

INTERNATIONAL MONETARY FUND

OFFSHORE FINANCIAL CENTER PROGRAM

A Progress Report

Prepared by the Monetary and Exchange Affairs and Statistics Departments

March 28, 2002

Contents	Page
Executive Summary	3
I. Introduction	5
II. The Assessments	6
III. Results of the Assessments	9
A. Findings on Regulatory and Supervisory Systems	10
B. Issues Raised by the Assessments	15
IV. Corrective Measures by Jurisdictions, Recommendations, and Technical Assistance	21
V. Future of the Assessment Program	24
A. The Accelerated OFC Assessment Program	24
B. Lessons Going Forward	25
VI. Participation in International Statistical Collections	27
A. The Coordinated Portfolio Investment Survey	28
B. The BIS International Locational Banking Statistics	30
VII. The Adequacy of Partner Country Statistics on Selected OFCs	30
VIII. The Adequacy of Macroeconomic Statistics Compiled by Selected OFCs	31
IX. STA's Work Program with Selected OFCs	33
A. Improving the Coverage of the CPIS for Selected OFCs	34
B. Improving the Coverage of Selected OFCs in Industrial Country Statistical Collections	35
C. Further Work on International Statistical Guidelines	35

Text Tables

1. Status of Offshore Financial Center Assessments	8
2. Status of FSAPs in Countries with International Financial Centers	9
3. Basel Core Principles for Banking Supervision: Areas of Weakness.....	12
4: Profile of Overall Compliance with 25 BCPs.....	13
5. IAIS Core Principles for Insurance Supervision: Areas of Weakness.....	13
6. Participation in International Statistical Collections by the Selected SEIFiCs.....	28
7. Macroeconomic Statistics Compiled by the Selected SEIFiCs	33

Boxes

1. OFC Assessment Modules.....	6
2: Cross-Border and Cross-Sectoral Exchanges of Information.....	18
3. Companies, Trusts, and Company and Trust Service Providers.....	20
4: Statistical Guidelines Need Updating to Account for SEIFiCs	36

Appendices

I. Basel Core Principles: Areas of Weak Compliance	37
II. IAIS Core Principles: Areas of Weak Compliance.....	38
III. 1997 Coordinated Portfolio Investment Survey	39
IV. Coverage of the 2001 CPIS for Participating SEIFiCs	41
V. BIS International Locational Banking Statistics for SEIFiCs	42
VI. Tables 8–13.....	43

Appendix Tables

8. Offshore Financial Center Assessments: Sectors and Methodology	43
9. Financial Sector Assessment Program (FSAP): Sectors and Methodology	44
10. FSAP Countries' Financial Structure	44
11. Financial Structure of Assessed Jurisdictions.....	45
12. Conformity with Supervisory Standards: BCP Compliance.....	46
13. Conformity with Supervisory Standards: ICP Observance	47

Executive Summary

The offshore financial center (OFC) program launched in July 2000 is addressing potential vulnerabilities in financial systems by identifying gaps in supervision and improving the coverage of statistics on the activities of OFCs in financial markets. The assessment component of the program has focused on jurisdictions with significant financial activity and few previous assessments of standards, subject to the agreement of the jurisdiction, while the statistical component has concentrated on extending the coverage of the Coordinated Portfolio Investment Survey (CPIS).

The OFC program has gained momentum in the last 12 months. Staff has now assisted in 12 Module 1 assessments, conducted 10 Module 2 and FSAP assessments, and scheduled a further 20 Module 2 assessments under its 2002 program. Three Module 2 assessments have been published. STA missions and seminars have resulted in participation in the end-2001 CPIS by 23 OFCs, including 17 small economies with international financial centers, compared with participation by only 4 OFCs, including 1 small economy, in the survey for end-1997.

The OFC assessment program consists of identifying gaps in national and global supervisory and regulatory networks, promoting actions by jurisdictions, and providing a structure for planning and delivering the technical assistance, to address the gaps.

The assessments have typically found that:

- In **banking supervision** there were weaknesses in anti-money laundering (AML) measures, independence of the regulator, and onsite and offsite surveillance; cross-border sharing of information was generally satisfactory or improving;
- **Insurance supervision**, which has until recently been accorded low priority, was weak in market conduct, on-site inspection and, in some cases, information sharing, and cooperation; and
- Jurisdictions have only recently begun to focus on regulatory and supervisory issues in the **companies and trusts sectors**.

