for quashing subpoena -- duty of depository.** (1) A customer or a foreign capital depository has ten days after service of an administrative or judicial subpoena upon either of them to file a motion to quash the subpoena before the administrative agency issuing the subpoena or a court with jurisdiction over the subpoena. The motion to quash may be based upon any one or combination of the following grounds:

(a) the financial record sought is incompetent, irrelevant or immaterial for the purpose for which it is sought;

(b) the release of the financial record would cause an unreasonable burden or hardship under the circumstances upon the customer or the depository;

(c) the state agency, local agency or other person seeking the financial record is attempting to harass the customer or the depository;

(d) there is no merit in the purpose for which the financial record is sought; or

(e) the state agency, local agency or other person has not made a reasonable effort to first obtain the financial record or the equivalent of the record from some other source other than the depository, if some other source exists.

(2) A foreign capital depository shall move on the basis of all appropriate grounds, including those set forth in subsection (1), to quash an administrative or judicial subpoena if the customer or the agent of the customer to whom the record relates has not received actual notice of the subpoena. If a foreign capital depository cannot determine from the customer or the customer's agent whether the customer or the agent has received actual notice of the subpoena, the depository shall move to quash the subpoena unless the customer and the depository have agreed in writing to the contrary.

(3) Failure of the customer or the depository to file a motion to quash the subpoena before the time established for the return of the subpoena constitutes a waiver of the right to object to the release or disclosure of the financial record.

(4) During the period for the filing of a motion to quash and continuing until a ruling is made upon a motion to quash, the depository shall, unless prohibited by the court, make available to its customer a copy of the subpoenaed financial record and shall preserve the original record without alteration.

(5) If a depository or a customer files a motion to quash an administrative or judicial subpoena issued pursuant to [sections 35 or 37], the proceeding must be afforded priority on the calendar of the agency or the court and the matter must be heard within 10 days from the filing of the motion to quash.

(6) A depository may charge a customer a fee for the reasonable cost of representing the interests of the customer pursuant to this section.

NEW SECTION. **Section (39) Limitations on use of financial record.** (1) The original or a copy of a financial record obtained by a state or local agency or another person pursuant to [sections 29 through 46] may not be

used or retained in any form for a purpose other than the statutory purpose for which the record was originally obtained. The statutory purpose must be determined with reference to the statute, rule, or other law sought to be enforced in the proceeding for which the record was obtained.

(2) A state agency or local agency may not provide a financial record obtained pursuant to [sections 29 through 46] to another state agency or local agency unless the other state agency or local agency has independently obtained authorization to receive the financial record pursuant to [sections 29 through 46]. This subsection does not prohibit:

(a) the transfer by one supervisory agency that obtained a financial record pursuant to [section 40(1)(c)] to another supervisory agency or supervisory agencies if that transfer otherwise complies with subsection (1); or

(b) the transfer of a financial record obtained pursuant to [section 36] by one criminal justice agency to another criminal justice agency in accordance with the Criminal Justice Information Act.

(3) A state or local agency or a court obtaining a financial record by administrative subpoena, search warrant, or judicial subpoena shall, at the request of a customer or foreign capital depository, provide for the in camera review of the record to determine whether the record contains material that is not expected to be the subject of the investigation, inquiry, or proceeding. The state or local agency or the court shall liberally grant requests for in camera hearings, protective orders, and other appropriate processes to protect the confidential nature of a financial record. The agency or court may permit public disclosure of a financial record only if it finds that disclosure is necessary for the fair resolution of an issue before it.

(4) Documents of a supervisory, state, or local agency and documents produced in court containing a financial record must be sealed by the agency or court at the conclusion of the proceedings in order to prevent access to the record and may be opened only for good cause shown.

NEW SECTION. **Section (40) Authorized disclosures of financial records.** (1) [Sections 29 through 46] do not prohibit:

(a) disclosure by a foreign capital depository of a financial record that is not identified with, or identifiable as being derived from, a financial record of a particular customer by name;

(b) disclosure by a foreign capital depository to an department, agency, office, bureau, or commission of the United States of a financial record when required by federal statute or regulation or when required pursuant to the terms of a treaty or other agreement between the United States and the government of a foreign country;

(c) disclosure of a financial record by a foreign capital depository to a supervisory agency when the disclosure is conducted in response to an exercise of the agency's supervisory function. The scope of an agency's supervisory function must be determined by reference to statutes granting authority to examine, audit, or require reports of a financial record or foreign capital depository.

(2) Whenever the request, order, demand, or other requirement for disclosure of a financial record prohibits the release to a customer of the facts of a disclosure, a foreign capital depository may not disclose either the fact or nature of the request, order, demand, or other requirement for disclosure, or the depository's response, to a customer or to any other person, except the officers and employees of the depository who are involved in responding to the request and to attorneys, auditors, and regulatory authorities who have a need to know in order to perform their duties, and except as disclosure may be required by legal process.

NEW SECTION. **Section (41) Fee paid to foreign capital depository for disclosure of record.** Except for a supervisory agency, a state agency or local agency obtaining a financial record in accordance with [section 34, 35, 36, or 37] shall pay to the depository providing the financial record a reasonable fee commensurate with the depository's costs of searching for, assembling, copying, labeling, and transporting, or any of these services, the financial record in question.

NEW SECTION. **Section (42) Confidentiality -- supervisory agency personnel -- penalty for violation.** (1) Except as required by judicial order or as otherwise provided by [section 14 and sections 29 through 46], an

employee of a supervisory agency who conducts an examination, investigation, or audit of a depository, or who receives a report or another type of information about a depository from another employee of a supervisory agency, may not disclose to another person who is not officially associated with an examination, investigation, or audit of a depository the identity of a customer.

