

BANKING IN PUERTO RICO: OPPORTUNITIES FOR INTERNATIONAL FINANCIAL ENTITIES

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INTRODUCTION

The dual banking system in the United States (U.S.) permits the organizers of a bank to be licensed under either federal or state law. Regardless of whether they are state or federally chartered, U.S. banks are subject to a complex body of frequently overlapping federal and state laws and regulations.¹

Add the historical and political background of the Commonwealth of Puerto Rico to these regulations and you end up with an even more complex body of laws and regulations that apply to domestic and foreign banks doing business in the Commonwealth. For example, under the Puerto Rican Federal Relations

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¹ Robert L. Tortoriello, *Legal Considerations Affecting Foreign Bank Acquisitions of United States Banks*, 1988 U. ILL. L. REV. 287, 288 (1988).

Act, unless locally inapplicable, the statutory laws that apply to the U.S. apply to Puerto Rico with the same force and effect.²

“Banks doing business in Puerto Rico benefit from the selective application of U.S. banking laws.”³ Puerto Rico’s political status has given its banking entities an alternative regulatory system in addition to the United States’ dual banking system. As mentioned, due to Puerto Rico’s status as an unincorporated territory of the U.S. and the Puerto Rican Federal Relations Act, U.S. and Puerto Rican banks will be subject to some, but not all, federal banking laws. Nevertheless, there are other U.S. laws that are mandatory to U.S. banks, but that are either less restrictive or voluntary for banks operating in Puerto Rico. Lastly, other federal banking regulations consider Puerto Rican banks foreign banks, thereby subjecting them to a different set of rules.

This paper will explore the different alternatives that international banking institutions have for establishing operations in Puerto Rico. To achieve this, the paper will provide a background on the political status of Puerto Rico, then briefly discuss some of the federal laws and regulations that apply to banking institutions in Puerto Rico. Finally, the paper will discuss the banking statutes of the Commonwealth and the different ways that organizations can operate banks there.

I. POLITICAL BACKGROUND OF THE COMMONWEALTH OF PUERTO RICO

In recent years, many laws enacted in Puerto Rico have been put in effect with the sole purpose of attracting capital to the Commonwealth in order to combat the current fiscal crisis. To understand why some banking laws of the U.S. apply to Puerto Rico and others do not, it is important to discuss the Commonwealth’s political status and history.

Puerto Rico became a U.S. territory in 1898 as a result of the Spanish-American War, which concluded with the Treaty of Paris. Pursuant to the Treaty of Paris, Spain ceded the territory to the U.S. and the U.S. Congress was tasked with determining the civil rights and political status of its inhabitants.⁴ Through the powers conferred by the Territorial Clause of the U.S. Constitution,⁵ the U.S. Congress enacted the Foraker Act in 1900, which established a civil government for Puerto Rico where the President of the U.S. — with the advice and consent of the Senate — appointed the governor, the Supreme Court, and the upper house of the legislature.⁶ Later in 1917, the U.S. Congress enacted the Jones-Shafroth Act, which granted Puerto Ricans U.S. citizenship, and replaced the upper house of the

² Puerto Rican Federal Relations Act, 48 U.S.C. § 734 (2016).

³ Felix J. Montañez-Miranda, *The Unique Position of Banks Doing Business in Puerto Rico*, 20 ANN. REV. BANKING L. 209 (2001).

⁴ Treaty of Paris, Spain-U.S., Dec. 10, 1898, 30 Stat. 1759. See also *Puerto Rico v. Sánchez Valle*, 579 U.S. ___, 136 S.Ct. 1863 (2016).

⁵ U.S. CONST. art. IV, § 3, cl. 2.

⁶ See Organic Act of 1900, ch. 191, 31 Stat. 77 (1901).

legislature with a popularly elected senate. That law was then amended in 1947 to empower the people in the territory to elect their own governor.⁷

In 1950, through the Puerto Rican Federal Relations Act, the U.S. Congress recognized the *principle of government by consent* and authorized the territory's inhabitants to "organize a government pursuant to a constitution of their own adoption."⁸ Two years later, with the U.S. Congress' approval, the Constitution of Puerto Rico was ratified. The new Constitution established a republican form of government for the territory and created the Commonwealth of Puerto Rico,⁹ a new political entity. The U.S. State Department, in its Foreign Affairs Manual, states that:

The term "Commonwealth," does not describe or provide for any specific political status or relationship. It has, for example, been applied to both states and territories . . . When used in connection with areas under U.S. sovereignty that are not states, the term broadly describes an area that is self-governing under a constitution of its adoption and whose right of self-government will not be unilaterally withdrawn by Congress.¹⁰

