

International challenges to the offshore sector

Dr Marion Williams, governor of the Central Bank of Barbados, answers The Financial Regulator's questions, and argues that the legitimacy of international financial institutions is being undermined by their threatening stance towards small offshore centers.

Over the last year or so, there has been an acceleration in several initiatives to diminish the activities of small international financial centres in developing economies, commonly called "offshore centres". This article addresses some of the issues as they affect these jurisdictions and discusses the significance of these initiatives for those international financial centres, with particular emphasis on Barbados.

The Barbados international financial services sector is approximately 35 years old in terms of the legislative preparation for the launch of the sector, but has been more actively promoted over the past 20 years. Barbados markets itself as a "low tax" rather than a "no tax" jurisdiction and it ensures that careful due diligence is conducted on applicants seeking to do business from within Barbados. Its international financial services sector is also supported by a range of double taxation treaties which have helped to make the sector attractive. In the context of the declining importance of the sugar industry and the difficulties of maintaining competitiveness in the manufacturing sector, due largely to diseconomies of small scale, the services sector was actively encouraged as an alternative foreign exchange earner. It was felt that with a growing class of competent professionals, the island had the resources to support a growing international financial services sector. Its highly literate work force, a time zone

similar to that of the eastern US, a modern communication system and direct air routes to the major metropolitan capitals were added advantages.

Just as other countries in the developed world gave incentives to specific sectors and activities so as to encourage their growth, the same was done in Barbados to encourage the growth of the international financial services sector. In the process Barbados was very careful to guard its good name and utilise the resources of international regula-



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an MA and a PhD respectively. She is also a qualified accountant. Before joining the Central Bank of Barbados in 1973, she worked at the East Caribbean Currency Authority. At the central bank she has held several senior management positions, including Senior Adviser and Deputy Governor. She is the author of *Liberalising a Regulated Banking System, the Caribbean Case*, published by Avebury.

tory and law enforcement authorities in its due diligence processes. Over the years, the country opted for careful selection of applicants and slow growth rather than rapid and questionable growth. Barbados' cautious approach to licensing is reflected in the fact that after 20 years as an offshore domicile it has only 47 offshore banks. It would be most ironic were it to be punished despite its care.

How do you view the current initiatives by the OECD, the FATF and the Financial Stability Forum to clamp down on offshore financial centres?

In evaluating recent initiatives, one has to distinguish between the actions taken and being contemplated by the Organisation for Economic Cooperation and Development (OECD) and those initiatives of the Financial Action Task Force on money-laundering (FATF) and the Financial Stability Forum. There can be no dispute about the importance of protecting financial centres from abuse by persons involved in illicit activity (the role of FATF) or of strengthening supervisory skills (the role of the Financial Stability Institute), or the gathering of information on volatile assets, a task being undertaken by the Financial Stability Forum. However, the designation of tax competition as harmful (by the OECD) brings an entirely different perspective to the whole matter and hits at the heart of the right of individual countries to put in place tax systems to encourage national economic development and growth, policies practised for centuries by the same countries who would seek to prevent their introduction in small and young developing countries. In addition, the idea that tax competition is harmful runs against the modern trend espoused by most major developed countries who otherwise advocate that competition be encouraged

and that capital be allowed to move globally, unfettered by national restrictions. Indeed, developing countries worldwide are struggling to conform to initiatives which encourage financial liberalisation which originated in North America, Europe and in international fora.

There is another aspect of the initiatives which deserves comment. There is a tendency, because of past valuable service in the area of bank supervision rendered by these organisations, to be respectful of present initiatives based on past performance. The enjoining of support of a reputable organisation to achieve objectives which

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specifically serve a few countries may not bring credit to that organisation unless it is seen to be fair. In the past the guidelines issued by these organisations have not been questioned, despite the fact that the issuing organisations were not international. However if their actions are not seen as

fair, it may be argued that they are operating without jurisdiction. The argument has already been made that international rules which are expected to be binding should be issued by international bodies. Though their influence will ensure their success, it is important that the credibility of these organisations not be undermined or their past good work may be forgotten and their future work tarnished.

How do you react to the suggestions by some financial supervisors, for instance Howard Davies from the UK's Financial Services Authority, that G7 supervisors like the FSA do not receive an adequate level of cooperation from many offshore regulatory authorities?

There is undoubtedly a need for greater cooperation among supervisory agencies and financial institutions. However, the question of cooperation has to be tackled at the level of establishing communication

channels. Efforts to address this problem should focus on the offenders. There is recognition that some countries need to take greater action to improve the regulatory processes and their response times. In addition, it is important to ensure that what is being asked of offshore jurisdictions compares fairly with what is being asked of onshore financial centres in developed countries. For example the banker-customer relationship is expected to be confidential, not unlike that of any other professional relationship, and continues to be a valued quality in banking systems in developed countries. One has to be careful that the private business of legitimate individuals is not wantonly revealed to third parties on bases which are different from those which apply to London or New York. Given the observed responses to difficulties experienced in large metropolitan jurisdictions, there is an uneasy feeling that developed countries with international financial centres will be given a somewhat different and milder treatment.

