



**NEAR EAST UNIVERSITY**

**Faculty Of Economics & Administrative  
Sciences**

**Department Of Banking & Finance**

**OFF SHORE BANKING**

**Graduation Project  
BANK – 410**

**Student : Esin KİTAPCI      970225**

**Supervisor : Asst. Prof. Okan ŞAFAKLI**

**Nicosia, 2002**

## ABSTRACT

International banking sector has become an important and fast growing sector in the world. Off shore banking has a different place in banking sector especially in island and small states. This sector provides a lot of benefit to the host country. Off shore banking has created employment and increased the level of national income of the country. Many small states and islands have managed to establish important off shore banking centers. For instance; Bahrain, Cayman Islands, Bahamas etc. North Cyprus is a quite new sector, however has an important activity for the development of the economy. Off shore banks started to establish in 1991 and every year is increasing continuously, now there are 48 registered off shore banks in North Cyprus. The main purpose of this study is to analyze the off shore banking in North Cyprus and assess their benefits and costs.

The result of these investigations showed that the benefits are much more than the costs of the off shore banking. However the contribution to the economic development of North Cyprus is sufficient when it is compared with the other off shore banking centers. North Cyprus has all the required qualifications to become an off shore center in the region, if right measures are taken by the government.

## ACKNOWLEDGEMENT

First of all ,I would like to say how grateful I am to my supervisor,Mr.Okan Şafaklı , friends, parents and elder brother.I could not have prepared this Graduation Project without the generous help of Mr.Türker Deler.

I would like to rhank my supervisor Mr.Okan Şafaklı. Under his guidance ,I successfully overcome many difficulties and learn a lot about Off Shore Banking.I asked him many questions patiently.

I also with to thank my advisor and supervisor Mr.Okan Şafaklı at my Undergraduate Education for his invaluable advices, for his help and for his patience also for his support.

Finally, I want to thank my family,especially my parents without their endless support,I could never have prepared this thesis without to encouragement and support of my parents and Dağhan Tamer.

## **TABLE OF CONTENTS**

<b>ABSTRACT</b>	<b>i</b>
<b>ACKNOWLEDGEMENT</b>	<b>ii</b>
<b>TABLE OF CONTENTS</b>	<b>iii</b>
<b>CHAPTERS</b>	
<b>1. INTRODUCTION</b>	
1.1 Aim of the study	1
1.2 Structure of the study	2
1.3 Limitations of the study	3
<b>2. GENERAL PRINCIPLES OF OFF SHORE BANKING</b>	<b>4</b>
2.1 Descriptions of the Off Shore Banking	4
2.2 History of the Off Shore Banking	5
2.3 The Types of the Off Shore Banking	6
2.3.1 Registrar Centers	7
2.3.2 Functional Centers	7
2.3.2.1 Off Shore Banking	7
2.3.2.2 Fund Providing Centers	8
2.3.2.3 Fund Collector Centers	8
2.4 Off Shore Banking Centers in the World	8
<b>3. THE ESSENTIAL FACTORS FOR THE DEVELOPMENT OF OFF SHORE BANKING</b>	<b>12</b>
3.1 Political Stability	12
3.2 Economic Stability	12
3.3 Convenient Legal Advantages	12
3.4 Infrastructure	13
3.5 Financial and Legal Advantages	13
3.6 Staff Availability	13



3.7 Telecommunications	13
3.8 Social Environment	13
3.9 Strategic and Geographical	13
<b>4. BENEFITS AND COSTS OF OFF SHORE BANKING</b>	<b>14</b>
4.1 Benefits	14
4.2 Costs	15
<b>5. OFF SHORE BANKING UNITS IN TRNC (IN CASE)</b>	<b>17</b>
5.1 Off Shore Banking services in TRNC	17
5.1.1 Establishment Principles	17
5.1.2 Producers and Requirements	19
5.1.3 Financial Provisions and Exceptions	20
5.2 Development of Off Shore Banks in TRNC	21
5.3 Convenience of Off Shore Banking in TRNC	23
5.3.1 Complete Exemption from Reserve Requirements Ratio	23
5.3.2 No Assigned Capital Requirement for an Off Shore Bank	23
5.3.3 Extension of Duty Free for Office and Household Equipment For the Exclusive Use of Off Shore Banks and Their Staff	24
5.3.4 Excellent Telecommunication	25
5.3.5 No Exchange Control	25
5.3.6 Non Bureaucratic Regulatory Frame and Simplified Bank Licensing	26
Procedure	
5.3.7 No Restriction on Repatriation of Profits	26
5.3.8 Comparatively Low Initial Setting up Costs and Annual Operation Costs	26
5.3.9 Eco Strategic Geographical Position	27
5.3.10 Availability of Expert Legal Accounting Management And Other	27
Services	
5.3.11 Accessibility by Sea and Air Via Frequent Daily Connections	27
5.3.12 Free Enterprise Economy, Democratic Political System and Pluralistic	28
Social Structure	

5.3.13 Availability of Educated, Skilled and Disciplined Professionals	28
5.3.14 Social and Political Stability	28
5.4 Contribution of Off Shore Banks to the Economy in TRNC	29
<b>6. CONCLUSION</b>	<b>31</b>
<b>REFERENCES</b>	<b>33</b>

# 1. INTRODUCTION

## 1.1 Aim of the Study

Off shore banking has become widespread from the 1960's on ward due to the incentives offered by a number of countries parallel to an increase in their world trade and to their desire to remain with in the money markets.

The aim is to be closer to the customers abroad and not to be far from the competetions and money abroad. An advantage of off shore banking is that, It is not affected by the rectrictions applied to the domestic banking system. The expectations on the countries offery incentives to the off shore banking sector may be summarized as the access to low interest loans, the promotion of foreign capital investment and growth an employment.

Off shore activities are quite new in North Cyprus as a latecomer to the market. TRNC enacted the Off Shore Banking Services Law in 1990. These laws provided the required rules and regulations for the proper functioning of off shore entitles as well as incentives. Currently there are 48 off shore banks in TRNC. In this study is to analyze the off shore banking in North Cyprus in order to assess it is benefits and costs and developed policies is to increase their numbers as well as their contribution to the economy.

This study will investigate the essential factors for the development of off shore banking system in North Cyprus and also to find their contribution to the employment, their expenditures to determine their contributions to the national income. Laws and regulation about the off shore banks are also analyzed in order to specify the requirements for the establishment and exemptions of the off shore banks in North Cyprus.

