



GOVERNMENT OF BERMUDA

Ministry of Finance

Submission to UK House of Commons Treasury Committee's Inquiry into Offshore Financial Centres

"Bermuda's Role in the provision of International Financial Services"

Submitter

1. Ministry of Finance makes this submission on behalf of the Government of Bermuda in response to the Treasury Committee press notice no.42 dated 30 April 2008 regarding the inquiry into Offshore Financial Centres.

Executive Summary

2. Bermuda's modern economy is based primarily on international business and tourism. International insurance and reinsurance is the dominant component of international business. The volume of premium flows (US\$116 billion) and the size of total assets (US\$440 billion) in 2006 position Bermuda as one of the top insurance markets in the world.

3. As a world market for insurance and reinsurance, Bermuda bolsters global financial stability through the efficient spread and diversification of insurance risk and provides market-driven solutions at the pace of modern business.

4. Bermuda's long-established consumption-based tax model assists in the efficient accumulation and deployment of capital on a global basis and results in greater competitive pricing for insurance premiums.

5. Bermuda has not adjusted its tax base to attract mobile capital from other jurisdictions.

6. Bermuda has a strong tradition of KYC in its business culture. Its institutional and legal framework for the supervision and oversight of financial services is based upon recognised international standards established by standard-setting bodies for the purpose of enhancing transparency and financial stability.

7. Bermuda embraces international cooperation and is regarded as a cooperative, transparent and responsible jurisdiction.

Economic Background

8. Bermuda is a small island nation in the mid-Atlantic with a land mass of 53 square kilometers and a population of 62,000. From the very early days of settlement in the 17th Century, Bermuda has been engaged in some form of international business. From whaling, ship-building and salt-raking (in the Turks Islands) during the 17th Century to export of spring vegetables to the eastern United States in the 19th Century, international commerce has been an enduring feature of Bermuda's economic history. Its modern economy is based primarily on tourism and international business. The Ministry of Finance has estimated Bermuda's GDP for 2007 at \$5.8 billion¹.

9. As Bermuda's economy developed during the 20th Century, tourism was the principal source of jobs – especially for those segments of the population not employed in managerial, professional, and technical occupations. But, during the last half of the 1990s, employment in hotels, restaurants, and other travel-related sectors declined appreciably. In contrast, employment levels in the expanding financial services and international business sectors were on a rising trend.

10. As the first decade of the 21st Century draws to a close, international business activity and the provision of business services have strengthened their positions as the leading sectors of Bermuda's economy, together accounting for some 45 per cent of GDP.² These leading sectors helped to sustain an average annual growth rate of 4 per cent during the period 2000-2006.³

11. For a small island nation situated 600 miles offshore from the North American continent, Bermuda – mainly through its international businesses and financial institutions – has leveraged the economic advantages of the Country's

¹ Bermuda dollar is pegged at par with US dollar.

² Ministry of Finance, National Economic Report of Bermuda 2007, Table 1, page 15.

³ Ibid, Table 2, page 16.

geographic position at the crossroads between North America, Europe and the Caribbean to provide market-driven solutions at the pace of modern business.

Bermuda's Comparative Advantage

12. The development of international business in Bermuda, particularly financial services, was both serendipitous and fortuitous. There was no marketing campaign, no re-writing of laws, no specially created income or corporate tax codes designed to lure onshore companies to Bermuda's international marketplace. Rather, the business developed first. Once it had taken root, the government sought – over a sixty-year period beginning in 1947⁴ – to ensure there was a suitable regulatory framework to govern operations in the emerging sector. Among the factors that have attracted international companies to Bermuda are (1) an effective legal framework; (2) a well-developed infrastructure; (3) high quality professionals and business services; (4) close geographic proximity to major markets in the United States and Canada; and (5) political stability.

13. At the end of 2007, there were 15,358 international companies and international partnerships on Bermuda's business registry compared to 13,509 in 2003.⁵ The majority of the international entities registered in Bermuda are owned and controlled by 'Fortune 1000' companies.

