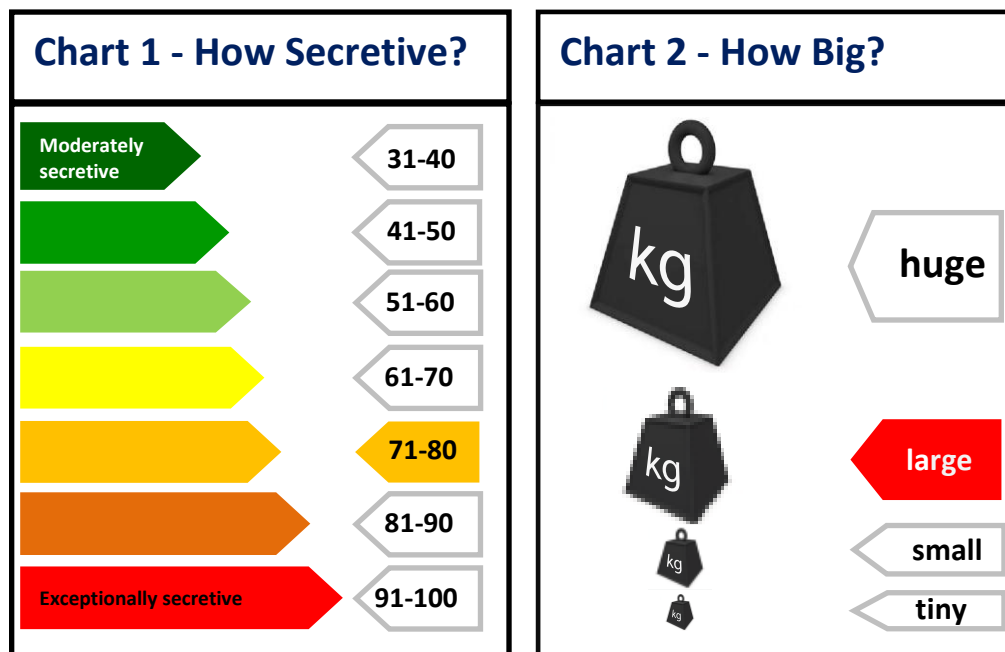


Report on Cayman Islands

Cayman Islands is ranked at second position on the 2011 Financial Secrecy Index. This ranking is based on a combination of its secrecy score and a scale weighting based on its share of the global market for offshore financial services.

Cayman Islands has been assessed with 77 secrecy points out of a potential 100, which places it towards the top end of the secrecy scale (see chart 1 below).

Cayman Islands accounts for slightly under 5 per cent of the global market for offshore financial services, making it a large player compared with other small island secrecy jurisdictions (see chart 2 below), though not on the same scale as huge players such as Luxembourg, UK and the USA.



Part 1: Telling the story

Britain's Caribbean backyard

The Cayman Islands is an Overseas Territory of the United Kingdom. It operates a considerable degree of political and economic autonomy from the UK but enjoys the UK's constitutional oversight at the same time – a crucial reassurance for foreign investors who have flocked to Cayman. The [Governor](#), appointed by the UK, presides over the Cayman cabinet and appoints members of the judiciary and the police commissioner. The UK has responsibility for defence, foreign affairs, internal security, the police, the civil service and 'good governance'.

Cayman markets itself as being an upmarket financial centre, and there is no doubt that a large share of its business comes from some of the world's biggest banks, corporations, hedge funds and other entities. It has been described as the world's [fifth biggest](#) financial services centre. Hosting over 10,000 mutual funds, almost 300 banks and over 90,000 companies, it is by far the world's leading domicile for hedge funds, the [leading domicile](#) for healthcare captive insurance companies, and it is [second](#) only to Luxembourg in mutual fund administration.

With financial services accounting for well over half of gross domestic product, this is, like many offshore jurisdictions, heavily reliant on the financial services industry. There are no direct taxes in Cayman; most government revenue comes from fees and duties such as import duties, work permit fees and financial industry registrations.