In this study, is to analyze the convenience of the off shore banks n TRNC. North Cyprus has an eco-strategic position with it is closeness to the oil rich Arab Countries. It



has a convenience as compared to Europe and the Middle East. It takes place as cross roads of Europe, Asia and Africa.

## **1.2 Structure of the Study**

In Chapter 2, information about the off shore banking is giving and descriptions and the types of the off shore banks. In this chapter include the history of the off shore banking sector and development of the off shore banks in world.

Chapter 3 the essential factors for the development of the off shore banking. Establishment of the off shore banks are based on many factor, which attract off shore activities to come in to that country and settle there. These factors are also; political and economic stability, legal environment, infrastructure, geographical position and the financial advantages.

In chapter 4 provides general information about the development of the off shore banking n North Cyprus. Moreover, benefits and costs of the off shore bank to North Cyprus. Information is given about their expenditures on staff tax payments, corporation tax payments and operating expenditures.

In chapter 5 presents an off shore banking units in TRNC.Establishment and principles, procedures and requirements and exemptions of the off shore banking required by laws in North Cyprus. In this chapter, it includes a development of off shore banking in TRNC and a convenience of off shore banks in TRNC.North Cyprus is an important location in the world. It takes place as cross roads of Europe, Asia and Africa. In this chapter as includes economic contribution of the off shore banking in TRNC.Off shore banks can have a significant contribution to the economic development of an island through establishing an international business and financial centers. These off shore banks increase national income and employment level of the country. So TRNC government avail from the benefit of theses activities they made some arrangements.

In chapter 6 is the conclusion chapter. It includes summary of the study. It also presents recommendations for research for a more comprehensive study of off shore banking.



### 1.3 Limitations of the Study

While this study was prepared it was faced some difficulties and some handicaps. Some of them were eliminated but some of them are prevent to expand this study.

The most important handicaps, which prevented to collect information is secrecy. It created problems in two ways. One of this, the officer at the public sector refused to give information because of legal restriction and lack of confidence. Another one, some of off shore banks did not want to give information and some of them did not give information about their personnel and lack of information themselves so these affected this thesis.

While this thesis was prepared, the main deficiency was that there is no statistical information about off shore banking. If off shore banks will be followed and given some statistical information annually, some important information which shows the developing of the off shore banking will be compared annually and developing of this sector can be seen. All these limitations affected the thesis in various ways, moreover they prevented it is expansion.

## **2. GENERAL PRINCIPLES OF OFF SHORE BANKING**

The International banking sector has been developing very fast in recent years. Especially off shore banking which is a branch of international banking is developing too. Off shore banks have an important contribution to the development of economies and in recent years off shore banking sector has become a significant sector in small states and islands.

### **2.1 Description of Off Shore Banking**

There are lots of descriptions of off shore banking: (Sezinler, M., 1994.)

- It is a kind of bank, which performs outside the country.
- It is a kind of free zone banking.
- It is kinds of banking intended to use the funds which are gathered abroad with the intention of using them, exempted from the rules, regulations and supervision which has been set for the domestic banking sector. (Atlas Bank, 1998.)

It is a kind of banking which enters the financial operations with foreign currencies on behalf of non-resident financial intermediaries as well as non-resident people. It is a type of bank that usually performs in free zone areas, rendering financial services with convertible assets for the multinational and international companies, in such circumstances where taxation and supervision are limited.

The above descriptions lead us to summarize the description of off shore banking as, the funds which are abroad to be used abroad or sometimes used in domestic economy (in that country); it administrated financial facilities such as transfer of international funds between the countries; generally established in free zone areas; it is excluded from the legislations of the domestic banking system working efficiently due to the financial legal advantages. (Türkiye İş Bankası, 1994.)

Off shore banking is getting more and more popular in many countries. The transactions volume, the activity areas, the qualification of it is personnel, the particular way of risk



taking, and the characteristics of its banking regulations, supervisions and the relation with the customers made off shore banks operate as wholesale banks. However, their operations outside the domestic banking system and their operating abroad carrying financial transactions without entering the domestic market, makes off shore banks different from commercial banks.

International banks are interested in off shore banking in order to gain large share of foreign currency and to be influential in capital markets. In order to have share in Eurodollar market and to avoid geographical restrictions and time differentiation, they start to become organized where there is a potential. In addition to this, benefiting from financial and legal advantages, exempted reserve ratio, low free and tax, flexibility of control, confidentiality of account, lead off shore banks to give better service to their customers and help to expand international banking transactions worldwide. Therefore, there has been great interest in off shore banking. Although, off shore banks are usually establishing in free zone areas, this is not an obligation and a general rules.

## **2.2 The History of Off Shore Banking**

Regarding the observation, the main financial source of offshore banking which functions outside its own country and which is not liable to the rules and regulations prepared for its own countries, banking system is the Eurodollar market. Due to the political and economic reasons in 1950's, U.S.S.R. banks withdrew demand deposit accounts from the U.S.A. banks and invested in the European countries. For that reason, the creation of Eurodollar market started and improved day by day. The main factors of increasing international money and the exchange of this international money with the Eurodollar market helped the development of the offshore market.

The second reason for the development of the offshore banking is the preparation of the new restrictions for the international trade facilities. Banks and the capital in capitalist countries during the 1960's, with the restrictions, brought strong control and high level of tax policy. Therefore, to overcome these restrictions, international capital started moving to those places in which there are minimum rules and regulations involved. This situation gave rise to the establishment of new offshore banks. Before the Gulf crises,

Bahrain was one of the most important offshore centers in the Middle East with the creation of the petrodollar market. (Ersan, İ., 1992.)

After the 1973 Yom Kippur War, the Arabic Countries that produced petrol-increased price of the petrol by twice or three times as much, with this a huge size "petrodollar" market was born. Especially Saudi Arabia and Kuwait's petrol richness increasing and wide important of Arab peninsulas by cultivating and building activities increased the economic activity. Regional banking was not capable of replying these changes. The deficiency in the boundaries of the low infrastructure directed Bahrain which didn't have petrol but refinery only, into rupturing the off shore bank units. In 1980's the economic and geographical advantages caused the establishment of new off shore banking centers. Especially Republic of Panama, Bahamas, Cayman Islands, Honkong, Singapore are some of leading small states and islands that have been benefiting from the off shore banking. (Ersan, İ., 1992.)

