

**FIFTH ANNUAL IMF ROUNDTABLE FOR OFFSHORE AND ONSHORE  
SUPERVISORS AND STANDARD SETTERS**

**TRANSPARENCY IN FINANCIAL MARKETS: WHAT ARE THE  
IMPLICATIONS FOR OFFSHORE FINANCIAL CENTRES**

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I have been asked to make a presentation on the state of transparency of activities undertaken in offshore financial centres (OFCs), the challenges faced by offshore financial centres in improving transparency, and the progress made in recent years on improving transparency.

**Overview**

Let me start by saying that I believe that when considering transparency in financial markets the implications for OFCs are, or should be, little if any different from those for jurisdictions generally. This is to be expected because the major OFCs play an important role in the global financial market place. They are an important contributor to global capital movements and it has been argued help to oil the market mechanisms. With this in mind any consideration of the implications for OFCs of transparency in the financial markets should start from an overview of the state of transparency from a global standpoint.

The importance of transparency has been recognised and increasingly emphasised by the international standard setters. It figures prominently in the codes and standards of the FATF, the Basel Committee, IOSCO, and the IAIS. In all respects no distinction is drawn between OFCs and non-OFCs. Transparency also figures prominently in the work of the international organisations, the FSF, the IMF, the UN, the OECD and the EU. In the case of the FSF a distinction continues to be drawn between OFCs and non-OFCs, mistakenly in my view, but generally such a distinction is being less and less drawn.

Enhanced transparency is rightly seen as important for effective financial regulation, for AML/CFT, for the fight against corruption and for dealing with harmful tax practices and in every respect it is a global approach that is required.

The need for a global approach to transparency has increased with –

- globalisation and the interlinking of economies;
- increasing international capital flows;
- the need for evidence of a level playing field to encourage the international application of international standards;
- recognition that crisis prevention is much more effective than crisis management;
- the need for a greater understanding of increasingly complex activities making up financial markets;
- the focus on a risk based approach to supervision.

The aide memoir issued following the Fourth Annual IMF Roundtable held in Cayman in December 2006 made reference to the dramatic growth in risk transfers between sectors and pointed out that disclosure was weak particularly with regard to counter parties, geographic location and residual risks. It was agreed that improved disclosure was called for from all markets, while avoiding imposing undue additional regulatory burdens.

The call for greater transparency has been given further impetus by the recent turmoil in the financial markets. A plethora of opaque institutions and vehicles have sprung up - what has been called the “shadow” banking system - and they have come to play an important role in providing credit across the financial system. Until recently, structured investment vehicles (SIVs) and collateralised debt obligations (CDOs) attracted little attention outside specialist financial circles. Though often affiliated to major banks they were not always fully recognised on balance sheets. With the credit crunch it has become apparent that one of the key features of the turmoil is this hidden

world. The affect of this on financial markets and on the position of “real” banks has been significant. Such activity is found in both OFCs and non-OFCs.

The European Commissioner for Internal Market and Services speaking in London last month stated that “there is a clear need for improved due diligence by firms and investors to manage their risks and to take informed decisions”. Informed decisions call for transparency. On the subject of hedge funds he referred to the recommendation of the FSF that “the global hedge fund industry should review and enhance best practice benchmarks in the area of risk management, valuation and information disclosure to investors and counter parties”. He also stated that “there are issues relating to transparency and governance that we need to engage with certain Sovereign Wealth Funds on”.

The EU is responding to the current credit crisis by calling for enhanced transparency for investors, markets and regulators. This is confirming the importance of transparency for greater understanding on the part of all relevant parties, and for the relationships that exist within the financial market place –

- between financial institutions and financial markets;
- between financial institutions/markets and investors;
- between financial institutions and the regulatory authorities;
- between certain non-financial institutions and the regulatory authorities;
- between regulatory authorities;
- between regulatory and law enforcement authorities.

The relevance of transparency to these relationships is particularly evident in the risk based approach to supervision, and risk assessment generally both for the financial institutions and for the regulatory authorities.

There are still barriers to transparency that need to be dismantled. For example, banking regulators should not be prevented from sharing information with the securities supervisors simply because the latter is not another banking regulator.

The desirable characteristics of transparency have been 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.

There is a need to avoid “black holes”. The “credit crunch” has shown that the scale and nature of off balance sheet activity was often not recognised by 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. 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.

The Basel Committee in October welcomed the dialogue between the public and private sector over the issue of enhanced transparency for cover payments initiated by the industry, and noted that improving transparency in international payments should aid anti-crime efforts world wide.

In essence there is a need to know –

- what is going on;
- who is doing what; and
- why they are doing it.

