

PART I

The past

Part I comprises the first third of the text, embracing nine chapters. The timespan is from the beginnings of 'Offshore' (say, the 1930s) until the late 1990s (say, 1998). Chapter 1 provides an overview and a brief analysis of each of the chapters that follow. More generally, this Part sets the scene, by describing the context in which 'Offshore' exists, and identifies why the lack of relevant information is problematic. Three different interest groups are identified – the marketplace, the service providers and consumers. The two factors that are at the very core of 'Offshore' (tax and regulation) are examined in detail.

Linkages

Not many people will defend tax havens . . . They make fine whipping boys.¹

1.1 The structure of the book

The three sections into which the book is divided equate roughly to the natural division between the past, the present and the future. Some licence is taken with this arbitrary division – but not to the extent that it will detract from the purposes described in the Preface.

Each chapter begins with a brief summary of its content. Many of the chapters ‘stand alone’, and can be read independently of other chapters. The object of Chapter 1 is not only to show the linkages between chapters but also to describe the core themes that run through the text.

1.2 What does ‘Offshore’ mean?

itions’ are suggested. The contributions of the OECD and of the IMF are noted in this respect. Some background information is provided on the origins of ‘Offshore’, and its development is traced. The world’s ‘Tax Havens’ (as defined by the OECD) are identified. Whether Tax Havens are the same as ‘Offshore Centres’ is a debate that is left until later, but section 2.7 shows that some writers see clear distinctions between the two.

¹ ‘The Mystery of the Vanishing Taxpayer’, 29 January 2000, Special Supplement, *The Economist*, p. 6.

1.3 The market, the buyers and the sellers

Chapters 3 and 4 identify three different interest groups that exist in respect of 'Offshore'. Chapter 3 focuses on the marketplace, that is to say the 'Offshore Centre' per se. Comment is provided on some features of 'Offshore' jurisdictions and on the legitimacy of such centres, as described by the IMF. Reference is made to the three attributes that are the hallmarks of all 'Offshore' jurisdictions – tax, regulation and confidentiality. A brief comment is provided on confidentiality in Chapter 3. A subsequent chapter is devoted to tax and regulation. Chapter 3 ends with a description of some of the characteristics of 'Offshore Finance Centres', and a comparison with some of the characteristics of mainland finance centres.

Chapter 4 considers the remaining two interest groups – the service providers and the consumers. The range of products offered by the service providers is examined in detail. The FSF's description of why OFCs are used is quoted. The consumer and his or her expectations are considered at the end of the chapter.

1.4 Three fundamental criteria for 'Offshore Finance Centres'

The three key attributes of 'Offshore Finance Centres' have already been mentioned. Chapter 5 concentrates on the second of these (tax) and Chapter 6 is devoted to regulation.

Insofar as tax is concerned, 'Offshore' infers either no tax at all or low tax (see the OECD's definition of a tax haven in section 12.3 below). On this basis, it can be no surprise that the 'Offshore' environment is a factor in many tax mitigation strategies. Chapter 5 begins with a discussion of the differences between avoidance and evasion. The chapter includes consideration of tax competition and tax harmonisation before describing the importance of 'Offshore' in tax planning. The OECD's approach to tax and 'Offshore' is described. The rest of the chapter is given over to a description of the EU's Savings Tax Directive and its implications for 'Offshore'.

It is suggested that regulation is one of the most critical components for success within any 'Offshore' arena – and the reasons for this are teased out in a description of the 'success paradigm' (see section 21.7 below). In the meantime, regulation is the last of the criteria mentioned above. It is described in Chapter 6. In the main, the people who use 'Offshore' do not live in the jurisdiction where they conduct their

business. Such people not only want to minimise their tax burden but also want to ensure that their assets are safe. This is why regulation is described as a ‘critical success factor’. Chapter 6 provides the rationale for regulation, and explains its functions by reference to a clinical analogy. As an adjunct to a commentary on the role of the regulator and supervisor, some of the components of regulation, including licensing, fit and proper, compliance and ‘Know Your Customer’, are described in detail. Reference is made to different regulatory models (e.g. Twin Peaks) and techniques (e.g. consolidated supervision). Some differences between regulation and supervision are described.

Chapter 7 expands the theme of regulation – but does so with the emphasis on the role of the regulator and the regulatory authority – within the context of evolving financial services. A number of operational matters are considered – such as training and experience, communications, boards – and some of the advantages and disadvantages of a single unified regulatory authority.