In the 1960's in order to avoid the capital erosion, The United States made new regulations. This worked just the opposite and these new regulations have got some leaks, which made incentives in the opposite way. In the 1980's, to solve the problem of capital erosion, The United States made new policies called "International Banking Facilities" in New York. In this way entered into the chain of off shore banking.

To become the center of the offshore Eurodollar market, England got rid of exchange control and gain importance as a financial center in the second half of the 20th century. Today, England is protecting its prestige by making approximately one third of Eurodollar facilities with geographical locations, the potential of qualified good personel and its traditional banking system. (Türkiye İş Bankası, 1994.)



## **2.3 Types Of Off Shore Banking**

Offshore banks can be classified into two categories such as register centres and functional centres. (Sezinler, M., 1992.)

### **2.3.1 Register Centers**

It is a centre, which is registered on a paper; it can be described as an office centre. These are offshore banks, which prefer to get the benefits from legislation and the financial advantages. These banks use other banks as representatives without opening any branches. Whenever they enter into financial activities in another country, they benefit from the tax advantages with the support of the banks, which are established in other countries.

These kinds of banks only pay annual fees to the country in which they seem to be established and in which they operate. Actually these banks do not perform as an offshore bank in that country. It is just shown on the paper. Netherlands, Bahamas and Cayman Islands can be given as the most important examples. (Aksu, S., 1991.)

### **2.3.2 Functional Centres**

These centres actually function as offshore banks. They accept demand deposits and provide loans and funds, converting assets into cash, entering into trade – unions in order to enlarge financial facilities. In addition to this, these centers are seen as a member of Eurodollar market functioning by transferring funds from those centres (countries) that have got excess funds to the centres that have fund shortages; London, New York, Zurich, Luxembourg, Hong- Kong, Singapore and Bahrain are the most important functional centres. On the other hand, functional offshore centres can be distinguished into three categories as regards the kinds of collected funds and the way of using collected funds as “Offshore banking”, “Fund providing centers” and “Fund Collecting Centres”

### **2.3.2.1 Offshore Banking**

These are the centres, which meet the demand and supply in the domestic as well as in the foreign market. They are functioning worldwide and are well developed in the banking sector. The most important offshore centres are London and New York.

### **2.3.2.2 Fund Providing Centers**

As its name implies, these banks provide funds from outside in favour of their countries. We can give Hong-Kong, Singapore, and Panama for this type of centres as example.

### **2.3.2.3 Fund Collector Centers**

These fund collector centres are established in rich areas where the collection of funds is easy and they supply these collected funds abroad. In other words, fund collector centres perform as an intermediary like collecting funds and transfer them to those countries that have shortages of funds. Bahrain is a good example to fund collector centres since the petroleum crises in 1970's.

It is possible to classify the offshore banks regarding their geographical location, potential and development. Therefore metropolitan centres like London and New York where the operation of capital market is being directed can be referred to as the main centres. On the other hand, in some countries there are some developed offshore banks called environmental offshore centres.

Nowadays there are around twenty offshore centers, which facilitate in different financial processes. At the same time offshore banks can be in the same category in more than one country due to the different legislation and cultural restrictions set by the different countries. For example, for the explanation of the above paragraph demand and the supply of the short-long term debts have different precautions in different countries. Some of the offshore banks emphasize on capital market and exporting of certificate of demand deposits; the others focus on converting the assets into cash; and some of them are interested in illegal funds, money laundering and make the accounts confidential. (Erdem, İ., 1991.)



## **2.4 Off Shore Banking Centers in the World**

There are certain offshore banking centres which are after the shares of international money pool that contains more than \$3 billion, which is estimated as a result of a supply of petrodollars to the world financial system. As it is mentioned before, some of these are "Registered Centres" in which some of them involve with accounting activities with other centres through cooperating with other banks' financial institutions, as they are representatives without opening branches. Netherlands, Antiliers, Bahama Islands, Cayman Islands, Mansh Sea Islands, Isle of man, Liechtenstein, Gibraltar are the most important registered centres in the world. (Hampton, M.P., 1998.)

The other centres are "Functional Centres" which are effectively involve with every sort of financial service. These functional centers, developed communication and transportation systems, effective money and capital markets and potential skilled working force with stable economic and political structures are accepted as an important chain of the international financial system. New York, Zurich, Tokyo, Hong-Kong, Singapore, Australia, New Zeland and Luxembourg are the most important functional centres. Bahrain, which became a controversial centre right after the Gulf crises is also accepted as an active functional centre. (Hampton, M.P., 1998.)

Offshore banking centres are in an effort to provide certain services as a result of intense competition among each other which is also raised by the purpose of increasing their shares in the Eurodollar pool. For instance, Bahrain and Cayman Islands, which are called "tax paradises", are accepting some illegal funds and secret accounts on one side and on the other side; they give out loans to Latin American countries. Netherlands Antiller provides facilities to American companies to export international tax exempted bonds. In recent years, Panama with its increased political risk is providing certain services to American and Japanese investors with its colon free trade zone. British investors and British Originated funds go to Mansh Sea Islands. Some illegal funds and secret money go to Switzerland where you can find secret financial law applications. Therefore most of the funds were transferred to Switzerland as a result of the Gulf crises.

Hong-Kong is a very interesting offshore banking centre where exists a huge market. Hong-Kong with its tolerating authority, huge sums of international money, tax exemptions to international loans and portfolio management, is one of the major offshore banking and trade centres in the Far East. Singapore, the strongest opponent of Hong-Kong, for lending purposes involves in selling and buying bonds that is indexed to gold and dollar. Japanese are in an effort to make Tokyo one of the international offshore banking centres. (Beyoğlu, O., 1994.)

There exists a chain of financial centres where it starts in Far East, passing over to Europe and ending in the U.S.A. The regulation of international banking in the U.S.A., which makes offshore, banking transactions possible, aims to provide back flow of dollar funds. American banks shift their Euromarket transactions to the centres that exist in Cayman and Bahamas Islands to gain tax advantages.

Bahrain, as the most important financial centre of Middle East has an interesting story. It started to gain importance with the civil war of Lebanon in 1970's. Bahrain was developed after the flow of petrodollars to the world financial markets as a result of oil shocks. But by 1980's due to the decrease in oil revenues, Bahrain became one of the active offshore banking centres. The number of offshore banking units (O.B.U) has increased to around 100 in Bahrain. The indications that are provided by the Bahrain monetary agency regarding the year ending 1989 shows that 19 Arab, 15 West European, 8 North American and 14 others, in total of 56 offshore banking units existed in Bahrain and their total debit and credits with the year ending December 31 1989 reached the 72.580 million US dollars. (Gulf International Bank, 1989.)