(2) A person who knowingly violates subsection (1) must be removed from office and is guilty of a felony. Upon conviction, the person shall be punished by a fine of ten thousand dollars, imprisonment in the state prison for not more than ten years, or by both fine and imprisonment.

NEW SECTION. **Section (43) Civil liability for wrongful disclosure of financial record -- damages and injunctive relief.** (1) A state agency or local agency that requests or receives a financial record in violation of [sections 29 through 46] is liable to the customer to whom the record relates in the amount of damages provided in subsection (4).

(2) A person who is not employed by a supervisory, state, or local agency or by a foreign capital depository and who requests or receives a financial record in violation of [sections 29 through 46 is liable to the customer to whom the record relates in the amount of damages provided in subsection (4).

(3) A director, officer, agent, or employee of a foreign capital depository who discloses or authorizes another to disclose a financial record in violation of [sections 29 through 46] is liable to the customer to whom the record relates in an amount of damages provided in subsection (4).

(4) Damages are equal to the sum of the following:

(a) ten thousand dollars, without regard to the type or number of records involved;

(b) actual damages sustained by the customer; and

(c) costs incurred in the action to successfully enforce liability under this section, together with reasonable attorney fees.

(5) A foreign capital depository may exercise remedies provided in this section on behalf of a customer and in connection with the exercise

of those remedies may act as the real party in interest. Damages recovered by the depository must be deposited in an account of the customer, but a depository may retain amounts recovered for its costs and reasonable attorney fees.

(6) The remedies provided in this section are not exclusive.

(7) In addition to any other remedy allowed by law, a customer may bring an action for injunctive relief under Title 27, chapter 19 to enforce the provisions of [sections 29 through 46].

NEW SECTION. **Section (44) Unlawful disclosure of financial record -- criminal penalties.** (1) An officer, director, agent, or employee of a foreign capital depository who discloses a financial record in violation of [sections 29 through 46] is guilty of a misdemeanor and upon conviction shall be punished by a fine of not more than five thousand dollars, imprisonment in the state prison for not more than one year, or by both fine and imprisonment. This subsection imposes absolute liability.

(2) An officer, director, agent, or employee of a foreign capital depository or an employee of a state or local agency who knowingly discloses a financial record in violation of [sections 29 through 46] is guilty of a felony and upon conviction shall be punished by a fine of ten thousand dollars, imprisonment in the state prison for not more than ten years, or by both fine and imprisonment.

NEW SECTION. **Section (45) Customer waiver invalid.** A waiver by a customer of a right granted by [sections 29 through 46] is not valid, whether granted with or without consideration.

NEW SECTION. **Section (46) Limitation of actions.** An action to enforce a provision of [sections 29 through 46] must be commenced within three years after the date on which the violation occurred.

NEW SECTION. **Section (47) Asset protection -- purpose and perspective.** (1) The legislature understands that asset protection includes the ability to minimize or avoid both the potential financial

impact and loss of privacy resulting from lawsuits. The legislature also recognizes that asset protection is a vital component of a depository designed to serve the interests of high net worth individuals who are not U.S. citizens and do not reside in the United States.

(2) The legislature further acknowledges that foreign judgments rendered in a foreign state are, unlike judgments rendered in other states of the union under the U.S. Constitution, not entitled by Montana courts to conclusive full faith and credit under common law, and that the principle of comity that encourages one nation to extend legal recognition to the judicial acts of another nation does not apply to the relations between Montana and a foreign nation.

(3) The Uniform Foreign Money-Judgments Recognition Act signifies a departure from comity in that it codifies the principles of comity, but with certain exceptions and modifications. [Sections 47 through 55] enact a further departure from comity that is intended to uphold the state's interest in extending to a customer of a foreign capital depository the maximum amount of privacy possible within prudential limits as well as state and federal law.

(4) [Sections 47 through 55] are not intended to circumscribe or conflict with the provisions of Title 25, Chapter 9, Parts 5 or 6, except in a case in which a foreign judgment has been obtained against the customer of a foreign capital depository.

NEW SECTION. **Section (48) Definitions.** Unless the context requires otherwise, in [sections 47 through 55], the following definitions apply:

(1) "comity" means the recognition of judicial acts that one country extends to another as a matter of custom, convenience, and expediency.

(2) "foreign judgment" means a foreign civil judgment as defined in 25-9-602.

(3) "foreign state" means a foreign state as defined in 25-9-602.

NEW SECTION. **Section (49) Defense against enforcement of foreign judgments -- depository obligations.** A depository shall, unless

relieved of the responsibility by a waiver signed by the customer, provide a customer competent legal counsel and defense against:

(1) the recognition in Montana of a foreign judgment rendered in a foreign state as provided in 25-9-605; and,

(2) the execution of a foreign judgment in Montana pursuant to Title 25, chapter 13 or Title 25, chapter 14, but only insofar as the execution would affect the customer's assets in the depository.

NEW SECTION. **Section (50) Filing fee.** A person seeking recognition of a foreign judgment rendered in a foreign state against a customer of the depository shall pay a filing fee of $2,500 to the clerk of the court in which the judgment is filed.

