

Narrative Report on Cayman Islands

Cayman Islands is ranked at fourth position on the 2013 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 70 secrecy points out of a potential 100, which places it in the mid-range of the secrecy scale (see chart 1).

Cayman Islands accounts for over 4 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), though not on the same scale as huge players such as Luxembourg, UK and the USA.

Part 1: Telling the story¹

Cayman Overview

The Cayman Islands is an Overseas Territory of the United Kingdom. As such, it operates with considerable political and economic autonomy from the UK, but with a strong degree of support and oversight from the UK at the same time – a crucial reassurance for skittish owners of global financial assets. The British Queen is Head of State and the [Governor](#), appointed by London, 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’.

Formerly a rather lawless turntable for drugs smuggling and money laundering, Cayman has steadily moved upmarket and sought to squeeze out some of the more egregious forms of money laundering – and since our last index in 2011 it has introduced some welcome if limited changes to curb its secrecy offerings. Yet as our index shows, Cayman still offers a wide range of harmful secrecy facilities including a law that can lead to prison terms not only for handing over information to unauthorised parties, but merely for *asking* for it (5(1)b). Cayman also offers an array of zero-tax privileges, common with many other tax havens. It has no direct taxes: most government revenue comes from fees and duties such as import levies, work permit fees and financial industry registrations. Cayman also continues to offer the offshore staple of “light-touch” and “flexible” financial regulation.

Chart 1 - How Secretive?

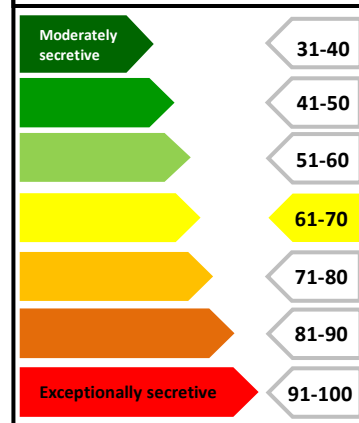


Chart 2 - How Big?



Much of Cayman's business today comes from the world's biggest banks, corporations, hedge funds and other entities and arrangements: it has grown into the world's [fifth biggest](#) financial services centre, by some accounts, [hosting](#) over 10,000 mutual funds, [second](#) only to Luxembourg. It hosts over 200 banks; 140 trust companies managing numerous trusts and other arrangements; and over 90,000 companies. It is by far the world's leading domicile for hedge funds, and the [leading domicile](#) for healthcare captive insurance companies. Financial services account for well over half of gross domestic product. Official statistics for Cayman are, in places, quite opaque; the [IMF](#), for instance, noted a major mis-match between Cayman's \$2.2 trillion in hedge fund assets and its merely \$768bn in portfolio equity claims.

The story: how Cayman became a tax haven

Like many islands in the Caribbean, the Cayman Islands served as an "offshore" pirate sanctuary as early as the 18th Century – though by no means the largest one. Its status as a tax haven today is the result of deliberate steps taken from the late 1950s, as well as Cayman's decision to remain an overseas territory of Britain, reassuring owners of international financial capital.

As late as the early 1950s Cayman was still a backwater dependency of British-ruled Jamaica with no telephone service, limited electricity supplies, no piped water, a heavy reliance on seaman's remittances, and no banks. According to the [Cayman Financial Review](#), mosquitoes were sometimes thick enough in the air to suffocate cows.

By the late 1950s, things began to change fast. An academic account explains:

Caymanians began to consider a model based on Bermuda and the Bahamas' nascent tax and exchange control avoidance businesses, Curaçao's "ring-fenced" tax regime benefitting from the extension of the U.S.-Netherlands tax treaty to the Netherlands Antilles, and the tax structuring business in the Channel Islands and Europe generally.

...

The British side of such transactions was already well developed: British banks and financial firms had more than a century of international operations, with experience to develop techniques 'only acquired by the inherited aptitudes and many years of experience'. The City [of London] had also developed considerable expertise navigating regulatory thickets.²

More surprisingly, perhaps, it seems that the promise of offshore financial service revenues were themselves a spur to Cayman's decision to separate from Jamaica in 1959:

For Cayman to enter this business would require new legal infrastructure, however, and as Caymanians explicitly feared, legislation at the Federation level could prevent it should Cayman joined [sic] the Federation.

