

HOUSE OF COMMONS TREASURY SELECT COMMITTEE

FINANCIAL STABILITY AND TRANSPARENCY

THE ROLE OF OFFSHORE FINANCIAL CENTRES (OFCs)¹

**SUBMISSION ON BEHALF OF THE OFFSHORE GROUP OF BANKING
SUPERVISORS (OGBS)²**

Executive Summary

- OGBS welcomes this opportunity to have an informed, balanced and objective debate on the role of OFCs in, and their commitment to, enhancing financial stability and transparency;
- OFCs through OGBS and otherwise have been and continue to be active participants in international action concerned to foster financial stability and transparency;
- OFCs through OGBS have played a particularly active role in the work of the Basel Committee on Banking Supervision and the Financial Action Task Force on Money Laundering and Terrorist Financing (FATF);
- for the majority of OFCs their subsidiaries and branches of international banks are deposit gatherers and the major part of the funds so gathered are up-streamed to their parent bank or other group entity, the loss of which could have a significant impact on the liquidity of the parent;
- of particular relevance to the issue of financial stability and transparency is information on the beneficial ownership and control of corporate vehicles (both legal persons and legal arrangements). OGBS proposed to the FATF, and led, a typologies project on the misuse of corporate vehicles, the report on which was published in October 2006.

¹ What is an OFC? The IMF in its progress report on the OFC assessment programme dated February 8th 2006, which is on the IMF website, included a list of 52 jurisdictions described as “offshore and international financial centres” which include Ireland, Luxembourg, Hong Kong China, Singapore and Switzerland. If the focus is on “offshore” meaning the providing of financial/corporate services to non-residents the list should include the USA and the UK. To narrow the definition, the IMF in working papers has sought to focus on those jurisdictions where financial services for non-residents predominate over domestic business, but this has the defect of excluding significant centres of “offshore” activity and by focusing on financial services fails to give sufficient weight to trust and company service activity because the authors do not consider the latter as financial services.

² OGBS is a body set up in 1980 at the instigation of the Basel Committee on Banking Supervision. It has the following membership - Aruba, Bahamas, Barbados, Bermuda, British Virgin Islands, Cayman, Guernsey, Isle of Man, Jersey, Labuan, Macau China, Mauritius, Netherlands Antilles, Samoa, Panama, and Vanuatu. Further information on OGBS can be obtained from its website - www.ogbs.net

- the Financial Stability Forum (FSF) has found no evidence that OFCs have been a major causal factor in the creation of systemic financial problems or are material to global financial stability;
- no evidence has been produced by the IMF or the international standard setters to suggest that the OFCs present different or greater issues than non-OFCs. Their focus, rightly, is on any jurisdiction that fails to meet the international standards of financial regulation and AML/CFT;
- international assessments of compliance with international standards show that the results for OFCs and non-OFCs are similar with good and some not so good performers in each group;
- OFCs play a significant role in the global financial market place. They are important contributors to global capital movements and it can be argued help to oil the market mechanisms;
- OGBS believe it is of particular importance that there should be a level playing field in the implementation of international standards of financial regulation, AML/CFT and measures against harmful tax competition;
- OFCs have played a key role in new market developments because as 'niche' market operators they have the ability to be 'fleet of foot' and better able to take advantage of new market opportunities as they arise;
- OFCs are complementary to and supportive of neighbouring finance centres such as the City of London which benefit greatly from the OFCs within their sphere of influence;
- OFCs have responded to the concerns expressed by the FSF and other bodies and have recognised the importance of increased transparency for effective financial regulation, for AML/CFT, for the fight against corruption and for dealing with harmful tax practices but in every respect consider it is a global approach that is required;
- there has been a significant increase in transparency of OFCs in recent years, and to the extent that gaps remain they are as if not more often to be found in non-OFCs as in OFCs;
- OGBS members recognise that international acceptance depends on their reputation for compliance with international standards and that there is no better position than to be so recognised by a third party such as the IMF;
- OFCs have been at the leading edge in regulating trust and company service providers who are key players in financial markets;
- the distinction between OFCs and non-OFCs is no longer seen by the international standard setters as being important in addressing the issues of financial stability and transparency. The IMF also has recently decided to integrate the OFC

assessment programme into the global Financial Sector Assessment Programme (FSAP);

- all significant financial centres are important for world wide financial markets stability and all should be subject to the same international standards and should offer the same degree of transparency;
- the recent market disturbances have not originated in the OFCs but the OFCs share in recognising the need to address the key requirements for enhanced transparency;
- that new financial products are to be found in OFCs is not because the OFCs are more lightly regulated. Reasons for the OFC location are the tax neutrality enjoyed, the low rates of personal and corporate taxation, and the level of professional expertise in associated areas of financial service activity;
- OFCs have taken positive action to improve transparency not least because they have more to lose through a failure to address the issues involved as their economies are heavily dependent on businesses serving financial markets;
- the main challenges to be addressed on issues of financial stability and transparency are the same for OFCs as for non-OFCs. They include protecting legitimate confidentiality, protecting competitiveness, ensuring a greater understanding of how information can be obtained, improving the gateways for information exchange, and resourcing;
- there is a need for a global approach to tackle what are global issues on a level playing field basis. Financial stability issues and risks are global in nature, and they call for a global response. The focus should be on the risks and the gaps in transparency wherever those risks and gaps arise. The overall message that this submission has sought to convey is that in relation to financial stability and transparency, both for the extent of the existing commitment and the need for further action, OFCs ought not to be separately distinguished but should be considered with jurisdictions generally.