The percentage distributions of total debits are as follows:

80% US\$, 10% local currencies such as Dinar and Riyal and the remaining 10% is DM and other convertible currencies. In the same manner the dollar and the local currencies constitutes the total loans. (Gulf International Bank, 1989.) The Arab countries provide the 41% of debits and 62% of loans. Within the same period, the contribution of offshore units to Bahrain's economy in which the personnel from Bahrain is 1228 and from foreign countries is 646.



Bahrain started to loose its attraction unexpectedly, right after 1990 Gulf Crises, although it has a very impressive increasing rate of popularity in offshore Banking among the financial markets in the last 15 years. The emergency of Kuwait's invasion caused disinjection of international capital out of the region. According the estimations, the local banks lost 15% of their accounts while the Offshore banking units lost 12% of their funds two weeks after the crisis. The estimate shows that the flow of capital out of the region reached \$50 billion in August 1990. These developments claim dissolution of banking in the Gulf region before the beginning of Gulf war. But, right after the war, it was expected that Bahrain would return to its good old days in a short period of time. (Gulf International Bank, 1989.)

### **3. THE ESSENTIAL FACTORS FOR THE DEVELOPMENT OF OFF SHORE BANKING**

In any country, development or establishment of offshore banks are based on many factors, which attract off shore companies to come into that country and to settle there. These factors are as follows: 9 (Chrown, J., Keller, T., 1985.)

#### **3.1 Political Stability**

Political stability is an important factor for the development of the country as well as offshore banking. The country should assure the foreign banks or companies that there would not be any political disturbances that will threat foreign companies' facilities in that country. Moreover, wars and demonstrations are the most important events that will make foreign companies aware that there is a political stability or there is no political stability in that particular country or area.

#### **3.2 Economic Stability**

For economic stability, macroeconomic indicators should be balanced such as low inflation rate, high foreign exchange reserves and low foreign debts. In addition to this, a country should provide guarantee to foreign banks that there will not be any repayment crisis that will affect the offshore banks in that country.

#### **3.3 Convenient Legal Environment**

The country should have an open economy, no restrictions on imports and exports, flexible foreign exchange policy and there should be no restrictions on transferring financial assets and funds.

#### **3.4 Infrastructure**

One of the important factors in the development of offshore banking in the country is transportation and telecommunication to have rapid air transportation; highways and qualified human resources are required.

### **3.5 Financial and Legal Advantages**

The financial transaction should not depend on tax. Exemption of reserve ratio, absences of control for accounts, confidentiality of accounts are the requirement of offshore banks to come and establish in any country.

### **3.6 Staff Availability**

They can find skilled and qualified local employee to employ.

### **3.7 Telecommunication**

Telecommunication service must be adequate and sufficient and also must be carried out systematically.

### **3.8 Social Environment**

There must be a good social environment; such as good hotels, restaurants, sports club etc. Some advantages must be provided for the foreign employees. (Kettell, B., 1998.)

### **3.9 Strategic Geographical Position**

The strategic position of the place should be close to those places that have financial and trade potential. Being in the same time schedule with the most important financial centres are the important factors for the development of offshore banking.



## **4. BENEFIT AND COSTS OF OFF SHORE BANKING**

### **4.1 Benefits**

Off shore banking has lots of benefits to the host country. Countries with small economies gain more from off shore banking with respect to large ones. It is frequently the case that small countries, often suffer from the disadvantages of being small size and thus most of them try to establish off shore banking center to avail themselves of the benefit of off shore banks and eliminate disadvantages of being small states. Bahrain is one of the most important off shore centers to utilize the benefits of off shore banks. There are 75 (in 2000) off shore banks in Bahrain and their contribution to the economy was about 10% of GNP. (Kettle, B., 1998.)

#### **Direct Benefits:**

Off shore banks provide to increase the service sector also provides to improve the modern banking and financing technique in host country. So they contribute to educate skilled and qualified personal for banking sectors of the economy.

Off shore banks also provide cheaper credits for the investment projects of the host country; they also raise the prestige of the country through out the world the inflow of foreign capital to the host country get easy and new investment areas are opened. (Zengin, E., 1989.)

#### **Indirect Benefits:**

One of the benefits that affected the income related the gains, are taxes and levies. Off shore banks increase the tax revenue of the host country. Host country imposes profit tax, corporate tax, annual license fees, registration charges, liquidity, audit chares and capital requirement etc. North Cyprus imposes US \$ 500,000 capital requirement, 2% profit tax and US \$ 10,000 audit fees. (Özgüm, E., 1989.)



Off shore banks pay the salaries of their employees so they contribute to the welfare of the host country. The salaries are spent in the host country and the net gain will be far greater if salaries are paid to local employees off shore banks incur operating expenditures and contribute to the increases in national income of the host country. These expenditures are rents paid for office and residential accommodation, charges for the use of telecommunication facilities, employer contributions to the social insurance and provident fund. In Bahamas, These expenditures amounted to 6.2 percent of GNP and in Cayman Island they amounted US \$ 10 million. (Merchant, I., 1979.)

Off shore banks employ local staff and pay salaries to them. If the number of off shore banks and employed local staff increases, this will increase the level of employment in the host country. For example; there are 75 off shore banks in Bahrain, According to the off shore banking services law; off shore banks employ local employee must be half from the other employee. (Çınar, H., 2000.)

#### **4.2 Costs**

Off shore banks not only provide benefits, but they also incur costs. Off shore banks that usually perform in free trade areas, rendering financial services with convertible assets for the multinational and international companies, in such circumstances where taxation and supervision are limited and it is excluded from the legislation of the domestic banking system. (Türkiye İş Banks, 1994.) So that off shore banking could be the impact of unfair competition on the domestic financial system. Off shore banks have competitive advantages with respect to the domestic banks; this problem could be avoided by limiting off shore banks to operate domestically. The host country to create appropriate environment for off shore banks did these expenditures, but usually there are much less than the corresponding gains.

Another cost is related to the illegal money transactions, government of the host country have to be very careful with illegal money transactions because if they permit this event to occur, they may provoke the reaction of other states. Thus they must try to prevent any money laundering.



