

Anthony Travers Speech
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In analysing the options for the future direction of our finance services industry there is no doubt that as a result of the global financial meltdown we are facing a fundamentally changed set of financial and regulatory circumstances. Keynes once said "When circumstances change I change my mind: what do you do?" It would be unreasonable to suppose that we do nothing. The high transactional volume, low profit per transaction model if not broken for the foreseeable future is at least substantially impaired. So the question that I will address is: how do we manage the development of the financial industry so it becomes an Apple and not an Edsel? To better understand what we should do I would first like to drill down to analyse how we are regarded by most of the G20 jurisdictions and why. We need to understand firstly where we sit in the spectrum of opinion and the reasons for the constant opposition and negativity which we face. I will then take a look at which of the changed circumstances in the global economy will have a material bearing on the Cayman Islands financial services industry and how we should position ourselves going forwards to improve our acceptance and viability.

We cannot deal effectively with the tidal wave of mischaracterisations and misperceptions that, with a seemingly metronomic regularity, threaten to engulf the offshore financial world, and particularly the Cayman Islands as one of its more successful jurisdictions, unless we understand the sources and justifications that drive the negativity. Only the naïve would attribute this to coincidence. I happen to agree on this point with '50 cent' when he raps "Everything happens for a real reason".

In my view, the sources of negativity can be broken down into three distinct groups.

The first group comprises small but disproportionately vocal bodies often of only one or two invariably disturbed individuals who have mastered the art of operating a blog site and who appear pathologically wedded to the notion that high taxation is a solution to global poverty. This is a doctrinaire belief to which they are entitled. What they are not entitled to do is present fictitious statistics about the extent of tax evasion or tax avoidance in the Cayman Islands which are designed to support their position. These individuals are very often supported by charities like Oxfam and by trade unions all of which share the common belief in large Government, a large public sector and high levels of social welfare spending. The fallacy in the positions of these groups is not simply the fanciful and unverifiable tax dollars that they suggest may be raised from dealing with tax evasion or tax avoidance in the Cayman Islands but the delusional notion that whatever monies are raised from increased levels of taxation globally will in some unspecified way necessarily be applied to reduce poverty in Africa.

This is simply an unrealistic objective given the extent of G20 debt, the interest service of which may rise to 20% of GDP within 20 years in certain countries. In my view, the effectiveness of these social activists is diminishing. Ironically, I conclude that, provided we continue to assert actively the truth of our position through our comprehensive public relations campaigns, it is unlikely that these groups will withstand the tax transparency that the Cayman Islands is now demonstrating because with transparency come the verifiable and positive statistics that show tax evasion in Cayman to be statistically irrelevant. I am pleased to be followed this morning by Richard Teather who will deal comprehensively with the mistaken belief that high taxation reduces poverty and show it to be a doctrine that is fundamentally flawed.

Whilst these groups may be increasingly irrelevant, the second source of public relations negativity is indicative of well organised and powerful public relations campaigns driven by onshore Treasury, supranational and domestic regulatory bodies which in turn are driven by populist politicians some of whom are anxious to suggest that the solution to mismanaged domestic fiscal and monetary policy lies in some mystical offshore pot of gold.

The last group we can characterise as blame-deflecting politicians or regulators anxious to obfuscate the failures of their domestic regulatory systems in the G-20 jurisdictions by suggesting that in some way it is the regulatory system of the offshore financial centre that is at fault. This is the reason why we see hedge funds rather than Freddie Mac and Fanny Mae now described as the root cause of the recent financial crisis in the same way that the Enron collapse was supposed to have its cause in the Cayman Islands and not Delaware, and the missing Bonlat monies were supposed to have disappeared in the Cayman Islands rather than in Parmalat's head office in Italy. There is surely no better spokesman for this group than Mr Gordon Brown who in an effort to sound Presidential when addressing the US Congress, and somewhat ironically for someone who was not even a conventionally elected Prime Minister, and whom, as I speak, may no longer be even that, asked the rhetorical question "Would the world not be a safer place if jurisdictions, such as the Cayman Islands, were outlawed?". Given that no financial institution in the Cayman Islands failed during the financial crisis, that we had no Northern Rock, no HBOS, no Lehman Brothers and no Bear Stearns, the correct answer should have been "Actually, Mr Brown, no, rather the contrary". But the concern is that Mr Brown's rhetoric, however misplaced in fact, suited the populist politics of the moment.