14. In Bermuda, the emphasis has always been on quality over quantity. This emphatic focus by the Ministry of Finance has established Bermuda in the top tier of premier international financial centres and distinguishes Bermuda from many other jurisdictions that compete in the arena of offshore financial services. Not all centres provide the same services or the same quality of service. Business leaders choose Bermuda for its high quality, its probity and its speed to market.

⁴ American International was the first international insurance company incorporated in Bermuda in 1947.

⁵ Ministry of Finance, National Economic Report of Bermuda 2007, Table 23, page 46.

15. In Bermuda, international insurance is the primary component of the international business sector. Captive insurance, life insurance and catastrophe reinsurance companies have a significant presence. With gross annual premiums of US\$116 billion, capital and surplus of US\$158 billion, and total assets of US\$440 billion recorded in 2006, Bermuda is a dominant player in the global insurance and reinsurance market.⁶ In establishing this position, Bermuda joins with other major centres such as London and New York – in a complementary rather than a purely competitive paradigm – to spread and diversify insurance risk around the world. This role is important to worldwide financial markets as it averts the concentration of risk and thereby bolsters financial stability in the wake of an event that triggers a claim.

16. Bermuda's insurance market has significant depth and sophistication in terms of product offerings. There is a fully developed mezzanine layer and the product lines extend well beyond excess liability coverage and property catastrophe protection. More recent lines include integrated occurrence coverage, punitive damages, secondary products recall and many other lines. Consequently, the Bermuda market has become a focal point for insurance managers, brokers, and underwriters with a global footprint. Further, the stability provided to the global financial system through well distributed catastrophe risk has been underscored by the reinsurance industry in the aftermath of Hurricanes Katrina and Rita.

17. Had US insurers been restricted to buying reinsurance in the US market, the burden of reinsurance claims arising from an event such as Hurricane Katrina could have led to the collapse of the US reinsurance industry and the primary market in 2005.

18. From the Ministry of Finance's perspective, Bermuda has demonstrated a comparative advantage in the development and provision of financial services to

⁶ Bermuda Monetary Authority Report and Accounts 2007, page 42.

the global community. Moreover, this economic achievement has been recognised by leading businesses and financial organizations worldwide.

19. The wide array of financial service entities doing business in Bermuda include:

- asset management
- commercial banks
- corporate services
- fund administration
- investment providers
- insurance and reinsurance
- mutual funds
- trust companies.

20. Bermuda has achieved a significant degree of development in insurance and reinsurance. While the Country is not an international banking centre – there are only 4 banks in Bermuda – it has made considerable progress also in providing services for trust business, mutual funds and asset managers. At the end of 2007, there were some 1,300 funds domiciled in Bermuda with a combined net asset value of \$249 billion.⁷

21. Bermuda's financial services sector is complemented by the dynamic and well-regulated Bermuda Stock Exchange. This international exchange provides regulated securities trading on one of the most technologically-advanced and secure electronic trading platforms in the world. The Bermuda Stock Exchange (BSX) is a member of the America's Central Securities Depositories Association (ACSDA). The BSX was successful in attaining this membership because of its modern clearing, settlement and depository service; it was assessed as a mainstream exchange, rather than a listings exchange service provider. In early 2006, the BSX was granted Designated Investment Exchange status by the UK

⁷ Bermuda Monetary Authority Report and Accounts 2007, page 33.

Financial Services Authority. The BSX has also been approved by the US Securities and Exchange Commission (SEC) as a designated offshore exchange. The BSX was accepted as a full member of the World Federation of Exchanges (WFE). It is also recognised by the Australian Tax Authority under the Foreign Investment Fund Taxation Rules.