The Cayman Companies Law in 1960, written by a Jamaican law firm and passed “as written” by the UK Colonial Office ([p22](#)), was designed with offshore business in mind. It was modelled closely on English company law, but, as a local registrar commented:

What really started the ball a-rolling were the bits of legislation offering tax concessions, and the idea that we could have a company separate from the individual, that he could shield behind the [company name].”

In other words, offshore tax and secrecy facilities.

One person who attended the launch of the Companies Act was James MacDonald, a Canadian lawyer who soon became a resident and began aggressively to promote its tax facilities overseas. And indeed, from the 1960s it was not only British but also Canadian interests that played an especially important early role in pushing an ‘offshore’ model. The first banks in Cayman with a retail presence were Barclays and the Royal Bank of Canada; Cayman’s first trust company, followed by the Bank of Nova Scotia Trust Company (Cayman), then the Canadian Imperial Bank of Commerce (CIBC).

Jamaica’s independence from Britain in 1962 provided Cayman with an early boost, as many international business interests active in Jamaica shifted to Cayman, attracted by the continued bedrock of the ongoing link with Britain as the mother country, not to mention Cayman’s more harmonious politics and race relations. A mosquito control programme made the islands more liveable, and infrastructure followed: the airport was expanded to let jet aircraft land, and the electricity and telephone networks were soon upgraded.

Over time, Britain’s colonial powers directly to control economic development in Cayman gave way to a greater degree of constitutional autonomy - in contrast to France, whose post-colonial overseas territories remained integral parts of the French state without the ability to set up their own independent and ‘offshore’ legislative frameworks. British decolonisation more broadly provided a further push to Cayman, as one account explains:

The post-war push for decolonization created the political space needed . . . by reducing British control and empowering interests within the British government which focused on the territories’ economic sustainability rather than on the impact “tax havenry” might have on the British Treasury.³

The impact of ‘tax havenry’ on other countries, rich and poor, was of no concern - as Bank of England internal correspondence ([p108](#)) illustrates:

“there is of course no objection to their providing bolt holes for non-residents.”

Cayman got its first chartered accountant in 1967, alongside an attorney called William S. Walker, who came to Cayman from Canada after finding it to be “just like the Bahamas, but new and better.” Walker helped draft trust legislation which, as a UK official later said,

“blatantly seeks to frustrate our own law for dealing with our own taxpayers.” The Cambridge-educated Walker and 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.” Increasingly, Cayman was becoming important in helping City of London businesses escape exchange control regulations, and also played a part in spurring the growth of the offshore, unregulated Eurodollar markets based in London.

In 1967 another external event boosted Cayman when the Bahamas, awash with U.S. Mob money, got its first black premier, Lynden Pindling. Skittish financial capital owners, already worried about the Cuban threat nearby, and with rising racial tensions in the Bahamas and the prospect for full independence (which came in 1973) looming, began to shift their attention to Cayman, with its reassuring bedrock of the link to London. Milton Grundy, another architect of Cayman’s early offshore laws, explained the impact of Pindling’s election ([p106](#)).

“It wasn’t that Pindling said or did anything to damage the banks,” he said, “it was just that he was black.”

As Bahamas business moved in, a solidly British and Canadian offshore sector began to attract a more pan-American clientèle, including more Latin American money. Top names in international law, such as Marshall Langer, began to promote the Caymans in the U.S. – helped by the fact that Miami is just one hour’s flight away.

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 for creating its own offshore legislation with less input from London.

Cayman’s prime offering was made explicitly 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.”

But there was, at the time, what one British government team ([p107](#)) called a “frightening lack of local expertise,” which enabled skilled lawyers and accountants to get what they wanted without any queries from inexperienced local legislators. Vassall Johnson said in 1973 that the islands did not have a single economist, and [added](#): “we have written away to the United Nations to get one.”

For a while, the Cayman Islands’ offshore centre was something of 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."

Following the 1960 Companies Law, Cayman worked hard to expand its offshore offerings, to create new offshore sectors. The Trusts Law of 1966 was next, based on British and Liechtenstein law; this was followed by laws including the Banks and Trust Companies Regulation law of 1968, based on Bahamian legislation; a new insurance law in 1979, and the Mutual Funds law in 1993.