NEW SECTION. **Section (51) Policy statement.** For the purposes of [sections 47 through 55, the legislature declares that the recognition of a foreign judgment pursuant to Title 25, chapter 9, part 6 and the execution of a foreign judgment against a customer of a depository is repugnant to the public policy of the state insofar as either would:

(1) facilitate the arbitrary or unlawful interference with an individual's privacy in contravention of international law;

(2) undermine the individual right of privacy and the right to private property provided for in the Montana Constitution and state law;

(3) stimulate or engender lawsuits motivated by greed or pecuniary speculation and lacking a good faith argument or other legally sound purpose;

(4) facilitate civil prosecution arising from class or ethnic hatred and nurtured by a corrupt legal system; or

(5) threaten the financial stability of the depository or the state by discouraging foreign depositors and investors from becoming customers or by encouraging customers to withdraw their capital from the depository.

NEW SECTION. **Section (52) Burden of proof -- financial liabilities.** (1) A person seeking recognition of a foreign judgment pursuant to 25-9-605 bears the burden of proving that the judgment:

(a) was rendered under a system that provides impartial tribunals or procedures that are compatible with the requirements of due process of law;

(b) the foreign court had personal jurisdiction over the customer when the judgment was rendered; and

(c) the foreign court had jurisdiction over the subject matter.

(2) The customer or the depository acting on behalf of a customer bears the burden of proving that any one of the grounds for nonrecognition provided for in 25-9-605(2) are extant.

(3) If the court finds that the person seeking recognition of the foreign judgment has failed to prove the judgment valid in accordance with subsection (1), or the customer or the depository succeeds pursuant to subsection (2), the court may not recognize the foreign judgment.

(4) If the person seeking recognition of a judgment under the Uniform Foreign Money-Judgments Recognition Act is unsuccessful in obtaining recognition of the judgment, that person shall pay the court costs and attorney fees for the parties opposing recognition or, if the customer has waived the depository's obligation provided for in [section 49], for the customer.

NEW SECTION. **Section (53) Damages -- in camera hearing.** (1) The court in which recognition of a foreign judgment is sought may award damages against the person seeking recognition of a foreign judgment to compensate a customer for the customer's loss of privacy.

(2) The amount of the damages awarded pursuant to subsection (1) must bear a reasonable relationship to the person's ability to pay and may not exceed $1 million.

(3) All or any part of a hearing necessary to determine the rights and obligations of the parties pursuant to [sections 47 through 55] and the Uniform Foreign Money-Judgments Recognition Act may be held in camera so as not to compromise the privacy of any of the parties.

NEW SECTION. **Section (54) Contingency fee arrangements prohibited.** A person seeking recognition of a foreign judgment against a

customer of a foreign capital depository may not engage legal counsel on a contingency fee basis for the purpose of attaining recognition of the same foreign judgment.

NEW SECTION. **Section (55) Non-recognition -- procedures to protect privacy.** (1) The court shall, at the request of a customer or a foreign capital depository, provide for an in camera review of the pertinent documents to protect to protect the confidential nature of financial records.

(2) The court may permit public disclosure of a financial record or proceedings closed pursuant to subsection (1) the only if it finds that disclosure is necessary for the fair resolution of an issue before it.

(3) Documents produced in court containing a financial record must be sealed by the agency or court at the conclusion of the proceedings to prevent access to the record and may be opened only for good cause shown.

NEW SECTION. **Section (56) State revenue from depository -- purpose and preference.** (1) The legislature recognizes that revenue gains to the state and the possibility of subsequent tax reduction for Montana taxpayers are among the most significant reasons for establishing a statutory framework for the foreign capital depository, and that a relatively steady, predictable flow of revenue is preferable to a volatile one. The legislature also acknowledges that the depository is subject to competitive pressures in the international financial services market. It is therefore in the state's interest to balance revenue expectations with incentives that will enhance the commercial attractiveness and viability of a depository.

(2) The legislature recognizes the hazards of fortune that may be suffered by customers of a depository who are citizens or residents of countries with unstable or repressive governments, and that capital in a depository may be abandoned as a consequence of a customer's disappearance or untimely death. It is in the state's interest to provide a decent interval of time before determining that capital is abandoned, and, in keeping with subsection (1), to allow a depository to charge a reasonable fee for the maintenance of the abandoned capital prior to its

escheatment to the state.

NEW SECTION. **Section (57) Tax status -- exemption guarantees.** (1) A depository is exempt from the corporation license tax as provided in 15-31-102 until October 1, 2012.

(2) A transaction between the depository and a customer that involves platinum, gold, and other tangible personal property is exempt from all forms of tax.

NEW SECTION. **Section (58) {standard} Termination.** [Sections 57 and 59 terminate on September 30, 2012.

NEW SECTION. **Section (59) State revenue -- assessment-- collection -- distribution.** (1) The depository shall pay to the department of revenue on June 15 and December 15 of each year a fee that is equal to 1.25 percent of the total value of assets on deposit or in a safe deposit, so that the total annual rate of assessment is 2.5 percent.

(2) The basis of the value ascribed to each asset is:

(a) the $U.S. dollar exchange value of the currency on deposit on the date of assessment;

(b) the spot market price of the gold, silver, platinum, and palladium held in precious metals accounts as published in the Wall Street Journal on the date of assessment; or

(c) the market value of other tangible personal property held in safe deposits or other accounts at the time of the assessment, as determined by the depository using a method approved by the department of revenue. The depository shall submit to the department of revenue within 60 days of the appraisal a report that documents the method and calculations of the appraisal.

(3) The semiannual assessment fee must be deposited into the general fund.