Introduction

1. The House of Commons Treasury Select Committee in its Sixth Report of Session 2007-08 entitled "Financial Stability and Transparency" referred to the potential uses of offshore centres and concluded that "they remain relevant in any discussion of financial stability". The Committee as a result concluded "we will undertake further work on offshore financial centres in the context of our ongoing scrutiny of financial stability and transparency to seek to ascertain what risks, if any, such entities pose to financial stability in the United Kingdom." OGBS welcomes this opportunity to have an informed, balanced and objective debate on the role of OFCs in, and their commitment to, enhancing financial stability and transparency on a global basis.
2. An interest in OFCs in connection with financial stability and transparency is not something new. In 1980 the Basel Committee on Banking Supervision instigated

the formation of OGBS because of a concern for the unknown threat to the stability of international banks arising from the business placed with their offshore subsidiaries about which little was known. At the time a very significant proportion of international loans to South American and other jurisdictions were being booked through foreign subsidiaries in OFCs because of a lower tax liability, and more accommodating regulatory requirements. There was concern that the OFCs were not applying adequate supervisory standards, and that the lack of transparency surrounding the loan business, and the position on actual or potential loan loss provisions, represented a hidden threat to the solvency of the international banks concerned.

3. The OGBS for their part – and with some foresight having regard to recent experience – were happy to work with the Basel Committee on these and other cross-border issues because they were concerned that the failure of a parent bank would have an obvious impact on subsidiaries and branches in their jurisdictions which in turn would have a serious impact on their economies which were increasingly dependent on financial services activity.
4. The OGBS consequently joined with the Basel Committee – for many years jointly chairing the Basel Cross Border Banking Working Group – in producing the following reports –
 - A Supplement to the Basel Concordat on practical aspects of international collaboration between banking supervisory authorities (1990);
 - Supervision of Cross-Border Banking (1996);
 - Essential elements of a statement of cooperation between banking supervisors (2001);
 - Customer Due Diligence for Banks (2001);
 - Shell banks and booking offices (2003);
 - Parallel-owned banking structures (2003);
 - Consolidated KYC Risk Management (2004).
5. The OGBS is currently represented on the Basel Committee’s AML Expert Group which reports to the Committee’s International Liaison Group. OGBS is also represented on the Basel Committee’s Cross-Border Bank Resolution Group.
6. OGBS members are fully committed to the Basel Core Principles, and are actively engaged in implementing the Basel II Capital Adequacy Requirements. OGBS members also recognise the significance of their activities for the liquidity of international banks. For the majority of OFCs their subsidiaries and branches of international banks are deposit gatherers, and have limited loan activity. The funds gathered are normally up-streamed to the parent and their loss to the parent either through market events, or through attempts by the host regulator to ring

fence the subsidiaries to protect the depositors' interests, can have a significant effect on the liquidity of the parent bank.

7. OGBS members have also long recognised the importance for their activities of AML/CFT, and in the mid-1990's sought and obtained observer status at meetings of the Financial Action Task Force on Money Laundering (FATF). Since then OGBS has been an active participant in FATF meetings, and shared in the work on the review of the FATF 40 Recommendations on money laundering and the 9 Special Recommendations on terrorist financing. OGBS members have provided the FATF with letters confirming their political commitment to compliance with the 40+9 Recommendations and OGBS is treated by the FATF as a body equivalent to the FATF Style Regional Bodies (FSRBs).
8. OGBS is a member of an Interpol Working Group on Money Laundering and Terrorist Financing. OGBS also has observer status, and has participated in, UN Conferences of State Parties on the Convention on Corruption and the Convention on Transnational Organised Crime.
9. Of particular relevance to the issue of financial stability and transparency is information on the beneficial ownership and control of corporate vehicles (both legal persons and legal arrangements). OGBS proposed to the FATF, and led, a typologies project on the misuse of corporate vehicles the report on which was published in October 2006. Many OGBS members lead international practice in this field by insisting on the divulgence and maintenance of information on the ultimate beneficial owners of such vehicles.
10. OGBS is a member of the FATF/Asia Pacific Group on AML project group on the links between anti-corruption and AML/CFT issues. OGBS also was invited to participate as an expert member of a Commonwealth Working Group on Asset Repatriation which published its report in 2005. OGBS was represented at the UN Intergovernmental Working Group on Asset Recovery meeting held in Vienna in August 2007. Individual OGBS members have put the principles of asset recovery and repatriation into practice through their seizure and return of the proceeds of corruption (e.g Jersey in respect of Nigeria and Abacha).
11. The foregoing should provide sufficient evidence to show that OGBS members and other OFCs have been and continue to be active participants in international action that is concerned to foster greater financial stability and transparency.

What evidence is there that OFCs pose a greater threat to financial stability than non-OFCs?