While democratic local debate on other legislation was often vigorous, the offshore laws were typically passed with "virtually no debate" (e.g. [p41](#)) highlighting the strong degree of 'capture' of the jurisdiction by the offshore financial services industry, as we have [seen](#) in numerous offshore centres. One common feature of this capture is what has been called, in Cayman's case, "the usual solidarity over measures to protect the financial industry" ([p62](#)) and what Michael Austin, one of the first accountants on Cayman, calls "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. This is formalised in a "[Private Sector Consultative Committee](#)", a structure set up in the 1960s where private sector operators discuss the legislation they needed, and typically write it for Cayman – with relatively little substantive input from Cayman civil servants – and almost never any dissent from London ([p120](#)).

The offshore sector is also deliberately ring-fenced from turbulent domestic politics. An in-depth analysis of Caymanian political history by two U.S. academics in 2013 notes how Britain plays a part in this capture:

"The checks-and-balances maintained through the British Governor and the Caymanian civil service removed much of the regulatory system from direct political pressures. Moreover, the independent judiciary led by the Chief Justice possessed autonomy, with final appellate review lodged, as it had been throughout colonial history, in the Privy Council" ([p57](#))

From early on in the sector's development, its effects were felt elsewhere, helping set the stage for today's towering inequalities in countries around the world. The same analysis continues:

"As the Labour Party in Britain was increasingly focusing on efforts to tax passive income, British wealth was passing "outside the more exposed forms of individual title and instead through the more elusive and labyrinthine network of trusts."

Scandals began to surface too. A Canadian banker, Jean Doucet, set up the International Bank and began mailing out pamphlets about 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. When his financial empire collapse in 1974 he fled to Monaco, from where he was later extradited to Cayman and convicted.

Other countries, noticing Cayman's increasing ability to undermine their own laws and tax systems, began increasingly to complain. Cayman's response was always essentially the same – as it is today – denial of wrongdoing. Assisting in tax evasion, Vassall Johnson said piously in 1975, was “unethical.”

Just 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 - and to bolster his case, Cayman defiantly passed a new law, the Confidential Relationships (Preservation) Law reinforcing banking secrecy. Under this law, people can go to jail not only for divulging information, but merely for [asking](#) for it. An outright challenge to the U.S., it remains in place today, a powerful secrecy mechanism.

The growing surge of petrodollars into world markets, in the 1970s, combined with an end to exchange controls and the growth of the Euromarkets, dramatically increased the scale and scope of the global financial services industries, some of which spilled into Cayman. By 1980, it hosted an estimated \$30 billion in Eurodollars, some three percent of the world total, and on a par with Hong Kong and Bahrain ([p28](#) and [p41](#)).

As the U.S. and other countries increasingly sought to push back against Cayman's harmful secrecy offerings, Cayman responded with a three-pronged strategy.

The first was to mount a public relations campaign, which was already in full swing by the 1970s. Cayman monotonously described itself as a ‘legitimate financial centre’ and “not a tax haven.” Yet the essential model remained intact: the attraction of foreign money, with plenty of secrecy and few questions asked. “What we sell is confidentiality; they can't match it,” a banker [said](#) in 1981. Vassall Johnson described secrecy as “the prime support of the country, of promoting the tax haven business.”

The second prong in the strategy was to concede narrow exemptions to its secrecy. Typically, a scandal or outside pressure would result in incremental reforms, often tailored only to the particular concerns raised, and often only designed to address (and then typically 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 early steps in tackling some of the most outrageous drugs (and other) crimes committed via Caymans – though these still left doors wide open for criminals, particularly from outside the US and UK.

The third prong was to move upmarket while seeking to expand its offshore offerings, to become somewhat less reliant on secrecy, and to develop offshore financial regulatory approaches. The focus began to shift beyond private client business towards more institutional investors. Insurance companies began to appear from the 1970s, followed by offshore investment funds in the 1980s, often in search of ways to escape exchange controls and for tax advantages. [Tax avoidance](#), as opposed to wholly illegal evasion, was also actively marketed.

Yet even as Cayman moved upmarket, secrecy and tax always remained a part of the package, to the present day. Many [Cayman-incorporated Structured Investment Vehicles \(SIVs\)](#), for instance, serve as vehicles for tax avoidance and evasion on the part of some investors – though this is often not the prime reason.

The breaking open of the Bank of Credit and Commerce ([BCCI](#)), in large part by New York District Attorney Robert Morgenthau and (now TJN senior adviser) Jack Blum in 1991, opened up what was must have been the most corrupt bank in global history. With its fingers in in heroin trafficking, arms dealing to terrorist regime, wholesale corruption on a global scale, the deliberate bribery and subversion of governments and much, much more, BCCI concealed its crimes by splitting itself three ways: it had its headquarters in London, and its two main operating subsidiaries in Luxembourg and Cayman. This split evaded centralised regulation - and when the balloon went up - allowed officials in Cayman and Luxembourg to point fingers elsewhere.