As noted by the U.S. State Department's definition, the term *commonwealth* does not provide a specific political status that would define its sovereignty, or lack thereof. The consequence of this ambiguous status is that "Puerto Rico may be found to be included within one Act whose coverage extends to territories of the United States and excluded from another."¹¹ The U.S. Supreme Court has stated that "whether Puerto Rico comes within a given congressional act applicable in terms to a 'territory,' depends upon the character and aim of the act."¹² More recently, the Supreme Court in *Puerto Rico v. Sánchez Valle*, 136 S. Ct. 1863, overturned a conviction based on double jeopardy concerns, stating that "[b]ecause the ultimate source of Puerto Rico's prosecutorial power is the Federal Government . . . the Commonwealth and the United States are not separate sovereigns."¹³ Going all the way back to the Spanish-American war in its analysis, the Supreme Court in *Sánchez Valle* confirmed that the sovereign powers of the territory — or lack thereof — were granted by Congress. This is a reason for concern, as in the same way these powers were given, they can be taken away.

Recently, the U.S. Congress made use of that power to tackle Puerto Rico's financial crisis. On June 30, 2016, president Barack Obama signed the Puerto Rico

⁷ See Act of Aug. 5, 1947, ch. 490, 61 Stat. 770 (1948).

⁸ See Act of July 3, 1950, 48 U.S.C. § 731(b) (2016).

⁹ In Spanish, "Estado Libre Asociado de Puerto Rico" (Free Associated State of Puerto Rico).

¹⁰ U.S. DEPARTMENT OF STATE, 7 FAM1121.2-1 (2009), <https://fam.state.gov/FAM/07FAM/07FAM1120.html> (last visited Jun. 15th, 2018).

¹¹ *García v. Frieseckee*, 597 F.2d 284, 293 (1st Cir. 1979).

¹² *Puerto Rico v. The Shell Company*, 302 U.S. 253, 258 (1937).

¹³ *Puerto Rico v. Sánchez Valle*, 136 S.Ct. 1863, 1876–77 (2016).

Oversight Management, and Economic Stability Act (PROMESA) into law, which among other things, established a Financial Oversight and Management Board with powers broad enough to effectively overrule decisions by Puerto Rico's democratically elected public officials.¹⁴

II. UNITED STATES FEDERAL LAWS AND PUERTO RICAN BANKS

Puerto Rico's complicated political history and its unique status as a Commonwealth causes some federal banking regulations to consider banks organized under Puerto Rican law as domestic banks, while others treat these entities as foreign institutions.

A. National Banking Act

The National Banking Act¹⁵ (NBA) was passed by the U.S. Congress and signed into law by President Abraham Lincoln to create a system of national banks, a uniform national currency, and a federal regulator that would supervise these banks.¹⁶ The federal regulator would be the Office of the Comptroller of the Currency (OCC), which still exists and supervises certain institutions.¹⁷ The underlying purpose for the enactment of the NBA was to generate enough tax income to pay for the Civil War.¹⁸

Within the NBA — as it stands today — the U.S. Congress explicitly stipulates that national banks operating in Puerto Rico are subject to the same laws that apply to national banks operating in the U.S.¹⁹ Consequently, under the Federal Deposit Insurance Act, a national bank established in Puerto Rico would be eligible to become an insured depository institution by the Federal Deposit Insurance Corporation (FDIC).²⁰

B. Federal Reserve Act

The Federal Reserve Act (FRA) carved out an exception to the general rule that all Acts that applied to U.S. banks would also apply to national banks in Puerto Rico. Section 19(h) gives the option for national banks located outside the continental U.S. to remain nonmember banks or to voluntarily become member banks of the Federal Reserve System.²¹ Since Puerto Rico is a Commonwealth located outside the continental U.S., national banks operating in the

¹⁴ See Puerto Rico Oversight, Management, and Economic Stability Act, 48 U.S.C. §§ 2101–2241 (2016).

¹⁵ National Bank Act, 12 U.S.C. § 38 (2012).

¹⁶ RICHARD SCOTT, JONATHAN R. MACEY AND GEOFFREY P. MILLER, *THE LAW OF FINANCIAL INSTITUTIONS* 10–11 (5th ed. 2013).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ See 12 U.S.C. § 42 (2016).

²⁰ Federal Deposit Insurance Act, 12 U.S.C. § 1813(a)(3) (2012).

²¹ See *id.* §§ 221–522 (2016).