It helps I feel to analyse the tactics of negativity adopted by all three groups which is deliberately designed to confuse. So firstly, let's get the terminology straight. By "tax evasion", we should mean an abusive process that relies on offshore bank secrecy that facilitates a resident of a high tax jurisdiction in failing to accurately report taxable income or gains. This is criminal and involvement with it may involve the offshore service provider in conspiracy to defraud the revenue albeit an onshore revenue. The fact

however is that Cayman has moved well away from that model and yet the public perception on this issue has lagged.

The expression 'tax evasion' is then deliberately misused synonymously with the expression 'bank secrecy' in a pejorative manner which evades completely the public policy argument in favour of legitimate bank confidentiality. That is to say it confuses the right to confidentiality about personal wealth and personal affairs with criminal conduct. Dan Mitchell will be happy to tell you that there are legitimate reasons why bank confidentiality is an essential feature in the civilised world if the rights of the individual are to be protected.

In agreeing to the OECD tax transparency accord in 2000, we recognised, in the Cayman Islands, that tax evasion and any involvement with it is wrong. It is therefore unfair that the expression 'tax haven' is continually used synonymously with 'tax evasion' and that both are used to mis-describe the Cayman Islands which not only suggests that no value added financial purpose is conducted in the Cayman Islands but also deliberately confuses the Cayman Islands with those jurisdictions, which until the most recent OECD initiative, maintained strict confidentiality laws that not only enabled tax evasion but actively encouraged it. Briefly put here, we could include in that group, Switzerland, Monaco, Andorra, Hong Kong, Singapore and Liechtenstein.

Further, the expression "tax evasion" is also deliberately conflated with "tax avoidance". But by "tax avoidance", we should mean the legitimate structuring that by definition relies entirely upon a lawful provision of the domestic tax law or regulation of a G-20 or onshore jurisdiction conducted fully in compliance with such domestic law. But lawful tax avoidance too has now assumed a pejorative connotation. The public relations responses from Cayman were initially so inept that no-one outside the Island would have concluded when President Obama made reference to the 12,000 companies in Uglund House that the President was engaged in an initiative to amend a lawful and proper provision of the US domestic tax law providing legitimate deferral for US corporates operating overseas. In some way, it was suggested by the US President that this "tax avoidance" was facilitated by wrongdoing in the Cayman Islands.

We well know that whilst Cayman law maintains a legitimate right of privacy, its confidentiality statute provides a clear gateway to ensure tax transparency. In medical, if not legal terms, the effect of the tax information exchange treaties in place is that you would need to be criminally insane to seek to evade tax in the Cayman Islands as the IRS has full access to all accounts (as now do 15 other tax authorities), a power of which the IRS should possibly be reminded since it has exercised its unrestricted right to make enquiry in relation to the US\$1.795 trillion dollars of bank deposits and interbank bookings in the Cayman Islands on less than 20 occasions in nearly a decade and with no discernible benefit to the United States Treasury as a result.



We know too that in 2003, under the European Union Savings Directive, and unlike many European jurisdictions which introduced a withholding tax mechanism and maintained confidentiality with regard to the identity of account holders, the Cayman Islands introduced a full proactive reporting disclosure system with all 27 European Union jurisdictions. Interestingly, the publically available statistics on deposits from European Union residents show statistically irrelevant deposits of \$35 million dollars.

We know too that the position with regard to all crimes anti-money laundering is as satisfactory, although surprisingly an FATF evaluation last year that ranked the Cayman Islands system under the Proceeds of Crime Law and the Money Laundering Regulations as superior to those of 40 other jurisdictions including the UK and the US never saw the light of day. And yet, no less venerable a personage than Senator Levin feels able to ignore Delaware, Nevada and Wyoming when he continues to describe the Cayman Islands as a "money laundering jurisdiction".