12. The Financial Stability Forum (FSF) in 2000 received a report of a Working Group on Offshore Centres. That report concluded that –

“3. OFCs, to-date, do not appear to have been a major causal factor in the creation of systemic financial problems. But OFCs have featured in some crises, and as national financial systems grow more interdependent, future problems in OFCs could have consequences for other financial centres. The significant growth in

assets and liabilities of institutions based in OFCs and the inter-bank nature of the offshore market, together with suspected growth in the off-balance sheet activities of OFC based institutions (about which inadequate data exist), increase the risk of contagion.”

13. The report also noted that, “5. Not all OFCs are the same. Some are well supervised and prepared to share information with other centres, and cooperate with international initiatives to improve supervisory practices. But the survey carried out by the Working Group indicated that there are serious concerns by onshore supervisors about the quality of supervision in, and degree of cooperation provided by, some OFCs.”
14. In the report of the OFC Review Group of the Financial Stability Forum, in which Group the OGBS has observer status, entitled “Review of the FSF Initiative on Offshore Financial Centres” (October 2007), it is stated –

“1. Since 2000, when the FSF OFC initiative began, significant progress has been made by offshore financial centres (OFCs) in enhancing their compliance with international standards regarding cross-border cooperation and information exchange and supervision and regulation more generally.”
15. The FSF noted that “3. As regards compliance with international standards and codes, concerns remain with respect to cooperation, prudential practices and market integrity, although the various efforts underway have not to-date produced clear evidence of remaining or new risks posed by OFCs that, in the judgement of the majority of Review Group members, are material to global financial stability”.
16. OGBS and other OFCs also have been active participants in the work of the IMF in implementing the FSF’s recommendations. This is evidenced by -
 - their voluntary participation in the IMF OFC assessment programme - in its report in 2005 on the first phase assessment results the IMF stated that “Compliance with standards in OFCs, on average, are better than in other countries assessed under the Financial Sector Assessment Programme (FSAP)”;
 - the publication of their assessment reports in full;
 - their participation in the IMF information framework initiative.
17. In January 2008 OGBS participated in the Fifth IMF Roundtable for Offshore and Onshore Supervisors and Standard Setters which focussed largely on transparency and its implications for OFCs, the implications and lessons learned from the recent financial crisis and the proposed integration of the IMF’s OFC assessment programme with FSAP. To quote from the Aide-Memoire issued by the IMF, “Some speakers noted that, as transactions and financial institutions became increasingly globalised, the distinction between offshore and onshore was becoming less relevant, especially since incentives (and the scope) for regulatory arbitrage have narrowed as a result of the action of the IMF and the standard-setters. Rather, OFC representatives argued jurisdictions should be distinguished

by their level of compliance with international standards. Other participants pointed out that the transactions in OFCs still raise legitimate concerns for onshore supervisory authorities, and that the publication of detailed IMF assessments helped address these concerns.”

18. Some discussants at the Roundtable observed that transparency among OFCs had increased with the demands of the global market place, but also stressed that gaps remain. The panellist representing the OFCs stressed that OFCs had as much at stake in promoting transparency and preventing global financial instability as other jurisdictions, since any instability caused by a lack of transparency or failure in an OFC would have significant reputational impact on the OFC with very considerable risks/costs for its economy.
19. Information on OFCs continues to be collected by the IMF and by the Bank for International Settlements. Of the 46 OFCs invited to participate in the IMF’s information framework initiative, 28 are submitting data, 6 have committed to participate but not yet submitted data and 12 have not yet agreed or declined to participate. However it should be noted that 8 of those declining already provide the IMF with, or alternatively publish, their data, or have declined not because they were non-cooperative jurisdictions but because they judged the OFC label inappropriate.
20. Although OGBS is not involved with matters of taxation it is worth pointing out that information of value as much to the international standard setters and financial regulators as to the tax authorities also has been gathered and published in tables included in the 2007 assessment by the OECD Global Forum on Taxation. This provides a comprehensive source of information on the domestic laws that permit information exchange, the access to bank information and the availability of ownership information. What this information shows is that the gaps that remain to be filled are as present in non-OFCs as in OFCs, and in some cases more so.
21. It is noteworthy that the Financial Stability Forum has now stated that its 2000 list of OFCs has served its purpose and is no longer operative. The FATF had an NCCT (Non-Cooperative Countries and Territories) list which initially included a number of OFCs but it is notable that the 5 jurisdictions that were the last to be removed from the NCCT list did not include any OFCs. The FATF’s International Cooperation Review Group has taken over the role of identifying jurisdictions that do not engage in international cooperation or practice effective exchange of information. In January 2007 the ICRG identified a total of 30 jurisdictions that it was suggested might need to be further addressed of which only 2 were in the IMF list of jurisdictions included in the OFC assessment programme. Of the 7 jurisdictions that were identified by the FATF at its Plenary meeting in February 2008, which called for particular attention in respect of their deficiencies in AML/CFT, none were included in the IMF list of OFCs.
22. Attached as an annex to this submission is a table which shows the results of assessments of compliance with the FATF 40+9 Recommendations covering a number of OFCs and a number of FATF member jurisdictions. These show that there are good and not so good performers among non-OFCs as well as OFCs, and

many of the latter compare favourably against some major non-OFCs. The same picture emerges whether the focus is on money laundering or on terrorist financing. This reinforces the view firmly held by OGBS that in addressing issues of financial stability and transparency attention should be focussed on all jurisdictions that are significant players in the global financial market place, and in particular those where gaps in transparency remain, and not on an OFC/non-OFC distinction.