Commonwealth may become members of the Federal Reserve but are not required to do so.²²

This conclusion can be supported by the legislative history of the FRA. As one author for the Annual Review of Banking Law stated:

Congress amended § 2 of the FRA twice, once in 1958, when Alaska was admitted into the Union as a state, and again in 1959, when Hawaii was admitted into the Union as a state. Each time, Congress amended the FRA to require national banks located in Alaska and Hawaii become members of the Federal Reserve System soon after those territories officially became states. Thus, Congress intended to require only those national banks located within a state to become members of the Federal Reserve System.²³

C. Bank Holding Company Act

The Bank Holding Company Act (BHC Act) regulates the companies that have control over any bank or over any company that is or becomes a Bank Holding Company (BHC) by virtue of the Act.²⁴ The BHC Act expressly includes Puerto Rico when it defines a bank as an institution that accepts demand deposits and is engaged in the business of making commercial loans.²⁵ The Federal Reserve Board (FRB) implements the BHC Act through Regulation Y, which governs the corporate practices of state-member banks and describes the transactions for which BHCs must seek and receive the Federal Reserve's approval.²⁶

Since the provisions of this statute apply to Puerto Rico, banks or companies over which the control is exercised will need the approval of the FRB for certain transactions. The necessity of the request for approvals under Regulation Y would apply even if the entity in the transaction is not a member bank of the Federal Reserve or an FDIC insured bank, if it accepts deposits and makes commercial loans.

D. Reserve Requirements: Regulation D of the Federal Reserve Board

Through Regulation D, the FRB establishes reserve requirements for banks. It expressly states that any institution organized under the laws of Puerto Rico is considered a foreign bank.²⁷ Because of this, national banks and other institutions operating in the Commonwealth are not bound by the reserve requirements of

²² Montañez-Miranda, *supra* note 3, at 213.

²³ *Id.*

²⁴ Bank Holding Company Act, 12 U.S.C. § 1841(a)(1) (2016).

²⁵ *Id.* § 1841(c)(1)(B).

²⁶ See Federal Reserve Bank of San Francisco, *Common Questions and Answers on Regulation Y* (Apr. 6, 2017), <http://www.frbsf.org/banking/regulation/regulations-policies-guidance/reg-y/> (last visited Jun. 16, 2018).

²⁷ See Reserve Requirements of Depository Institutions (Regulation D), 12 C.F.R. § 204.2(o) (2018).

Regulation D. Nonetheless, banks operating in Puerto Rico do have reserve requirements under the Banking Law of Puerto Rico, which will be discussed later.

E. International Banking Act

The International Banking Act, through the Federal Reserve's Regulation K, was promulgated to set the rules governing foreign activities of U.S. banking organizations. It explicitly states that banks doing business in Puerto Rico are considered foreign banks.²⁸ This essentially benefits the national banks operating in the Commonwealth because they would be able to take advantage of the benefits of acting as a foreign bank.²⁹

III. BANKING LEGISLATION IN PUERTO RICO

A. Banking Law of Puerto Rico

Banks organized in Puerto Rico are governed by the Banking Law of Puerto Rico of 1933, also known as Act 55,³⁰ which establishes the organization and legal powers of banks and the requirements for the prudent and financially sound operation of institutions. Act 55 sets forth reserve requirements, borrowing limits, and other solvency related matters for all banks doing business in Puerto Rico.

The Banking Law of Puerto Rico defines a foreign bank as a:

[C]orporation or entity organized for the purpose of engaging in banking business, under the laws of another territory or state, or the United States, or a foreign country, which operates a bank and does business in the place of its incorporation and has been authorized to operate in Puerto Rico under [the provisions] of this title.³¹

Act 55 stipulates that foreign banks may do business in Puerto Rico and may establish local offices, so long as prior to carrying on their operation, they file with the Puerto Rico State Department: (1) a duly authenticated copy of its charter or articles of incorporation; (2) a sworn statement of the president, manager, agent, cashier, or other authorized officer of said bank, and attested to by a majority of the board of directors; (3) a certificate under the official seal of the bank and the signatures of its president, vice-president or other acting head, and its cashier, if there is one, certifying that the bank has consented to be sued in the courts of Puerto Rico; and, (4) written consent of the designated resident agent.³² The

²⁸ See International Banking Act of 1978, 12 U.S.C. § 3101(7) (2016).

²⁹ Montañez-Miranda, *supra* note 3, at 215.

³⁰ Banking Law of Puerto Rico, Act No. 55 of May 12, 1933, 7 L.P.R.A. § 1 (2010).

³¹ *Id.* at § 3(d).

³² Authorization for Foreign Banks, 43 P.R. Op. Att'y Gen. 72 (1972).

requirement for a foreign bank to have a resident agent in Puerto Rico is intended only for foreign entities; domestic institutions do not have such requirement.³³

Additionally, Section 181 of the Banking Law provides that if any foreign bank has commenced business without having presented for filing the required documents, such bank will be fined the sum of one thousand dollars (\$1,000.00) for each day it neglects to file such documents.