If my definitions are correct then the negative public relations comments should be unsustainable and indeed the 20 applications made by the IRS under the US/Cayman Tax Treaty are statistically insignificant when compared to the 45,000 requests made by the IRS of various Swiss Banks.

How then did the Cayman Islands find itself on the OECD grey list of non transparent tax havens this time last year? Apparently, the OECD felt entitled to recognise tax transparency only if it arose from a specific form of treaty that the OECD approved. So did therefore the Cayman Islands subsequent advance to the white list improve the issue of global transparency as the OECD claim? The answer is absolutely not. Substantively, nothing has changed. All that had occurred was that the Cayman Islands had to enter into the same form of transparency mechanics as had existed under the Unilateral Mechanism in a different form of bilateral agreement. Again, the statistics on actual requests will support the truth of the substantive position. And we must not forget, as I was about to do, the full regulator-to-regulator disclosure under the IOSCO membership and accords.

Not only is the operational validity and effect of our procedures continually reviewed by on-site investigations by the FATF and the IMF, and indeed most recently, fully corroborated by the report of the US General Accountability Office, but in the event, the Department of Justice in 20 years has managed only 250 applications pursuant to its all encompassing authority under the 1990 Mutual Legal Assistance Treaty. The well informed criminal would be better employed establishing his company in Delaware where, unlike the position in the Cayman Islands, no information whatsoever is required on ultimate beneficial ownership prior to establishing a corporate structure. There is very little empirical evidence however to support the suggestion that that is the reason why there are 217,000 registered offices situate under one roof in one building in the Vice President's home State of Delaware. So I won't make that suggestion.

I have dwelt at some length on the factual position to emphasise how odd it is that these negative public relations campaigns of the last decade can have persisted in the light of the fundamental advances made by the Cayman Islands in relation to all crimes anti-money laundering and tax transparency. No doubt we are partially to blame. Before the Cayman Finance initiative of last year, neither the private sector nor successive governments had in the past properly funded compelling public relations campaigns to redress the mischaracterisations. If you leave a vacuum, no doubt detractors will fill it. But that of itself cannot justify the continued mischaracterisations.

So it must be that we are dealing with a hidden agenda or possibly not-so-hidden agenda and in my view it is this. To identify the reasons for the continual negativity, we have to look back to the 1998 OECD report on "Harmful Tax Competition" which sought to create a fictional world (of which Louis Carol would have been proud) in which all countries should be taxed at an agreed super rate of tax established by a globally omnipotent Mad Hatter. In this world, any jurisdiction establishing a lower or no rate of tax is branded as a "tax poaching" tax haven that harbours weapons of tax destruction. With imperiously retro-engineered Euro logic, the tax haven, and there were 47 on the original list in which Cayman took pride of place, was defined in entirely subjective terms to be any jurisdiction with low or nominal taxes, no transparency, bank secrecy and last but by no means least no substantial business activity.

Whilst Cayman has dealt with two of the four so called indicia that described a tax haven in the Harmful Tax Competition Report, in my view the recent financial crisis has enhanced the threat of tax competition to certain G-20 jurisdictions in the light of their budget deficits. This then is really all about who controls global financial services and capital flows and the right to tax those capital flows and the issue is as it has always been the fear of the OECD that capital being inherently mobile will flow to the jurisdiction with the most competitive tax rate. But we regard the absence of direct taxation in the Cayman Islands as fundamental to the continued success of the financial services industry and we should therefore be circumspect about who is suggesting that we introduce any form of direct taxation and analyse better the truth of their intentions. And if that is right, it is the lack of substantial presence with which we have not yet dealt here in Cayman, and with which we must now deal, if our financial services industry is to be accepted and viable.

In formulating our response, let us look at what may have changed externally since the 1998 Report and what has not. What has changed for the positive is that it is now increasingly difficult for either the lunatic-fringe or for the supranational bodies to continue to mischaracterise our position given that the tax and regulatory transparency established by the Cayman Islands is verifiable. The truth deniers cannot continue to defy gravity. It is possibly for this reason that we see President Sarkozy comment now "That there are now no tax havens" and indeed the recent OECD list refers to "jurisdictions substantially in compliance".

