

**DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK**

**NON SOVEREIGN GUARANTEED OPERATIONS USE OF FOREIGN ENTITIES  
GUIDELINES**

**This document was prepared by the Office of Institutional Integrity, which helped to produce this document.**

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## Non Sovereign Guaranteed Operations Use of Foreign Entities Guidelines

### Background

1. The purpose of this Guideline, which replaces GN-2341-1 and OP-597-1, is to describe steps that shall be taken when a Foreign Entity (as defined below) is used in connection with non-sovereign guaranteed operations.
2. The IDB Group has taken note of international developments in offshore finance. As part of the international finance community, it is making efforts to ensure that staff involved in lending operations is aware of such developments and to harmonize and update its guidelines and procedures.
3. While Offshore Financial Centers (“OFCs”) may facilitate private investment and economic development by accommodating legitimate investment concerns, the risks posed by OFCs have been recognized in various international and national fora.<sup>1</sup> Those risks include, *inter alia*, capital flight from poor countries, avoiding law enforcement through non-transparent structures, public corruption, money laundering, terrorist financing, harmful tax practices that undermine fair competition and public confidence in tax systems, and harm to the global financial system.<sup>2</sup>
4. The IDB Group, in the context of its NSG operations, generally avoids the risks posed by OFCs by providing financing to companies that are incorporated in the countries where the projects are located. In some cases, however, ownership in the private entity that receives IDB Group financing is held through one or more legal entities incorporated in a

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<sup>1</sup> A June, 2000 IMF background paper on OFCs stated:

OFCs can be used for *legitimate reasons*, taking advantage of: (1) lower explicit taxation and consequentially increased after tax profit; (2) simpler prudential regulatory frameworks that reduce implicit taxation; (3) minimum formalities for incorporation; (4) the existence of adequate legal frameworks that safeguard the integrity of principal-agent relations; (5) the proximity to major economies, or to countries attracting capital inflows; (6) the reputation of specific OFCs, and the specialist services provided; (7) freedom from exchange controls; and (8) a means for safeguarding assets from the impact of litigation etc.

They can also be used for *dubious purposes*, such as tax evasion and money-laundering, by taking advantage of a higher potential for less transparent operating environments, including a higher level of anonymity, to escape the notice of the law enforcement agencies in the "home" country of the beneficial owner of the funds.

International Monetary Fund (IMF), *Offshore Financial Centers*, background paper (June 23, 2000).

<sup>2</sup> See, e.g., *Tax Havens and Development*, Official Norwegian Reports 2009:19 (June 18, 2009); United Nations (U.N.), Office for Drug Control and Crime Prevention, Global Programme Against Money Laundering, *Financial Havens, Banking Secrecy and Money Laundering* (1998); International Monetary Fund (IMF), Monetary and Capital Markets Department and Legal Department, *Offshore Financial Centers: A Report on the Assessment Program and Proposal for Integration with the Financial Sector Assessment Program* (May 8, 2008); the G20, *Declaration on Strengthening the Financial System* (2 April, 2009, London).

jurisdiction other than the project host country (each a “Foreign Entity”). In other cases, a Foreign Entity is used to receive or channel the financing provided by the IDB Group. Information regarding the involvement of a Foreign Entity in NSG operations is gathered through project due diligence and integrity due diligence. Several OFC Lead Organizations have been producing information on progress made by jurisdictions regarding the enforcement of financial and tax regulations. When a Foreign Entity is organized in a jurisdiction identified in lists, classifications or other public statements prepared by OFC Lead Organizations, it may present heightened risk to the IDB or its member countries.

5. In order to address risks that may arise from the use of a Foreign Entity organized in a jurisdiction identified in lists, classifications or other public statements prepared by OFC Lead Organizations, IDB Group Windows<sup>3</sup> will take the following steps in connection with each NSG operation:
  - i. Determine whether a Foreign Entity is used in connection with the NSG operation;
  - ii. Determine whether any such Foreign Entity is organized in a jurisdiction identified in lists, classifications or other public statements prepared by OFC Lead Organizations;
  - iii. Assess the risk presented by such Foreign Entity;
  - iv. Take measures to mitigate any such risk, as appropriate; and
  - v. Disclose the use of any such Foreign Entity used in connection with the NSG operation.

### **Use of a Foreign Entity**

6. In connection with each NSG operation, the Window shall determine whether a Foreign Entity shall be used by determining whether:
  - i. The legal entity receiving IDB Group financing is a Foreign Entity;
  - ii. The legal entity receiving IDB Group financing has one or more Principal Shareholders<sup>4</sup> that is a Foreign Entity, or is otherwise controlled<sup>5</sup> by a Foreign Entity;
  - iii. The legal entity receiving IDB Group financing has one or more wholly-owned subsidiaries that is a Foreign Entity; or

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<sup>3</sup> The IDB Group Windows (“Windows”) are the Structured and Corporate Finance Department and the Opportunities for the Majority Sector of the Inter-American Development Bank, the Multilateral Investment Fund, and the Inter-American Investment Corporation.

<sup>4</sup> A “Principal Shareholder” is one that owns, directly or indirectly, 20% or more of the company.