Once a foreign bank is authorized to do business in Puerto Rico, it will have the same powers as a domestic bank.³⁴ In the same manner, the foreign entity will be subject to the supervision and regulations of the Commissioner of Financial Institutions (hereinafter, “the Commissioner”) and must comply with all the provisions of the Banking Law of Puerto Rico, except where specifically exempted.

For instance, even though banks in Puerto Rico have the capacity to become member banks of the Federal Reserve System, they are not required to do so.³⁵ This means that, if organized only under the Banking Law of Puerto Rico, banks are not subject to the initial capital and legal reserve requirements of the Federal Reserve. However, Act 55 provides its own capital and reserve requirements. Under Act 55, every bank organized and established in Puerto Rico must do so with a capital investment of at least five million dollars (\$5,000,000.00) represented by common stock, and a reserve fund of no less than one million dollars (\$1,000,000.00).³⁶ Act 55 also sets forth the obligation of every bank, foreign or domestic, to establish a legal reserve, which has been set by the Commissioner at twenty percent (20%) of its obligations payable on sight.³⁷ The Act provides a distinction for violating the reserve requirement between domestic and foreign banks. If a domestic bank has less than the required amount of legal reserve and fails to complete the full amount after thirty (30) days of notice by the Commissioner, the Commissioner may declare said bank in liquidation and it will be deemed as a corporation to be liquidated. On the other hand, if this were to happen to a foreign bank, the Commissioner will direct the cancellation of its license and the liquidation of its business in Puerto Rico.³⁸

Furthermore, because the Federal Deposit Insurance Act includes Puerto Rico in its definition of a state, banks organized under the Banking Law of Puerto Rico may be insured by the FDIC “upon application to and examination by the [FDIC] and approval by [its] Board of Directors.”³⁹

³³ Designation of Resident Agent, 28 P.R. Op. Att’y Gen. 3 (1957).

³⁴ 7 L.P.R.A. § 111 (2010).

³⁵ 12 U.S.C. § 1841(a)(1) (Provided that the entity doesn’t have the elements of a Bank Holding Company).

³⁶ 7 L.P.R.A. § 112 (authorizing the Commissioner to set the legal reserve up to 30% of obligations payable on sight).

³⁷ *Id.* at § 35 (It is worth noting that § 35 authorizes the Commissioner to require a larger amount of capital if he/she deems it convenient and beneficial for the public interest. If a bank is organized in this manner, the reserve fund required must be at least 20% of the capital).

³⁸ *Id.*

³⁹ See Federal Deposit Insurance Act, 12 U.S.C. §§ 1813(a)(3), 1815(a)(1) (2016).

B. Legislation to Attract Banking Practices to Puerto Rico

1. *International Banking Center Regulatory Act of 1989*

Puerto Rico's political status as an unincorporated territory of the U.S. has been for decades a reason for local lawmakers to get creative and enact laws to attract foreign investments. The International Banking Center Regulatory Act of 1989 (Act 52)⁴⁰ was one of these efforts. Act 52 was enacted to allow banks and other entities to engage in banking activities in Puerto Rico through an International Banking Entity (IBE). Act 52 defined IBEs as "any person other than an individual who is incorporated or organized under the laws of Puerto Rico to which a license has been given under Section 232(c) of [the] Act."⁴¹

Given that for certain banking matters Puerto Rico is considered an international jurisdiction, entities that organize under Act 52 would be able to stay clear of FRB jurisdiction if they abstain themselves from certain practices. As previously discussed, the BHC Act will apply to banks in Puerto Rico if they accept deposits from U.S. residents and if the requisites for a BHC under the BHC Act are present. Therefore, if the BHC Act doesn't apply, IBEs wouldn't be subject to FRB regulation.

2. *International Financial Center Regulatory Act of 2012*

In 2012, the Puerto Rican government enacted the International Financial Center Regulatory Act of 2012 (Act 273).⁴² The enactment of Act 273 was another effort by the government to boost Puerto Rico's economy. Act 273 builds on Act 52 by expanding the previous benefits of IBEs to International Financial Entities (IFE) with the objective of attracting U.S. and foreign capital to Puerto Rico.

Under Act 52, IBEs received a different tax treatment than the ones afforded to IFEs. The benefits to IBEs were given to the entities by operation of law, which meant that they could be modified or repealed at any time by the legislature. Under Act 273, licensed IFEs would secure their tax benefits as contractual rights for a fifteen (15) year period, regardless of any future changes in Puerto Rico's laws. This provides the eligible entities with supplemental assurance that their benefits will not be taken away, thereby providing a boost in confidence for these firms to make the necessary investment to start or move their operations to the Commonwealth.

Act 273 authorizes IFEs to engage in traditional banking and financial transactions with non-residents of Puerto Rico, albeit with some exceptions.⁴³ Act

⁴⁰ International Financial Center Regulatory Act of 1989, Act No. 52 of August 11, 1989, 7 L.P.R.A. § 232(r) (2010).