Last month the German Chancellor, Angela Merkel, said that European Union leaders would decide at a summit in March on measures designed to boost transparency in financial markets. This can be expected to have implications for jurisdictions outside the European Union, both OFCs and non-OFCs.

### **Transparency from the OFCs viewpoint**

While transparency is a global issue, as I have indicated in the foregoing, let me for the purposes of this presentation now focus on the position from the OFCs viewpoint.

First and foremost there is a **general commitment to international standards** on the part of OFCs, and a wish to be seen to be compliant in the application of those standards. OFCs have had to deal with the historic view held by G7 and other jurisdictions that OFCs only succeed if they are secretive and non-transparent. The OFCs have responded by being fully supportive of the IMF/OFC assessment programme, and the assessments for AML/CFT carried out by the FATF style regional bodies. They are reinforcing this position by voluntarily engaging in the full **publication of their assessment reports**, something that a number of FATF member jurisdictions balked at for some time. With the publication of assessment reports there has been a considerable improvement in the degree of transparency of activities undertaken in OFCs.

Much information has also been gathered, albeit for tax purposes, and published in the tables included in the 2007 assessment by the OECD Global

Forum on Taxation. This is 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 does show is that the gaps that remain to be filled are as present in non-OFCs as in OFCs.

As IMF assessments are only carried out every four or five years it is important that there is an adequate interim **process of update and review** in place. The FATF has put in place a review process, with the frequency depending on the extent of the gaps to be filled in securing largely compliant or fully compliant ratings in respect of the FATF Recommendations. This approach is being followed by the FATF style regional bodies. The OGBS for its part includes in its annual meetings a review process in respect of the action plans that have been adopted by the assessed member jurisdictions.

Having committed themselves to comply with international standards OFCs have looked for evidence of equivalent application by non-OFCs. There is **competition in the market place**, and 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. Against this background it is important that there should be a level playing field and transparency is not held back by unevenness in the surface. In many cases this unevenness arises in jurisdictions or political sub-divisions that balk at any suggestion that they are “offshore” but who through their professionals, if not through the authorities, market themselves as centres for what they themselves describe as “offshore” activities. A number of these centres are far less transparent than the so-called OFCs, particularly in the area of company formation and administration.

OFCs often play a key role in **new market developments** because OFCs traditionally are “niche” market operators. They are usually able to pass

legislation more quickly, and their legislation is likely to be more user friendly as far as non-resident business is concerned. Some critics of OFCs will argue that this is done with a view to lowering standards, but in reality it is because OFCs can be quicker in responding to market needs. Not surprisingly many innovators in the financial market place will find OFCs a favourable location in which to base their activities. OFCs therefore have a key role to play in improving the general understanding of new market developments.

To ensure there is a good understanding of what is going on in their jurisdictions, most OFCs - and particularly the major ones - have been keen and active **participants in international fora** whenever they have been given the opportunity to be so. The Basel Committee encouraged the formation of the Offshore Group of Banking Supervisors in 1980 because of a lack of understanding as to what offshore centres were doing in the area of international loans. The OGBS has been an active participant in the FATF since 1994 and is treated by the FATF as equivalent to an FATF style regional body. OGIS is an active player in the IAIS and individual OFCs are active participants in IOSCO and the IAIS. OFCs have been among the first to be accepted by IOSCO in respect of its multi-lateral memorandum of understanding, and it is noteworthy that a very significant proportion of the countries signed up to the MMOU are OFCs.

Both OGBS and OGIS have also sought to play a role in the FSF but have not received the encouragement they would have wished for from some FSF members.

OGBS members have been active in negotiating **memoranda of understanding** with other jurisdictions. There is still considerable variation in this respect. However, the last review undertaken by OGBS showed that the Bahamas, Bermuda, Cayman, Guernsey, Isle of Man, Jersey and Panama in particular all have a significant number of MOUs. The establishment of such relationships, and the greater understanding that comes from this, are

important elements in enhancing transparency between regulatory authorities.

Because of the historic view that is held about them, but also because of their own recognition of the importance of transparency for their reputation, OFCs have been at the leading edge in dealing with what the FATF include in the definition of **non-financial businesses and professions** but which are key players in financial markets (e.g. trust and company service providers, lawyers and accountants). 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 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 the FATF typology on 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 that produced the best practice statement, which working group included non-OFCs, to see whether there is any appetite for a meeting to consider what further progress could be made in this area.

Recognising the importance of transparency, the majority of OFCs willingly agreed to join in the **IMF information framework initiative**. There are some countries still to commit themselves, but for the most part this appears to be due to two factors –

- a reluctance to allocate resources to the collection of statistics in the absence of a clear indication that the information will be global and therefore of sufficient value;

- a reluctance on the part of some jurisdictions to be labelled as OFCs.