1.5 The ‘Offshore’ enigma

Much has been said and written about money laundering. It is frequently the case that ‘Offshore Centres’ are blamed for not doing more to frustrate the attempts of criminals in laundering the proceeds of their crimes and to prevent terrorists from financing their illegal activities through ‘Offshore Finance Centres’. Chapter 8 explores the extent to which this accusation is justified. The FATF and its work are considered at some length. The crime of money laundering is defined, and some of the factors that contribute to its insidious nature are described. The implications for ‘Offshore Finance Centres’ are considered before an analysis of the fight against money laundering is provided. The chapter introduces ‘Financial Intelligence Units’ and includes a description of their role and that of the Egmont Group. Reference is made to the Wolfsberg Principles. The chapter ends with some comments on the Basel Committee’s paper entitled ‘Customer Due Diligence for Banks’. Comments on the threats imposed by terrorist financing are mentioned.

1.6 ‘Offshore’ in context

The global financial environment impinges upon ‘Offshore’ in many ways – not least through the myriad organisations whose operations

bring them into close proximity with that environment. Some of these organisations are described in Chapter 9.

1.7 The supranational focus

The extent to which the 'Offshore' environment has become the focus of global attention is perhaps best understood by reference to work undertaken at the end of the 1990s by three supranational organisations.

The respective reports of the FSF, the FATF and the OECD are analysed in Chapters 10, 11 and 12, respectively. These reports are fundamentally significant because their influence on the 'Offshore' environment is direct. The involvement of the IMF and of the World Bank is also described.

The OECD published a report in 1998 entitled 'Harmful Tax Competition – An Emerging Global Issue'. The OECD believed that the development of tax systems encouraged by the globalisation of business enabled 'tax havens' to develop. The OECD's report proceeded to define a 'tax haven' and has led to substantial changes in the 'Offshore' industry.

Meanwhile, in February 2000, in order to identify anti-money laundering weaknesses generally, the FATF published a report entitled 'Report on Non-Cooperative Countries and Territories' that focused on (unnamed) countries and territories that were described as 'uncooperative' in the war against money laundering. This was to set the scene for what turned out to be a 'name and shame' exercise.

The FSF created a Working Group on 'Offshore Finance Centres'. The Group was asked to research and assess certain jurisdictions. The Group's work was completed in March 2000, and its conclusions were published in the 'Report of the Working Group on Offshore Financial Centres'. A survey (of both mainland and 'Offshore Finance Centres') was undertaken to obtain appropriate information. The results of the survey were used to classify those jurisdictions that were considered to have significant 'Offshore' activities into three categories according to their perceived quality of supervision and degree of co-operation.

1.8 Problems associated with some financial environments

Chapters 13 and 14 are a mirror image of each other. They describe some of the problems that affect the global financial services network.

Chapter 13 focuses on 'Offshore' and Chapter 14 looks at mainland jurisdictions – sometimes called 'Onshore'. There are many reasons for problems in financial services jurisdictions and it is naïve to suggest that merely tightening the rules will eradicate all weaknesses. Some of the examples cited will indicate why this is so. It is also the case that any jurisdiction that wants to continue in business as a financial services centre in the longer term cannot tolerate weak regulation and control. To do so would weaken the foundations on which meaningful growth will depend.

The following quote gives food for thought: 'It is often suggested that markets push governments into complying with international standards . . . At most . . . markets will encourage countries to claim to implement international standards, but will not encourage them to implement standards properly.'²

1.9 'Offshore' and small island jurisdictions

Chapter 15 presents some (brief) comments on the correlation between 'Offshore' finance and small island jurisdictions. The chapter indicates some of the tensions that exist in such environments and also describes some characteristics that make small islands ideal for the conduct of financial services – but at a price!

1.10 An overview of some financial centres

In order to 'globalise' the matters under discussion, Chapter 16 presents some information and figures that indicate the size of the 'Offshore' environment. However, there are problems in trying to do so because the statistics available are limited and because 'Offshore' centres are in a period of continuous change. Within limitations, the chapter provides a snapshot of how things stand currently in some jurisdictions. The information is not comprehensive – this is not the purpose of the text.

² J. Ward, 'Is Basel II Voluntary for Developing Countries', December 2002, *The Financial Regulator*, Vol. 7, No. 3, p. 54.

1.11 The extent to which ‘Offshore’ business is restricted to ‘Offshore’ centres

Chapters 17 and 18 present some information on two of the world’s largest – and most respected – financial services centres. A closer look at what happens in the United States and in the United Kingdom indicates that what might be described as ‘Offshore’ business is carried on in centres other than small islands located off a mainland. The chapter further indicates that even the largest financial services jurisdictions face challenges.

1.12 ‘Offshore’ and financial stability, money laundering and tax evasion

‘Directors [of the IMF] recognised that OFCs could pose risks, associated with prudential and financial integrity concerns, to the international financial system.’³ This is so, despite the fact that ‘only limited evidence was available that far on the direct risks posed by OFCs for the global financial systems’.⁴ There are at least three areas in which ‘Offshore’ impinges upon the global economy – financial stability, money laundering and tax evasion. Chapter 19 considers the extent to which ‘Offshore’ is the cause of difficulties in respect of each.