Official statistics for the Cayman Islands are, in places, quite opaque; the [IMF](#), for instance, notes a major mismatch between Cayman's \$2.2 trillion in hedge fund assets and its merely \$768bn in portfolio equity claims.

Cayman's Confidential Relationships (Preservation) Law, enshrining financial secrecy (though with some limited avenues for disclosure) remains a cornerstone of the country's financial sector, although as a jurisdiction offering a wide range of services, this is far from being the only attraction. "Light-touch" financial regulation and Cayman's 'flexibility' in designing it (meaning its willingness to craft legislation quickly and with little democratic accountability to the people ultimately affected by that legislation), remains, as with many offshore jurisdictions, another key attraction.

History

Like many islands in the region, the Cayman Islands served as an "offshore" pirate sanctuary as early as the 18th Century – though this was only of minor importance. It was only in the 1960s that it began to come into its own as a financial centre and secrecy jurisdiction.

In the early 1960s, Cayman was a backwater dependency of Jamaica with no telephone service, limited electricity supplies, and no piped water. According to the [Cayman Financial Review](#), mosquitoes were sometimes thick enough in the air to suffocate cows. It was Jamaica's independence from Britain in 1962, and Cayman's decision to remain a British Crown Colony, that sowed the seeds of change. Upon independence, business interests in Jamaica, wanting the continued stability that flowed from having Britain as the mother country, shifted to Cayman.

Soon afterwards, a series of things happened, with Canadian and British interests playing an important early role. The first banks in Cayman with a retail presence were Barclays and the Royal Bank of Canada; Cayman's first trust company, the Bank of Nova Scotia Trust Company (Cayman) opened its doors in 1965, followed soon by the Canadian Imperial Bank of Commerce. A mosquito control programme starting that same year made the islands far more livable, and infrastructure followed: the airport was expanded to let jet aircraft land, and the electricity and telephone networks were soon upgraded. Cayman got its first

chartered accountant in 1967, alongside an attorney called William S. Walker, whom some have called the founder of the Cayman financial centre. Walker helped draft trust legislation which, as UK official later said, “blatantly seeks to frustrate our own law for dealing with our own taxpayers.” The Cambridge-educated Walker, alongside the Oxford-educated lawyer John Maples (later to become a British Conservative MP) and their respective firms were instrumental in bringing British clients to Cayman: as the Cayman Financial Review put it: “between Walker and Maples, they had access to most of the influential business people in London.”

But it was events elsewhere that really spurred Cayman’s rise. In 1967 the Bahamas, then awash with U.S. Mob money, got its first black premier under Lynden Pindling. The Bahamas, with rising racial tensions and the prospect for full independence (which came in 1973), began to be seen as less hospitable. Milton Grundy, another architect of Cayman laws in those days, explained the impact ([p106](#)). “It wasn’t that Pindling said or did anything to damage the banks,” he said, “it was just that he was black.” Investors, also worried about the Cuba threat nearby, started flocking from the Bahamas to Cayman, with its reassuring close ties to Britain.

As business moved in from the Bahamas an offshore sector that had once been solidly British now began to attract a far more pan-American clientèle. Top names in international law, such as Marshall Langer, began to promote the Caymans in the U.S. and with Miami just an hour’s flight away, the character of the islands began to change. A new constitution in 1972, entrenching the Privy Council in London as the final appeal court, solidified the British link, but also gave Cayman more scope for self-governance and therefore more scope for creating its own offshore legislation with less interference from London.

Cayman’s prime attraction was clear from the outset. In the words of Sir Vassal Johnson ([p150](#)), who became Cayman Financial Secretary in 1968, the principle behind the offshore industry was “to afford international investors a legitimate expectation of a level of privacy . . . void of tax deductions in the Cayman Islands.” Bank of England internal correspondence from 1969 ([p108](#)) highlights Britain’s tolerance for questionable activities: “there is of course no objection to their providing bolt holes for non-residents.” There was also, at the time, what one British government team ([p107](#)) called a “frightening lack of local expertise,” which was often useful for the skilled lawyers and accountants seeking to get their way in the face of inexperienced legislators. According to Financial Secretary Vassall Johnson in 1973, the islands did not have a single economist, [adding](#): “we have written away to the United Nations to get one.”