NEW SECTION. **Section (60) Revenue audits -- charges.** (1) The department of revenue shall conduct an annual audit of a foreign capital

depository to verify that internal financial records of the depository comply with state law and regulations pertaining to the depository and that fees owed to the state have been properly calculated and paid on time.

(2) A depository shall pay to the department of revenue the cost of an annual audit provided for in subsection (1).

(3) The department of revenue may charge the depository up to $400 a day for each auditor involved in the conduct of an audit.

NEW SECTION. **Section (61) Deficiency assessment -- notice -- penalty and interest.** (1) If the department of revenue determines through an audit of a depository that the amount collected pursuant to [section 60] is less than the amount owed by the depository, the department shall send by certified mail to the depository a notice of the deficiency and require payment of the amount owed plus a 10 percent penalty within 60 days of the depository's receiving the notice.

(2) The depository must bear the interest charge on any deficiency assessment issued by the department of revenue in accordance with subsection (1). The rate of interest charged to the depository may not exceed 12 percent per year.

NEW SECTION. **Section (62) Right of appeal.** A depository that receives a notice of deficiency assessment may appeal the amount of the fee, penalty, or interest charged in accordance with 15-2-201.

NEW SECTION. **Section (63) Limitation on penalty and interest.** An amount of penalty or interest owed by the depository pursuant to [section 61] may not be assessed or collected with respect to the year for which a semiannual fee is assessed unless the notice of the additional amount owed is mailed within 5 years from the date the fee was paid.

NEW SECTION. **Section (64) Action by attorney general.** Action may be brought by the attorney general in the name of the state at the request of the department of revenue to recover the amount of any fees,

penalties, and interest due under [sections 59 through 62].

NEW SECTION. **Section (65) Abandoned capital -- disposition -- escheatment.** (1) A depository shall presume capital on deposit in a depository account abandoned in accordance with the provisions of 70-9-201.

(2) A depository shall dispose of the abandoned capital in the manner provided for in Title 70, chapter 9, except that:

(a) no notice of the property presumed abandoned may be published as prescribed in 70-9-302; and

(b) the record of deposit required under 70-9-309 may not be made available for public inspection; and

(c) all money received by the department of revenue as a consequence of the abandonment of capital in a depository must be deposited in the general fund.

(3) A depository may deduct from property presumed abandoned a charge imposed by reason of the owner's failure to claim the property within a specified time only if there is a valid and enforceable written contract between the holder and the owner under which the holder may impose the charge and the holder regularly imposes the charge, which is not regularly reversed or otherwise canceled. The amount of the deduction is limited to an amount that is not unconscionable.

NEW SECTION. **Section (66) Injunctions.** The department of commerce may institute and maintain in the name of the state actions for
injunctive relief as provided in Title 27, chapter 19, to:

(1) enjoin a violation of [sections 1 through 68], a rule adopted pursuant to [sections 1 through 68], the terms or conditions of a charter, or an order of the department or the board; or

(2) require compliance with [sections 1 through 68], a rule adopted pursuant to [sections 1 through 68], the terms or conditions of a charter, or an order of the department or the board.

NEW SECTION. **Section (67) Civil penalties.** (1) Except for the penalties for wrongful disclosure provided for in [section 43] A person who violates any provision of [sections 1 through 68], a rule adopted under [sections 1 through 68], or an order of the department or the board is subject to a civil penalty not to exceed $10,000 per day of violation. Each day of violation of [sections 1 through 68], a rule adopted under [sections 1 through 68], the terms or conditions of a charter, or an order constitutes a separate violation.

(2) The department may institute and maintain in the name of the state any enforcement proceedings under this section. Upon request of the department, the attorney general or the county attorney of the county where the violation occurred shall petition the district court to impose, assess, and recover the civil penalty.

(3) Action under this section does not bar:

(a) enforcement of [sections 1 through 68], rules adopted under [sections 1 through 68], orders of the department or the board, or terms or conditions of a charter by injunction or other appropriate remedy; or

(b) action under [section 68].

NEW SECTION. **Section (68) Criminal penalties.** (1) Except for the penalties for wrongful disclosure provided for in [section 44], a person who knowingly operates a depository without a charter or in violation of the terms or conditions of a charter, or in violation of [sections 1 through 68], a rule adopted pursuant to [sections 1 through 68], or an order of the department or board; or a person who knowingly makes any false statements or representations in a application, report, or other document filed or maintained as required by [sections 1 through 68] or required by rules adopted under [sections 1 through 68] is subject to a fine not to exceed $10,000 for each violation or imprisonment not to exceed 6 months, or both. Each day of violation constitutes a separate violation.

(2) A person convicted of a second or subsequent criminal violation is subject to a fine not to exceed $20,000 for each violation or imprisonment not to exceed 1 year, or both. Each day of violation constitutes a separate violation.

(3) Action under this section does not bar enforcement of [sections 1 through 68], rules adopted under [sections 1 through 68], orders of the department or the board, or terms of a charter by injunction or other appropriate remedy.

NEW SECTION. **Section (69) {standard} Severability.** If a part of [this act] is invalid, all valid parts that are severable from the invalid part remain in effect. If a part of [this act] is invalid in one or more of its applications, the part remains in effect in all valid applications that are severable from the invalid applications.

NEW SECTION. **Section (70) {standard} Codification instruction.** (1) [Sections 1 through 46 and sections 66 through 68] are intended to be codified as an integral part of Title 32, and only those provisions of Title 32 identified in [this act] as applicable to this chapter apply to [sections 1 through 46 and sections 66 through 68].