⁴¹ *Id.*

⁴² International Financial Center Regulatory Act of 2012, Act No. 273-2012, 7 L.P.R.A. §§ 3081-3106 (2013).

⁴³ An IFE under Act 273 may, among other things, make or place deposits with certain Puerto Rico government entities, participate in granting and/or securing loans that originate from certain Puerto Rico government entities, and buy bad loans from banks in Puerto Rico. Article 12 of Act 273 regulates the permitted and prohibited activities of IFEs. For the complete list of permitted and

273 encompasses a wider variety of permitted transactions than those previously authorized to IBEs. Existing IBEs benefitting from the previous Act 52, may elect to continue taking advantage of the benefits provided by it, or they may voluntarily convert to an IFE. By converting to an IFE, an IBE will be able to expand its operations to include more of the eligible IFE activities permitted under Act 273 and obtain a tax grant for it.

Act 273 allows any entity organized under the laws of Puerto Rico, the U.S., or any foreign country to request from the Office of the Commissioner of Financial Institutions (OCFI) a license to be organized as an IFE.⁴⁴ For the license to be approved, the IFE must employ a minimum of four (4) full-time persons at its business office in Puerto Rico, unless the Commissioner authorizes a lesser number at the request of the interested party.⁴⁵ An IFE must also obtain office space within the Commonwealth, where it will conduct its business activities with the required personnel and maintain the necessary documents and records.

In the case of a corporation, the IFE would be required to have authorized capital stock of not less than five million dollars (\$5,000,000.00) and two hundred fifty thousand dollars (\$250,000.00) of paid-in-capital, unless the Commissioner authorizes a lesser amount. Such capital shall be paid in full at the time the license is issued.⁴⁶ Moreover, every financial institution must possess and maintain in Puerto Rico not less than three hundred thousand (\$300,000.00) in unencumbered assets or financial guarantees acceptable to OCFI, unless the Commissioner authorizes a lesser amount.⁴⁷

Once an entity meets these requirements, it may apply to OCFI for a permit to organize itself as an IFE. Once the permit is granted, the IFE shall file with the Puerto Rico State Department its articles of incorporation, or any other document that establishes the legal status of the entity, along with a copy of the permit. The Puerto Rico State Department will then issue a certification under its official seal, which has to be submitted to OCFI, indicating that the documents have been filed. After this process, the Commissioner will issue or deny the IFE license.

Once the IFE license is issued by the Commissioner, the IFE may submit a copy of it to the Secretary of Economic Development and Commerce to request the grant exemption. The grant is then issued by the Secretary of Economic Development and Commerce after obtaining a favorable recommendation from the Secretary of the Treasury of Puerto Rico. The tax grant will be extended for a period of fifteen (15) years, which can be renewed for two additional fifteen (15) year terms, again, depending on the favorable recommendation of the Secretary of the Treasury.⁴⁸ For the extensions to be granted, the IFE must request them six (6) to twenty-four (24) months before the end of the applicable fifteen (15) year term.

prohibited activities, *see* International Financial Center Regulatory Act of 2012, Act No. 273–2012, 7 L.P.R.A. §§ 3091.

⁴⁴ 7 L.P.R.A. § 3084(a).

⁴⁵ *Id.* § 3092(a).

⁴⁶ *Id.* § 3084(b)(3)(A).

⁴⁷ *Id.* § 3087(a)(7).

⁴⁸ *Id.* § 3087(e).

During the fifteen (15) year period, the IFE organized under Act 273 will be subject to a fixed four percent (4%) Puerto Rico income tax rate on the net income derived by the IFE from its eligible activities. The IFE will also benefit from a full property tax exemption, which includes tangible and intangible property belonging to the IFE, and from a Municipal License tax exemption. Furthermore, when an extension is requested, the IFE's applicable tax rate may increase from four (4) percent up to ten (10) percent. The Secretary of Economic Development and Commerce, upon recommendation of the Commissioner and the Secretary of the Treasury, will determine the tax rate that better protects the socioeconomic interests of Puerto Rico.⁴⁹

The shareholders of the IFE also receive beneficial tax treatments under Act 273. Puerto Rico resident shareholders or partners of an IFE will be subject to a six percent (6%) tax rate on the dividends or benefits of the net income of the IFE, including the alternate basic tax and alternative minimum tax. Yet, any non-Puerto Rico resident will have a full Puerto Rico income tax exemption on the IFE's distributions.⁵⁰