The importance of OFCs to global financial markets

23. Notwithstanding the foregoing it is to be expected that there will continue to be some focus on the major OFCs. This is because they play a significant role in the global financial market place. They are important contributors to global capital movements and it can be argued help to oil the market mechanisms. OFCs also often facilitate investment decisions that have consequential employment and trade benefits in other jurisdictions.
24. Globalisation has involved multi-national companies seeking out opportunities to minimise their global tax liabilities and OFCs as low tax jurisdictions have often been attractive business locations. More and more countries are recognising that low taxation can and does encourage investment and job creation, and OFCs are now under increasing pressure from the reduction in corporate tax rates taking place in many non-OFC jurisdictions.
25. The review of financial regulation in the Crown Dependencies carried out by Her Majesty's Government in 1998 (the Edwards Report) referred to the case in favour of offshore financial centres from a global perspective. The report on the review referred to a number of elements as follows –
 - the right to supply services. There are many quality services for customers that well regulated offshore centres are well able to supply and have a perfect right to supply like anyone else. Examples are offshore funds, captive insurance, trust services and services to expatriates, and in recent years specialist funds or other corporate vehicles in structured finance transactions;
 - stability. Political and fiscal stability is an advantage that many offshore centres are better able to offer which is attractive to residents of less politically stable jurisdictions;
 - risk spreading. International clients wishing to spread their risks may find it helpful to spread their assets between different jurisdictions including offshore centres, particularly those centres that have established a level of expertise (e.g. in trust administration, captive insurance etc);
 - convenience and simplicity. Especially in an electronic age, the offshore centres are well placed to facilitate business or coordinate transactions involving many different jurisdictions through the provision of a base free from the tax and other complications of the larger jurisdictions. In this way they may help to lubricate the world's financial markets. Examples are international custody or treasury operations in banking services;

- innovation and flexibility. Offshore centres are sometimes better able than the larger centres to test out innovative financial products such as new insurance or investment vehicles. They can respond flexibly and quickly to the changing needs of international customers and markets. In the larger centres, the ramifications of change are typically wider;
 - regulation. The offshore centres may also be able to lead the way in certain areas of regulation which can be attractive to some market participants in providing legal certainty and a reputation for quality. Examples are the regulation of trust and company service providers.
 - fiscal elements. A degree of competition in tax rates may be helpful, not least in giving the large countries an added incentive to avoid penal rates of tax. Low rates of taxation and tax neutrality come together to encourage the use of offshore financial centres, and the resultant lowering of business costs is frequently supportive of investment in business activity in other jurisdictions which investment would otherwise not have occurred.
26. There is keen competition in the market place and OGBS believe it is of particular importance that there should be a level playing field in the implementation of international standards of financial regulation, AML/CFT, and measures against harmful tax competition. While it can be argued that good business should not be concerned about transparency there is a natural desire on the part of many in the financial market place to protect their privacy not because they are engaged in financial crime but because of the natural desire to hold to themselves the details of their financial circumstances and activities. The absence of a level playing field is a matter of concern for OFCs. Jurisdictions or political sub-divisions that are “onshore”, through their professionals if not through their authorities, are marketing themselves as centres for what they describe as “offshore” activities. A number of these centres are far less transparent than the OFCs, particularly in the area of company formation and administration.
27. Competition has encouraged new market development. OFCs have played a key role in this respect because they are “niche” market operators. They succeed on their ability to be “fleet of foot” and being better able to take advantage of new market opportunities as they arise. They are able to pass legislation more quickly, and their legislation is likely to be more user friendly as far as non-resident business is concerned – not with a view to lowering standards but just to be quicker in responding to market needs. Not surprisingly many innovators in the financial market place find OFCs a favourable location in which to base their activities or pilot particular projects and activities. OFCs therefore have a key role to play in improving the general understanding of new market developments. It is accepted that more information on and a greater understanding of new financial market activities is required. What is important however is that efforts in this respect are coordinated recognising that this is a global issue. All the major players need to be involved in understanding and monitoring market/product new initiatives. OFCs are willing to play their part but they will be discouraged from doing so if they find they are being discriminated against simply because they are categorised as OFCs.

28. As noted in para 6 above, the OFCS are significant fund gatherers with a high proportion of the funds held as bank deposits being upstreamed to a parent bank. Those wishing to place their funds in an OFC to take advantage of the tax neutrality and political stability, and the investment opportunities available (e.g offshore funds), will be clients of financial institutions/intermediaries that will use the financial services available in centres such as London and New York. In this way the OFCs are both complementary to and supportive of these centres, and the latter derive considerable business through this relationship. It can be argued therefore that the City of London and the European capital markets benefit greatly from having OFCs within their sphere of influence.