(2) [Sections 47 through 55] are intended to be codified as an integral part of Title 25, chapter 9, and the provisions of Title 25, chapter 9 apply to sections 47 through 55].

(3) [Sections 56 through 64] are intended to be codified as an integral part of Title 15, chapter 31, and the provisions of Title 15, chapter 31 apply to [sections 56 through 64].

(4) [Section 65] is intended to be codified as an integral part of Title 70, chapter 9, and the provisions of Title 70, chapter 9 apply to [section 65].

-END-

APPENDIX 1

STATUTES REQUIRING AMENDMENT FOR DEPOSITORY LEGISLATION

Note: Before the draft bill can be completed, a number of areas of law must be addressed and modified to facilitate the insertion of the laws relating to the foreign capital depository into the Montana Code Annotated. This is primarily a technical exercise. In most cases, the required amendments are minor in scope; they are needed wherever the depository will "touch" existing laws. These amendments, with rare exceptions, will not significantly alter existing functions, processes, programs, etc. There is a possibility, however, of unforeseen complications and the near certainty of having to include some temporary provisions (with delayed effective dates in order to avoid unintended tax liabilities for the depository).

The following list is fairly comprehensive, but probably not complete. The inclusion of amendments to this number of statutes will greatly expand the physical size but not the substantive scope of the bill.

Title 15, Chapter 1

15-1-501 **Disposition of tax proceeds.**

Title 15, Chapter 31

15-31-101 **Organizations subject to tax.**
15-31-102 **Organizations exempt from tax.**

Title 25, Chapter 9

25-9-506 **Fees.**
25-9-603 **Applicability.**

25-9-605 **Grounds for nonrecognition.**

25-9-609 Uniformity of interpretation.

Title 32, Chapter 1

32-1-101 **Short title -- application -- purpose.**

32-1-102 **Institutions to which chapter is applicable.**

32-1-202 **Powers and duties of state banking board.**

32-1-107 **Trust company defined.**

32-1-234 **Confidentiality--penalties.**

32-1-301 **Organization and incorporation--articles of incorporation.**

32-1-446 **Safe deposit department.**

32-1-461 **Bonding of employees.**

32-1-462 **Persons previously convicted under banking laws.**

32-1-464 **Fraud by director, officer, or employee.**

32-1-468 **Removal of director, officers, employees.**

32-1-473 **Theft of bank funds by officers and employees.**

32-1-491 **Destruction of bank records.**

32-1-492 **Reproduction of bank records--admissibility in evidence.**

32-1-501 **Dissolution, closing, and liquidation.**

Title 70, Chapter 9

70-9-101 **Uniform Unclaimed Property Act.**

APPENDIX 2

MEMORANDUM

TO: Interim Subcommittee on Foreign Investment Depository

FROM: David S. Niss

RE: Options for Enacting Depository Privacy Law(s)

DATE: November 30, 1995

I. Introduction.

At its first meeting, the Subcommittee received a memorandum and oral presentation on federal laws governing confidentiality in banking transactions. This memorandum updates the Subcommittee with information on the status or federal and state laws as explained to the subcommittee to date, and suggests options for the Subcommittee in determining what laws governing confidentiality of depository information, if any, to recommend to the Legislature.

II. Status of Current Law.

A. Federal law.

1. Constitutional Law.

In United States v. Miller, 425 U.S. 435 (1976), the United States Supreme Court held that a depositor did not have a recognizable expectation of privacy in checking account records (required to be

maintained by the Bank Secrecy Act of 1970) under the U.S. Constitution that would entitle the depositor to challenge a subpoena of the depositor's bank records by the United States.

2. Statutes.

In response to Miller, Congress enacted the Right to Financial Privacy Act of 1978*, modifying Miller by prohibiting federal agencies from obtaining copies of bank records unless the bank complies with certain procedures (obtains customer authorization, uses an administrative subpoena or summons, a search warrant, a judicial subpoena, grand jury subpoena, or formal written request) and notifies the depositor or of the demand or obtains a judicial delay of notification**. The RFPA does not apply to:

a. voluntary disclosure by a bank of depositor information in excess of that allowed by the "safe harbor" provision of 12 U.S.C. section 3403(c);

b. requests from private individuals or organizations;

c. requests by state government agencies;

d. requests by local government agencies; and

e. the bank records of corporations, partnerships composed of more than 5 individuals, trusts, and other legal entities.

The RFPA has been held to preempt state law only to the extent that a conflict exists between the RFPA and state law***. Therefore, because the RFPA does not address the foregoing types of disclosures, requests for disclosures, or records, the Legislature is

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* 12 U.S.C sections 3401-3422

** 12 U.S.C. section 3409

*** In re Grand Jury Subpoena, 481 F. Supp. 833 (D. Conn., 1979); United States v. First Bank, 586 F. Supp. 174 (D. Conn., 1983).

free to enact a privacy law restricting access to records of the depository in those instances.

B. State Law.

1. Constitutional Law.

Article II, section 10 of the Montana Constitution appears to provide a substantive right of privacy to a depositor. However, the application of section 10 to bank records is open to question since the Montana Supreme court held in Hastetter v. Behan, 196 M 280, 639 P2d 510 (1982) that a person has no legitimate expectation of privacy in telephone records. The Montana Supreme court used the same reason relied upon by the U.S. Supreme Court in Miller. Even if the Court were to apply section 10 to depositors, it is clear that section 10 constrains only government and not private acts. State v. Long, 216 M 65, 700 P2d 153 (1985).