## **5. OFF SHORE BANKING UNITS IN T.R.N.C (IN CASE)**

Off shore banking understanding is newly developed in the TRNC. Recent developments, for the attraction of off shore banking units have been found successful. Recently, Pakistan and two other ones by Germans have established the number of off shore banks from countries other than Turkey. According the interviews we have done with the managers of some of these off shore banks, all of them seem to be dealing only with good transfers among many countries without intervening domestics markets. (Interview some Off Shore Banks Manager, 2002.) In other words, these off shore banks in the TRNC are functioning as an intermediary among Singapore, London, Arabic Countries, Turkey and USA only for good transfers and not financially.

### **5.1 Off Shore Banking Services in TRNC**

Off shore banking services are licensed under the provisions of the off shore Banking Service Law No: 46/2000 enacted by the Parliament of the TRNC and the regulations laid down by the Council of Minister published in the Official Gazette.

The law and regulations aim, to explain the principles for establishing and operating the off shore banking units so as to enable commencement of the off shore banking activities and the effective pursuance thereof, with positive contribution to the services sector of the TRNC directly and indirectly to the general economy. (Bıçak, A. Altınay, M. , 1995.)

#### **5.1.1 Establishment Principles**

According to the Off Shore Banking Services Law; as well as real persons also corporate bodies, such as the foreign banks, foreign persons and the corporate bodies may apply to the Central Bank for the purpose of carrying on off shore banking operations in the TRNC. Those who apply for the Central Bank under the law point of out above are considered prospective units. The documents to be submitted by prospective units on application and establishment the contents thereof shall be specified in regulations by the Council of Minister.



According to the regulations if the candidate unit which is a branch of foreign bank, the application must contain:

1. Reason for application;
2. Type of the off shore banking operations envisaged;
3. Curriculum vitae relating to its field of activity and experience if any off shore banking;
4. Audited accounts for the last three financial years;
5. Financial capacities and a short history of its achievements;
6. The fields in which it will be able to contribute to the development and expansion of off shore banking services in the TRNC with the ultimate aim of establishing in the wide sense of an off shore financial center;
7. In the pursuit of off shore banking operations envisaged in the TRNC to what extent it will be able to act independently of decisions taken outside the TRNC;
8. Short, medium and long-term aims and objectives;
9. List of principal shareholders or those having controlling interest and the proportions of shares held by them to total shares and information regarding financial positions of shareholders who are in a position of controlling in the administration;
10. Name, address and qualifications of accountants or auditors proposed to be brought from abroad;
11. The feasibility report for the first three years in respect of the proposed off shore banking services. The feasibility report to be prepared shall indicate profit and loss accounts, balance sheets, funds flow forecasts and assumptions made;
12. List of branches and/or subsidiary establishments in other countries and banking license or correspondence relationship obtained in those countries;
13. Memorandum and/or Articles of Association of the establishments;
14. Organization chart and particulars regarding directors and top-level administrative staff of parent establishment;
15. Certified copy of the resolution of the parent establishment of the unit to carry on off shore banking services in the TRNC.
16. Letter of comfort;
17. List showing experience, title, post and nationality of foreign nationals who will be employed in the off shore banking services.



According to the same regulation if the candidate unit is a bank to be established in the TRNC, the application must contain:

1. Memorandum and Articles of Association of the proposed bank;
2. Declaration of the founders. The number of founders may not be less than 10;
3. Same documents as asked from the branch of a foreign bank to be established indicated in the precious section as, 1,2,6,7,8,9,10,11,13,16,17

### **5.1.2 Procedures and Requirements**

1. Charges payable on application shall be fixed by decision the Council of Ministers but this amount shall not exceed US \$ 1.000
2. The Central Bank evaluates applications of prospective units with in one month at the latest and submits the application to the Ministry responsible for the financial matters together with it is views there on. Then the Ministry responsible for the financial matters examines the application and if deemed suitable gives a provisional license with in fifteen days as a latest.
3. Minimum cash paid up capital required of off shore banks is US \$ 500.000. Upon payment of the cash capital into a blocked account at the Central Bank, the provisional license is rendered absolute and the Ministry responsible of financial matters issues the business license to the applicant.
4. The candidate unit than proceeds to the Register of Companies and fulfills the requirements of the company laws.
5. If the candidate unit, which is a branch or establishment of a foreign bank, it is a prerequisite that such a bank should have made a good reputation at the national level and that it has been registered in a country where there is adequate banking experience.
6. If the candidate bank is being established for the first in TRNC, conditions applicable to the promoters of a bank are set in the banking law.
7. Off shore banking units must within three month at the latest after receipt of the business license from the Ministry of Finance, specify it is place of business, be fully staffed and commence services as specified in it is Memorandum of Associations. Otherwise the license is deemed invalid.
8. The operations should be outward oriented except for projects approved by the State Planning Office and the Council of Ministers but in foreign currency. Off shore banking

Units are obliged to restrict their services to customers who are foreign national not resident in the TRNC and to other off shore units.

9. In their financial dealings off shore banking units are free and independent of the taxation and financial provisions that are enforced in the TRNC.

10. Off shore banking units may not secure funds from any bank, legal and real persons or corporate bodies within the TRNC.

11. It is essential that the members of the off shore banking units should be foreign national not resident in the TRNC and not of Turkish Cypriot stock. (Bıçak, A. Altınay, M., 1995.)

### **5.1.3 Financial Provisions and Exemptions**

Financial provisions and the exemptions given below to the off shore banking units can be considered as some of the main advantages of operating in the TRNC.

1. Off shore banking units are subject to tax at a rate of 2% on "taxable income to be ascertained" under the provisions of the Corporation Tax Law and the Income Tax Law.

2. Off shore banking units shall pay the Central Bank an annual audit charge of US \$ 10,000.

3. There shall be a reduction amounting to 50% of the sum due under the Income Tax Law in favor of the foreign personnel employed by the off shore banking units.

4. Office vehicles and equipment imported by the off shore banking units for their own needs and an adequate number of other vehicles and equipment approved by the Ministry of Finance are exempted from custom duties.

5. Off shore banking units may transfer money abroad, which they have secured or transferred from abroad as well as their profits.

6. Off shore banking units don't have to comply with the requirements regarding liquidity, capital ratio against risk and similar reserves envisaged in TRNC.