<sup>5</sup> Control means the power to, directly or indirectly, direct or cause the direction of the management and policies of companies or projects, whether through the ownership of voting shares, by contract or otherwise. Control will be determined in the context of each specific transaction structure and could include majority ownership of voting shares, other control mechanisms (such as “golden shares,” veto rights or shareholders’ agreements requesting special majorities) or, in the case of investment fund financing, the control exercised by a general partner or fund manager.

- iv. Any other beneficiary of an IDB Group financing or any obligor to an IDB Group entity in connection with a financing (*e.g.*, a guarantor) is a Foreign Entity.

### **Determining if a Foreign Entity is Organized in a Jurisdiction Identified by OFC Lead Organizations**

7. If a Foreign Entity is used in an NSG operation, the Window shall determine whether the Foreign Entity is organized in a jurisdiction identified in lists, classifications or other public statements prepared by OFC Lead Organizations. Such information will be maintained and updated by the Office of Institutional Integrity.

### **Assessing OFC Risk**

8. If a Foreign Entity used in an NSG operation is organized in a jurisdiction identified in lists, classifications or other public statements prepared by OFC Lead Organizations, the Window shall assess the risk presented by the use of that Foreign Entity.
9. While the lists of the OFC Lead Organizations provide guidance regarding the risk, in the context of a particular project, the risk presented may vary depending on the project and/or the Foreign Entity.

### **Mitigating OFC Risk**

10. If a Foreign Entity used in an NSG operation is organized in a jurisdiction identified in lists, classifications or other public statements prepared by OFC Lead Organizations, the Window shall take measures to mitigate any risk presented by the use of that Foreign Entity, as appropriate.<sup>6</sup>

### **Disclosure**

11. If a Foreign Entity organized in a jurisdiction identified in lists, classifications or other public statements prepared by OFC Lead Organizations is used in connection with an NSG operation, the Window shall disclose that fact in management level project documents and Board/ Donors Committee level project documents. Such disclosure shall provide:
  - i. the name and place of incorporation of the Foreign Entity;
  - ii. a Foreign Entity Rationale;
  - iii. a description of the external list(s) and classification(s) referenced;
  - iv. a description of any mitigation measures taken in connection with this operation; and
  - v. the Window's assessment of the risk presented.

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<sup>6</sup> Mitigation measures will depend on the risk presented, but may include: (i) requiring beneficiaries of an OFC structure to represent that they will pay all appropriate taxes; (ii) requiring an opinion from outside counsel that the pricing of related party transactions complies with applicable laws; or (iii) requiring that a Foreign Entity organized in a jurisdiction identified in lists, classifications or other public statements prepared by OFC Lead Organizations relocate its domicile.

12. Examples of Foreign Entity Rationales that are generally adequate include:
  - i. The Foreign Entity is the same nationality as the primary sponsor or shareholder(s);
  - ii. The Foreign Entity avoids double taxation for investors from different jurisdiction;
  - iii. The judicial system applicable to the Foreign Entity allows for more reliable enforcement of contracts than that of the project host country; or
  - iv. The jurisdiction of incorporation of the Foreign Entity provides legal features that are not available in the project host country, for example:
    - a. The proposed investment vehicle structure (*e.g.*, LLCs) does not exist under the law of the project host country;
    - b. Certain agreements – like shareholders agreements or put options – are unenforceable under the law of the project host country;
    - c. Security arrangements are unenforceable – or have inefficient or uncertain enforcement – under the law of the project host country; or
    - d. Foreign judgments are unenforceable – or have inefficient or uncertain enforcement – under the law of the project host country.

### **Role of the Office of Institutional Integrity**

13. The Office of Institutional Integrity shall, in coordination with the Office of Risk Management, serve as an advisory resource to the Windows regarding the assessment of the risks presented to NSG projects by OFCs, and the design of adequate mitigation measures. Windows may consult with the Office of Institutional Integrity regarding any OFC issue.
14. The Office of Institutional Integrity shall monitor the lists, classifications and/or public statements relevant to OFC matters made by OFC Lead Organizations and maintain updated information.
15. The Office of Institutional Integrity will share with VPS and VPC, as appropriate, any information gathered through this OFC disclosure process that the Office of Institutional Integrity considers could inform technical assistance or other support for borrowing member countries through SGO interventions.
16. The Office of Institutional Integrity will consult with other IDB Group entities with regard to OFC developments, as appropriate.

### **Monitoring/ Reporting**

17. Windows shall monitor all NSG operations for changes in OFC risk on an ongoing basis throughout the project cycle.
18. Windows shall report any OFC issues that arise in connection with portfolio operation to the Board/ Donors Committee in accordance with their other portfolio reporting obligations.

## **Lessons Learned**

19. Management shall report to the Board/ Donors Committee regarding implementation of this Guideline, and any lessons learned, three years from the approval of this Guideline.

## **Definitions**

Foreign Entity: A Foreign Entity is a legal entity organized in a jurisdiction other than the project host country.

Foreign Entity Rationale: A Foreign Entity Rationale is a rationale for using a Foreign Entity rather than an entity established in the project host country.

OFC Lead Organizations: The OFC Lead Organizations are the Financial Action Task Force, the Global Forum on Transparency and Exchange of Information for Tax Purposes, the Organization for Economic Cooperation and Development, and the Financial Stability Board.