2. Statute.

Section 32-6-105, MCA, provides:

Interestingly, the foregoing section purports to apply to "any...government entity". Additionally, the issue of whether the statute applies to the status of a customer account in addition to an individual "transaction" is unclear. The differences between 32-6-105, MCA, and the RFPA are also apparent in that the Montana statute does not provide for notice, even delayed notice, to the depositor. Additionally, what constitutes an "electronic funds transfer" and a "financial institution" under 32-6-103, MCA, may, at least in so far as those definitions apply to the status of a depository account, be open to debate. Nor does the statute provide a depositor with a substantive right of privacy that may be invoked

in the face of a subpoena. Finally, at least two commercial banks in the State do not regard the statute as controlling disclosure of account information*.

3. Common Law.

As discussed at the first meeting of the Subcommittee, there are several common law theories that might be used to protect the confidentiality of depositor records in the depository. These theories are contract, invasion of privacy, defamation, interference with a business relationship, and negligence. Several of these theories have been used successfully in other states**. However, no reported cases in Montana have been located applying the same theories to depositor accounts in financial institutions in Montana.

III. Conclusion

Because it is questionable whether the right to privacy found in Montana's Constitution would apply to depositor bank records of the depository, and because of the questionable application and meaning of section 32-6-105, MCA, conclusive protection against disclosure of depository bank records of customer accounts must come from a statute yet to be enacted by the Legislature. That statute may not conflict with the RFPA.

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* A depositor agreement provided by Norwest bank, with which a similar agreement provided by First Bank differs only slightly, provides a number of instances not addressed by section 32-6-105, MCA, in which the bank may disclose depositor information, including if the bank determines that "disclosure is necessary to protect...the interests of the bank".

** Chief among these successful theories is the implied contractual term of a bank's duty of confidentiality. See, e.g., Barnett Bank of West Florida v. Hooper, 498 So.2d 923 (Fla., 1986), in which the court held that a national bank owes an implied duty to its depositors not to disclose information to third parties concerning its depositors' accounts.

IV. Options for the Subcommittee.

A. Do nothing. The current law will apply.

B. Recommend to the Legislature a law (or an amendment to 32-6-105) to provide a substantive right of privacy for depositors.

C. Recommend to the Legislature a law (or an amendment to 32-6-105) to provide a substantive right of privacy for depositors and a procedural mechanism for enforcement similar to that used by the RFPA. If this option is chosen, issues that the Subcommittee may wish to address, in addition to those raised by analogy to the RFPA*, include the following:

1. Should a higher standard for issuance of a subpoena (e.g., issuance of the subpoena only upon probable cause determined by a court of record) be required for subpoena of depository customer records than is required by current law?

2. Should both the depositor and the depository be allowed to enforce the right of confidentiality, or should the depository even be required to do so?

3. What remedies should be allowed for breach of the right of confidentiality (e.g., personal liability of depository employees, actual or punitive damages, costs and attorney fees, quashing of subpoena and suppression of evidence, injunctive relief, etc)?

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* An outline of the sections and subsections of the RFPA is attached for the Subcommittee's use. A state statute intended to operate in a manner similar to the RFPA may need to address many of the same subjects as the RFPA, particularly the methods government may use to obtain bank records and the exceptions to the prohibition on government demands for bank records.

APPENDIX 3

MEMORANDUM

TO: Subcommittee on Foreign Investment Depository

FROM: David S. Niss

RE: Comparison of Right to Financial Privacy Laws; Application and Amendment of the Uniform Enforcement of Foreign Judgments Act and the Uniform Foreign Money-Judgments Recognition Act

DATE: March 22, 1996

I
INTRODUCTION

This Memorandum provides information to the Subcommittee on two separate but related topics: financial privacy laws and two uniform acts regarding enforcement in Montana of civil judgments from courts of foreign countries. These subjects are related in that a person intending to collect money from a Depository customer must first determine that the person is a customer of the Depository (and probably also determine the size of any deposits) and then secondly, enforce any foreign judgment by levy against the customer's assets in the Depository.

II
RIGHT TO FINANCIAL PRIVACY LAWS

A. The RFPA Revisited

Subcommittee members will recall that the general prohibition contained in

the federal Right to Financial Privacy Act (federal RFPA)* contains numerous exceptions. The main exceptions are:

1. The Act does not apply to records of certain bank customers (corporations and partnerships of more than 5 partners);

2. The Act does not apply to requests by state or local officials or by private parties;

3. Federal officials may obtain, and a financial institution may release, otherwise prohibited bank records by the following methods:

a. customer authorization

b. administrative subpoena or summon;

c. search warrants;

d. judicial subpoena;

e. formal written requests.

As previously discussed with the Subcommittee, the federal RFPA prohibits government officials from requiring and bank officials from releasing customer documents, subject to the foregoing exceptions, and requires that in most cases, the customer be given notice of the demand and an opportunity to respond with a motion to quash. The Act also prohibits transfer of information obtained to other federal agencies, allows a financial institution to notify federal officials of suspected wrongdoing by a depositor, and is inapplicable to numerous other proceedings or transactions (such as other specific federal statutory requirements, loan applications, requests by supervisory agencies, litigation demands under the federal civil or criminal rules, subpoenas by administrative law judges, grand jury proceedings, crimes against the financial institution, etc). Some or most of the types of provisions of the federal RFPA are also commonly found in state financial privacy laws as well.

B. State Laws

* 12 USC sections 3401-3422.

