A WORLD WITHOUT IFCs

International Financial Centres – Be Careful What You Wish For

By Marcus Killick, CEO, Isolas LLP, Gibraltar

If, as some would wish, the International Financial Centres that some still refer to as 'tax havens' simply ceased to exist, what would happen? The global economy might not grind to a halt but the criminal activity that certain parties still accuse the small centres of, may actually get worse. Corruption and money laundering would increase not decrease. It is the better small centres that now have the tightest controls, whilst scandal after scandal plagues banks in larger centres (one only has to look at Danske Bank or the central London property market for evidence of this). Furthermore, international trade would become less efficient and therefore more costly. Competition would lessen. For those who continue their misguided attacks on the small centres, be careful what you wish for.

As I reached for my keyboard to commence another article on the merits of International Financial Centres (IFCs) it occurred to me that I have now been writing such articles for nearly 25 years. Of course, IFCs were referred to differently then, normally 'tax havens'. After that we had 'Offshore Financial Centres', another meaningless and factually inaccurate term (Luxembourg and Switzerland were landlocked last time I checked an atlas). This brief moment of reminiscence led me to consider, is the term IFC any more meaningful than either of its predecessor terms?

I have yet to come across a definition of an IFC that is accurate enough to be meaningful. The pejorative attempt to do so, by saying they were uncooperative, secretive and with weak regulation, never got very far when it was quickly discovered that the centres they wanted to include were none of these things.

That is not to say that historically a number of the smaller centres were not guilty of all of these things. A number possessed and even prided themselves as having statutory banking secrecy, virtually non-existent anti money laundering controls, an unwillingness to assist any international enquiry, opaque trusts and banks willing to operate accounts anonymously. Indeed, this was business as usual in some places. They facilitated tax evasion on a massive scale and helped drug dealers hide their profits. Not all centres were like this, but enough were to contaminate the reputation of the rest.

Yet that was then. Moving forward, any Austin Powers style 'Dr Evil', able to time travel from those times to now, would feel himself not only in a different time, but on a different planet. Automatic sharing of tax information, public registers of beneficial ownership (well, soon), banks who, if someone walked in with a briefcase of cash, would reach for the phone to call their local financial intelligence unit, rather than reach for the account opening form; these centres are now certainly more bureaucratic but the financial institutions in them are safer

Those who claimed that international cooperation and the end of secrecy would be the death knell of IFCs were wide of the mark. Business still comes; different business but better business. So how did we find this role, and why have we been so successful?

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Cross Border Trade is Beneficial

The simple answer is that, unless you have a North Korean approach to world engagement, we live in an interconnected world. Cross border trade in goods and services, provided it is done on a fair basis, benefits both parties. Ideally it should be as frictionless as possible. Yet, whilst technology advances at a frightening speed, the mechanics of tax and tariffs tend to be more byzantine in their approach. Trade can often involve a accidental triggering of double taxation, reducing its efficiency and attractiveness.

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The transparent use of tax-neutral centres as part of the trade process helps alleviate this. Tax is paid where it should be, not where it shouldn't.

Similarly, the increase in international scrutiny, including onsite reviews, of centres' compliance with expected regulatory standards has led to increased confidence in those utilising them. Knowing that the counterparty you are using is appropriately regulated and supervised gives a security that had never previously existed. Indeed, these centres are increasingly being used as safe rather than secret havens in times of insecurity in an individual's or firm's home jurisdiction.

Increased international commerce has also led to an increase in internationally mobile workers and their families. This mobility covers all spectrums of the workforce. Not all countries have double taxation treaties with each other, therefore a tax neutral jurisdiction is an important element of both personal tax and estate tax planning. This attraction is further enhanced by the fact that a number of centres, particularly the UK Crown and Dependent Territories, generally have a rigorously enforced rule of law and low rate of corruption.

The improved reputation that the loss of the stigma of secrecy and non-cooperation has given also allows firms a freedom to select a jurisdiction of residence without the risk of that jurisdiction being placed on a blacklist.

Tax Moderators

The small centres also act as a tax moderator. Fair tax competition is practised throughout the globe. It helps promote efficiency in Government spending and is a healthy guardian against excess. Penal taxation is also unfair taxation. Without this, larger centres may be tempted to introduce such taxes on individuals and companies who might be less economically mobile.

However, by far the biggest contribution the centres make is in innovation and speed of response. The size of the centres promotes a greater synchronicity between Government, regulators and industry. The private sector generally has far greater access to (but not influence over) the public sector. Legislation can be passed faster, and regulations enacted or changed more swiftly.

> **"Globalisation is with us. Of course, improvements can be made. However, those who dream of walls and tariffs between nations are creatures of the past, not yet extinct and still dangerous, but the fossils of the future."**

A perfect recent example of this is in the area of distributed ledger technology. (DLT). Whatever one's views on Bitcoin and other crypto currencies, it is clear that DLT, or Blockchain as it is sometimes described, has the potential to materially change the manner in which transactions are undertaken. Like any disruptive technology, the opportunities come with risks including the extreme volatility of the crypto currencies, fraud, market manipulation, and theft..

It has been centres such as Gibraltar that have not merely embraced the new technology but, more importantly, led in creating a suitable regulatory structure in which DLT can thrive and investors obtain a level of protection. Such an approach would be impossible in larger jurisdictions with more cumbersome regulatory and legislative structures. These larger players are effectively at least during the initial phases, left with the choice of banning DLT and crypto or letting it have free rein, neither option being conducive to sensible growth.

DLT has been but one manifestation of where smaller centres have become the petri dishes or sandboxes for financial service innovation. From insurance to funds, these centres have been the origins of subsequent mainstream products. Without their existence such products would have taken years to be brought to market, if they would have been taken at all.

This speed to market also exists at a firm as well as a product level. The process of licensing new financial service businesses tends to be far faster in the smaller centres. The process is no less rigorous, but speed is delivered by the centre's size and the ability of applicants to deal with regulators at a more senior level than would normally be possible in the larger centres. Better communication creates better understanding. These firms, which are almost always outward facing, can then provide their services to markets which would otherwise be deprived of such choice.

Economic Benefit

Small centres are also of direct economic benefit to their larger neighbours. Gibraltar provides employment to thousands of cross-border workers, in an otherwise economically disadvantaged region of Spain. Money flowing into Channel Island banks from around the world does not stay there but flows on to London, so helping the City.

The world has been right in encouraging and sometimes cajoling or even threatening some small centres to improve their standards. These centres were not the ground zero of money laundering, fraud and the hiding of assets, but many did participate and facilitate this in the past. In truth, the larger centres were no less guilty. Nor indeed have these unfortunate by-products of a free market system gone away. But they have become more difficult to carry out and easier to detect and punish. Indeed, a number of small centres have been at the vanguard of such improvements.

Globalisation is with us. Of course, improvements can be made. However, those who dream of walls and tariffs between nations are creatures of the past, not yet extinct and still dangerous, but the fossils of the future. The world is interconnected and interdependent. Small financial centres would not exist without their larger counterparts; however larger ones would not thrive or be as efficient without their smaller siblings.

We do however need a new term. All financial centres are international in some shape or form; many have more international business than domestic. The percentage mix should not be the differentiating factor. If you want to differentiate the compliant from the remaining ones, who fail to meet the standards required of them (and some of these are very large centres), let's just call the good ones 'Internationally Integrated Finance Centres'. IFC