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INFO ROUTINE WASHINGTON, GRAND TURK, ANGUILLA, TORTOLA  
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SUBJECT: CAYMAN ISLANDS: ANNUAL REVIEW FOR 1999

SUMMARY

1. There have been better years in Cayman. Economy continues to perform well, but international tax initiatives take up much of the Government's energy. Destruction of the prison a salutary experience. Damage limitation for the UK following the Chancellor's non-appearance at the Commonwealth Finance Ministers' Meeting (CFMM) and Barclays Bank's abrupt closure of their Cayman Brac branch. Need for change of political class in the next elections.

ECONOMY - FINANCIAL SERVICES

2. Largely good news. Despite the acrimonious litigation that followed the resignation/dismissal of its British CEO in mid-year, the Cayman Stock Exchange (CSX) increased its listings in 1999 by over 50% and its capitalisation rose to USD21bn. The CSX also achieved its prime objective for 1999 by obtaining London Stock Exchange recognition as an approved institution. There was similarly a 13% increase in the number of mutual funds, a 15% increase in company registrations whilst the asset base of the Category "A" banks and trust companies increased by 26% over 1998 to around USD1bn. There was also an 18% increase in shipping tonnage registered in Cayman and overall the economy grew by almost 5%, thus maintaining its impressive record over the past few years. Although the very occasional closing of a Category "A" bank still attracts John Grisham-style headlines, a better indication of the state of Cayman's banking sector came with the opening of the impressive new UBS building and the ground-breaking for the new Royal Bank of Canada headquarters. If the bad guys are in retreat, the good and the powerful are certainly putting their money where they believe their future lies.

ECONOMY - TOURISM

3. The second pillar of the economy, tourism, also continued to do well. Ground was finally broken on the multi-million dollar Ritz-Carlton project late in the year and construction is already well under way with the new Holiday Inn in West Bay. The rapidly developing cruise ship market - passenger arrivals up 20% to over 1 million this year - could however prove something of a mixed blessing. Five superliners decanting some 10,000 people into the streets of Cayman on one day in high season taxes the infrastructure and creates its own problems, whilst the massive power of the major cruise lines enables them to squeeze the margins of local Caymanian tour operators unmercifully. A small disturbance in the tourism sector was the birth of a new trade union, the National Association of Caymanian Employees (NACE), which is focussing its immediate energies on perceived injustices in the hospitality industry.

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#### THE TAX HAVEN QUESTION

4. The major concern for the economy, shared by public and private sectors alike, was the continuing international attack on so-called tax havens. This has become something of a growth industry with ever more organisations demanding that these "havens" defend themselves by preparing position papers and attending meetings. The Cayman Islands Government (CIG) has maintained a constructive dialogue with the OECD and EU despite being faced with less transparency than they would have liked. A perception remains that protestations about a "level playing field" were a bit rich given the views of Luxembourg, Switzerland and others.

5. The CIG has addressed these initiatives very thoroughly, but their insistence upon putting up the most comprehensive position papers and sending the biggest teams to the various "talks" is beginning to impact on Government business. The CIG approach is driven by the fear - fuelled by the private sector - that appearance on any one of the so-called "black lists" will fatally damage the Caymanian economy. Survival is what is at stake in the minds of the CIG, even though the international organizations give little indication that they understand the possibly dire consequences of their initiatives. On a more upbeat note, Financial Secretary George McCarthy completed a most successful year as President of the Caribbean Financial Action Task Force (CFATF). His, and Cayman's strong reputation on the anti-money-laundering front, has resulted in Cayman being asked to host the first United Nations Offshore Forum Plenary in March 2000.