According to a recent law review article*, seventeen states** have enacted laws similar or nearly identical to the federal RFPA. Briefly reviewed below are some of the major provisions of the laws of several of these states. The state laws reviewed below concern disclosure of information about customer deposits in banks generally, and are not, as far as can be determined, written to address institutions of the type being considered by the FID Subcommittee.

1. California

Chapter 20 of the California Government Code contains the California Right to Financial Privacy Act that is identical in many respects to the scheme, arrangement, and language to the federal RFPA. The Act Prohibits officers, agents, and employees of state and local agencies from obtaining financial records of bank customers except as authorized by the Act; provides immunity for a financial institution refusing to produce records in good faith reliance upon the Act; and provides a special procedure for a grand jury investigating financial records. Violation of the Act is a misdemeanor (one year and $5,000 maximum penalty); a successful customer enforcing the Act may recover costs and attorney fees; and injunctive relief is authorized.

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* Steadman, Constitutional Law: Kansans Have No Reasonable Expectation of Privacy in Bank or Telephone Records [State v. Schultz, 850 P.2d 818 (Kan. 1993)].

** Steadman lists the states of Alabama, Alaska, California, Connecticut, Florida, Louisiana, Maine, Maryland, Missouri, Nebraska, Nevada, New Hampshire, North Carolina, North Dakota, Oklahoma, Oregon, and Tennessee. Steadman notes that Colorado has also interpreted its constitution to reject the holding in US v. Miller. Other states than those listed may also have "state RFPA-type statutes. An electronic search by LSD library staff indicates that there is at least one other state, Texas, with right to financial privacy statutes that predate the Steadman article. See Tex. Rev. Civ. Stat. Ann. art. 342-705 (Vernon Supp. 1993.

2. Missouri

Sections 408.675 through 408.700 of Missouri Revised statutes enact the Missouri Right to Financial Privacy act. The Act prohibits state agencies from obtaining and financial institutions from supplying customer banking records except as authorized by the Act. The two principle exceptions to the prohibition are customer authorization and subpoena. No express exception is made for either search warrants or administrative requests by law enforcement agencies. However, section 408.690, paragraph 15, does provide that the Act does not apply to "a law enforcement inquiry or to a government authority or government employee in a law enforcement inquiry." The Act requires that a government agency seeking financial records of a customer pay "a fee for reimbursement for such costs as are reasonably necessary and which have been directly incurred in searching for, reproducing, or transporting books, papers, records, or other data required or requested to be reproduced." A three year statute of limitations for enforcement of the Act is provided. Violations are punishable by payment of $1,000, any actual damages, and, in a successful enforcement action, costs and attorney fees. Injunctive action is allowed, and use of customer records by a grand jury is also addressed.

3. North Dakota

Sections 6-08.1-01 through 6-08.1-08 of the North Dakota Century Code address disclosure of customer financial information. Section 6-08.1-03 prohibits a financial institution from disclosing customer information to any person, a government agency, or a law enforcement agency unless in accordance with the chapter of the NDCC or pursuant to "valid legal process". Customer consent is provided for, as is reporting of suspicious conduct, cost reimbursement, and liability for damages. Fees and costs are not addressed.

4. Oklahoma

Chapter 6, sections 2201 through 2206 of Oklahoma statutes are the Financial Privacy act. Section 2203 prohibits a financial institution from releasing customer financial information to a government authority (state agencies or employees only) unless the customer consents or the information has been subpoenaed. The customer has 14 days to file a motion to quash. The Act does not apply to disclosure to a supervisory agency, loan applications or credit reports, reports by bank officials of suspicious activity, and grand jury proceedings. Reimbursement of costs is addressed but penalties are not.

C. Cayman Islands

The Confidential Relationships (Preservation) Law of the Cayman Islands has three main sections that address the application and scope of the Act, testimony concerning confidential matters given in public proceedings, making private use of confidential information, and penalties for violations. Confidential information is defined to include information concerning any property which the recipient is not authorized by the principle to divulge. Interestingly, the Act does not apply to the divulging of confidential information by a bank to the extent that disclosure is "reasonably necessary for the protection of the bank's interest". The primary provision of the Act prohibits disclosure of information in a proceeding unless the witness first applies for direction from the judge concerning the disclosure. Another provision prohibits a person in possession of confidential information from disclosing it for his or her own benefit or the benefit of another without consent of the principle. A penalty of $5,000 and two years imprisonment is provided.

D. Considerations for the Subcommittee

If the Subcommittee believes that a financial privacy law should be enacted in Montana, the scheme if not actual provisions of the federal RFPA may serve as a basis for a state act, as it has in most other states. The

Subcommittee may also want to consider the enactment of additional provisions such as:

1. strengthening the customers substantive right of privacy in bank records and/or enactment of a statutory privilege assertable by a customer;

2. civil and/or criminal penalties for breach of the act;

3. creation of a cause of action for breach of the act, with statutory and/or actual damages;

4. injunctive relief;

5. a statute of limitations;

6. a reimbursement procedure for the cost of compliance by the financial institution;

III

The Uniform Enforcement of Foreign Judgments Act and the Uniform Recognition of Foreign Money-Judgments Act

A. History and Overview

In 1989, the Montana Legislature adopted the Uniform Enforcement of Foreign Judgments Act ("Enforcement Act") as Title 25, Chapter 9, part 5, MCA. The Act was proposed by the National Conference of Commissioners on Uniform State Laws as a method of implementing the Full Faith and Credit Clause of the U.S. Constitution*, and provides for the filing of judgments from other states, and their subsequent enforcement, as if those judgments were the judgments of Montana courts. The Enforcement Act has been adopted in some form by 43 other states.