Other legislation in the 1990s, notably on money-laundering, helped mitigate but not eliminate the taint from more egregious financial crimes. The legislation could pierce Cayman’s Confidential Relationships (Preservation) Law – but only in [limited circumstances](#): international bodies have continued to cite money laundering concerns, as the sections below explain. The setting up of the Cayman Islands Monetary Authority in the early 1990s, a response to the BCCI scandal, was designed to help remove some of the taint; its independence from local politics has helped insulate it from periodic corruption scandals.

Light-touch financial regulation

Cayman’s tradition has been for minimal regulation, hiding behind the argument that supposedly ‘sophisticated’ investors can look after themselves and that ‘the markets’ always know best. Until the Mutual Funds Law of 1993, for example, there were no laws regulating funds. Eduardo d’Angeolo Silva, president of the Cayman Islands Bankers Association, [said](#) in 2000 that laws to curb criminality were, in effect, ‘self regulating.’ Anthony Travers, later a chairman of the Cayman Islands Monetary authority, [explained](#):

“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.”

Cayman's responsibilities to others, it seems, were shrugged off, leaving people elsewhere to pick up the tab when things went wrong.

Other 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; or where the bankrupt U.S. telecoms giant MCI/WorldCom used Cayman companies to hide losses; and a scandal involving the disgraced Italian firm Parmalat – continued to surface. But their nature – based more on regulatory laxity than on secrecy – highlight the change from the days of BCCI, when the offering was more heavily secrecy-based.

The Cayman Islands offshore centre today

Every offshore financial centre strives to portray itself as a 'clean', cooperative and transparent jurisdiction – and Cayman is no exception. Its officials repeat this claim routinely and point, among other things, to Cayman's white listing by the OECD. Yet as we have explained [in great detail elsewhere](#), the white lists are little more than fig leaves of [only limited use](#), and Cayman only cooperates when under severe [duress](#).

Still, Cayman is undoubtedly 'cleaner' than some other secrecy jurisdictions, and on our [ranking](#) of pure secrecy scores it is only in 47th place among 82 jurisdictions. What is more, its secrecy score has improved from 77 in our last index to 70 this time, a welcome improvement. Cayman reacts more quickly than many jurisdictions to international pressures – though not always in desirable ways: when it is not pro-actively complying, it is seeking to find clever ways to sidestep new pressures, and sometimes even to profit from offering avenues for financial players to sidestep them. The approach of the European Union's pioneering Savings Tax Directive is a case in point: one account drawn from official documents summarises the approach as:

“an aggressive strategy of negotiation and threats of litigation to secure the best terms it could with respect to the Directive.” [\(p53\)](#)

As Cayman has moved upmarket, it has squeezed out many of the most egregious forms of money laundering, replacing them with more complex strategies involving sophisticated institutional players, though typically on the basis of 'softer' yet still harmful offshore offerings such as lax financial regulation and tolerance of tax avoidance. When defending itself, Cayman repeatedly points at other jurisdictions such as the City of London and Delaware, to argue that their regulations and laws are often equally full of holes: there is some merit in this argument.

Further reading:

