The Financial Services Industry: Is it on the Verge of Extinction?

In the Affirmative, Contribution by
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Introduction

It is a privilege to have been asked to participate in this debate on the future of our financial services industry along with my colleague Brian Moree.

My contention is that the industry as we have known it for decades is undergoing rapid and irreversible change. We are not simply witnessing an evolution in the industry. Instead, the very basis for our model has changed.

We are moving from the by-gone days of absolute secrecy to information sharing agreements with a growing roster of countries.

The OECD's aggressive demands for Tax Information Exchange Agreements (TIEAs), and the fact that many jurisdictions, including Switzerland, the gold standard in financial services, have all now agreed to sign a raft of these agreements is a decisive signal that a client's reasons for being offshore are changing – dramatically.

If the industry and the various jurisdictions are unable to innovate and create new value for clients – we are headed for extinction

Further, for a variety of reasons, we will have little choice as regards to moving from a zero percent tax jurisdiction on corporate profits in the industry to some type of arrangement that is aligned with growing international demands and standards.

Slogans, past glory and wishful thinking are irrelevant: It's what we are in function and fact that is relevant and will help to define the new international landscape as regards to financial services.

Climate Change

Recent storm clouds, among them recent events in Liechtenstein and the UBS case, are but symptoms and warning signs of a broader climate change in geopolitics and the global financial services industry.

Unfortunately, many of us still believe that these are passing clouds, rather than a gathering storm that has begun to wash away many of the fundamentals we have taken for granted since the inception of our own entrance into the financial service sector in the middle of the last century.

This climate change involves a critical economic security issue for much of the Western industrialized world, an issue that came to the forefront even before a global financial meltdown that has made economic conditions even worse in those countries pressing for radical changes in offshore tax havens such as The Bahamas.

The issue for these countries is quite simple – they desperately need the tax dollars resident in international offshore tax centres. This economic security issue is a matter of survival and national security for these countries.

To maintain its generous social welfare model and make up for the extraordinary fall-off in its tax revenues generated by being an export-driven economy in such dire economic times, Germany has become unrelenting and aggressive in pursuing the money its citizens have relocated in offshore tax centres.

How aggressive? We will come to that momentarily. But with a reported $485 billion in undeclared assets deposited abroad, German authorities will not be deterred.

To help find some of the trillions of dollars needed to maintain its triple A rating, satisfy its major creditors, finance looming deficits and entitlements, including an overhaul of its health care system, the United States has also joined in a concerted effort to force an end in banking secrecy as we know it.

The old mantra, that the Republicans were better for The Bahamas when it came to such issues is now irrelevant as U.S. politicians across party lines and ideological divides are now of one accord, bedfellows in pursuit of the common goal of tracking down the dollars needed to keep America afloat.

The UBS case, which we will also come to momentarily, is but another warning shot from our American neighbour.

In the UK, we may have to wait until after a general election to learn exactly how poorly are its finances. But, this we know: When Prime Minister Gordon Brown wanted to introduce a second major stimulus package this year, he was warned off by Bank of England Chairman, Mervyn King who advised that the public finances would not allow for another package.

Whether denominated in pounds, dollars or Euros, the industrialized world, through individual action and multilateral force through groups such as the OECD, are effectively dismantling many of the core raison d'êtres for offshore tax centres

More Storm Clouds

After the OECD challenge of 2000 many thought that the worse was over. But the herd of elephants stampeding to smash overseas tax havens had only just gotten their trunks under the proverbial tent. Or, to employ another metaphor, the goal post we were given after satisfying the OECD and others has once again been moved.

And, to be sure, it will not be the last time that the post will be moved.

The case of Liechtenstein is chillingly instructive, and sent fear and shock waves around the world, with aftershocks that are continuing to reverberate.

Indeed, if what occurred there had happened in The Bahamas, we would not be having this debate.

But since this debate is happening within the context of the large shadow cast by events in Liechtenstein, how does what happened there affect us?

You will recall the events in this case. In 2008, Germany paid a former employee of the LGT Group for a computer disc with details of its citizens and other nationals using this Liechtenstein based foundation to avoid taxes in their home countries.

The Germans estimated that they were losing $5.9 billion U.S. dollars a year from accounts in Liechtenstein alone.

This aggressive act of paying for the information, then helping the individual in question relocate to a third country, was followed by a series of other aggressive steps.

To pressure tiny Liechtenstein, Germany threatened to refuse Schengen privileges in the EU passport free travel zone. Germany went on to share the information with the U.S., U.K., Australia, Canada, France, Italy, New Zealand and Sweden.

A number of these countries then launched their own investigations into tax avoidance by their citizens in Liechtenstein.

By this time catastrophic damage had been done to the principality's reputation and the confidence many had placed in its secrecy and confidentiality.

To avoid its own looming extinction Liechtenstein began signing a variety of TIEAs. The country also tightened its own internal regulatory regime for banks and fiduciaries.