It was, essentially, a free-for-all. Drugs profits and other nefarious money flew in by the planeload; if there was enough of it, it would get a police escort to the bank. *Time* magazine in 1973 [cited](#) an investment banker who explained the islands’ attraction succinctly: “We like the place because it is suitably devoid of law.” From the 1960s, Cayman worked hard to modernise and expand its legislation, with the 1960 Companies Law rather similar to the UK statute; a new insurance law in 1979, and the Mutual Funds law in 1993. Still, the same free-wheeling attitude prevailed. Michael Austin, one of the first accountants on Cayman, put the

attitude slightly differently: the financial sector was based upon “a hugely friendly relationship between the government and the private sector.” In essence, the government would create the laws that the private sector practitioners asked for. Under a “Private Sector Consultative Committee”, inaugurated in the 1960s, private sector operators discussed the legislation they needed, and the Cayman authorities essentially wrote it – with almost no dissent from London, ever ([p120](#)).

Scandals began to surface quite early. A Canadian banker, Jean Doucet, set up the International Bank and began mailing out pamphlets outlining the tax benefits of Cayman, to tens of thousands of clients worldwide. Chris Johnson, a local accountant wrote a qualified audit report on Doucet’s businesses that he said was ‘basically telling the government to close the bank down’ – but instead he was fired. Doucet became the largest employer on the islands, threw lavish parties and must have felt untouchable. However, he had invested in long-term assets backed largely by short-term deposits (exactly the same kind of problem that helped trigger the global financial crisis from 2007 onwards) and in 1974, financial stress led to his financial empire’s collapse. He fled to Monaco but was extradited to Cayman and convicted.

Exchange and currency controls were relaxed in the 1970s, by which time other countries, noticing Cayman’s increasing ability to undermine their own laws and tax systems, began to complain. Cayman’s response was always essentially the same – as it is today – straight denial that they were facilitating any wrongdoing. Assisting in tax evasion, Vassall Johnson said piously in 1975, was ‘unethical.’

Weeks after he said that U.S. authorities at Miami airport served a subpoena on Anthony Field, managing director of Cayman-based Castle Bank and Trust, on suspicion of assisting U.S. clients evade taxes. Before a Florida [Grand Jury](#), Field refused to divulge client details, saying he would breach confidentiality laws in Cayman. To bolster his case, the Cayman Islands defiantly passed a new law, the Confidential Relationships (Preservation) Law reinforcing banking secrecy. The law makes it possible for people to go to jail not only for divulging information, but merely for [asking](#) for it. It was an outright challenge to the United States tax authorities, and it remains in place today. Though it has never produced a conviction, it remains a powerful deterrent to disclosure.

However, pressure from outside, particularly from the U.S., continued. Cayman adopted a two-prong strategy.

A first part of the strategy was to mount a public relations campaign, which by the 1970s was already in full swing. There were repeated references to the Cayman as a ‘legitimate financial centre’ and not a tax haven. A modicum of real clean-up hid what was essentially business as usual: the attraction of foreign money, with few questions asked. Whatever the official line, however, private operators continued to market secrecy. “What we sell is confidentiality; they can’t match it,” one banker [said](#) in 1981. Vassall Johnson described secrecy as “the prime support of the country, of promoting the tax haven business.

The second part of the strategy was to allow narrow exemptions to its secrecy laws. Using a broad strategy common in other secrecy jurisdictions, Cayman responded to external pressure for change with incremental reforms, often tailored only to the particular concerns raised, and only designed to address (and then often only in part) the concerns of the particular (usually powerful) country that had made the complaint. The signature of a narcotics agreement with the U.S. in 1984, then a tripartite U.S.-UK-Cayman Mutual Legal Assistance treaty in July 1986, were meaningful steps to tackle some of the most egregious drugs (and other) crimes committed via Caymans, but they still left doors wide open for criminals, particularly from outside the US and UK.