7. Off shore banking units are classified as non-residents for exchange control purposes and as such can operate freely without any exchange control restrictions.

8. Expenditures incurred by off shore banking units during their operations shall be secured from funds outside the TRNC.

9. Representative office, which cannot have banking license, shall pay an annual control charge of US \$ 3,000 to the Central Bank.



## **5.2 Development of Off Shore Banking in TRNC**

Northern Cyprus has a suitable location, economic and political environment for the development of off shore bank. Tax incentive (while local companies 25% corporation tax but off shore banks only pay 2% corporation tax over their net profits), exemption from exchange control, duty free goods (importing or purchasing locally office and household equipment except furniture and cars free from custom duties for off shore banks), good telecommunication system, staff availability and English language skill are some of the favorable factors in Northern Cyprus. Secrecy and disclosure of confidential information are strictly obeyed and controlled. (Bıçak, A. Altınay, H.M., 1995.)

As it is indicated in following, Off Shore Banks started to establish in 1991 and every year there is a continuous increase and now 48 off shore banks, which were registered with the Registrar of Companies. (Central Bank of T.R.N.C, 2000.) But are all off shore banks really active or not?

Off Shore Banks in TRNC:

1. The European Business Bank Ltd.
2. The European Commerce Bank Ltd.
3. The Euro Textile Bank Ltd.
4. Atlas Bank off Shore Ltd.
5. İmar Bank off Shore Ltd.
6. Özbank off Shore Ltd.
7. Alliance Investment Bank off Sore Ltd.
8. Oki Bank off Shore Ltd.
9. Mediterranean Union Bank off Shore Ltd.
10. World Vakıf off Shore Ltd.
11. Optima Bank off Shore Ltd.
12. Northern Island Bank off Shore Ltd.
13. Cyprus Islamic Bank off Shore Ltd.
14. Facto Bank off Shore Ltd.
15. First Merchant Bank Off Shore Ltd.



- 16.Şeker Bank off Shore Ltd.
17. Toprak Bank off Shore Ltd.
18. Cleveland off Shore Ltd.
19. Bank Turquoise off Shore Ltd.
20. Adabank off Shore Ltd.
21. Olden Union off Shore Ltd.
22. Trade Deposit off Shore Ltd.
23. Unibank off Shore Ltd.
24. Cyprus Trade Development Bank off Shore Ltd.
25. Metropolitan Investment Bank off Shore Ltd.
26. Maritima off Shore Ltd.
27. Yaşarbank Foreign Trade off Shore Ltd.
28. EGS Bank off Shore Ltd.
29. Technical Export Import Bank off Shore Ltd.
30. Soutstar off Shore Bank Ltd.
31. Banks 2000 off Shore Ltd.
32. Renfrew Security Bank and Trust off Shore Ltd.
33. Excess Bank off Shore Ltd.
34. Dinamic Bank off Shore Ltd.
35. Yurt Security off Shore Ltd.
36. Bank Girişim off Shore Ltd.
37. Prudential off Shore Ltd.
38. Cey Off Shore Ltd.
39. Efectif Bank off Shore Ltd.
40. New York Bank off Shore Ltd.
41. Pamukbank off Shore Ltd.
42. Egebank off Shore Ltd.
43. Kıbrıs Türk Dış Ticaret Bankası off Shore Ltd.
44. Kentbank off Shore Ltd.
45. Basic Bank off Shore Ltd.
46. Economy Bank off Shore Ltd.
47. IOB Bank off Shore Ltd.
48. Clover Bank off Shore Ltd.

### **5.3 Convenience of Off Shore Banks in TRNC**

#### **5.3.1 Complete Exemption From Reserve Requirements**

##### **Reserve Ratio:**

The percentage of a bank's checking and savings accounts that are kept in the bank or on deposit at the central bank. By changing the percentage of required reserve, the Central Bank can directly affect the amount of money available for making loans.

In addition to this, the Central Banks can act as clearinghouse for checks and regulates the commercial banking systems. (Dudly, L., 1984.) In Northern Cyprus every commercial bank deposits 15% of their savings accounts within the Central Bank in order to be secured when they are faced in a kind of bankruptcy. However, unlike the commercial banks, offshore banks are exempted from holding any kind of reserves, which by reducing the cost of money collection enables them to lend out at a lower rate. In other words, offshore banks are not required to deposit any money to the Central Bank. Therefore; they can use 100% of their customers' deposits and decrease the cost of money. As a result of this, they can lend out long-term debts with low interest rate to the borrower and they can give high rate of interest to the depositors compared to commercial banks.

According to the services law prepared by the Turkish Republic of Northern Cyprus, any kind of offshore units which applied for the establishment purposes are not required to deposit any reserves with in the Central Bank. (Off Shore Banking Service Law of the T.R.N.C, 2000.) As a result of this, offshore units are completely exempted from minimum reserve requirements when they are established in the Republic of Northern Cyprus.

#### **5.3.2 No Assigned Capital Requirement for an Offshore BankCapital Requirement:**

Is the amount of capital required by the Central Bank in order to establish a bank? In the Turkish Republic of Northern Cyprus \$ 2 million is the required minimum amount of capital in order to establish an offshore bank. The above amount is the minimum

capital requirement set by the Central Bank. Permission is given only after depositing such an amount with the Central Bank of the Turkish Republic of Northern Cyprus.

However, offshore banks in many countries are not required to have any amount of capital to establish an offshore bank in that country. Since offshore establishments have both direct and indirect advantages for the country, reserve requirement should be abolished only for offshore establishments, in order to attract offshore units to come and operate in that country.

However, in Northern Cyprus, the minimum capital requirement for establishment and provisional licence of an offshore bank is \$500.000. Upon payment of cash capital into a blocked account within the Central Bank, the provisional licence is rendered absolute and the ministry responsible for financial matter issues the business licences to the applicants.

### **5.3.3 Extension of Duty Free For Office and Household Equipment For The Exclusive Use of Offshore Banks and Their Staff**

The privilege permits offshore banking units to import their office and household equipments from their home country to where they are established.

According to the Offshore Services Law of the Turkish Republic of Northern Cyprus part four, article 20, office vehicles and equipments imported by the offshore banking units for their own needs as well as an adequate number of other vehicles and equipments approved by the Ministry responsible for financial matters shall be exempted from customs duty . (Off Shore Banking Law of the T.R.N.C, 2000.) Therefore, offshore banking units that will be established (in the Turkish Republic of Northern Cyprus) have the exemptions of customs duty that will help in the development of the offshore banking.