Now, banks are now obligated to identify clients and source of funds, to report suspicious movement of funds, and to guarantee legal assistance to foreign criminal investigations.

Liechtenstein also had to change its tax regime, and now provide for a 12.5 percent flat corporate tax, which is a platform that may allow them to enter into double taxation treaties.

Liechtenstein's experience will become our future.

Even Switzerland, in a much stronger position than Liechtenstein and The Bahamas, has had to change. It now has a double taxation treaty with the U.S., article 26 of which has the same effect as a TIEA.

Switzerland has also had to step in to protect UBS, which, for a variety of reasons has come under concerted pressure by U.S. authorities. The handing over of the names of over 4000 high net worth individuals to the U.S. may be only the beginning of longer term assault on bank secrecy, of which Switzerland is the gold standard.

UBS' agreement with the U.S. government has also sent shockwaves and opened the floodgates for all manner of agreements and deals that will fundamentally change the world of tax avoidance.

And the US has been aggressive in targeting UBS executives for possible prosecution. You may be aware of the incident involving Martin Lechti, who was the Zurich-based head of North and South America for UBS's international wealth management business who was detained as a "material witness" while visiting Miami.

As an aside, I have been told, but cannot confirm that Mr. Lechti may have been on his way to The Bahamas.

If Switzerland will no longer be Switzerland, how can The Bahamas, once nicknamed the Switzerland of the Caribbean, maintain its position?

Well, we all agree that it can't. The debate is about the nature of that change. Our core business was private banking servicing high net worth clients as a result of a zero percent tax platform and confidentiality.

Now, both of those foundations are on the chopping block.

The 2000 assault by the OECD though more dramatic in some ways, was the beginning of a dramatic permanent international climate change for offshore tax centres.

We can either deny the magnitude of the change or we can begin to more aggressively respond to the inevitable. It has been one of our conceits to believe that since we have always survived, this is just another series of events which we will easily ride out.

Some of us are so busy looking at the blue skies of yesterday that we can’t believe that the looming storm clouds are a serious as they are.

Our Response:

The old order, in fairly short order, will be defunct. To survive we will need a carefully configured strategy, rather than maintain the status quo.

We already know that to get off the OECD’s grey list we have agreed to sign TIEAs with a variety of countries and propose to so do with a number of others. While we cannot resist signing TIEAs we should carefully negotiate the details.

But more will have to be done. We should pursue a carefully calibrated strategy.

In addition to increasing our information exchanges we will also have to probably introduce some type of corporate tax with a low rate to bring us in line with OECD standards and the EPA, as well as meet other obligations related to accession to the World Trade Organization.

Changes to our tax code will decrease the pressure on us and will also enable us to go after markets like Canada, which has a double taxation treaty with Barbados, giving that country greater access to that market.

Moreover, we have some sophisticated wealth management tools that we should hold on to, and which can be used for tax deferral and estate planning purposes that will be in line with internationally recognized standards.

But, there is even more that must be done. We have to be proactive, not only to secure our interests but also so that we are perceived to be working within the mainstream.

Unlike jurisdictions such as Singapore and Hong Kong, our infrastructure has been lacking, especially as regards to a more highly trained cadre of human resources more open to rapid change and cutting edge innovation.

Recently, you may recall, that in terms of ranking for competitive purposes done by the Global Financial Services Index, we ranked 35th out of 59 jurisdictions reviewed.

The rankings were done in relation to: business environment, market access, general competitiveness and infrastructure. Cayman was ranked 21 and the British Virgin islands came in a 29.

In many areas of national life we are often complacent, resisting the need for reinvention. Just as we must reinvent critical elements of our tourism industry so we must do in financial services.

For example, Mexico, the second largest economy in Latin America has blacklisted us. With some key changes we can enjoy greater access to that market whose high net worth sector continues to grow by 12 percent a year.

To avoid extinction we will need to widen our narrow parameters. Similar to Delaware we should seek to create a larger cadre of skilled workers in the legal field, and consider the creation of a commercial court which will specialize in related matters.

And, because groups like the OECD may have overreached, scores of high net worth individuals may begin to follow their money to welcoming jurisdictions.

We should therefore streamline our various processes so that these individuals can easily relocate to The Bahamas, bringing with them a capital pool which can assist us with national development.

This may necessitate the elimination of exchange control, which the current administration has pledged to do. The elimination of such control will make our stock market more efficient, eliminating the current two tier system between domestic and international stocks.

Just as we are an open international open shipping registry, we can simultaneously become an international arbitration centre, which I am informed is under active consideration and some preparation.

Conclusion:

What we will become tomorrow requires urgent action now if our financial services industry is not to become an historic memory.

I support the motion that we are headed for extinction unless we make the urgent changes needed to ensure not simply the bare survival, but, more critically, the retooling of our financial services sector.