In the 1980s, Cayman also began to expand its focus significantly beyond private client business in the direction of attracting more institutional investors. Insurance companies began to come in from the 1970s, followed by offshore investment funds in the 1980s, often in search of ways to escape exchange controls and for tax advantages. Cayman began to attract a larger wealthy clientele, and luxury hotels began to spring up amid a property boom.

This era marked an expansion into more subtle strategies: [tax avoidance](#), as opposed to tax evasion was one approach. Wholly illegitimate activities increasingly began to be interspersed with more legitimate activities, giving the place a more up-market feel than before, and helping Cayman with its public relations drive. This process, which has continued until today – was more of an expansion in the range of facilities provided than a full displacement of one by the other. Cayman structures, protected by its confidentiality laws (and others) continue to service illegitimate activities today. Many [Cayman-incorporated Structured Investment Vehicles \(SIVs\)](#), for instance, also serve, often just incidentally, as vehicles for tax avoidance and evasion on the part of some investors.

Meanwhile, Cayman marketing of itself as a ‘legitimate’ financial centre was increasingly founded on permissive regulation, rather than pure secrecy-based business. The breaking open of the Bank of Credit and Commerce ([BCCI](#)), in large part by TJN senior adviser Jack Blum and New York District Attorney Robert Morgenthau in 1991, opened what was then probably the most corrupt bank in global history: with fingers in heroin trafficking, arms dealing, wholesale corruption on a global scale, and much, much more. BCCI had managed to conceal its crimes by running its two main operating subsidiaries out of Luxembourg and Cayman, and each with strong secrecy laws and a tradition of deliberately relaxed financial regulation. Its third main centre was London. Running its affairs out of more than one secrecy jurisdiction helped it evade centralised regulation.

Other legislation in the 1990s, notably on money-laundering, helped further mitigate – though by no means eliminate – the taint from the most egregious forms of financial crime. These laws, which could pierce Cayman’s Confidential Relationships (Preservation) Law -- though only in [very limited circumstances](#) -- were far from adequate: Eduardo d’Angeolo Silva, president of the Cayman Islands Bankers Association, [said](#) in 2000 that these laws ostensibly to curb criminality were, in effect, ‘self regulating.’ In recent years, a number of international bodies have criticised Cayman’s ongoing willingness to facilitate tax evasion

and avoidance and continue to cite money laundering concerns (see further details, in the sections below,) though in many cases it has been less stridently criticised than have many other jurisdictions.

Until the Mutual Funds Law of 1993 there were no laws regulating funds, for example, and when regulation was adopted it was extremely rudimentary. Anthony Travers (later a chairman of the Cayman Islands Monetary authority) [explained](#) the approach: “the only effective regulatory mechanism with respect to the sophisticated institutional business that Cayman attracted... was a *caveat emptor* [buyer beware] system. . . the responsibility of the Cayman government was managed by avoiding the concept of prudential regulation.”

Today’s role of Cayman Islands

A series of financial scandals implicating Cayman – including the discovery that the fraudulent U.S. energy company Enron had used hundreds of unregulated Cayman subsidiaries to keep billions off its balance sheet; another where the bankrupt U.S. telecoms giant MCI/WorldCom was found to have widely used Cayman companies to hide losses; and a scandal involving the disgraced Italian firm Parmalat - kept Cayman on the financial map. More broadly, weaknesses in prudential regulation – which, among other things, requires financial institutions to hold a certain level of capital against their assets – was a key factor behind the global financial crisis – a crisis in which Cayman and other secrecy jurisdictions [played a key role](#).

Cayman’s relaxed funds law served as the bedrock of the hedge fund industry which now sees Cayman as its top domicile; it also saw Cayman attract a very large share of major new sectors in financial engineering such as private equity, debt and bond issues, and securitisation.

The Cayman Islands today prides itself on being a ‘clean’ jurisdiction and points to, among other things, its white listing by the OECD. However, as we have explained [in great detail elsewhere](#), this kind of white listing is little more than a fig leaf, and the international information-sharing agreements used as the basis for such white-listing , which Cayman has signed under severe [duress](#), are of [only very limited use](#).

