

Cayman: the Lehman moment

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Cayman is posing a challenge. It claims that it is well regulated, as do many of its competitors. But what happens if the regulator is bust? Or has to impose swingeing cuts on its activities to meet budget constraints? What then? And what if, in any event, the rule of law fails because the government cannot pay its employees?

At least in theory this will happen this month in Cayman. Those Islands [are insolvent](#). They cannot pay this month's wage bill. At least, not without the permission of the UK, and that permission has not been given because as yet the Islands have not got a viable plan to restore solvency.

I have described this as a 'Lehman moment' in a previous blog. I think it is, because just as when Lehman failed it became apparent that the market model for investment banking had changed forever, so too does the failure of Cayman represent such a moment. Cayman has proven that the model of the small island secrecy jurisdiction is unsustainable. If the biggest player in that market cannot make it pay enough to cover the needs of its local population and at the same time maintain the regulatory environment that is required then for all practical purposes the model has failed.

Now, I'm quite realistic: this does not mean that secrecy jurisdictions are going to disappear over night. Just as investment banking did not disappear with Lehman nor will secrecy jurisdictions go because Cayman has failed, with Jersey and Guernsey likely to follow. But Lehman did suggest that the relationship between the state and unregulated banking had changed. This is what Lord Turner was saying when making his much [quoted comments](#) last week. After Lehman the idea that anything the market wanted to do was acceptable ceased to be the regulators fall back position. Now that is true of offshore: just because the market wants it does not make it socially useful, socially acceptable or something that the state must support.

The first two of these conditions has always been true — even if quietly ignored.

The change is in the third condition. The reality that the financial risk in places like

Cayman might be a contingent risk of the UK was first noted in a National Audit Office [report in 2007](#). What was contingent then is reality now: the UK will not let Cayman borrow because that risk without Cayman raising sufficient revenue to repay the loans falls straight on the UK balance sheet. Insolvency in Jersey and Guernsey would have the same impact.

So that third condition — the relationship with the state has changed and for much the same reason: the implicit guarantee has become explicit.

This is, of course, of primary concern in the UK Crown Dependencies and Overseas Territories, but these are in most cases major market players. Taking out Lehman changed investment banking — although only now are we realising that not by enough. Maybe Chris Bryant at the FCO realised, [when sending his letter](#), that real action is required this time. Certainly the message is blunt enough. He is saying

Do not assume tax haven status will continue

Raise new taxes

Assume the G20 will act

Assume the Foot Commission will not deliver good news

Assume the offshore market will decline

And more besides.

Is he also saying that the UK will not longer underpin offshore? It is hard to see how not.

Of course, I expect he will approve a loan to Cayman. But I really do hope and think the conditions will be tough. Real change will be required. And the implications are very clear: London is in as effective control in Cayman now as if it were Norfolk (where I live).

Of course, that means it joins the Turks & Caicos in this position. And de facto the Isle of Man — whose whole budget is dependent upon London, which [subsidises it by £230 million a year](#) — which is how the Isle of Man can afford the 0% tax on corporate profits that is driving Jersey and Guernsey to the wall.£160;

Suppose the UK now applies the same logic to all these places. What then? First, London will still get funds. This is not the end of the City as we know it.

Secondly, if these places charge tax (as it seems they must) then they will have to compete on a level playing field — i.e. without the massive state subsidies that ironically they have enjoyed to date — albeit from the implicit guarantee they have enjoyed.

Third, as I said on Channel Islands radio this morning — if the local finance sector is really as good and as honest as it claims then it can happily survive without either low taxes or, most especially the secrecy that permits it to handle tax evaded funds at present. And if it cannot compete without those two effective subsidies than it has no right to survive.

But of course the City and each of these places will look different as a result of change. It will be harder for the City to pursue its socially useless activities — much of which is channelled through secrecy jurisdictions. Hedge funds will be taxed and accountable — which will reduce their impact on the world. Transparency and accountability will increase — as will the quality of governance to which offshore is an ever present implicit threat because of the necessary pretence that using it entails. And resources will be better allocated as a result. Risk to the UK tax payer will be reduced.

And yes, there is likely to be a crisis in the Crown Dependencies and Overseas Territories. Some of their trade will go — seeking other places for illicit funds until all boltholes are closed. If Switzerland is a precedent at least half the money in these places may be illicit. Many bankers, lawyers and accountants will be unemployed as a result. Please do not cry for them — those who handle stolen goods do not need sympathy.

But we will need to support those who really live and work in these places. Yes, I do think this a UK responsibility. And yes, I do think this may mean their sovereignty may be clipped. But if we are going to give support, help rebuild their economies, help bail out people who face ruin when property prices there plummet as financiers leave, then without doubt there will be a price to pay. That will be supervision, maybe membership of the EU, and an end to secrecy.

This is within the UK's right to command now it has realised it holds the purse strings.

What is most important to note is that it has no right to walk away from this duty. It is trying to do so on banking — to the chagrin of Germany and France. It cannot be allowed to do so on this issue. It would be wholly unacceptable for the UK to bail out Cayman et al and allow the offshore abuse to continue. So action is needed now, on Cayman first, on the Isle of Man second, and with contingency plans for the Channel Islands third.

This what this Lehman moment means. Chris Bryant has shown bottle. let's hope there's plenty more of it in stock.

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