But against that positive, we have already seen a very subtle negative shift in the rhetoric. If we assume that President Obama chooses his words carefully, you will note that he does not mis-describe the Cayman Islands now as a tax haven, and he does not talk about the Cayman Islands in relation to tax evasion. There is a reason why he talks in terms of 12,000 companies in one building and describes the arrangement as a "tax scam". This is not so deep code for the lack of substantial presence and indeed, Senator Levin's committee specifically talks about the lack of infrastructure and the lack of substantial presence in the offshore jurisdiction.

The "Stop the Tax Haven" Bill, which we seemed to have stopped for the time being, was based on that premise but we were not assisted on the substantial presence argument by two specific events. Firstly, the repeal of S864 of the IRS Code some twelve years ago was responsible for moving a good deal of corporate and fund administration onshore and secondly, the self-inflicted immigration difficulties in Cayman, which I will come to, have had a similar effect on the fund administration industry. Whilst we cannot deal with the former, we must certainly deal with the latter and I will return to that point in a moment.

Whilst there is then internationally some tacit recognition of the advances made by the Cayman Islands on the issue of transparency, the moral opprobrium argument is maintained now by the G-20 on the basis that tax competition itself is a "tax scam". But it is the change in the US position on this point that is most troubling. The tax competition element of the OECD Harmful Tax Competition initiative was derailed in 2000 by the intervention by then US Treasury Secretary O'Neil, who whilst agreeing that tax transparency was a legitimate objective would have no part of a European based agenda which sought an international accord that would render tax competition in some way improper or unlawful.

But now in the face of declining tax revenues, the costs of the financial bailout and an aggressive policy of social reform including health care, we note that the rhetoric from the White House has taken on an altogether more socialist tone which appears more consistent with that of the European Union based members of the G-20. That is to say, a decade after publication of the 1998 Report, the US and European position on tax competition may now be aligned and that is a fundamental shift, the importance of which for Cayman must not be ignored.

So how do these understandings translate into current policy and direction for financial services in the Cayman Islands?

Firstly, we are encouraged that the Premier sees the establishment of an expanded and viable financial services community as critical to the local economy. He is right to do so. In 2007, there were approximately 5,800 persons directly employed in the financial industry who indirectly provided nearly 13,000 total jobs approaching 40% of the local employment, nearly 50% of Government revenue and

\$1.2 billion or 55% of gross domestic product. More crucially, employment in the fund administration industry was running at about 50/50 Caymanians to Expatriates. 400 fund administration jobs exported to Canada as a result of the roll-over policy and immigration issues generally means therefore 400 fewer jobs for young Caymanian professionals.

But the Premier is right to focus on supporting immigration for the financial services industry so for a second reason. Further expansion of that industry is not only relevant to government revenues, employment and local trickledown economics. It is critical now to take the range of financial services quantitatively and qualitatively to a much higher standard which involves real financial engineering being undertaken from within the Cayman Islands and thereby establishing here an improved substantial presence to deflect the future attacks on the Cayman Islands that are already formulating. This substantial presence should ideally encompass not only fund management but investment and merchant banking, reinsurance business and indeed an expansion of fund administration and it is therefore essential to attract to Cayman for the long term financial professionals who provide these services. We will not be accepted as a financial centre until we provide the range of services typically provided in a financial centre.

As matters stand, it is too easy for Senator Levin to suggest that because of the conduct of financial operations in the Cayman Islands does not resemble a car manufacturing plant in Detroit with 5,000 people under one roof that in some way Cayman financial operations are a sham and should be ignored. So in terms of direction of the financial services industry, having concluded that tax competition is and remains the concern of certain G-20 jurisdictions and that lack of substantial presence will be the OECD's weapon of choice, we must increase and improve the range of financial activities undertaken in the Cayman Islands rather than in New York, Chicago or London. Anecdotally and in simplistic terms, if the fees charged on a transaction are 95% payable in New York and 5% payable in Cayman, we need to work on evening out that percentage. To do so, we fully support the further development of the Premier's immigration policy to provide the necessary long term security of tenure to real financial engineers and professionals whom we must persuade to relocate.