Cayman is undoubtedly ‘cleaner’ than Panama, say, in terms of traditionally defined criminal money, although its [role](#) (along with that of many other secrecy jurisdictions) in the latest global financial crisis must not be forgotten. Cayman is on better intellectual ground when it responds to criticism by (regularly) pointing back at supposedly ‘onshore’ jurisdictions such as the City of London and Delaware, to argue that their regulations and laws are often equally full of holes.

Further reading:

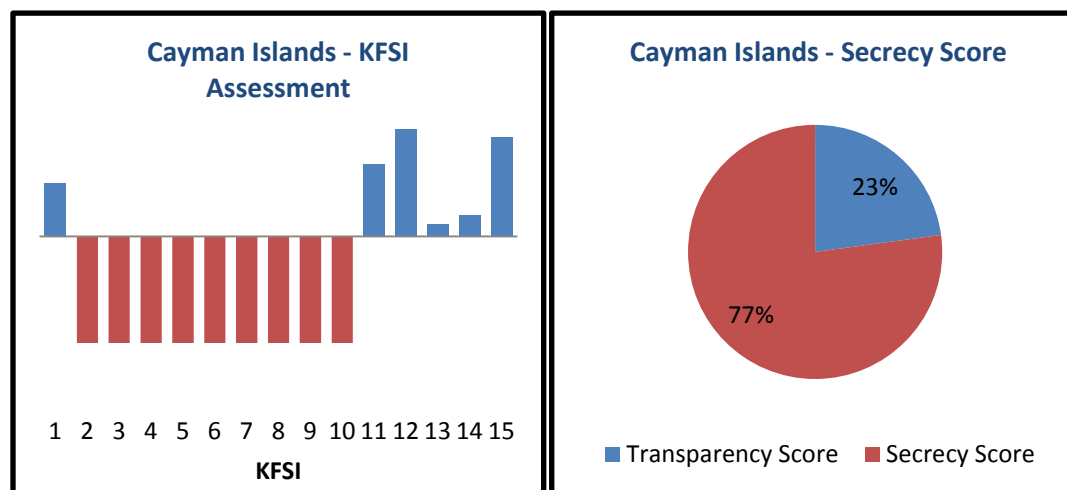
- History of the Cayman Islands, in six parts, [Cayman Financial Review](#).
- [Treasure Islands](#), particularly pp103-121, which provides much political context, and looks at some of the subtleties of the relationship with Britain.
- [The database report provides](#) more information on Cayman Islands as a secrecy jurisdiction.

Next steps for Cayman Islands

Cayman Islands' 77 per cent secrecy score shows that it must still make major progress in offering satisfactory financial transparency¹. If it wishes to play a full part in the modern financial community and to impede and deter illicit financial flows, including flows originating from tax evasion, aggressive tax avoidance practices, corrupt practices and criminal activities, it should take action on the points noted where it falls short of acceptable international standards. See part 2 below for details of Cayman Islands' shortcomings on transparency. See this link <http://www.secrecyjurisdictions.com/kfsi> for an overview of how each of these shortcomings can be fixed.

Part 2: Secrecy Scores

The secrecy score of 77 per cent for Cayman Islands has been computed by assessing the jurisdiction's performance on the 15 Key Financial Secrecy Indicators, listed below.



The numbers on the horizontal axis of the bar chart on the left refer to the Key Financial Secrecy Indicators (KFSI). The presence of a **blue** bar indicates a positive answer, as does **blue** text in the KFSI list below. The presence of a **red** bar indicates a negative answer, as does **red** text in the KFSI list. Where the jurisdiction's performance partly, but not fully complies with a Key Financial Secrecy Indicator, the text is coloured **violet** in the list below (combination of red and blue).

This paper draws on key data collected on Cayman Islands. Our data sources include regulatory reports, legislation, regulation and news available at 31.12.2010². The full data set is available [here](#)³. Our assessment is based on the 15 Key Financial Secrecy Indicators (KFSIs, below), reflecting the legal and financial arrangements of the Cayman Islands. Details of these indicators are noted in the following table and all background data can be found on the [Mapping Financial Secrecy web site](#)⁴. This data is the basis on which the [Financial Secrecy Index](#)⁵ is compiled.