Transparency and OFCs

29. OGBS recognises the importance of transparency for effective financial regulation, for AML/CFT, for the fight against corruption and for dealing with harmful tax practices but in every respect consider it is a global approach that is required.
30. The desirable characteristics of transparency can be listed as access, timeliness, relevance and quality. To achieve effective transparency it is necessary therefore –
- for quality information to be obtained and held by those practicing in the market place;
 - for the information that is obtained and held to be accessible in a timely manner to those who need it for the effective operation and regulation of the financial market place;
 - for the information to be able to be shared between all relevant parties.
31. There is a need to avoid “black holes”. The “credit crunch” has shown that the scale and nature of off balance sheet activity was not recognised by all regulatory authorities. It was said to be something that was not on their radar screens. Information obtained through effective banking supervision was lost through a plethora of hedge funds, SIVs, and CDOs – colloquially referred to as ‘the shadow banking sector’.
32. Understanding what is going on in the market place – particularly for law enforcement purposes – also calls for increased knowledge of the beneficial ownership of companies and other corporate vehicles.
33. There has been a significant increase in transparency of OFCs in recent years, and to the extent that gaps remain to be filled they are as if not more often to be found in non-OFCs as in OFCs.
34. OGBS members and other OFCs are –
- publishing their IMF OFC assessment reports;

- publishing AML/CFT assessments carried out by the FATF style regional bodies of which they are a member;
 - participating in the IMF information framework initiative;
 - supplying data to the Bank for International Settlements;
 - involving themselves with international fora including the Basel Committee on Banking Supervision, FATF, IOSCO, IAIS, the Egmont Group, the Financial Stability Forum, the United Nations Counter Terrorism Committee and the UNODC;
 - providing information to the OECD Global Forum on Taxation;
 - signatories in many cases to the IOSCO Multilateral Memorandum of Understanding – a significant number of OFCs were among the first to sign up;
 - sharing information with other jurisdictions through memoranda of understanding between regulators, MLATs, and tax information exchange agreements;
 - joining in supervisory colleges (recognising that for many host supervisory authorities the subsidiaries and branches of foreign banks can have a systemic impact greater than the parent bank will have in its home jurisdiction);
 - ensuring through both on-site and off-site supervision that regulated institutions comply with international standards of financial regulation and AML/CFT, and adopt the principles of transparency necessary not least to enable independent assessors of compliance such as the IMF to test the effectiveness of the regimes in place;
 - matching non-OFCs in the establishment of FIUs, in the making of STRs and the sharing of information with correspondent bodies. The latter is particularly important because OFCs are usually part of a trail in the pursuit of those engaged in financial crime the prosecution of whom will take place in another jurisdiction (for example, a number of successful prosecutions in the USA have depended on information provided by an OFC).
35. The OGBS also produces annually summary statements whereby individual members set out what action has been taken in the past year to further ensure compliance with the Basel Committee Core Principles, and the FATF 40+9 Recommendations. These summary statements are made available to the FATF, the IMF, the FSF, the Basel Committee on Banking Supervision, the UNCTC and other interested parties.
36. OGBS members recognise that international acceptance depends on their reputation for compliance with international standards. There is no better position for an OFC than to be recognised by a third party such as the IMF that it

is compliant with the international standards set by the Basel Committee on Banking Supervision, IOSCO, IAIS and the FATF. It should come as no surprise therefore that OGBS members have been keen to participate in the IMF OFC assessment programme.

37. Some G7 jurisdictions are of the view that the OFCs have only moved in the direction of greater transparency and compliance with international standards because they have been under threat. However, to counter this view it is worth remembering that the OFCs have been at the leading edge in regulating trust and company service providers which the FATF include in the definition of non financial businesses and professions but which are key players in financial markets. As recent events have shown, the traditional focus on banking regulation has not been sufficient to deal with the increasing complex financial markets and those engaged in business within those markets. The OGBS has recognised the importance of non financial businesses and professions, and has sought to promote as an international standard a Statement of Best Practice for trust and company service providers (TCSPs) which was supported by the publication in 2004 of a report on seeking effective exchange of information and supervision in respect of TCSPs. The OGBS also promoted and led a FATF typology into the misuse of corporate vehicles. To-date the G7 countries have been reluctant to progress the idea of an international standard for TCSPs but the OGBS has recently written to those who took part in the working group - including representatives of the IMF, FATF and OECD - that produced the best practice statement to see whether there is any appetite for meeting to consider what further progress could be made in this area.
38. The report on the FATF typology into the misuse of corporate vehicles, published in October 2006, identified a number of next steps which it was recommended the FATF should take, which included what more could be done to ensure that adequate, accurate information on the beneficial ownership and control of legal persons/legal arrangements might be obtained or accessed in a timely fashion by competent authorities. The need for action in this respect - hopefully through the adoption by non-OFCs of the regulation of TCSPs that features prominently amongst OFCs - is evident from the assessment of compliance with the FATF Recommendations. At the time of writing this submission, of 19 FATF member jurisdictions assessed for compliance with Recommendation 33 (legal persons - beneficial owners) only 3 had a compliant/largely compliant rating, whereas of 12 OFCs assessed 7 had that rating. Similarly of the 10 FATF members assessed for compliance with Recommendation 34 (legal arrangements such as trusts - beneficial "owners") none had a compliant/largely compliant rating, whereas of 12 OFCs assessed 7 had that rating.
39. This message has been reinforced by the introduction into the US Senate by Senators Levin, Coleman and Obama of the "Incorporation Transparency and Law Enforcement Assistance Act". To quote from Senator Levin's statement "Federal legislation is needed to level the playing field among the States, set minimum standards for obtaining ownership information, put an end to the practice of States forming millions of legal entities each year without knowing who is behind them, and bring the United States into compliance with its international commitments." It is noteworthy that Senator Levin in proposing a tightening of the incorporation

rules in the USA, so that information on the beneficial ownership of companies is available, has made specific reference to the fact that most offshore jurisdictions already request this information.