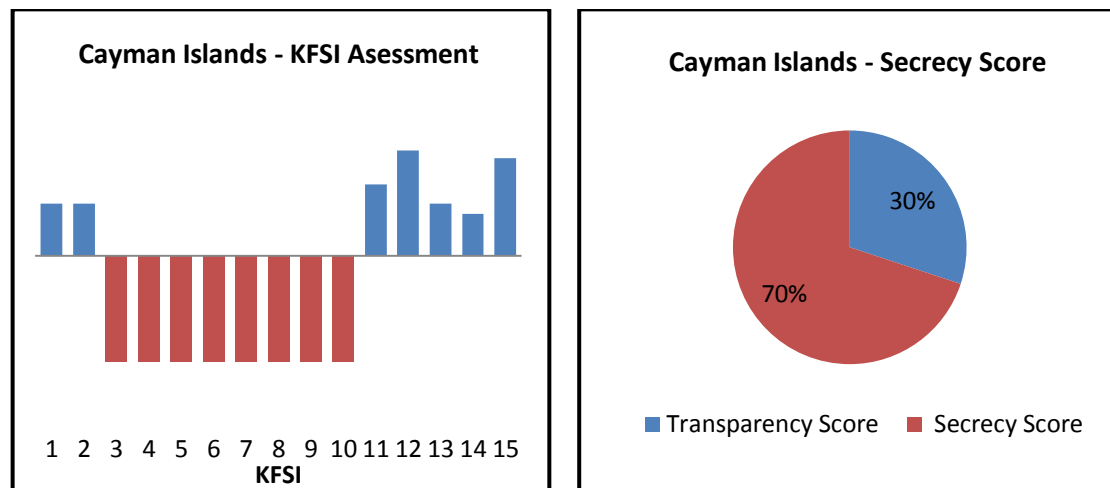
- History of the Cayman Islands, in six parts, [Cayman Financial Review](#).
- [Creating Cayman as an Offshore Financial Center: Structure & Strategy since 1960](#), Tony Freyer, Andrew P. Morriss, Arizona State Law Journal, 2013. While almost wholly uncritical and pro-tax haven, it nevertheless contains a wealth of interesting data, analysis and original source material.
- [Treasure Islands](#), particularly pp103-121 in the UK edition, which provides much political context, and explores some of the subtleties of the relationship with Britain.
- The UK [narrative report](#) provides background about the Overseas Territories and Crown Dependencies.
- [The Cayman database report](#) for our index provides more on the secrecy jurisdiction.

Next steps for Cayman Islands

Cayman Islands' 70 per cent secrecy score shows that it must still make major progress in offering satisfactory financial transparency. 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.financialsecrecyindex.com/kfsi> for an overview of how each of these shortcomings can be fixed.

Part 2: Secrecy Scores

The secrecy score of 70 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 31.12.2012⁴. The full data set is available [here](#)⁵. 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 [Financial Secrecy Index website](#)⁶.

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/foundations, or are trusts/foundations prevented? Cayman Islands partly discloses or prevents trusts and private foundations
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/€10? Cayman Islands does not require that company ownership details are publicly available online
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/€10? Cayman Islands does not require that company accounts be available on public record

6.	Country-by-Country Reporting: Are all companies required to comply with country-by-country financial reporting? Cayman Islands does not require country-by-country financial reporting by all companies
EFFICIENCY OF TAX AND FINANCIAL REGULATION – Cayman Islands	
7.	Fit for Information Exchange: Are resident paying agents required to report to the domestic tax administration information on payments to non-residents? Cayman Islands does not require resident paying agents to tell the domestic tax authorities about payments to non-residents
8.	Efficiency of Tax Administration: Does the tax administration use taxpayer identifiers for analysing information efficiently, and is there a large taxpayer unit? Cayman Islands does not use appropriate tools for efficiently analysing tax related information
9.	Avoids Promoting Tax Evasion: Does the jurisdiction grant unilateral tax credits for foreign tax payments? Cayman Islands does not avoid promoting tax evasion via a tax credit system
10.	Harmful Legal Vehicles: Does the jurisdiction allow cell companies and trusts with flee clauses? Cayman Islands allows harmful legal vehicles
INTERNATIONAL STANDARDS AND COOPERATION – Cayman Islands	
11.	Anti-Money Laundering: Does the jurisdiction comply with the FATF recommendations? Cayman Islands partly complies with international anti-money laundering standards
12.	Automatic Information Exchange: Does the jurisdiction participate fully in Automatic Information Exchange such as the European Savings Tax Directive? Cayman Islands participates fully in Automatic Information Exchange

13.	<p>Bilateral Treaties: Does the jurisdiction have at least 46 bilateral treaties providing for information exchange upon request, or is it part of the European Council/OECD convention?</p> <p>As of 31 May, 2012, Cayman Islands had less than 46 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 This narrative report is based on information up to date at 1 October 2013, however all references to FSI scores or ratings reflect the 2013 results.

² Freyer, Morriss, pp11-12

³ See [Creating Cayman as an Offshore Financial Center: Structure & Strategy since 1960](#), Tony Freyer, Andrew P. Morriss, Arizona State Law Journal, 2013, p4

⁴ With the exception of KFSI 13 for which the cut-off date is 31.05.2012. For more details, look at the endnote number 2 in the corresponding KFSI-paper here:

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

⁵ That data is available here: <http://www.financialsecrecyindex.com/database/menu.xml>.

⁶ <http://www.financialsecrecyindex.com>.