Bermuda's Consumption-Based Tax Model

22. Bermuda has a long-established and highly efficient consumption-based tax system that has been in place since the 19th Century. One of the first legislated taxes, the Revenue Act 1898 that made provision for the collection of customs duty, remains in effect today.⁸ For the greater part of the 20th Century, customs duty accounted for more than 50 per cent of government revenue. Stamp duties accounted for the next largest share of tax revenue. In the latter part of the 20th Century, other forms of indirect taxes were introduced, including payroll tax, passenger taxes, and property tax. For the fiscal year 2007/08 (April-March), these five tax sources together with annual fees for international companies generated \$745 million or 80 per cent of the revised estimate of \$929 million in total revenue for the year.⁹

23. In a broader sense, it should be noted that the scale of taxes imposed by the Government of Bermuda is in line with those prevailing in several other countries with which it conducts the bulk of its foreign trade. In Bermuda, the ratio of total Government receipts in relation to GDP was approximately 17.8 per cent of GDP in 2007¹⁰. For the United States and Canada the same ratio was in the range of 19.5 to 20.5 per cent of GDP in 2007.

24. In making the comparison, it is important also to take account of the fact that as a British Overseas Territory, Bermuda does not bear the costs of an

⁸ Revenue Act 1898, Revised Bermuda Laws, Volume 5.

⁹ Government of Bermuda, Budget Statement 2008/09, Table II, page 23.

¹⁰ Total receipts includes \$929 million in taxes, licences and fees booked to the Government Consolidated Fund plus about \$98 million of social insurance contributions that goes into the Contributory Pension Fund for payment of pensions and allowances to senior citizens.

external affairs department, external defence, foreign embassies and membership in international organizations. In 2005, such costs were estimated in the range of \$10 million to \$15 million¹¹, equivalent to about 0.3 per cent of GDP.

25. Bermuda does not have, nor has it ever had, any form of direct tax on income. Further, the absence of direct tax does not provide a necessary and sufficient condition for labeling a jurisdiction as a 'tax haven'.

26. In this regard, it is important to note that Bermuda's consumption-based tax system has not been targeted by the Organization for Economic Cooperation and Development (OECD) as unfair or designed for the purpose of attracting mobile capital. OECD has not recommended any changes to Bermuda's tax structure. In a sense, this can be seen as an important victory for Bermuda, because it means that OECD has recognised Bermuda's system of taxation as legitimate, fair and principled in the context of the global economy.

27. The tax structure is an element of Bermuda's success and should be evaluated in objective economic terms. The tax system was shaped for efficiency and fairness to Bermudian taxpayers. It was not designed to attract mobile capital from onshore jurisdictions. Further, Bermuda authorities do not condone tax evasion. There are treaties in place to exchange tax information with other jurisdictions including for instance the United Kingdom and the United States of America.

28. The Government of Bermuda rejects absolutely any reference to Bermuda as a 'tax haven'. Bermuda's tax regime applies equally to local and international companies and other entities. Businesses, in particular international companies, pay a significant share of total taxes in Bermuda.

¹¹ Report of the Bermuda Independence Commission, August 2005, page 41.

29. The comparative tax differences that exist in the international arena are due to the nature of the tax model that is adopted by different jurisdictions. In Bermuda's case, the consumption-based model has proven to be quite compatible with the operation of an economy based primarily on the provision financial service activities. Further, it has been shown that the scale of taxes levied in Bermuda is not out of line with that of developed countries.

30. As there are no taxes on capital, firms domiciled in Bermuda are able to allocate capital efficiently. Subsidiaries or branches that operate in various other countries of the world pay all taxes that are applicable in the country where the business activity occurs. The remaining profits can be re-invested in that country or distributed to the company's head office. If that head office is in a country that charges income tax against a firm's foreign income, then the firm is in effect suffering from double taxation on its profits. If the distributed profits are accumulated in Bermuda, or a jurisdiction with a similar tax structure, then the capital pool remains intact and is available to be reinvested anywhere in the world where the firm has the greatest opportunities.