40. The general message OGBS would wish to leave with the Treasury Select Committee is that all significant financial centres are important for world wide financial markets stability and all should be subject to the same international standards and the same degree of transparency.

The need for a global approach

41. There is therefore a need for a global approach. In this respect drawing a distinction between OFCs and non-OFCs is increasingly artificial, and runs the real risk of diverting attention from the real issues. The IMF have recognised this in their recent decision to integrate the OFC assessment programme into the IMF financial sector assessment programme (FSAP). As a result of this integration the IMF will no longer maintain an OFC list. This action on the part of the IMF reflects the priority being attached to issues of financial stability. The OFCs assessments undertaken to-date have focussed mainly on compliance with the international standards set by FATF, the Basel Committee on Banking Supervision, IOSCO and IAIS. The emphasis of the FSAP is on financial stability and financial sector development with the assessment of standards and codes playing a supporting role.
42. The FSAP provides an explicit mandate to assess micro-financial vulnerabilities, both nationally and internationally. Applying this broader view to OFCs will enable more comprehensive risk assessments. It is recognised that given the large volumes of financial transactions conducted using the major OFCs, failures of OFC domiciled institutions or systems could have broader systematic implications – although recent experience suggests that these failures are more likely to arise from situations developing in non-OFCs than from within the OFCs themselves. Assessments under the FSAP will involve specific attention to such vulnerabilities and the adequacy of contingency mechanisms. OFCs are also important links in the vertical chain of financial transactions, and play a key role in global risk transfer mechanisms. Consideration of these linkages in the context of the FSAP will enhance the effectiveness of the IMF's multilateral surveillance mandate.
43. The need for a global approach is also evident from the fact that the troubles in recent times have not come from the offshore world. The sub-prime mortgage crisis in the USA was not an OFC phenomenon. The liquidity crisis is also a problem arising from the credit policies of the parent banks, not from the excesses of OFCs subsidiaries or branches. Indeed quite the contrary, for the latter are a source of up-streamed funds upon which parent banks are heavily dependent (for example, for Jersey based subsidiaries and branches group loans comprise 75% of total assets). The problem facing the banking community in raising new capital, rolling over long term borrowings, maintaining a stable retail deposit base, maintaining committed funding lines, are the problems of the parent bank not of the OFCs making. However, the major OFCs have a significant involvement in the world financial market place. They therefore accept that they need to join in measures designed to enhance financial stability, particularly through greater

transparency. Particularly is this so where securitisation and new financial products are involved. To quote the Chairman of the Treasury Select Committee, "the best and brightest at our top investment banks have expended great energy designing ludicrously complex financial products, which you need a Nobel Prize in physics to understand. Whilst financial innovation and securitisation have brought real benefits and allow for risk dispersion through the system, it has come at a cost. Product complexity has introduced increased opacity into our financial system, making it almost impossible to determine where risk lies and making it much more difficult to achieve financial stability."

44. The fact that a number of the new financial products are to be found in OFCs is not because the OFCs are more lightly regulated, as some might believe. For the most part off-balance sheet securitisation, hedge funds and private equity have not been subject to on-going regulatory oversight in on-shore as well as offshore jurisdictions. Also, because many OFCs have tighter controls on company incorporation and trust and company administration than the non-OFCs, what regulation has applied at authorisation stage has been tougher in the former than the latter. Reasons for an OFC location are the tax neutrality enjoyed, the low rates of personal and corporate tax, and the level of professional expertise in associated areas of financial service activity. It is also the case that OFCs as niche market operators are quicker to enact legislation and produce a business environment favourable to new business.
45. The leveraging that has taken place off balance sheet was not sufficiently appreciated by regulators world-wide. A full picture calls for action by regulators collectively and there is a need for greater transparency among all the parties involved so that a proper risk assessment process can be applied effectively. OGBS members are committed to playing a full part in this.
46. OFCs recognise the need for this greater transparency. What should be clear to all is that this is not something which can be laid at the door of OFCs alone. While the OFCs as host supervisors accept that they have a part to play in providing for greater transparency in monitoring the spreading of risks by international banks through securitisation and new financial products, for a total picture to be obtained it is as if not more important for the home supervisors to implement measures that require appropriate disclosure by the parent banks. These are issues that have to be tackled on a global level playing field basis. OFCs are accustomed to being blamed for the ills of the financial market place. Politically it is understandable that there is an obvious attraction in being able to suggest that problems arise because of the activities of OFCs. However, the necessary joining of the key OFCs in a global approach to tackling what are global issues will be more likely to be achieved if they are treated as equals with non-OFC jurisdictions rather than as pariahs. As the Governor of the Bank of England in December 2007 told the Treasury Committee, "I think the problems we are facing are international in nature..... it has been a very salutary lesson, because this crisis has become international in nature. It is not a crisis of emerging market economies or failed macro-economic policies in the rest of the world, this crisis goes right to the heart of the financial centres of the three big developed parts of the world". Because OFCs are so heavily dependent for their economic well-being on their financial

service activity they are as enthusiastic about the current crisis being tackled by the major international finance centres as those centres themselves.

