Forbes.com

Commentary

A Healthy Economy Needs Offshore Financial Centers

Charles Jennings 4.01.09

GEORGE TOWN, Grand Cayman--Whether G-20 leaders choose to recognize it or not, the Cayman Islands and other well-regulated offshore jurisdictions are key players in the international financial community, ideally placed to play a part in a solution to the present economic difficulties. Several world leaders, due to meet in London on April 2 for the G-20 summit, have pointed the finger of blame at offshore financial centers for contributing to, or even causing, the world's financial crisis. The rhetoric is heated. British Prime Minister Gordon Brown recently stood before the U.S. Congress and asked, "How much safer would everybody's savings be if the whole world finally came together to outlaw shadow-banking systems and offshore tax havens?"

The answer to the prime minister's question is simple: banning offshore centers won't make a blind bit of difference in making financial markets safer or less volatile, and in fact could make things worse. A recent report from the Financial Services Authority, the U.K. regulator, explicitly noted that offshore financial centers were not the cause of the global financial crisis. Instead, the report blamed inadequate regulation of banks in London and New York. Bashing offshore banking is just a convenient smokescreen for the shortcomings of "onshore" oversight.

The nature of business undertaken offshore is easily misrepresented, too. For example, my firm's office building, Ugland House in George Town, Grand Cayman, has drawn attention because it provides registered office services to over 18,000 companies. U.S. President Barack Obama, during his election campaign, referred to Ugland House as "either the biggest building or the biggest tax scam in the world."

This elicited cheers from the audience but overlooked the fact that there are many such places all over the world, including in onshore jurisdictions. Ugland House simply provides companies with a registered office address as required by local law, a law similar to that of every U.S. state. A single building in Delaware, for example, provides a registered office for over 200,000 companies. A well-researched report by the U.S. Government Accountability Office, the congressional watchdog, fully acknowledged Ugland House's registered office function and has helped to confirm the reality.

Here are the facts. Cayman Islands companies help American businesses, and fund managers in particular, compete for and service an international client base. International businesses with stakeholders from several countries frequently have to choose where to incorporate a business without giving any one stakeholder a "home field advantage." Also, many international investors will not invest directly in a U.S. company for a variety of good business, tax and legal reasons, such as class action litigation risk. Cayman solves these problems by enabling businesses and investors from around the world to form an entity in a neutral jurisdiction with stable political and judicial institutions, a deep reserve of local professionals, and a legal system that safeguards the rights of creditors and investors.

Cayman Islands companies engage in a range of cross-border business transactions. For example, they help Boeing sell aircrafts to emerging-market airlines; enable U.S. corporations to access global markets more competitively; enable banks to make secured loans to finance power projects in developing countries; and help hedge fund managers to attract international investors. These transactions support thousands of jobs and ultimately generate taxable business activities in the United States and other G-20 countries.

The fact that Cayman is tax-neutral does not affect the obligation of the stakeholders in these transactions to pay tax in their home jurisdictions. Cayman has repeatedly condemned tax evasion and introduced several transparency measures. It has voluntarily signed several Tax Information Exchange Agreements with other governments (including several unilaterally), shared tax information with U.S. authorities and adopted the E.U. Savings Directive in 2004, which provides for automatic reporting of accounts established by E.U. citizens. As the U.S. GAO documented, Cayman has won plaudits from U.S. federal agencies, including the Internal Revenue Service, for its timely cooperation with information requests.

Cayman operates a well-regulated financial system. Bernard Madoff, for example, could not have run his Ponzi scheme from Cayman, where local regulation requires investment managers to use an approved and registered auditor. Also, Cayman's anti-money laundering laws are recognized by the Financial Action Task Force as more compliant with international standards than those of the U.K. and by the International Monetary Fund for promoting a "strong compliance culture."

Through its investment funds and companies, Cayman acts as a crucial channel for inward investment into the major economies, including the United States. According to U.S. Treasury figures, Cayman investment funds are the third largest holders of U.S. debt, sovereign and private. Cayman investment funds are already lining up to play a role in the economic recovery by attracting international institutional investors to investment funds that will support economically productive ventures, including many in G-20 economies. For example, several funds registered at Ugland House have been established to acquire so-called "toxic assets" for international investors in the manner advocated very recently by the U.S. Treasury secretary, thus helping banks onshore to resume much-needed lending.

While overheated political rhetoric drowns out reasoned discussions on the uses of offshore centers, those who understand international economics value the role that they play. U.S. senators and G-20 leaders must beware of unexpected and unintended consequences of sweeping anti-offshore legislation that risks inhibiting the flow of capital into the U.S. and Europe at a time when it is needed most to support businesses and jobs.

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