Having said this, it is important to note that in the Barbados case, cooperation is high on the agenda. Our international financial services sector is based on a foundation of international treaties with a number of countries. An important aspect of these treaties is a provision for the exchange of information between jurisdictions, which clearly signals that Barbados does not intend to accommodate illicit activity. In addition the Core Principles For Effective Bank Supervision provide for the establishment of mechanisms for sharing information among supervisors. Cooperation with international authorities by Barbadian officials is also enshrined in law, in the form of the Proceeds of Crime Act. Under this act the High Court on an application by the director of public prosecutions can direct any public entity to hand over records that may pertain to a criminal investigation.

How do you react to the suggestion that low prudential safeguards allow offshore banks to pursue riskier strategies, and that capital flight on behalf of offshore

registered banks and other entities exacerbated the Asia crisis?

There have always been weaknesses in regulation of both onshore and offshore centres world-wide. A remedial approach should seek to identify these points of weakness and deal with them, but one has to be careful how one concludes that closer regulation will eliminate volatile capital flows. For example, knowledge of the size of assets held in these centres may be important and the regulation of international financial centres is critical, but it will not prevent the kind of capital movement that precipitated the Asian financial crisis. This was exacerbated by the herd instinct among financial analysts, fund managers and institutional investors, and is not unrelated to the weaknesses of program trading which helped along a financial crisis in the US a few years ago. Indeed it may well be the case that identical information and points of view by all participants in the market worsens the herd aspect of these crises.

How would you react to the proposal that G10 banks should face higher capital charges for exposures to offshore banks and other entities?

We began by pointing out that offshore centres should not be painted with the same brush. An attempt by G10 banks to apply higher capital charges for exposures to offshore banks and other entities would be discriminatory. In addition it would be inconsistent with the new capital adequacy proposals developed by the Basel committee themselves and might bring them up against a charge of being less than transparent, a quality continuously being advocated in the financial world. The new proposals represent an attempt to get away from arbitrary risk weights and move towards a situation in which various types of risk exposures are properly assessed. Risk weights in respect of both onshore and offshore should reflect actual risk. To do otherwise for small offshore centres only is to open the Basle committee guidelines to the charge of being arbitrary and fundamentally flawed in their application.

What is the best way to ensure that all financial centres around the world impose minimum standards?

Much is already being done to ensure that minimum standards are maintained around the world. Regulators world wide have been charged to implement the Core Principles of Banking Supervision. The Offshore Group of Bank Supervisors is also committed to the maintenance of the highest standards of reg-

Task Force. It is noteworthy that while developed countries apply the FATF's 40 recommendations, the CFATF has devised its own list of 19 recommendations which are applied in addition to the 40 recommended by the FATE. Despite these efforts, one cannot deny that some have slipped the net or that some jurisdictions need to improve their regulatory systems as they apply to the international financial sector.

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ulation of its members. In the Caribbean itself, the Caribbean Group of Bank Supervisors was formed 17 years ago to establish common standards of regulation among its members and to ensure that its practices are consistent with the highest international standards. Barbados is a very active member of both the Caribbean and offshore group.

A major concern of OECD and other initiatives has been the use of offshore centres as vehicles in the laundering of the proceeds of illicit activity. The establishment of the Caribbean Financial action Task Force (CFATF), a body established with the principle objective of putting anti-money laundering mechanisms in place, and modelled on the European FATE, has helped in the process of screening out the unwelcome. Barbados played an active role in the establishment of the CFATE. Indeed, the Caribbean is one of the few regions in the world which has established its own task force and this model is now held in high regard and is being copied by other regions. It is interesting to note that an OECD press release of April 28, 1998 indicated that ministers of a number of member countries urged the Financial Action Task Force to foster the development of FATF-style regional bodies like the Caribbean Financial Action

However, Barbados has had very few problems of illicit activity and none of volatile capital flows.

How do you react to the idea that G7 countries and others would name and shame "uncooperative" offshore centres and possibly go on to apply sanctions against them?

Any attempt to "name and shame" countries which are deemed to be uncooperative must be approached carefully. It may well be that countries already taking action to ensure that their jurisdictions are clean, may not feel that they have any obligation to make any commitment to the OECD, a body which really has no legitimate authority over them, and of which they are not members. To "name and shame" a country because of this stance, particularly where its jurisdiction is clean, would be to use big-stick tactics.

The OECD therefore needs to be sensitive to the fact that by virtue of sheer power it has the potential to demolish the economies of many of these small states. To do so because they question OECD's legitimacy to call them to account would be a departure from the high principles expected of the OECD. Power places an obligation on those holding it to exercise it carefully.