47. Financial stability and transparency will be further enhanced, embracing both OFCs and non-OFCs, by –

- a global approach;
- the dropping of the OFC/non-OFC distinction and embracing OFCs in the IMF FSAP;
- ensuring that processes/procedures are capable of responding quickly to the fact that financial markets are constantly developing new vehicles;
- ensuring good information is available rather than focussing simply on information exchange mechanisms – particularly in respect of beneficial ownership;
- extending the regulatory approach to TCSPs and the creation of an international standard in this respect;
- ensuring greater understanding and enhancing the relationships between all relevant authorities;
- recognising the importance of cross-border collaboration in dealing with banks in difficulties.

48. As far as the final bullet point is concerned it is important that proper regard is had for cross-border issues where international banks are involved. Issues that OGBS has suggested the Basel Cross-Border Bank Resolution Group should address include –

- how to define a systemic bank with cross-border operations – there is the issue here of the bank that is not systemic in its home country but through its foreign operations is systemic in a host country;
- how far can or should a host regulator allow a branch or subsidiary to be dependent on the parent bank and/or the home regulator;
- how far can and should home country deposit protection/rescue packages extend to foreign branches and subsidiaries;
- how far can the laws/legal judgements of the home country extend to the country in which foreign branches and subsidiaries are located;
- how to enhance communication flows from home to host, from host to home, and in some cases where there are regional centres (e.g. for treasury operations) from host to host both as a routine and when there are problems;

- how to deal with situations where a foreign subsidiary has minority shareholders and independent non-executive directors;
 - how to ensure that a foreign subsidiary, prompted by its regulator or by its Board of Directors, does not act in a way (e.g. through clawing back up-streamed funds placed with the parent) that is detrimental to the health of the parent;
 - how to deal with a situation where the foreign subsidiary is a subsidiary of a holding company and not of the parent bank.
49. Financial stability is of key importance to OFCs. Their economies are heavily dependent on serving financial markets. They are therefore keenly interested in the Financial Stability Forum's work on market and institutional resilience and will take whatever action is necessary to ensure that they play a full part in following the actions set out by the FSF which have a relevance for all financial centres both OFCs and non-OFCs.

Main challenges facing OFCs (and non-OFCs)

50. The main challenges facing OFCs when addressing transparency are common to those facing non-OFCs. They can be said to be –

i. protecting legitimate confidentiality

Legitimate reasons for protecting confidentiality include –

- the protection of commercially confidential information of financial service businesses for competitive reasons;
- the protection of individuals from improper harassment by the State (or by a Foreign State);
- the protection of the right of the individual to due process and civil rights;
- the protection of the source of information.

Particular difficulties often arise also in complying with the requirements of data protection legislation;

ii. protecting competitiveness

The absence of a global level playing field continues to encourage the retention of barriers to transparency in the interests of safeguarding a jurisdiction's economic interests.

iii. ensuring that there is a greater understanding of how information can be obtained. Accusations of a lack of transparency often arise from a failure of a

requesting authority to understand how best to approach the authority from whom information is required;

- iv. improving the gateways particularly in response to the problems faced in exchanging information between different regulators (e.g. between banking and securities regulators) and between regulators and enforcement agencies;
- v. resourcing

Data collection and information sharing are accepted as important but for many authorities are not considered to have as high a priority as engaging in the onsite and offsite examinations required to ensure compliance with international standards.

51. However, while there are challenges to be faced, the major OFCs have a firm commitment to the principles of transparency as embodied in the international codes and standards. OGBS members and other OFCs have come a long way since the FSF report in 2000 in which reference was made to the lack of comprehensive and up-to-date data on OFCs financial activity impeding effective monitoring and analysis of capital movements.
52. OFCs face the challenge of a far greater exposure to reputational risk than most if not all non-OFCs should money laundering or terrorist financing be identified. There is also a much greater threat that they will be put on 'black lists', or face restrictions on financial transactions. This is notwithstanding the fact that the scale of money laundering/terrorist financing may be much smaller than in many non-OFCs. There is also the ever present attitude that where problem cases do arise in the case of the OFC it is frequently portrayed as the tip of an iceberg whereas a similar case in a non-OFC in the same circumstances will be portrayed as a bad apple in an otherwise good barrel.

Conclusions

53. In conclusion it can be stated that –
 - the international standard setters are not focussing on OFCs per se. The FATF priority list of jurisdictions identified by the International Cooperation Review Group does not include any OFCs. IOSCO has indicated that in seeking to identify non-cooperative jurisdictions it is not focussing on OFCs per se. The Basel Committee does not focus separately on the OFCs and neither does the IAIS;
 - all OFCs have been or will be subject to an assessment of compliance with international standards of financial regulation and AML/CFT by the IMF, or for AML/CFT by the FATF FSRBs;
 - OFC assessments are published in full on the relevant websites. Information is thereby available to other regulatory authorities, and to financial institutions to assist in their risk assessment processes. The OFCs performance compares well with that of many non-OFCs. The IMF in its

progress reports has evidenced the progress being made. The gaps that remain to be filled are those that the assessments show are also to be found amongst many if not all non-OFCs;