As stated in the review of the FSF initiative on offshore financial centres produced by the OFC Review Group in October 2007 the IMF's information framework initiative has provided structural and activity indicators on banking, insurance and collective investment schemes. At that time, of the 46 jurisdictions invited to participate, 28 jurisdictions had submitted data, 5 more had committed but had yet to submit data, and 5 had yet to confirm participation. 8 had declined to participate but a number of those jurisdictions had done so apparently because of the framework's association with OFCs.

In addition 24 OFCs provided data out of the 72 countries participating in the IMF's 2005 coordinated portfolio investment survey.

What are **the main challenges** facing OFCs when addressing transparency? In common with non-OFCs, they can be said to be –

(1) **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 in complying with the requirements of data protection legislation.

(2) **Protecting competitiveness**

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

(3) Ensuring that there is a **greater understanding** of how information can be obtained. A number of OFCs have been in the forefront on this through engagement in an active outreach programme.

(4) **Improving the gateways** particularly in response to the problems faced in exchanging information between different regulators (e.g. between banking and securities regulators).

(5) **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 onsite and offsite examinations to ensure compliance with international standards.

However, while there are challenges faced, there is a firm commitment to the principles of transparency as embodied in the international codes and standards among OFCs.

We have come a long way since the FSF report in 2000 in which reference is made to the lack of comprehensive and up-to-date data on OFCs financial activity impeding effective monitoring and analysis of capital movements.

**Transparency - the future**

In looking to the future it is important that transparency should be considered in its widest sense and on a **global basis**. The OFCs wish to be, and should be, seen as a part of the global market place. This brings with it responsibilities. The OFCs will need to share with non-OFCs in improving

transparency in financial markets and the non-OFCs will need to treat the OFCs as equals in this respect. There is a need for a level playing field and this calls for a global approach. Hopefully it will be more and more recognised and appreciated that much more can be achieved through treating OFCs as equals and not as pariahs, and through the avoidance of double standards.

It is believed there is much to be gained by **dropping the OFC/non-OFC distinction** and focussing on the financial centres according to the level and scope of their financial activity and their compliance/non-compliance to international standards. The international standard setters appear to be already seized of this point and it is considered that the process would be assisted if OFCs no longer formed part of a separate IMF OFC assessment programme and are embraced by FSAPs. The FSAPs include a broader vulnerability analysis covering the role of macro financial linkages, financial safety nets, as well as potentially larger sets of standards and codes.

For the future there is the internationally recognised need also to focus on filling the current gaps in transparency. Much has been achieved in relation to banking and what might be described as traditional financial market activities. It is now accepted that more information on, and a greater understanding of, **new financial market activities** is required. What is important is that efforts in this respect are co-ordinated, recognising that this is a global issue and not simply an EU or a G7 issue. Also in the same way that the Basel Committee embraced the OFCs in 1980 on international loan activity, so should all the major players be involved in any new initiatives.

Another major gap is in the area of **company and trust administration** which has not received the attention it deserves largely because the international standard setters traditionally have been a collection of regulatory authorities and TCSPs generally are not regulated in non-OFC jurisdictions. Because TCSPs and other non-financial businesses and professions active in financial markets have not been regulated there has been less focus on the issues in this

area, and a reluctance to establish international standards if that calls for an element of regulation. The result has been a “black hole” reflected in the results of the AML/CFT assessments undertaken by the FATF and the IMF which show almost without exception that FATF recommendation 5 on customer due diligence is a recommendation for which only partial compliance is being secured largely because of lack of information on **beneficial ownership** and an inability to have access to that information. For so many aspects of the international standards set, beneficial ownership information is of key importance but there remains a reluctance on the part of many jurisdictions to grasp the nettle of what needs to be done to ensure that adequate, accurate and current information on beneficial ownership is obtained and is accessible in a timely fashion.

Transparency will also be assisted by greater understanding and enhanced relationships between all interested parties. This in turn can be encouraged by negotiating MOUs and MLAs and using these as a basis for regular contact. It can also be progressed by more personal contacts through participation in international fora. There is also a need for more interplay between the standard setters to deal with the difficulties that remain in ensuring effective coordination.

**In summary** therefore I would suggest that transparency would be further enhanced in both OFCs and non-OFCs by –

- a global approach;
- the dropping of the OFC/non-OFC distinction and embracing OFCs in the FSAP programme;
- ensuring that processes/procedures are capable of responding quickly to the fact that financial markets are constantly developing new vehicles;
- ensuring information is available rather than just focussing in 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.

In all these respects you can be assured that the OFCs will continue to play an active and positive role, but they will be more encouraged to do so if they are not discriminated against and they are treated as equal partners on a global level playing field.