#### **5.3.4 Excellent Telecommunication**

The effectiveness and efficiency of an offshore bank requires excellent telecommunication worldwide, which is the basis of their financial transactions.

Any deficiency in telecommunication may cause inadequacy in transactions and this can be a waste of time and money, so the available telecommunication technology in the country where the offshore banking units will be establishing should be under serious consideration.

In the development of offshore banks in the TRNC, adequate telecommunication system plays a very important role. Therefore; development of telecommunication system in the Turkish Republic of Northern Cyprus is an essential factor for the development of offshore banks.

#### **5.3.5 No Exchange Control**

The transactions of offshore entities is apparently based on foreign currency, to the country where the offshore banking units are located should be accepted as normal. So that there should be no restrictions on currency transactions on offshore banking units. The applications in the Turkish Republic of Northern Cyprus on exchange control are similar with the explanation above.

As it is mentioned in the Offshore Services Law of the Turkish Republic of Northern Cyprus part third, article 11. Offshore banking units may transfer abroad money, which they have secured, are transferred from abroad as well as their profits. Offshore banks shall keep the amount necessary to meet expenditures relating to personal administration and maintenance for each accounting period in foreign currency account opened with authorized banks and makes their payments there from. This case is the privilege in the establishment and in the development of offshore banking units in the Turkish Republic of Northern Cyprus.



### **5.3.6 Non Bureaucratic Regulatory Framework and Simplified Bank Licensing Procedure**

The bureaucratic regulations in the country where the offshore banking units are supposed to be established has to be so simple that it should attract the potential offshore banking units.

The institutions in charge of offshore banking establishment procedures in the Turkish Republic of Northern Cyprus are the Central Bank together with the Ministry of Finance. The application form is considered in the Central Bank and then sent to the Ministry of Finance for further evaluation. If the applicants are accepted to start an offshore banking business in Northern Cyprus, provisional license is issued approximately within 45 days.

### **5.3.7 No Restrictions on Repatriation of Profits**

There should not be any restrictions for the transfer of profit earned by the offshore banking units from the country where the offshore banks are located. The Turkish Republic of Northern Cyprus, there are no restrictions and repatriation of profit from the offshore banking units. It is also mentioned in the Offshore Services Law of the Turkish Republic of Northern Cyprus; part third; article 11, that offshore banking units may transfer abroad money which they have secured or transferred from abroad as well as their profit.

### **5.3.8 Comparatively Low Initial Setting up Cost and Annual Operation Costs**

The offshore banking units are expected to have low initial setting up costs together with annual operation costs comparatively. In the Turkish Republic of Northern Cyprus, offshore banking units are expected to pay to the Central Bank in the sum of 10.000US\$ as annual audit charge.

### **5.3.9 Eco-Strategic Geographical Position**

The location where an offshore banking unit is established has crucial importance for communication and operational purposes. Offshore banking units should be close to places where the financial activities are involved.

Turkish Republic of Northern Cyprus has the eco-strategic position with its being close to the oil-rich Arab countries. More convenient as compared to Europe and Middle East, Cyprus is at the crossroads of Europe, Asia and Africa. So, the Turkish Republic of Northern Cyprus has a privileged position to enhance its role as a potential offshore center. (Kanizi, E., 1998.)

### **5.3.10 Availability of Expert Legal Accounting Management and Other Services**

The offshore banking units should be able to find services such as legal accounting management whenever the service is required. So the availability of such financial services is another incentive for offshore banking.

### **5.3.11 Accessibility by sea and Air via Frequent Daily Connections**

The location of offshore banking units should be connected to the world by the sea and air through daily flights and sea excursions to achieve the efficiency and effectiveness of the operations. Turkish Republic of Northern Cyprus, from this point of view, has the best location with less than three hours of flying time from important centers of Europe, the Middle East and North Africa. Unfortunately, there are inconveniences regarding the daily flight frequency in The Turkish Republic of Northern Cyprus. There are no direct flights to the North Nicosia Ercan Airport, except via Turkey, and this makes air transportation very expensive.



### **5.3.12 Free Enterprise Economy, Democratic Political System and Pluralistic Social Structure**

The political, economic and social structure of the country where the offshore banking units are established should be well stabilised. Although, the Turkish Republic of Northern Cyprus has the required criteria for free enterprise economy, democratic, political and pluralistic social structure, it does not have the international recognition which is a great disadvantage for the establishment of offshore banking units in the Turkish Republic of Northern Cyprus. The ones that are operating in the TRNC right now are usually coming from Turkey. There are a total of around 48 offshore banks in the TRNC, and more applications are coming to the Central Bank for new establishments.

### **5.3.13 Availability of Educated, Skilled and Disciplined Professionals**

Offshore banking requires well-trained professionals, and educated and skilled personnel are considerably important in the establishment of offshore banking units. Although, The Turkish Republic of Northern Cyprus has a great potential in skilled and educated staff, it has a lack of experience and training, which requires a time period for the resolution. Even though there are sufficient university graduates in the Turkish Republic of Northern Cyprus, most of them are not experienced in their professions, and inter-training courses will help to give experience to these people in their professions.

### **5.3.14 Social and Political Stability**

It is very important for the establishment of offshore banks. Especially political stability is the main factor of a dynamic business sector. The country that has fluctuating political conditions is always subject to uncertainties. Political uncertainties can be discouraging for the establishment of offshore banking units in the host country.

Unfortunately the Turkish Republic of Northern Cyprus partially has Political uncertainties that can be discouraging for the establishment of offshore banking in the TRNC.

#### **5.4 Contribution of Off Shore Banks to the Economy in TRNC**

Off shore banking can have a significant contribution to the economic development of an island through establishing an international business and financial center. These off shore activities increase income and employment level of the country. The government of TRNC realizing the importance and contributions of the off shore banking to the economic development, so TRNC authority avail from the benefit of these banks they made some regulations. The aim of these regulations are enable commencement of the off shore banks and the effective pursuence thereof, with positive contribution to the service sector of the TRNC directly and indirectly to the economy in general. According to regulations;

- Off shore banks shall be subject to tax at a rate of 2% on taxable income to be ascertained under the provision of corporation tax law and income tax law.
- Off shore banks have to pay charge payable on application is US \$ 1,000 that has to be deposited at the Central Bank.
- After the off shore bank having received the provisional license and completed the registration procedures, an off shore bank must deposit US \$ 20,000 to the Revenue and Tax Office as license fee. This amount of license fee has to be deposited every year in January. (State Planning Organization, 2002.)