As previously mentioned, the tax grant provided to an IFE under Act 273 is of a contractual nature between the IFE and the government of Puerto Rico.⁵¹ Lawmakers designed it this way to ensure that the IFE will be entitled to the tax exemption until the grant expires, even if there are changes in the laws of the Commonwealth. However, the Commissioner has the power to revoke, suspend, or not renew the tax grant. Pursuant to Section 18 of Act 273, the Commissioner can revoke the license of any IFE and impose heavy penalties for violations of the provisions of the Act. Act 273 even imposes the possibility of jail time to any official or employee that participates in prohibited activities.⁵²

As we can see, it is a complicated process with multiple steps and government entities involved. Nevertheless, the benefits derived from being organized as an IFE under Act 273 are well worth the effort when we take into consideration the eligible activities that they will be able to participate in and the favorable tax considerations that the IFE will be able to take advantage of. The permitted and prohibited activities for an IFE are set forth in section 12(a) of the Act.⁵³

Another benefit for IFEs is that, upon authorization by the Commissioner, they are allowed to establish branches outside of Puerto Rico, either in the U.S. and its possessions, or in other foreign countries, provided that these branches do not accept any kind of deposit.⁵⁴

For someone considering to apply for a license to do business as an IFE under Act 273, certain facts may seem attractive to them. For instance, Section 4 of Act 273 expressly prohibits the Commissioner to establish interest rates to be paid or charged by an IFE. Additionally, it does not empower the Commissioner to

⁴⁹ 7 L.P.R.A. § 3087(e) (2013).

⁵⁰ *Id.* § 3085(i).

⁵¹ *Id.*

⁵² For a full list of the permitted and prohibited activities under Act 273, see 7 L.P.R.A. §§ 3091 (2013).

⁵³ *Id.*

⁵⁴ 7 L.P.R.A. § 3091(a)(22)(A).

establish lending limits or to maintain reserves over its deposits.⁵⁵ Furthermore, Section 19 of the Act provides that all the information submitted by the IFE to the Commissioner will be treated as confidential. The Commissioner cannot reveal any of the information unless there's a written court order from a court of competent jurisdiction or a formal order from a governmental agency in the course of its supervising powers, when the Commissioner understands that such action is in the best public interest.

Act 273 also considers certain aspects of Federal banking laws. For one, Section 8(f) provides that the holder of an IFE license shall:

- (1) Adopt the business policies and procedures to ensure that the international financial institution complies with the applicable state and federal laws, including this chapter, the Bank Secrecy Act, and the USA Patriot Act;
- (2) faithfully comply with the applicable state and federal laws and the regulations applicable to the international financial institution, including this chapter, the Bank Secrecy Act, and the USA Patriot Act;
- (3) file currency transaction or suspicious activity reports required by the Bank Secrecy Act and the USA Patriot Act, when necessary, and
- (4) follow the practice rules and procedures that are necessary in the business to meet the requirements of OFAC, as applicable.⁵⁶

These additional safeguards should be viewed as a vote of confidence for anyone who intends to invest in an IFE under Act 273. Another attractive reality for an entity to organize as an IFE under Act 273 is the fact that the entity will have access to the United States judicial system through the U.S. District Court for the District of Puerto Rico. In addition, the close economic relation between Puerto Rico and the U.S. gives IFEs a solid opportunity for financial success.

It is also worth mentioning that since Puerto Rico does not have a central bank, it relies on the U.S. Federal Reserve System. According to DLA Piper, the Federal Reserve Bank of New York has already opened banking accounts to IFEs

⁵⁵ Nevertheless, Section 4 provides that “in the case of licensed international financial institutions expressly authorized to receive deposits in accordance with Section 12(a)(1) and (2), the Commissioner may establish reserve requirements, that in no case shall exceed 20% of the total demand deposits maintained by the international financial institution (except for the demand deposits maintained by the Government Development Bank for Puerto Rico and the Economic Development Bank for Puerto Rico that are duly secured by cash collateral.) The Commissioner shall establish the reserve requirements, computation method, and other details in the licenses concerned or the regulations, circular letter, or any other written communication.” 7 L.P.R.A. § 3083 (2013).

⁵⁶ *Id.* at § 3087(f).

organized in Puerto Rico under Act 273.⁵⁷ As such, an IFE may become a client of the Federal Reserve Bank of New York, which does not equal to the entity being a member of the Federal Reserve System or being regulated by the Federal Reserve. Thereby, and in the same way it worked under Act 52, as long as the IFE is not a banking subsidiary of a BHC, there is no requirement for the IFE to have its deposits insured by the FDIC.⁵⁸