#### POLITICS

6. With elections scheduled for November 2000, there will be some reluctance to address contentious problems with no vote-catching potential. Indeed, the unofficial campaign has already begun and the deal-making season is upon us. There lies the central weakness of the Cayman scenario: a truly first-class centre of excellence in financial services and tourism with some 40,000 inhabitants of whom barely half have Cayman status. The electorate is therefore so tiny (c.10,000) that the Father of the House, John McLean, has served in the Legislative Assembly continuously and inauspiciously since 1974 being returned last time with 322 of the 464 votes cast in his constituency.

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There is an urgent need for a new wave of younger and untainted politicians, as well as for some reform of the nationality rules to allow for a wider electorate.

#### THE PRISON CRISIS AND THE ISOLATION FACTOR

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7. The prison crisis was sad but instructive. The overcrowding which, at the moment of explosion had 310 in an institution designed for 170, had been highlighted by a series of reports over more than 6 years. Nothing had been done, and the Cayman preference for denying a problem in the hope that it will quietly go away, was shown up in all its futility. They have paid a heavy price, but if in some way it helps to unblock the corporate memory on other problems currently under denial, it would have been worth it. It is a poor reflection on a country as advanced as Cayman that we have as yet no genuine remand facilities, no drug rehabilitation centre, no home for the criminally insane, no young offenders centre. No need in Cayman, runs the refrain. Wrong.

8. The worst aspect of the prison crisis was the sense of isolation. For over 14 days there was a genuine risk that some 300 felons would break out of a perimeter fence [REDACTED]

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#### REGIONAL RELATIONS

9. Regionally Cayman maintained its status as a business hub by playing host to a substantial number of high profile international events in addition to the highly successful CFMM. Relations with Cuba were smooth enough to allow us to deal swiftly and painlessly under the terms of the 1998 Migration Agreement with more Cuban refugees who drifted ashore. Progress on a Maritime Delimitation Agreement with Cuba has also been trouble-free and similar talks with Honduras and Jamaica are progressing well. More regional kudos was gained by the decision from General Motors (GM) to relocate its regional headquarters to Grand Cayman.

#### UK RELATIONS

10. A steady stream of UK visitors started with Baroness Symons in January and ended with DUS John Shepherd on a short but effective visit in November. The visit of [REDACTED] from HM Treasury [REDACTED]

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could not shrug off Caymanian dismay and confusion at the Chancellor's decision not to attend the CFMM in person.

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That the event went off so well with no evidence of acrimony, I count as a significant success.

11. Barclays' decision to close its tiny branch in Cayman Brac after 40 years of serving that community of 1,300 people was a public relations disaster and very badly received. There was no prior discussion with the CIG (almost all of whose huge accounts are with Barclays) and when the plea for a grace period was made to allow for alternative arrangements to be worked out, the Barclays CEO granted a week's extension up to 15 December. It would have been better if he had said nothing. I wrote to the Chairman on behalf of Executive Council and received a predictably anodyne reply. I still find it hard to believe that the dimension of any loss that Barclays might have been sustaining on the Brac would have been statistically relevant even on their regional balance sheet.

12. More positive from the UK/Cayman perspective was the visit by [REDACTED] from OTM who were able to eradicate some serious misconceptions concerning the White Paper. And most welcome of all was the use of GGF to meet a substantial part of the cost of the PSU during the prison crisis. This gesture was seen as confirmation of the partnership ethos extolled in the White Paper and was much appreciated.

#### CONCLUSION

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But it is a remarkable place and the amount of professional excellence across the financial service sector is deeply impressive. With 47 of the world's top 50 banks present on Island, their advice on (and criticisms of) the OECD and EU initiatives are important. Which is why even the election campaign will pay second fiddle to the publication of the OECD list in mid-2000. Will it be white or black or, as is now mooted, merely grey? Whatever the outcome, it will set the tone for the immediate future.

14. The fear remains that for larger political reasons the list will lump together the better regulated jurisdictions and the most suspect whilst more powerful nations will continue to exempt themselves from censure and sanction. To what extent these important considerations will engage the interest of the 10,000 voting Caymanians however is debatable.

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