31. Thus, Bermuda's tax structure allows a greater proportion of the capital pool to remain in the private sector thereby permitting a higher level of corporate investment worldwide. This may be viewed as one of Bermuda's major contributions to the global economy. In the case of the insurance sector, which is the largest segment of Bermuda's international business, the ability of reinsurance companies to accumulate loan loss reserves without paying tax on interest earned actually facilitates competitive pricing for insurance premiums that ultimately benefits purchasers of insurance products worldwide.

32. Bermuda's connection to the US insurance market is instructive in this respect. In 2005, US insurance companies reinsured some 45 per cent of their risks with Bermuda companies compared to some 41 per cent for companies

based in the United Kingdom, Germany and Switzerland combined¹². Based upon the research by Professor J. David Cummins, it is likely that, in 2008, Bermuda will again provide the largest share of property and catastrophe reinsurance coverage for the United States of America. Further, it has now been affirmed that Bermuda reinsurers will cover more than 30% of the losses of Hurricane Katrina and pay out more than \$22 billion to rebuild Florida and the Gulf coast.

Maintaining International Standards

33. The development of Bermuda's local and international business environment is based on three key principles:

- transparency and know your customer
- responsible but appropriate regulation and
- international cooperation.

34. **Transparency:** Bermuda has a long standing practice of know your customer or KYC. Further, Bermuda does not have bank secrecy legislation. Rather Bermuda relies on the common law principles of privacy of information which may be disclosed provided there is express power under law. Any entity seeking to register and carry on business in and from Bermuda is vetted fully by the public authorities. This approach to vetting includes a review of the owners as well as the proposed business. Further, the Bermuda Monetary Authority vets all shareholder controllers and directors of licensed entities. In addition to these vetting procedures, Bermuda law expressly prohibits companies from certain specific activities, including gambling and dealing in arms. Such a review process for registration of businesses in Bermuda has served the jurisdiction very well, especially in our efforts to identify risks.

35. **Regulation:** The independent regulator of financial services is the Bermuda Monetary Authority which has the mandate for overseeing the financial

¹² J. David Cummins, The Bermuda Insurance Market, An Economic Analysis, 2008, page 34.

services sector. The regulator is independent and has responsibility for reviewing the operations and controls of financial institutions operating in and from Bermuda. In addition, the Bermuda Monetary Authority is an active representative in standard-setting bodies such as the International Association of Insurance Supervisors (IAIS), International Organization of Securities Commissions (IOSCO) and participates in the deliberations of the Offshore Group of Banking Supervisors (OGBS).

36. Financial services operating in and from Bermuda are subject to international standards that have been incorporated into our domestic laws and related supervisory practices. Key standards include:

- Basle I and Basle II capital standards for banking
- IAIS standards for insurance (Bermuda is presently finalizing a multilateral mutual agreement with IAIS)
- IOSCO core principles for investment business (Bermuda recently signed a multilateral mutual agreement with IOSCO)
- Financial Action Task Force (FATF) recommendations for anti-money laundering and combating terrorist financing.

37. Bermuda's regime for oversight of its financial services and systems for prevention of money laundering has been assessed by the International Monetary Fund in 2003 and 2007. As well the jurisdiction's regime was reviewed by the Financial Stability Forum in 2000 and KPMG on behalf of the Foreign and Commonwealth Office in 2000. Bermuda has been a full member of the Caribbean Financial Action Task Force (CFATF) since 1995. The CFATF was the first regional body of the FATF.

38. In 1997, Bermuda adopted legislation to make money laundering an offence subject to criminal prosecution. Presently the Bermuda Monetary Authority, as the independent regulator, carries out supervisory reviews of the

AML systems and controls of all financial service providers. Bermuda authorities are implementing a national action plan to enhance Bermuda's AML/CFT regimes. The enhancements will ensure that the jurisdiction complies with the most recent recommendations of the FATF.

39. As Bermuda has strictly practiced KYC, the IMF assessors have recognised that the risk of money laundering within Bermuda's financial services sector has been minimal.