3. *Positive Outlook for the Sector*

Per the Statement of Motives of Act 273, as of June 30, 2011, there were thirty-one (31) IBEs, with total assets of around \$43.6 billion and only five (5) entities holding tax exemption decrees to render financial services to foreign markets. In a 2015 interview, the former Commissioner of OCFI, Mr. Rafael Blanco, stated that at that moment there were thirty-two (32) IBEs and eighteen (18) IFEs.⁵⁹ According to him, those thirty-two (32) IBEs had a capitalization of \$5.77 billion and total assets worth \$50.3 billion. By these figures, in just over two years after Act 273 was enacted, there was an increase in total assets of IBEs in Puerto Rico of \$6.7 billion. Moreover, on an August 2017 note, Bloomberg Businessweek reported that there were forty-four (44) IFEs at the moment, “with 18 opening in the past year.”⁶⁰

Since the enactment of Act 273 these figures keep rising. By the end of 2016, IBEs accounted for \$60.2 billion in total assets.⁶¹ This is an increase of over \$16.6 billion or twenty eight percent (28%) in total assets in the period of four (4) years that the act has been enacted. By the same token, IFEs totaled \$848 Million by the end of the second quarter of 2017, up \$150 Million from the end of 2016.⁶² For a territory whose economy has been struggling for years, to see that there is a space growing at this pace is an astonishing thing. One can only hope that this trend continues and helps improve the economy as the Commonwealth struggles to get out of its current fiscal situation.

It is worth noting that in hopes of boosting economic growth, the Puerto Rican government seeks to create an interplay between Act 273 and the Act to

⁵⁷ Ileana Fernández-Buitrago & José A. Sosa-Llorens, *International Financial Entities in Puerto Rico*, DLA PIPER: PUBLICATIONS, (Jan. 18, 2017), <https://www.dlapiper.com/en/us/insights/publications/2017/01/international-financial-entities-in-puerto-rico/> (last visited Jun. 15, 2018).

⁵⁸ *Id.*

⁵⁹ Ely Acevedo Denis, *Empresas que tienen a P.R. de paraíso fiscal manejan sobre \$50 mil millones*, NOTICEL (Jul. 21, 2015, 04:00 AM AST), <http://www.noticel.com/noticia/178517/empresas-que-tienen-a-p-r-de-paraíso-fiscal-manejan-sobre-50-mil-millones.html#comment-2149744335>.

⁶⁰ Tom Metcalf, *Could Puerto Rico Be the Next Hot Tax Haven?*, Bloomberg Newsweek (Aug. 22, 2017, 5:00 AM), <https://www.bloomberg.com/news/articles/2017-08-22/could-puerto-rico-be-the-next-hot-tax-haven>.

⁶¹ OFFICE OF THE COMMISSIONER OF FINANCIAL INSTITUTIONS OF PUERTO RICO, REPORT ON INTERNATIONAL BANKING ENTITIES (2018) <http://www.ocif.gobierno.pr/documents/Q2-2013/ibe.pdf>. For a copy of the graph prepared by the OCFI detailing the assets to capital ratio of IBEs, see, *infra*, Figure 1. Assets to Capital Ratio of International Banking Entities in Puerto Rico.

⁶² Metcalf, *supra* note 60.

Promote the Transfer of Individual Investors to Puerto Rico of 2012 (Act 22).⁶³ By making use of both these Acts, an individual that becomes a bona-fide resident of Puerto Rico, as defined by the Act, will be fully exempt from Puerto Rican income tax under Act 22 and from applicable U.S. income tax for the dividends received from the Act 273 entity.⁶⁴

CONCLUSION

Some federal banking laws consider Puerto Rico an international jurisdiction, while others consider it a state. As discussed, the complicated political status of the Commonwealth can also be the catalyst for positive developments and provide a competitive advantage. The ambiguous status has permitted Puerto Rico to enact laws that consider U.S. and other foreign IBEs and IFEs as foreign entities in the Commonwealth. This has allowed them to set up operations in Puerto Rico and take advantage of favorable tax rates. These entities are getting benefits like tax havens around the world, while still being in a U.S. jurisdiction, and being able to rely on the U.S. court system and the U.S. currency.

Act 273 was enacted to expand the service sector, generate jobs, and grow the economic activity of Puerto Rico. Whether that has happened is yet to be seen.

The licensing requirements set forth in Act 273 are fairly simple to comply with. The biggest hurdle to setting up these entities is establishing correspondent relationships with other banks, which IBEs and IFEs need in order to send or receive money from around the world.⁶⁵ Furthermore, apart from operating an office with at least four (4) full-time employees and having a paid-in capital of two hundred and fifty thousand dollars (\$250,000.00) in order for IBEs and IFEs to be eligible for the tax grant, the reality is that the local population might not be reaping many benefits from this surge of international entities flocking to Puerto Rico. Therefore, even though Act 273 gives entities the potential to save millions by setting up shop in the Commonwealth, it doesn't ask a lot in return from the institutions that would help spark economic growth. Because of this, it is safe to conclude that Act 273 certainly has its flaws. Nevertheless, it is a positive thing to see that an economic segment of the Commonwealth is seeing some growth.