No federal legislation or treaties currently exist governing the recognition and enforcement of judgments of courts of foreign countries in the United

* Art. IV, Section 1 of the Constitution provides that "Full Faith and Credit shall be given in each State to the ...judicial Proceedings of every other State."

States. The U.S. Supreme Court has also made it clear that unlike judgments of sister states, judgments of courts of foreign countries are not subject to the Full Faith and Credit clause*. For these reasons, the enforcement of judgments rendered by courts of foreign countries is a matter of state, not federal, law**. In 1993, the Montana Legislature adopted at Title 25, Chapter 9, part 6, MCA, the Uniform Recognition of Foreign Money-Judgments Act ("Recognition Act"). The Recognition Act has been adopted by 24 other states and the Virgin Islands.

B. Requirements and Implementation of Each Act

Although the Enforcement Act was the earlier of the Acts adopted in Montana and is more easily comprehended, judgments of courts of foreign countries would be subject first to the requirements of the Recognition Act and secondly, the Enforcement Act. For this reason, the Acts will be briefly reviewed here in the chronological order in the which they would be applied to a creditor of a Depository customer***.

Under the Recognition Act, a judgment meeting the definition of a "foreign judgment" in section 25-9-602, MCA, that is enforceable in the country were it was rendered, in accordance with 25-9-603, is enforceable under the Enforcement Act in the same manner as a judgment of a sister state unless that judgment is subject to one of the defects listed in 25-9-605 or the court lacked personal jurisdiction over the defendant for reasons other than those listed in 25-9-606, MCA.

Under the assumption of recognition in 25-9-604, MCA, the burden is upon

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* Hilton v. Guyot, 159 U.S. 113 (1895).

** Erie Railroad Co. v. Thompkins, 304 U.S. 64 (1938).

*** Copies of both the Enforcement Act and the Recognition Act were previously distributed to Subcommittee members by Stephen Maley's memorandum of March 15, 1996. The Acts were included as attachment no. 10.

the defendant to raise the grounds for nonrecognition provided in 25-9-605. No method of determining those grounds is provided for in the Recognition Act; however, there appears to be an assumption in the Act that a court would provide the necessary due process safeguards for litigating the issues. Under 25-9-605, their are both mandatory (subsection (1)) and discretionary (subsection (2)) grounds for the court not to recognize the judgment.

According to scholarly writings on the subject*, the most common ground for a court in the United States to fail to grant recognition to the judgment of a court in a foreign country is that the foreign court did not have personal jurisdiction over the defendant (25-9-605(1)(b)). As personal jurisdiction (as tested by U.S. law) is principally a function of the due process requirements of notice and opportunity to be heard, a failure of personal jurisdiction most commonly will result if the foreign court has tried the civil case against a defendant "in absentia", without notice to and participation by the defendant. Regardless of the system used by the foreign court to obtain personal jurisdiction, section 25-9-606, MCA, provides that objections to personal jurisdiction won't be successful if the foreign court relied upon any of the methods listed in subsection (1).

If no defenses to the recognition of the judgment are raised by the defendant, or defenses are raised but are determined against the defendant, the court must recognize the judgment. No method of enforcement is directly provided for in the Recognition Act. However, section 25-9-604 provides that "The foreign judgment is enforceable in the same manner as the judgment of a sister state that is entitled to full faith and credit." The method referred to, of course, is filing under the Enforcement Act.

The method of enforcement of a judgment of a sister state, or a judgment of the court of a foreign country recognized under the Recognition Act,

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* See, e.g., Brand, Enforcing Foreign Judgments in the United States and United States Judgments Abroad, American Bar Association Section of International Law and Practice, 1992, pp. 14, 15.

under the Enforcement Act is mostly mechanical. Sections 25-9-503 and 25-9-504, MCA, provide for the filing of the judgment with the clerk of court, along with an affidavit setting out the last known address of the judgment debtor and other information. Once the judgment and affidavit have been mailed to the debtor, the sheriff may levy upon the property of the debtor (including the proceeds of an account in the Depository) after a 30 day waiting period.

C. Possible Amendments or Additional Requirements

Because Montana has enacted both the Enforcement Act and the Recognition Act, it is easier in Montana than in many other states to enforce a money judgement of a court of a foreign country. "Speed bumps" might still be added to either or both the Recognition Act and Enforcement Act to make it more difficult for a foreign judgment creditor to discover the assets of the debtor in the Depository and levy upon those assets. However, due regard must be given to the fact that both acts are uniform acts and due regard must be given to the requirements of due process, equal protection, and to the administration of justice* provisions of the state and federal constitutions. No attempt has been made here to analyze the types of amendments suggested below for these constitutional considerations.

Amendment of the Enforcement Act or the Recognition Act themselves could be more problematic than making additional requirements applicable only to enforcement of foreign money judgments against a customer or the Depository. Regardless of which method is chosen, the types of requirements that might be made applicable to enforcement or recognition actions in which customers of the Depository are interested are the following:

1. a requirement that the Depository be made an indispensable party to the action;

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* Art. II, sec. 16 of the Montana Constitution provides: "Courts of justice shall be open to every person, and speedy remedy afforded for every injury of person, property, or character. ...Right and justice shall be administered without sale, denial, or delay."

2. a requirement that the Depository appear and submit evidence on any issue in the action;

3. a requirement for posting of a bond or other security for the anticipated costs (including attorney fees) of the action;

4. an increased filing fee for the recognition and/or enforcement action; and

5. procedural requirements for the litigation of foreign country law in the action.

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