- the IMF has decided to drop its OFC list and integrate the present OFC assessment programme into its global Financial Sector Assessment Programme;
- the OFCs have shown that they are very much alive to the relevance of compliance with international standards for their own reputation. They have recognised that a failure to comply with the international standards, and not to be viewed as equivalent with non-OFC jurisdictions in their application, can have a detrimental impact on the success of their finance centre activities upon which their economies largely depend. To this extent the market influences on OFCs to comply with international standards can be far greater than the market influences on non-OFCs;
- the international concern for the current lack of transparency on beneficial ownership is not one that is peculiar to OFCs. Indeed the OFCs through their regulation of trust and company service providers are in a better position to meet the requirements through the availability and accessibility of information on beneficial ownership;
- the OFCs through OGBS have been active in both the setting and application of international standards. There are no grounds for suggesting that the cooperation of the OFCs has only been obtained because of their separate identification by the Financial Stability Forum as an area of special concern;
- the FSF initiative, and the consequential IMF assessment programme, are not concerned with taxation issues. At the same time the view taken of OFCs by FSF members on occasion appears to be greatly and often predominantly influenced by taxation concerns. However, it should be noted, in respect of the OECD harmful tax initiative, that most OFCs are now described as “participating partners” and, with a few exceptions which include two OECD Member States, OFCs are fully committed to the OECD principles of transparency and information exchange;
- OFCs can be expected to maintain and enhance their compliance with the international standards on financial regulation and AML/CFT because it is in their best interests to do so;
- there is no case for maintaining an OFC/non-OFC distinction when focussing on compliance with international standards. The better focus should be on activities and issues, and on whether a jurisdiction is compliant/non-compliant or cooperative/non-cooperative;
- OGBS believes that the monitoring of compliance with international standards of financial regulation and of AML/CFT can and should be left to the international standard setters. The latter through their own formal processes can identify those jurisdictions that are not compliant, and in

particular those that are not compliant with the standards of international cooperation and effective information exchange. The FSF with its concern for global financial stability should receive reports from the international standard setters on which jurisdictions are failing to comply with the international standards, their significance for world financial markets, and the collective action that might need to be taken to bring those jurisdictions into compliance;

- financial stability issues and risks are global in nature, and they call for a global response. The focus should be on the risks and the gaps in transparency wherever those risks and gaps arise. The overall message that this submission has sought to convey is that in relation to financial stability and transparency, both for the extent of the existing commitment and the need for further action, OFCs ought not to be separately distinguished but should be considered with jurisdictions generally.

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Chairman - OGBS

June 2008

³ Colin Powell has been Chairman of OGBS since 1980. He is also Chairman of the Jersey Financial Services Commission (1999 -), and Adviser on International Affairs to the States of Jersey's Chief Minister's Department (1999 -). He was Economic Adviser to the States of Jersey from 1969 to 1992 and Chief Adviser from 1992 to 1999.

Summary of Ratings of Compliance with the FATF Recommendations

FATF 40+9 Recommendations (as at 1 March 2008)

	No: rated as C/LC (Incl. N/A)	No: rated as PC/NC	Ratings of Key Recs. ⁽⁴⁾		Rating of Rec. 5 (CDD)
			C/LC	PC/ NC	
<u>OFC's</u>					
Bahamas - Dec 2007	22	27	5	7	PC
Bahrain - Nov 2006	24	25	4	8	PC
Bermuda - June 2007	19	30	5	7	NC
Cayman - Dec 2007	38	11	11	1	PC
Cyprus July - 2006	39	10	9	3	PC
Gibraltar - May 2007	32	17	6	6	PC
Macau China - July - 2007	26	23	8	4	PC
Malaysia (Labuan) - July 07	33	16	8	4	LC
Monaco - Feb 2008	20	29	4	8	PC
Panama - May 2006	39	10	12	-	LC
Samoa - July 2006	5	44	-	12	PC
Vanuatu - Nov 2006	11	38	4	8	PC
<u>FATF Member Countries</u>					
Australia - Oct 2005	26	23	9	3	NC
Belgium - June 2005	42	7	11	1	LC
Canada - Feb 2008	30	19	10	2	NC
China - June 2007	24	25	4	8	PC
Denmark - June 2006	22	27	6	6	PC
Finland - June 2007	19	30	4	8	PC
Greece - June 2007	13	36	3	9	NC
Iceland - Oct 2006	23	26	6	6	PC
Ireland - Feb 2006	28	21	10	2	PC
Italy - Oct 2005	31	18	7	5	PC
Norway - June 2005	33	16	10	2	PC
Portugal - Oct 2006	36	13	11	1	LC
Singapore - Feb 2008	43	6	11	1	LC
Spain - June 2006	32	17	9	3	PC
Sweden - Feb 2006	29	20	9	3	PC
Switzerland - Oct 2005	33	16	8	4	PC
Turkey - Feb 2007	16	33	3	9	NC
United Kingdom - June 2007	36	13	11	1	PC
United States - June 2006	43	6	11	1	PC

Note:

- C = Compliant
- LC = Largely Compliant
- PC = Partially Compliant
- NC = Non-Compliant
- N/A = Not applicable

⁴ Recommendations 1, 5, 10, 13, 23, 35, 36, 40; SR I, II, IV, V