

International Banking and Financial Center Reform

ATTORNEYS

- Arturo J. García-Solá
- Ernesto N. Mayoral
- Rubén Méndez-Benabe
- Paul R. Cortés-Rexach
- Ricardo J. García-Negrón
- Yamary I. González-Berríos
- Lizzie M. Portela-Fernández
- Carla S. D'Almeida-Aracena
- Rica López de Alós
- Melba I. Acosta-Febo
- María Cristina Salas-Díaz
- Fabio Jiménez-Cadena
- Kristina S. Rodríguez-Evans

PRACTICE AREAS

- International Banking and Financial Entities (IFEs and IBEs)

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On February 16, 2024, the Governor of Puerto Rico signed into law House Bills No. 1699 and No. 1700, to approve Acts No. 44-2024 and No. 45-2024, respectively.

The International Financial Center Regulatory Act (Act 273-2012), which governs International Financial Entities ("IFEs"), was amended by Act No. 44-2024. These amendments significantly reform both laws and are designed to strengthen the regulation and oversight of IBEs and IFEs "to modernize and strengthen both, make them stronger, more efficient, more resilient and better prepared to face changes in the markets and ensure that the international banking and financial entities are solvent and solid, operate competitively and responsibly and contribute to the Island's economic growth for the benefit of everyone in Puerto Rico", as set forth by the Puerto Rico Commissioner of Financial Institutions (the "Commissioner") in a press release issued on February 19, 2024.

Some of the fundamental amendments that affect both IBEs and IFEs are as follows:

- **Capital:**
 - Minimum paid-in capital:
 - Existing IFEs and IBEs: Must increase their paid-in capital in a staggered manner until they reach the required \$10 million. Each entity shall submit an individual capital plan subject to the approval of the Commissioner.
 - *De novo* IFEs: the minimum initial paid-in capital requirement is increased to \$10 million, which must be paid in full at the time the license is granted.
 - The amount of paid-in capital may never be less than 10% of the deposits accepted by the IFE/IBE unless the deposits are insured.
 - The capital must always comply with the regulatory definition of "well capitalized", according to standards established in the federal regulations of the federal supervisory agencies, as they are applicable based on the activities carried out by the entity, or those capital levels provided in the regulations, circular letters or guidance issued by the Commissioner.

■ **Unencumbered Assets:**

- As a requirement to obtain the respective license, the entities, in addition to the \$10 million in initial paid-in capital, must maintain unencumbered assets with local banks in Puerto Rico.
- For existing IFEs and IBEs, the value of the unencumbered assets will increase in the following staggered manner for each of the following license renewal years:
 - Year 2024-2025: \$500,000
 - Year 2025-2026: \$750,000
 - Year 2026-2027: \$1,000,000
 - Year 2027-2028: \$1,500,000
- *De novo* IFEs (that organize after the effective date of these amendments) must have at least \$1 million in unencumbered assets.

■ **Employees:**

- Both IFEs and IBEs must:
 - Employ a minimum of 8 full time employees in their offices located in Puerto Rico.
 - Provide annual training, paid for by the employer, in compliance with the laws of Puerto Rico and the United States, related to money laundering, financing of terrorism, among other laws or measures relevant to the industry.
- For IFEs:
 - At least 2 employees must be part of the compliance department.
 - Must employ a full-time compliance officer and those additional people who are necessary to support the functions of a department of compliance that is totally autonomous.

■ **Independent Directors:**

- The entities are required to have, as a member of the Board of Directors, an independent director that has no economic interest, nor banking, commercial, business, consulting, family, or legal relationship, among others, with the entity, or the owners of the entity, and is not an employee of the entity or part of its management group.

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- **License Renewal:**
 - The annual license fee to operate an IFE and IBE, effective January 1, 2024, will be:
 - \$25,000 for each annual license renewal
 - \$5,000 for each additional office or branch
 - The annual license renewal application and fee are due 30 days prior to the expiration date of the license.
 - Stringent sanctions and penalties will be imposed for late renewals.
 - The license renewal application shall comply with new requirements, including but not limited to, providing details on material changes since the initial application or previous license renewals, evidence of maintaining required capital and unencumbered assets, payment of renewal fees, an auditor's report on BSA and OFAC compliance programs, and an affidavit from the CEO certifying various aspects of compliance with regulations.