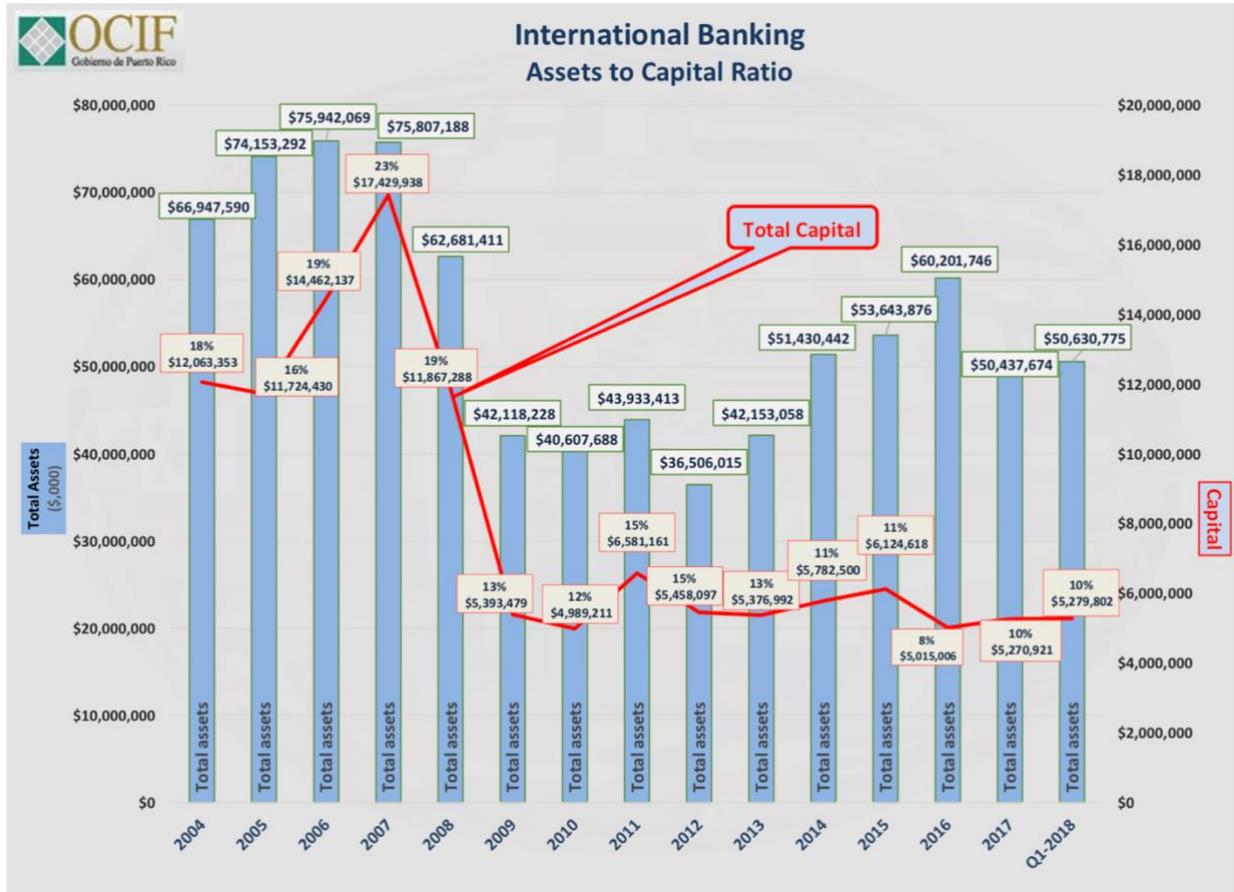
Puerto Rico's status, for better or worse, permits its government officials to get creative when promulgating legislation. To this point, the Commonwealth has offered banking entities a positive environment where it basically lets them decide to which regulatory and supervisory authorities they want to subject themselves to, depending on how they organize their entities.

⁶³ Act to Promote the Transfer of Individual Investors to Puerto Rico, Act No. 22-2012, 13 L.P.R.A. §§ 10844-10855 (2012).

⁶⁴ Fernández-Buitrago & Sosa-Llorens, *supra* note 57.

⁶⁵ Acevedo Denis, *supra* note 59.

FIGURE 1. ASSETS TO CAPITAL RATIO OF INTERNATIONAL BANKING ENTITIES IN PUERTO RICO⁶⁶



⁶⁶ OFFICE OF THE COMMISSIONER OF FINANCIAL INSTITUTIONS OF PUERTO RICO, REPORT ON INTERNATIONAL BANKING ENTITIES (2018) <http://www.ocif.gobierno.pr/documents/Q2-2013/ibe.pdf>.