The assessments also commented on the following **issues common to all sectors**:

- **AML regimes** frequently elicited recommendations for improved legal frameworks;
- Jurisdictions' supervisory capabilities, especially for ongoing supervision, were found to be constrained by the high **costs and shortages, of skilled and experienced staff**; and
- **Cross-sectoral information sharing arrangements** were found to require significant enhancement.

Countries have in some cases moved rapidly to correct deficiencies identified in the assessments by, for example, strengthening laws, conducting AML training programs, and exiting activity which it is not cost-effective to supervise. However, substantial work

is still required from the jurisdictions, the international institutions, and the standard setters in fulfilling the objectives of the program:

- **Jurisdictions** should continue to focus on upgrading their legal, regulatory, and supervisory systems, considering exit from OFC activities where it is not cost effective to meet international standards; and prioritizing the areas highlighted above;
- **The program has elicited considerable demand for technical assistance;** coordinated input from the Fund, other technical assistance providers, and donors will be crucial to satisfying a demand that is growing with completed assessments;
- **Standards setters** should move forward with their work to develop standards for the oversight of company and trust service providers, and advance their discussions on the treatment of bearer shares **to help guide the assessments;** and
- **The Fund** could complete the assessment program in its present form by end-2003.

The **outreach program on statistics** found that:

- **Data on asset holdings in OFCs can be collected from the better regulated sectors, especially from banks,** and to a lesser extent insurance companies and mutual funds; little or no data are available for other corporations (and trusts). There are severe constraints on data collection due to the lack of resources.
- **The expanded Coordinated Portfolio Investment Survey (CPIS) is expected to improve understanding of global capital markets** and to improve balance of payments and international investment position statistics.

In 2002, the Fund will upgrade the CPIS to an annual basis, work to fill gaps in sectoral coverage, and seek to increase the number of participating jurisdictions. Work will also be undertaken to update international statistical guidelines on OFC issues and make better use of industrial country information on counterparty OFCs.

I. INTRODUCTION

1. In July 2000, the Executive Board supported the initiation of a program for offshore financial centers (OFCs) in the context of the Fund's responsibility to help members¹ identify and reduce vulnerabilities from weaknesses in their financial systems.² Inadequate financial supervision and the inability to carry out comprehensive risk analysis because of a lack of reliable data create possible risks for financial stability. Assessments with appropriate follow-up can reduce potential financial vulnerabilities in the jurisdictions and in the international financial system. More comprehensive statistical coverage of OFCs' financial activities can improve monitoring and analysis of international finance.

2. As agreed by Executive Directors, the assessment component of the OFC program is primarily concerned with assessing financial regulation and supervision in OFCs, including AML and countering the financing of terrorism.³ It provides the basis for technical assistance to address the shortcomings identified in supervisory systems and AML regimes.

3. In line with the Executive Board's support for an intensified effort to improve coverage of statistics in OFCs, the statistical component aims to encourage wide participation in the Fund's Coordinated Portfolio Investment Survey and in the Bank for International Settlements' (BIS) international locational banking statistics, and to help OFCs improve their national macroeconomic statistics. Both the Coordinated Portfolio Investment Survey and the BIS locational banking statistics contribute to identifying the role of OFCs in global finance and in the links between OFCs and potentially vulnerable economies.

4. **This paper summarizes findings and lessons from the OFC assessments conducted to date, and discusses plans for the assessment program. It also reviews progress in the statistical program to encourage OFC participation in international data collections and upgrade their macroeconomic data.** The following Section II describes the geographic, sectoral, and thematic scope of the assessments. Section III describes the principal results of the assessments in terms of sectoral findings, and issues raised by the assessments, including the cross-sectoral findings on: AML regimes, supervisory resources, and cross-border information sharing and cooperation. Section IV considers follow-up actions by the jurisdictions and technical assistance. Section V discusses the future of the assessment work in the light of the lessons staff have learned. Section VI, the first to center on the statistical component of the program, reviews the effort to encourage participation by small economies with international financial centers in international statistical collections. Section VII assesses the adequacy of partner country statistics on financial flows and positions with these economies. Section VIII discusses the adequacy of

¹ Dependent territories of members would be covered by virtue of their relationship to the member; the Fund provides policy advice and technical assistance to nonmembers.