40. Bermuda's well developed regime for monitoring closely those businesses which set up in Bermuda has served Bermuda well not only to know customers, but also to identify business trends. As financial structures become more complex and involve cross border transactions, cooperation and appropriate regulatory structures are key. For example, as Special Purpose Vehicles (SPV's) and transformers became popular, Bermuda authorities reviewed such structures closely with both industry and the regulator to determine the nature of the risk. SPV's related to insurance are fully regulated. Where such vehicles are owned by an overseas financial institution, Bermuda adopted the practice of coordinating approval of any structure with that institution's relevant regulator. As these structures have developed, Bermuda has undertaken to implement appropriate regulatory regimes and oversight.

41. At the same time, standards and regimes must be developed to check abusive use of structures. This is not a simple task but Bermuda is a strong advocate of the basic fundamentals. First, Bermuda does not condone abuse of business structures. Second, Bermuda does cooperate internationally in all areas including tax. Third, Bermuda continues to commit more resources for development of highly skilled professionals and an effective regulatory regime.¹³

¹³ Bermuda Monetary Authority Report and Accounts 2007, page 62.

42. Terrorist financing is not seen as a high risk in Bermuda. This is mainly due to the nature and high quality of business that the jurisdiction has supported and the long-standing policy of turning away dubious business. There is domestic legislation dealing with anti-terrorist financing and for enforcing international sanctions. In addition, there is a MOU which deals with the enforcement of UN sanctions extended to Bermuda. There is a requirement for companies to seek consent to carry on business in designated areas which is managed by the Minister of Finance. Where there have been breaches the Minister has exercised her power to investigate and is presently winding up one company for dealings in oil contrary to UN sanction on Iraq. Again Bermuda has had an occasion to deal with suspect financing and dealt with it accordingly.

43. We note for the record that the current President of the Financial Action Task Force visited Bermuda in April 2008. He was greatly encouraged by the robust nature of Bermuda's AML/CFT regimes and the enhancements that Bermuda authorities are in the process of implementing in the wake of the International Monetary Fund's most recent assessment of same.

44. **International Cooperation:** Bermuda embraces international cooperation and is regarded as a cooperative jurisdiction. The Country has entered into a number of international agreements to assist other jurisdictions by sharing information with overseas regulators, tax authorities, and policing services.

45. As a case in point, collaboration between authorities in Bermuda and authorities in the British Virgin Islands (BVI) led to the conviction in the BVI of a group of companies known as IPOC, and a wind-up Order issued by the Supreme Court of Bermuda against the same group of companies in May 2008. As a result of the conviction in the BVI, \$45 million of assets held by IPOC was confiscated as proceeds of crime and is to be shared between the two jurisdictions.

46. The action against the IPOC group was initiated in Bermuda in 2004 and took 4 years to conclude. Bermuda authorities remained steadfast throughout and committed significant resources and public funds to the process. This case and its outcome represent clear and substantial evidence of Bermuda's commitment to financial stability and transparency in the global arena.

47. The Bermuda Monetary Authority has the capacity to assist a foreign regulator of financial services by sharing information in its possession and has entered into MOUs for this purpose. The Authority also has the capacity to assist in matters which are not under review by the Authority, provided it is satisfied that it is a legitimate regulatory review being conducted in the overseas jurisdiction. The scope of assistance extends to seeking information from both regulated and non-regulated persons.

48. With regard to criminal investigations, there is express power to cooperate under the Criminal Justice (International Cooperation) (Bermuda) Act 1994 (CJIC). The Bermuda Financial Intelligence Unit (FIU) has been a member of the Egmont Group since 1999. The Egmont Group consists of country representatives of financial investigation units and now represents over 100 countries. It was set up to facilitate effective international cooperation between FIUs to combat money laundering. At the annual plenary meeting held in Bermuda in 2007, the Bermuda Charter was signed by all members. This Charter formalised the Egmont Group and established a permanent secretariat. Further, Bermuda's law enforcement authorities have access to Interpol via Her Majesty's Government.