The Key Financial Secrecy Indicators and the performance of Cayman Islands are:

TRANSPARENCY OF BENEFICIAL OWNERSHIP – Cayman Islands	
1.	Banking secrecy: Does the jurisdiction have banking secrecy? Cayman Islands does not adequately curtail banking secrecy
2.	Trust and Foundations Register: Is there a public register of Trusts and Foundations? Cayman Islands does not put details of trusts on public record
3.	Recorded Company Ownership: Does the relevant authority obtain and keep updated details of the beneficial ownership of companies? Cayman Islands does not maintain company ownership details in official records
KEY ASPECTS OF CORPORATE TRANSPARENCY REGULATION – Cayman Islands	
4.	Public Company Ownership: Does the relevant authority make details of ownership of companies available on public record online for less than US\$10? Cayman Islands does not require that ownership of companies is put on public record
5.	Public Company Accounts: Does the relevant authority require that company accounts are made available for inspection by anyone for a fee of less than US\$10? Cayman Islands does not require that company accounts be available on public record
6.	Country-by-Country Reporting: Are companies required to comply with country-by-country financial reporting? Cayman Islands does not require country-by-country financial reporting by companies
EFFICIENCY OF TAX AND FINANCIAL REGULATION – Cayman Islands	
7.	Fit for Information Exchange: Are resident paying agents required to report to the

	<p>domestic tax administration information on payments to non-residents?</p> <p>Cayman Islands does not require resident paying agents to tell the domestic tax authorities about payments to non-residents</p>
8.	<p>Efficiency of Tax Administration: Does the tax administration use taxpayer identifiers for analysing information effectively, and is there a large taxpayer unit?</p> <p>Cayman Islands does not use appropriate tools for effectively analysing tax related information</p>
9.	<p>Avoids Promoting Tax Evasion: Does the jurisdiction grant unilateral tax credits for foreign tax payments?</p> <p>Cayman Islands does not avoid promoting tax evasion via a tax credit system</p>
10.	<p>Harmful Legal Vehicles: Does the jurisdiction allow cell companies and trusts with flee clauses?</p> <p>Cayman Islands does allow harmful legal vehicles</p>
INTERNATIONAL STANDARDS AND COOPERATION – Cayman Islands	
11.	<p>Anti-Money Laundering: Does the jurisdiction comply with the FATF recommendations?</p> <p>Cayman Islands partly complies with international anti-money laundering standards</p>
12.	<p>Automatic Information Exchange: Does the jurisdiction participate fully in Automatic Information Exchange such as the European Savings Tax Directive?</p> <p>Cayman Islands participates fully in Automatic Information Exchange</p>
13.	<p>Bilateral Treaties: Does the jurisdiction have at least 60 bilateral treaties providing for broad information exchange, covering all tax matters, or is it part of the European Council/OECD convention?</p> <p>As of June 30, 2010, Cayman Islands had few tax information sharing agreements complying with basic OECD requirements</p>
14.	<p>International Transparency Commitments: Has the jurisdiction ratified the five most relevant international treaties relating to financial transparency?</p> <p>Cayman Islands has partly ratified relevant international treaties relating to financial transparency</p>
15.	<p>International Judicial Cooperation: Does the jurisdiction cooperate with other states on money laundering and other criminal issues?</p>

<p>Cayman Islands partly cooperates with other states on money laundering and other criminal issues</p>

¹ Our definition of financial transparency can be found here:

<http://www.secrecyjurisdictions.com/PDF/FinancialTransparency.pdf>.

² With the exception of KFSI 13 for which the cut-off date is 30.6.2010. For more details, look at the endnote number 2 in the corresponding KFSI-paper here:

<http://www.secrecyjurisdictions.com/PDF/13-Bilateral-Treaties.pdf>.

³ That data is available here: http://www.secrecyjurisdictions.com/sj_database/menu.xml.

⁴ <http://www.secrecyjurisdictions.com>.

⁵ <http://www.financialsecrecyindex.com/>.