Another contribution of the off shore banks are:

- Creating Employment:

Off shore banks employ local staff and pay salaries to them. If the number of off shore banks and employed local staff increases, this will increase the level of employment in the country. (Eraslan, N., 1999.)

- Increase in national income:

Off shore banks pay the salaries of their personnel so they contribute to the welfare of the host country. Especially the salaries are spent in the host country and the net welfare aim will be far greater if salaries are paid to local employees. Off shore banks incur

operating expenditures and contribute the increase in national income of the host country. Mostly of these expenditures are rents paid for office and residential accommodation, charges for the use telecommunication facilities, payment of the municipal tax on rents, employer contributions to the social insurance and provident fund and other purchasing of services.

- Off shore banks also provide cheaper credits for the investment projects of the host country: They also raise the prestige of the country through the inflow of foreign capital to host country and new investment areas are opened. In North Cyprus, enterprises which are owned by the citizens of the TRNC may take permission from the Council of Ministers to borrow cheaper credit from an off shore bank if the investment project is approved by State Planning Organization. Otherwise local citizens of the TRNC may take credit from off shore banks, because off shore banks' operations are valid for to off shore not on shore.

- Off shore banks bring modern banking services, high technology and new financial techniques so the increase the contribution of educated, skilled personnel for banking and other sectors of the economy. (Eraslan, N., 1999.)



## CONCLUSION

Off shore banking sector has developed very fast. Off shore banks provide benefits to the host country and for this they utilize some advantages, which are provided by the host country. Around the world, there are many off shore centers and Honking, Cayman Islands, Bahrain are some examples. The off shore banking in TRNC could be considered as an alternative sector in the economic development of the economy.

Off shore banks are operating under the off shore Banking Services Law (46/2000) in TRNC. Those regulates the establishment and operations of off shore banking. Law is supported by the regulations. The shortcomings of the laws and their applications were detected by interviews, which are carried out off shore banks, inspector of the Central Banks, some officers of the Tax office and Company Registrar.

The reason I have chosen the off shore banking models of TRNC is because, it is the most important sector developing to the economy of TRNC. North Cyprus is geographically located for this reason why we should develop the off shore banking units in North Cyprus. Since all trade ships, that carries cargo from Europe to Middle East or to Far West has to get through the Mediterranean and also pass through Cyprus, there is a great trade potential for Cyprus. In the carrying process of the cargos, off shore banks can play the primary role to make the transportation process easier and cheaper.

Since the international arena does not recognize us as a Republic, we should attract Turkish investors to come to the island and establish off shore banks rather than considering foreign investors. In other words it is very convenient for the Turkish investors to establish off shore banks in TRNC and that what they are doing.

For the long term planning we can consider foreign investors or banks to come and establish off shore banking in Northern Cyprus after the solution of the political uncertainties.

Since the understanding of the off shore banking units are newly establishing in TRNC, some improvements have to be made to mobilize necessary resources for the infrastructure. The necessary fields that should be improved are as follows:

- Improvement in telecommunication services
- Decreasing minimum required capital
- Minimization of bureaucracy
- Improvement of financial and banking services
- Improvement of transportation facilities for better accessibility
- Improvement of inter course services to give better knowledge and experience to the university graduates
- Improvement of energy sources

A great number of favorable factors can make TRNC one of the most attractive places in the world for registration of off shore entities in the near future.

## REFERENCES

- Aksu, S. (1991). "Serbest Bölgeler ve Kıyı Bankacılığı", T.C.M.B, Ankara.
- Atlas Bank. (1998). "Off Shore Banking", Nicosia.
- Apak, S. (1993). "Uluslararası Bankacılık ve Finansal Sistemler", İstanbul.
- Beyoğlu, O. (1994) "Bankacılığın Dünyü, Bugünü ve Yarını", Lefkoşa.
- Bıçak, H.A. and Altınay, M. (1995). "Off Shore Activities in the T.R.N.C", International Conference on Banking and Finance and Off Shore Activity in Islands and Small States, Malta.
- Chrown, J. & Keller, T. (1985). "Off Shore Investment Centers", London.
- Central Banks of T.R.N.C. (2000). "Media Bultens", on September, no: 28, Nicosia.
- Çınar, H. (2000). "Türkiye'de ve Dünya'da Serbest Bölgeler" Master Tezi, İstanbul.
- Dudley, L. (1984). "Money and Banking", Sinapore.
- Eraslan, N. (1999). "Off Shore Banking in T.R.N.C", Master Thesis, FaMagosta.
- Ersan, İ. (1992). "Kıyı Bankacılığı ve Ekonomik İlişkilerdeki Yeri", Seminer Notları, İ.T.O, İstanbul.
- Erdem, İ. (1991). "Dünyada ve Türkiye'de Kıyı Bankacılığı", İstanbul.
- Gulf International Bank, "Gulf International Market", Mimeo.



Hampton, M.P. (Mapping the Minefield: Theories of islands Off Shore Financial Centers with Reference to Jersey”; in Banking and Finance in island and Small States, London.

Interview some Off Shore Banks Manager. (2002). Nicosia.

Kanizi, E. (1998). “TRNC Banking Analysis about International Banking”, Master Thesis, İstanbul.

Kettell, B. (1998). “Off Shore Banking Centers: in Case of Bahrain”, London.

Off Shore Banking Service Law of the T.R.N.C part: 2 article 6, T.R.N.C.

Off Shore Banking Service Law of the T.R.N.C part: 4 article 20, T.R.N.C.

Özgüm, E. (1998). “K.K.T.C ‘de Bankacılık” Continental Bank, Nicosia.

Sezinler, M. (1994). “Off Shore Banking and Off Shore Centers”, Ankara.

Sezinler, M. (1992). “Off Shore Banking and Off Shore Banking Centers”, Ankara.

State Planning Organizations, (2002, March). “Guide for Foreign Investors”, Nicosia.

Türkiye İş Bankası, (1994).”Off Shore Banking”, Press No: 75, Ankara.

Zengin, E. (1989). “Kıyı Bankacılığı ve Tarihsel Gelişim Uygulama ve Türkiye”, İstanbul.