49. With respect to tax matters, under CJIC the Attorney General may assist overseas authorities in tax fraud cases. Bermuda has entered into international agreements to exchange information on tax – in both civil and criminal matters – with other tax authorities. The first agreement was entered into with the United

States more than 20 years ago. Recently, agreements were concluded with Australia and the United Kingdom.

50. Bermuda's cooperative stance in the fight to counter and prevent tax evasion has been publicly recognised by the OECD, the United States of America, Australia and the United Kingdom. On December 4, 2007, on the occasion of signing the TIEA between Bermuda and the United Kingdom, the Financial Secretary to Her Majesty's Treasury, the Right Honourable Jane Kennedy, MP, hailed the new arrangement, and stated: "...I commend the Government of Bermuda for its willingness to implement the high standards of transparency and exchange of information to which it is committed and for its continuing leadership in this important global tax policy area."

51. Bermuda is presently in negotiation with a number of other countries (including EU members) and with the European Commission. Under these agreements Bermuda has upheld the OECD standards for transparency and has adopted wide parameters for sharing information. Also, Bermuda has been an active participant in the OECD working group on tax information exchange.

52. **Accounting and Auditing Principles:** The auditing profession is overseen by the Institute of Chartered Accountants of Bermuda (ICAB). ICAB is an affiliate of the Canadian Institute of Chartered Accountants (CICA). An agreement originally signed in August 1973, and restated in July 1998, formalises the relationship between CICA and ICAB.

53. The Minister of Finance has the power to mandate generally accepted accounting and auditing principles in Bermuda under the Companies Act 1981. The following accounting and auditing principles are permitted in Bermuda:

- International Accounting Standards
- International Financial Reporting Standards

- International Standards on Auditing

54. **Ratings: The External Validation**

Country credit ratings are valuable tools for assessing risk and for determining the cost of debt, but they provide benefits on a number of other levels as well:

- they can lend credibility and can enhance the reputation of a country
- they help address misconceptions
- they have the ability to highlight consistency of performance
- they are important in helping to build investor confidence.

55. Since its first rating in 1994 by Moody's Investors Service – a sovereign credit rating of Aa1 – Bermuda consistently has maintained high investment grade ratings by Moody's, Standard and Poor's, and Fitch Ratings.

Conclusion

56. Bermuda has matured as a market and a developed service centre for financial services with a global platform. It is a jurisdiction of choice for the insurance sector and has developed a strong market in the investment field. Bermuda is politically stable and has a track record of superior economic performance.

57. To be successful in the competitive global arena, an international financial centre must be efficient, flexible, and ready to adapt to international developments and opportunities. At the same time, it must commit the resources to provide good governance, proper regulation and effective oversight. Together these factors characterise a sound financial centre. Businesses seek to do business in a jurisdiction that is sound and credible, and known internationally for probity, endurance, and market-driven solutions. Bermuda signifies this brand.

58. As the global market becomes more interdependent, there is no question that jurisdictions must cooperate and inter-act. The challenge is how jurisdictions

may work together to ensure that businesses are properly regulated and minimise risks. Bermuda's strategy has been to adopt international standards and practices using the prism of a risk-based approach and to monitor business trends and practices.

59. Bermuda authorities have entered into MOUs for the purpose of information sharing. This underscores the jurisdiction's approach towards transparency and international cooperation.

60. The breadth of 'blue chip' companies that have chosen to do business through Bermuda, including those with strong links to Lloyds of London, is testament to that reputation. Bermuda neither has ignored nor shirked its international responsibilities.

61. In summary, the Government of Bermuda is proud that the jurisdiction has made a positive contribution to transparency. This was done through strengthening international cooperation with overseas regulators, tax authorities and law enforcement officials. In addition, global financial stability has been enhanced by Bermuda's international role as an effective reinsurance market for the spread and diversification of insurance risk and the efficient allocation of capital.

June 18, 2008