The development of an improved financial infrastructure in the Cayman Islands needs to be supported for another reason. As I mentioned earlier, another fundamental that has changed for the Cayman Islands financial services industry is that our traditional financial markets, the US and the UK, are now operating in a deleveraged financial environment and it therefore follows that the volume of transactions seen at the peak of the market in 2007 may not be seen again for the foreseeable future and indeed we see company incorporation numbers currently down by some 38%. This means that in terms of both Government revenues and revenues payable to the private sector, higher fee levels will have to be extracted from each transaction. Current transactional flows resemble 2004/2005 and so if nothing more is done, one simple solution is for Government to return to its expenditure levels in the

2003/2004 budget, which is some CI\$317,000 annually. Interestingly, when looked at from the opposite perspective, the current deficit supports the maths of that conclusion. But that would require extensive cuts in Government expenditure and whilst cuts to that expenditure may be an essential short term expedient, the recommended approach for the long term is to boost Government revenue.

Given the competitive nature of the offshore market place, this means in turn that to charge these higher fees the financial services industry has to provide higher quality of service and of a sort in relation to financial engineering management and administration not previously provided in the Cayman Islands. This again means more and higher quality personnel. As has always been the case, Government revenues will then follow the fortunes of the financial services industry.

There is no doubt that the current administration's approach to immigration has done a good deal to redress the negative effects of both a tightened immigration and roll-over policy but more will have to be done in terms of implementation if Government is to provide the environment in which the financial services industry can develop an enhanced state of revenue generation per transaction.

What has not yet been addressed and what must be solved, in the minds of the voting public in the Cayman Islands, is the understandable concern that surrounds the issue of work permits. By that I mean that we really have to confront the 800 pound gorilla in the room and deal with the heresy that the highest quality financial professionals can be attracted the Cayman Islands to develop the financial services industry with the requisite substantial presence on the basis that they are here for the short term and with the view to being replaced. That dog will no longer hunt. It is an unrealistic delusion. We understand the long term concerns of the Caymanian public but these must be addressed by decoupling the issue of work permits and security of tenure for financial professionals from the issue of status and voting and this conundrum has not yet been effectively solved. Of course, we must ensure proper integration for Caymanian professionals but at no time was the roll-over policy ever the correct response to an evident failure to provide that integration.

As a corollary however, no one in the financial industry should, in the absence of income tax and payroll taxes, mind paying \$20,000 dollars of more for a professional's work permit, provided these work permits can be obtained by the Cayman financial organisation when they want them and kept for as long as they want them. The stakes here are high. If we cannot elevate our financial services industry by providing substantial presence and verifiable value added, the recent fee increases will not be sustainable and we face a further exodus of organisations and employment opportunities, and then the inevitable race to the bottom on fees with lower cost jurisdictions which will ultimately see Government revenues from financial services decline not increase.

Further, as I said earlier, we need to be circumspect about those who are suggesting that we cross the Rubicon and introduce any form of direct taxation. Those who seek to do so to a highly mobile financial industry are at best guessing at the outcome or to the more cynical amongst us, have a very good idea of the outcome but the fact is that we have no positive basis whatsoever that would justify that decision. There are always good sounding reasons for high levels of welfare and public service spending, free medical health and pensions. But the question must first be asked: what are the appropriate levels of these benefits for an Island population of 60,000? If we first do not answer that question correctly and make appropriate legislative modifications to ensure the benefit levels are appropriate and sustainable, there is no certain limit to the revenue that must be generated to pay for the programmes and therefore no upper limit to the rate of taxation that may be applied. We are very fortunate today to have Jim Miller and David Shaw who will describe the inherent dangers of this approach later today.

We do have a real world comparison for analysing what can go wrong here. In 1975, when I left the United Kingdom, my point was proved beyond a doubt by a top rate of tax on unearned income in excess of 20,000 pounds a year of 98%. Those who suggest any form of taxation without first ensuring that public expenditure is under control, need to understand that they do not thereafter, whether the tax is income tax, payroll tax, community service tax or any other form of tax, control either the rate of tax applied or the resulting rate of the exodus of the financial services industry.