Timothy Ridley: Reading the tea leaves – whither the private trust industry in the Cayman Islands

Remarks by Mr Timothy Ridley, Chairman of the Cayman Islands Monetary Authority, at the 10th Anniversary Dinner of STEP Cayman, George Town, Grand Cayman, 25 October 2006.

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First, may I thank the STEP council for paying me the honour of inviting me to address you on the occasion of the 10th anniversary of STEP Cayman. Secondly, I must issue the usual caveat that my comments tonight are personal and do not necessarily reflect the official Cayman Islands Monetary Authority (CIMA) position. Finally, may I warn you that it is indeed daunting to speak to those who are considerably more expert than I on trust and trust related matters. So please consider this an avuncular 'fireside chat" from a retired warhorse that must be suffered politely by those paying for his nosebag.

We have enjoyed a breathless two decades in the Cayman Islands and not simply due to Hurricanes Gilbert and Ivan. Cayman and other small international financial centres (SIFCs as we are now termed) have struggled to deal with the onslaught of the UK, the US, the EU and their client alphabet soup international standard setters (who seem dedicated to the game of leapfrog). The enthusiasm of the UK is particularly ironic, given that the mother country had for many years encouraged her offspring to develop as financial centres in order to reduce the financial burden on the UK. The cost to the SIFCs in terms of financial and human resources and lost opportunities has been significant, as was perhaps the very intention of the anti competitive and protectionist drivers of the onslaught. But by dint of fleet footwork, hard work and some good fortune we have survived and indeed thrived and have become an important cog in the wheel of global capital markets. But the onslaught is by no means finished. Indeed we may merely be at the end of the beginning. Where the initiatives can be expected to go next must be left for another evening.

Tonight, I propose to spend a little time on the subject nearest and dearest to the hearts and minds of many a STEP member. If there is one piece of the Cayman success story that lacks the full luster of the others it is perhaps the private client segment. It may very well be not so much that Cayman is losing ground to its competitors but that private client and trust business, while reasonably successful, has been overshadowed by the overwhelming success of the banking, insurance, structured finance and more recently fund industries that have been the primary focus of the local and international professionals and service providers. Dare I say it, because the pickings have been far better. Local anecdotal cocktail party chat seems to be that we think we are perceived as not much interested in private client and trust work, as not being the dynamic innovators we once were and as not having moved with the times both to innovate and also to relax some of the more burdensome aspects of our regulatory regime, particularly with respect to the licensing of private trust companies. Against that, we still have an excellent cross section of major brand named trust companies and a good and growing number (around 80) of licensed private trust companies. Of course we do not know the number of private trust companies in our main competitor jurisdictions as they are generally not required to be licensed.

Over the past few months I have been informally polling local and overseas professionals to ascertain their views. It is certainly the case that the feedback from the local enquiries was somewhat pessimistic. The overseas feedback less so.

Apart from immigration, the high cost of doing business in Cayman (including may I say local professional fees) and the knock-on effects (subjects for yet another evening), the common theme from most local (and some overseas) professionals is the uncompetitive regulation or overregulation of private trust companies and the cumbersome and sometimes intrusive licensing procedures. Following discussions between CIMA and STEP, I am hopeful that you will see an improvement in the processing of applications and a reduction in the time taken to carry out the due diligence. In particular, CIMA welcomes an early filing of the details of directors, shareholders, settlers etc so we can commence our due diligence as early as possible. We are also reviewing the personal questionnaire to see if it can be shortened and also made more "user friendly". The proposal that CIMA issue a general advisory or guidance as to what we consider not "carrying on trust business" and thus not requiring licensing runs the risk of making black white and did not find favour with us. So

we will not be so proceeding. Nevertheless, CIMA will continue to entertain specific submissions for "no action" letters as has happened occasionally in the past.

The foregoing may be a temporary band-aid. We at CIMA very much prefer to see a legislative solution to the problem and have so indicated to STEP. I believe the Deputy Financial Secretary, Ms Deborah Drummond, leans to this view also. I personally would be supportive of a less stringent regime, given that an application of CIMA's internal risk rating has resulted in nearly all existing licensed private trust companies being categorized as "low" risk. But these matters are not always as simple as they may first seem. We must be mindful that there is significant pressure from outside to extend regulation rather than reduce it. And it is necessarily more difficult to argue the case for deregulation than simply not to regulate something in the first place. On the other hand, I am not aware that there was any in-depth analysis of the need to regulate private trust companies in the early 1960's immediately prior to the enactment of the Banks and Trust Companies Law in 1966 (Cayman simply copied the Bahamas legislation lock, stock and barrel). Demand for the animal in the form we now know it was small if not non existent. Wealthy settlors (often with inherited UK/US wealth) were content to entrust their assets passively to brand named trust companies. Today, the drivers of the private trust companies are very much entrepreneurial families from all around the globe who have little time for traditional corporate trustees and who wish to control more closely the investment of the assets. Equally, old line corporate trustees struggle to fit the demands of such clients and their risk appetites within the traditional trust framework. The best solution to these frictions is often the private trust company controlled by the family (or family friends or friendly trustees or charities) perhaps administered by an unrelated corporate trustee (or more likely by the family office).

