



Caribbean IFCs: Well Regulated Parts of the International Furniture



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OBSERVERS OF OFFSHORE FINANCIAL CENTRES will know that post 2008 they have been weathering a perfect storm. Firstly, reduced transactional flows, simply because there is less money available for structured finance and investment generally. Secondly, a constant barrage of negative publicity, which deliberately seeks to conflate tax evasion and tax avoidance, orchestrated by extreme left wing Non-Governmental Organisations (NGOs) and various G20 Treasury Departments and thirdly, unprecedented levels of additional tax and regulatory compliance, specifically in the form of the Foreign Account Tax Compliance Act (FATCA).

In so far as hedge and mutual funds with management in the EU are concerned, we can add the EU Alternative Investment Fund Directive. Those in the NGOs who regard the continued progress of the offshore financial centres through gritted teeth may take the absence of much in the way of positive announcements as to the outcome as an indication that the offshore jurisdictions have been dealt a cumulative body blow. But an analysis of the statistics shows that nothing could be further from the truth.

The comparative silence has more to do with the largely ineffective public relations campaigns, which are typical in those offshore jurisdictions, than any analysis of transactional flows. If we take, firstly, the position of the Cayman Islands financial service industry as indicative, although shifts within it are apparent, the position appears robust.

Thus, new incorporations in the Cayman Islands are running at close on 1,000 per month for an aggregate total of some 98,000 companies, which just exceeds the pre-crisis total. Mutual and hedge funds, including the newly registerable Master Funds now total some 11,379, (anecdotally 75 per cent of the world's hedge funds with published assets under management have increased over the prior 12 month period from US\$1.798 trillion to US\$1.964 trillion). Admittedly, if we correct to deduct the master funds and undertake a like for like comparison, we find that the number of administered and licensed feeder funds comes in at around 8,750, a robust figure but only just above 2006 levels.

Consolidation in the banking industry shows a notable resultant decline in the number of licensees, the total now dropping to 210 banks and trust company licenses. However, 40 of the top 50 banks of the world remain represented in subsidiary or branch form with banking assets and liabilities remaining at a robust US\$1.5 trillion, of which 80 per cent represents inter-bank bookings between onshore banks and their Cayman Islands branches or subsidiaries.

The insurance industry, which continues to punch above its weight in terms of local management and administration, and therefore, substance, shows a steady increase with a total of 40 licenses granted over the prior year making an aggregate of 761 with US\$12.3 billion in annual premiums and total assets of US\$54.9 billion (but a distant second to the Bermudian figures below).

Exempted limited partnerships, the vehicle of choice for the private equity industry, continue to show improvement with some 2,368 registered in 2013 with an aggregate total exceeding 14,355. (Asset figures are not available for private equity).

The fortunes of the British Virgin Islands largely follow the statistics of the incorporation of IBCs with a comparatively spectacular aggregate total of 454,257 IBCs as at 30 June 2014 (of which 40 per cent are Asian promoted), less than one per cent off the prior year's figure, although Q3 2013 incorporations show a reduction of 15 per cent over Q3 2012. Limited partnerships in the BVI now total 538 with 237 bank licenses as at 30 June 2014, a small increase. There are clearly far fewer funds registered in the BVI than the Cayman Islands, the cumulative total now aggregating 2,186, a drop of three per cent over the prior year.

Bermuda reflects, as has always been the case, far lower overall numbers, save in relation to insurance where it remains the leading offshore jurisdiction. Some 665 funds are regulated in Bermuda with assets under management of US\$183 billion. There are only 13,174 companies showing a declining total from the recent high of 13,648 in 2013 and slightly increased aggregate total of 1,439 exempted partnerships.

As a matter of internal policy, the banking industry in Bermuda has always been restricted so there exist four commercial banks, none of which feature to any significant extent in international capital flows. But the Bermuda Insurance Industry



remains dominant with 1,206 registered licensed entities, a number which appears stable with over US\$120 billion in gross annual premium income and total assets of over US\$505 billion, showing a healthy increase year on year of 12 per cent and 11 per cent respectively.

Whilst, in the light of the expressed challenges, the foregoing figures may be described as surprisingly robust, and in virtually every category in each jurisdiction indicate recovery to pre-financial crisis levels, a keener analysis of the position of these offshore financial centers should take into account the overall revenue and expenditure position.

Thus, the budget address for Bermuda for 2014-2015 reveals current expenditure of US\$1.112 million with a revenue shortfall annually of US\$300 million projected with revenue having peaked in 2010/2011 at US\$990 million but with current gross debt at a worrying US\$1.7 billion.

The figures for the British Virgin Islands seem relatively benign with annual revenues largely supported by IBC fees from the financial services industry of US\$302 million of which only US\$23 million is needed for debt servicing. The question for the BVI financial services industry remains whether it is too narrowly based on the volume incorporations of the IBC which is a high volume low profit model that may not be sustainable in a newly and more heavily regulated global environment. In that context, any reduction in IBC incorporations may well be a troubling indicator in a jurisdiction that has less in terms of local administration and substance to add value or to generate additional Government fees.

Whilst as mentioned above the figures for the Cayman Islands financial services industry appear robust, it should be cautioned that the figures broadly, for the various categories of license, have with the exception of the number of bank licenses, only just returned to pre-crisis levels. But the Budget in June 2006 shows the expenditure for the Cayman Islands Government amounted to US\$499 million. In 2014, that figure had grown to US\$644 million, an increase of some 28 per cent.