1.13 ‘Offshore’ and the future

Chapter 20 attempts to tease out some options for the future of ‘Offshore’ post FSF, FATF, OECD and the catastrophic events of 11 September 2001 in the USA. There may be a direct correlation between the general public’s perception of finance centres and their ultimate survival. The question is whether in fact there are really any options at all.

1.14 Assessment criteria

The penultimate chapter of the book, Chapter 21, is a practical chapter – in that it provides some suggestions that users and potential users of

³ *IMF Executive Board Reviews the Assessment Program on Offshore Financial Centres*, 24 November 2003, IMF.

⁴ *Offshore Financial Centres – The Assessment Program – A Progress Report and the Future of the Program*, 31 July 2003, International Monetary Fund, p. 5.

‘Offshore Centres’ might consider in deciding whether to use offshore centres at all, and if so which, jurisdiction they might use.

1.15 Conclusion

By way of a brief recap, the last chapter, Chapter 22, draws together some of the themes that have been examined in the previous chapters. The chapter concludes with some crystal ball gazing.

The 'Offshore' environment

The demonstrated success of most of these [Offshore] centres and their liberalised financial regimes has to an extent rewritten the geography of world finance.¹

2.1 Introduction

Jurisdictions that provide financial services can be broadly categorised as being 'Onshore' or 'Offshore'. These two financial environments co-exist within the global economic environment. This chapter starts with a brief explanation of the origin of the 'Offshore' environment and then proceeds to identify jurisdictions that might be described as 'Offshore Finance Centres'. The growth of the sector is described in terms of available statistics.

2.2 Geographical dispersion

There are many ways in which the geographical dispersion of the 'Offshore' environment can be analysed. Here are two examples. First, Johns² believes that 'Offshore Centres' fall within the following four regions:

- the Caribbean Basin (e.g. Bermuda, the Bahamas, the Cayman Islands, the Netherlands Antilles and Panama);
- Europe (e.g. Switzerland and Luxembourg);
- the Middle East (e.g. Bahrain and the UAE); and

¹ C. F. Kerr and P. Donald, 'Some Aspects of the Geography of Finance in Canada', in *Readings in Canadian Geography*, ed. Robert M. Irving, Toronto, Holt, Rinehart and Winston, 1965, as quoted in R. A. Johns, 'A Study of Trans-national Economic Development', *Tax Havens and Offshore Finance*, Frances Pinter (Publishers) Ltd, 1983, p. 34.

² R. A. Johns, *Tax Havens and Offshore Finance – A Study of Transnational Economic Development*, Frances Pinter (Publishers) Ltd, 1983, p. 191.

- the Far East (e.g. Hong Kong, Singapore and Vanuatu).

Elsewhere, five regions have been identified as follows:

- Africa (e.g. Mauritius, Seychelles);
- Asia and the Pacific (e.g. the Cook Islands, Labuan, Nauru, Niue, Samoa etc.);
- the Caribbean (e.g. Anguilla, Antigua, Aruba, the Bahamas, Barbados, the Cayman Islands etc.);
- Europe (e.g. Cyprus, Gibraltar, Guernsey, the Isle of Man, Jersey etc.); and
- the Middle East (e.g. Bahrain, Dubai, the Lebanon).

Whether either of these categorisations is precise, or even whether any other is more precise, is not the most significant point. The most important point is that, despite how such jurisdictions are dispersed, they are not represented by a single global organisation. It might be argued that this is not surprising in light of this sort of dispersion – but, precisely because of their dispersion, there is an even greater need to be identified by a collective grouping within a sole forum. Each jurisdiction is relatively small so the potential synergies arising from combining forces seem worth considering. The implications of not having done so remain to be seen.

In the meantime, the geographical spread might have something to do with the intrinsic secretiveness that is or was the hallmark of every member of the 'Offshore' community – and which prevented the interdependence that a single forum infers. This individualism has been counter-productive generally, not least when it came to negotiating with the supranational organisations about issues that are common to all (see Chapters 10 to 12). The implication is that it has been easier for the supranational organisations to impose their will on individual jurisdictions than it might have been if the supranational organisations had to deal with a composite, representative body. The Offshore Group of Banking Supervisors (see section 9.21 below) comes closest to being that representative – but, since 'Offshore' comprises much more than banking, the OGBS's focus, while significant, is not comprehensive. There have been some suggestions about how best to tackle representation, but at this moment, there are no firm plans for change. Historically, when Americans want to use an 'Offshore Centre', they have tended to use the jurisdictions located in the Caribbean. By way of contrast, the Isle of Man and the Channel Islands (Jersey and Guernsey) have been used by