Since CIMA's position is that regulation must meet the test that it be necessary, appropriate and proportional and that the benefits must outweigh the burdens and costs, it seems to me very timely that we revisit the 41 year old regulatory regime for private trust companies in that light. Prima facie, it appears to me the burdens of the current system outweigh the benefits. This is underscored by the fact that a number of key competitor jurisdictions such as Bermuda, BVI, Jersey and even Singapore choose not to regulate private trust companies or subject them to a lighter touch. Further, there is currently no international standard setter mandating the regulation of trust companies or company managers. To-date CIMA has followed the Offshore Group of Banking Supervisors Statement of Best Practice for Trust and Company Service Providers. This Statement interestingly notes that a number of jurisdictions do not regulate trust and company service providers, but does not specifically address the issue of private trust companies, although it does recognise a "lighter touch" is appropriate for those, such as company formation agents, who do not act as trustees.

Cayman has recently set something of a precedent by reducing the regulation of debt issuing trustees wholly owned by licensed trust companies. I hope that this first toe in the water can be the basis for a broader review of the regulatory regime so that we can enhance Cayman's attractiveness for Islamic finance structures (that require the use of a special purpose trustee company) and for family/private trust companies by reducing the level of regulation or by eliminating it entirely. My personal preference would be to amend the definition of "carrying on trust business" in the Banks and Trust Companies Regulation Law so that the activities of a typical special purpose trust company or family/private trust company fall outside the scope of the Law.

There is proper concern about not watering down the scope of our anti money laundering regime. It is arguable that the general AML regime that applies to all Cayman entities is sufficient for private trust companies. An alternative would be to require that any private trust company (even if no longer licensed) continue to appoint a local unrestricted trust company as its authorized agent with responsibility for ensuring AML compliance. While on the subject of AML, I should mention that the Guidance Notes Committee has started its work to see how we can move our AML regime to a more flexible (dare I say it common sense) principle and risk based system rather than the current overly prescriptive and rule based system. This will certainly help reduce the unfortunate perception of Cayman's gold-plated and over egged regime.

There are also concerns about the loss of revenue to the Government if the existing 80 or so restricted trust companies were to deregister. No doubt the auditors would also file objections but I think we could safely ignore those. To solve the loss of revenue, I would suggest that the precedent set by the mutual fund industry be followed. So if the sector servicing private client business recommends deregulating private trust companies, I trust they will support the quid pro quo of an increase in their fees to balance the Governments books.

The final issue is how to retain some overall monitoring and to obtain useful statistical information about the number of private trust companies in existence in Cayman. I personally dislike a system whereby CIMA does not (properly) regulate an entity yet still bears the reputational risk because there is a filing or registration with it, and perhaps a nominal fee. And I think we need to steer clear of words such as “exempted” or “excluded” as these seem now to raise red flags in the eyes of the alphabet soupers. One suggestion to consider is that there be a separate PTC category under the Companies Law (perhaps in the same manner as LDCs or SPCs) in a way that would enable the Government to keep track of the number of these entities and also charge an additional fee! An alternative may be to require the local authorized agent to file with CIMA or the Government a quarterly list of its unregulated private trust company clients.

Let me now turn to what we might consider doing to regain our reputation for innovation. Let me back up a little by saying that I do not think that “compliance fatigue” alone stopped us innovating. For many years Cayman was the leading inventor and enhancer. In the trust field alone we saw the Fraudulent Dispositions Law, the Trusts (Foreign Elements) Law, the STAR trust, the Perpetuities Law and the reserved powers trust. But inevitably the speed of innovation slowed as we could find no new Holy Grails. Other jurisdictions simply turned the photocopier on (as admittedly we do too), and there has thus been a great convergence of products in the various competitor jurisdictions. But there are some things out there we should look at. And we must always listen closely to what our business producers are telling us. So I put these ideas forward for you to chew on. First, should we abolish the rule against perpetuities entirely and allow South Dakota style dynasty trusts and as also proposed in some SIFCs. Second, should we reduce the 6 year period in our Fraudulent Dispositions Law to match that of the Bahamas? In this connection, is our Bankruptcy Law a potential deterrent to wealthy clients actually coming to live here (check the sections on settlements)? Third, should we move ahead with a Foundations Law? Fourth, should we revisit extending the Hague Convention on Trusts to the Cayman Islands? Fifth, would investor protection treaties help? Sixth, should we include a Delaware style statutory limitation on trustees’ liability? Seventh, what can we do to deal with the long term threat that the EUSD will be expanded to include all types of passive income and cut-through provisions applicable to companies, trusts, partnerships and other entities (even Foundations and Anstalts!)? Lastly, is our court and judicial structure of respected generalists the right one for increasingly complex and lengthy litigation?

These are all ideas that various of you and your overseas colleagues have floated. I suggest that the time has come to stop floating and to get some focused discussion and agreement on what should be done. I know that STEP will find that the Deputy Financial Secretary will lend a willing ear.

I hope this evening I have given you some small cause for optimism and much food for thought. Thank you very much for listening.