It should also be noted that the fact that the Cayman Islands Government was able to balance its budget in 2014 and reduce

the outstanding debt to US\$548.8 million, with a principal repayment of US\$26.3 million, was largely attributable to the some US\$90 million aggregate increase in fees in the financial services industry in 2013 which some say, has rendered the industry less competitive (the Master Fund registration being particularly unnecessary from a regulatory perspective and largely, in any event, benefiting the Accounting Profession).

Other observers however, recognise that it is only the well organised offshore financial centre with a developed infrastructure that is likely to be in a position to comply with the rigorous filing and other requirements imposed now by FATCA and other similar OECD initiatives dealing with proactive tax reporting.

Indeed, if we take the Cayman Islands as an example, the well-established and now routine compliance with the FATF Anti-Money Laundering Requirements which are of application to any Cayman Islands entity, corporate or trust, have already laid the foundation for the enhanced (but only slightly so) due diligence requirements now necessitated by FATCA.

In fact, there is very little additional due diligence to do (other than applying cold compresses to a brow fevered by the making sense of the 200 pages of FATCA Guidance Notes clearly drafted by the UK and US Treasury Departments) although many more forms to file. Jurisdictions like the BVI which have relied to a greater extent not on obtaining original KYC documentation on file but on the expedient of the Introducer's Certificate, will find that there is greater work now to be undertaken to ensure FATCA compliance. So too, the level of due diligence under FATCA is the greater and more time consuming in relation to the private client area.

Compliance, for example, in the context of a mutual fund or hedge fund or other institutional book of business is a relatively simple extension of the pre-existing due diligence requirements undertaken by most administrators, a conclusion which minimises the application of FATCA in relation to the greater part of the assets managed and administered in the Cayman Islands.

Paradoxically, what now becomes clear as

a result of this increased tax transparency is that the historical arguments of the NGOs in relation to the extent of tax evasion in the offshore jurisdictions are proven to be the purest nonsense. Not only have the Tax Information Exchange Agreements failed to generate any discernable revenue but what will now be shown is that the tax revenues generated for the benefit of the USA and the UK Treasuries from FATCA will be marginal.

So too, predictions that the European Union Alternative Investment Fund Directive would prove damaging to the Cayman Islands financial services industry have turned out to be ill founded. In part, as predicted, this is simply because of the US\$1.9 trillion AUM assets under management in the Cayman Islands fund industry pre the Directive, only some 20 per cent were managed in EU jurisdictions, primarily London, the greater percentage, in excess of some 65 per cent, being managed in the US and outside of the territorial ambit of that Directive. But in the event, and as was predicted, the effect of the Directive has been to cause a number of major Cayman Islands hedge fund groups to move their management from London out of the EU whether to the Channel Islands, Switzerland, Dubai, Hong Kong or Singapore with the result that whilst assets under management in the Cayman Islands hedge fund industry have grown since the application of the Directive, the percentage of such assets managed in the EU has dropped from over 20 per cent to 16 per cent.

In terms of future issues of concern, much has been made of the OECD Base Erosion Profit and Shifting initiative which is a belated response to what appear to be aggressive but legitimate tax avoidance strategies lawfully to avoid taxation. The comment of Mr Angel Gurría, Secretary General of the OECD, is instructive:

"We cannot blame business for using rules that policy makers themselves have put in place".

The latest OECD report Base Erosion Profit and Shifting focuses not on the so called 'tax havens' but on the 'preferential regimes' which is of course shorthand for Ireland and the Netherlands, and other jurisdictions which have utilised double tax treaty networks to minimise the effective tax rate of corporations like Google, Starbucks,



Amazon and Apple. What the OECD Report does not emphasise is that it is the OECD model treaty on transfer pricing, adopted by most of the OECD jurisdictions, and the product of some 15 years of tax free research and development by the OECD, that simply does not work. But once again, we see the finger of failed onshore law and regulation point at the offshore jurisdiction as being causative, rather than the flawed domestic tax policy of the G20 jurisdictions.

The Base Erosion and Profit Shifting report of 2015 calls for proposals to develop “solutions to counter harmful regimes more effectively taking into account factors such as transparency and substance”. In the light of FATCA, it would be impossible now to develop systems of greater transparency and so what precisely the OECD thinks it means remains opaque. What is even less clear is how proposals relating to greater “substance” can be drafted onto international financial transactions without occasioning wide spread disruption and unintended consequences.

“In light of FATCA, it would be impossible now to develop systems of greater transparency”

In just the same way that the arguments that tax evasion is in some way fundamental to the operations of offshore financial centres like the Cayman Islands have been shown to be hopelessly flawed, so too, suggestions that international financial transactions which meet the commercial tests of the market place are flawed because they are undertaken without “adequate substance” are unlikely to gain universal acceptance.

At some point, which we are no doubt approaching, it will have to become recognised by even the most strident of NGOs that the well regulated and transparent offshore financial centre is simply a part of the international furniture.

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He has served as Chairman of the Cayman Islands Stock Exchange from inception and has advised the Cayman Islands Government on legislative initiatives. Anthony has served as the Chairman of Cayman Finance, the representative body of the Cayman Islands Financial Services industry.

Anthony has spoken and written extensively on offshore issues over the years and was awarded the Order of the British Empire for service to the Cayman Islands Financial Services industry.

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