- **Books and Records; Main Center of Operations; Records Retention**
 - In addition to keeping the books and records of the IFEs and IBEs in Puerto Rico, the administration and main operations (including management, accounting and compliance) of such entities must be carried out in their principal offices in Puerto Rico.
 - IFEs and IBEs shall submit annual reports of their financial conditions and results of their operations within 90 days of the closing of each fiscal year
 - IFEs and IBEs can destroy their books, records, files, or documents, after 5 years since the last entry within said books, records, files, or documents, or since the date any obligation ceased being enforceable, according to the documents themselves. The entities must keep an annual registry of the documents destroyed, which shall be retained for a period of 15 years from December 31st of the year corresponding to each annual registry. Prior to January 31st of each year, an official of the IFE or IBE shall certify that the annual registry pertaining to the year before contains the information required for every document that was destroyed during the previous year.

Some of the fundamental amendments applicable exclusively to IBEs are as follows:

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■ **Transfers of Capital or Control of an Entity:**

- No transfers of equity or control of an IBE may be carried out without the prior written authorization of the Commissioner, if through said transaction a person could directly or indirectly acquire control of 10% or more of any class of capital shares, or participations in the capital of an IBE.
- Such requests for approvals are subject to a non-refundable fee of \$35,000.
- Any excess costs resulting from the Commissioner's investigation will be paid by the applicant in advance.

■ **Legal Reserve:**

- For IBEs authorized to accept deposits, the Commissioner may establish legal reserve requirements that in no case may exceed 20% of the total deposits payable on demand maintained by the IBE.
- In such event, the Commissioner will establish the requirements for the composition of the reserve, the method of calculation, and other details of the reserve.

Some of the fundamental amendments applicable exclusively to IFEs are as follows:

■ **New Permit and License Applications:**

- Only legal entities (no individuals) may apply to the Commissioner for a permit to organize an IFE.
- New applications will be charged a non-refundable fee of \$50,000 to cover the initial investigation costs. Applicants would have to pay for expenses exceeding \$50,000 resulting from any investigation of an application.
- In its investigation, the Commissioner will request personal and business information from any person who directly or indirectly owns or control any participation in the capital of an IFE. Such persons are required to submit their financial statements and personal history statements. As such, the requirement of information would no longer apply solely to those who possess or control 10% or more of the interest in the entity's capital.
- The Commissioner may request the full name, primary address, marital status, background checks, social security or its equivalent, and passport number of each director, executive officer, or employee that the Commissioner deems pertinent.

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- Applicants will also be required to submit evidence of the minimum paid-in capital, source of funds and availability of the unencumbered assets.
- Only *persons*, other than individuals, that are organized and incorporated under the laws of Puerto Rico, the United States, or its states or territories will be allowed to operate as IFEs in Puerto Rico. Only in those cases in which the Commissioner authorizes it, an IFE can be a unit of another person, other than an individual, incorporated or organized under the laws of Puerto Rico, the United States, or its states or territories.
- The Commissioner may deny issuance of a license upon the understanding that the proponent of the IFE lacks financial responsibility, aptitude, character, or experience.
- The Commissioner may also deny issuing licenses or license renewals due to insolvency of the entity or conviction of an entity's investors or directors for felonies such as fraud, tax evasion, among others.
- An application that is incomplete and has not been completed within a term of 30 days (or as such term is extended by the Commissioner), counted from receipt of an incomplete application notice from the Commissioner, will be deemed to have been voluntarily withdrawn.
- **Licenses and Renewals:** The annual license fee to operate an IFE, effective January 1, 2024, will be:
 - \$50,000 for the original license.
 - \$25,000 for each annual license renewal and \$5,000 for each additional office or branch.
 - The annual license renewal application and fee are due 30 days prior to the expiration date of the license.
 - Penalties and sanctions will be imposed for late renewals.
- **Transfers of Capital or Control of an IFE:**
 - Regardless of the amount or percentage involved, any transfer of capital shares or capital participations of an IFE will be void if the prior written authorization of the Commissioner is not obtained.
 - IFEs must include with the application a payment of \$25,000 for research.
 - Any application OR request for transfer of capital or control to a non-affiliated entity that results in a direct or indirect ownership of 10% or more, for the first time, will be subject to payment of a non-refundable application fee of \$50,000.

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- **Change in Allowed and Prohibited Transactions:**

- IFEs and IBEs may act as custodians of virtual assets and currencies, with prior request for determination of “no objection” from the Commissioner.
- Nonetheless, IFEs and IBEs may not operate as an exchange of virtual currencies or digital assets.

- **Examinations:**

- The Commissioner may conduct examinations or audits of the operations of any IFE.
- The entities shall provide accounting books, files, records, documents, and any requested information, except information that is protected by attorney-client privilege.

Both acts will become effective 90 days after their approval (i.e., on May 16, 2024).

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