² For the background to their discussions and decision see BUFF/00/98 of July 14, 2000, and SM/00/136 of June 23, 2000.

³ See BUFF/00/98 and BUFF/01/176 of November 14, 2001.

macroeconomic statistics of small island economies with international financial centers. Section IX concludes with STA's planned program for work with selected OFCs on statistics. The appendices provide additional detailed and supporting material on the two components of the OFC program.

II. THE ASSESSMENTS

5. **The OFC program assesses supervisory and regulatory arrangements** relevant to reducing potential vulnerabilities in the jurisdiction and internationally. In most cases, this involves assessment of banking supervision and AML measures. Supervision or oversight of insurance, securities, and the companies and trusts sector are also assessed where relevant.

6. The program envisaged a sequenced process of assessments organized by modules (Box 1) that allowed for the results of Modules 2 and 3 to be published with the agreement of the jurisdictions. In prioritizing jurisdictions for assessment, the staff has focused on two factors: whether the country's international financial activity is significant, and whether supervisory standards have previously been assessed.⁴ The effective conduct of assessments depends on reaching agreement with the jurisdictions contacted. Following Module 1 assessments, jurisdictions have exhibited a preference for delaying the publishable Module 2 assessments in order to receive technical assistance to upgrade their AML and prudential supervisory systems, resulting in some delay in the pace of publishable assessments.

Box 1. OFC Assessment Modules

The OFC program envisaged a step-by-step sequence of assessments, organized as increasingly comprehensive modules (see SM/00/136):

Module 1: self-assessment assisted by a staff member or consultant,

Module 2: stand-alone assessment by a team of specialized supervisors of jurisdictions' supervisory and regulatory practices assessed relative to the standards determined by the Basel Committee, the International Association of Insurance Supervisors (IAIS), and the International Organization of Securities Commissions (IOSCO),

Financial Sector Assessment Program (FSAP) (or Module 3, for nonmembers in the OFC context): comprehensive vulnerability assessment which could incorporate the results of the principles assessments

⁴ Some of the most significant OFCs are British Crown Dependencies and Overseas Territories which were assessed in the UK-commissioned studies, *Review of Financial Regulation in the Crown Dependencies*, 1998, by A. Edwards (Edwards Report), and *Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda*, 1999, by KPMG Peat Marwick (KPMG Reports).

7. **Staff has now assisted with 12 Module 1 assessments, and conducted 10 Module 2⁵ and FSAP⁶ assessments.** The majority of the assessments have been carried out for Caribbean and Central American and European jurisdictions, with two assessments in the Asia-Pacific region (Tables 1 and 2 below). Three assessments (for Cyprus, Gibraltar, and Panama) have been published; the remaining seven are going through the Fund's internal review process with possible publication dates varying between two and four months.

⁵ Three of the jurisdictions with Module 2 assessments had previously had Module 1 assessments, so later discussion reflects the results of at most 19 jurisdictions.

⁶ FSAPs to non-industrialized countries are conducted in cooperation with the World Bank.

Table 1. Status of Offshore Financial Center Assessments

Jurisdiction	Type and Status of Assessment ^{1/}			
	Module 1	Module 2		
		2001	2002	2003
Africa				
Seychelles			scheduled ^{4/}	
Asia and the Pacific				
Cook Islands			scheduled	
Macao SAR		review ^{2/}		
Malaysia (Labuan)			scheduled	
Marshall Islands			scheduled	
Nauru				planned ^{6/}
Niue	completed			planned
Palau			scheduled	
Samoa			scheduled	
Vanuatu			scheduled	
Middle East				
Bahrain 7/			planned	
Europe				
Andorra	completed		review	
Cyprus		published		
Gibraltar		published		
Guernsey			scheduled	
Isle of Man			scheduled	
Jersey			scheduled	
Liechtenstein			scheduled	
Monaco	completed		scheduled	
Western Hemisphere				
Anguilla			scheduled	
Antigua and Barbuda	completed			planned
Aruba	completed	review		
Belize		comments ^{3/}		
Bermuda			scheduled	
British Virgin Islands			scheduled	
Cayman Islands			scheduled	
Dominica	completed			planned
Grenada	completed			planned
Montserrat			scheduled	
Netherlands Antilles	completed		underway ^{5/}	
Panama	completed	published		
St. Kitts and Nevis	completed			planned
St. Lucia	completed			planned
St. Vincent and the Grenadines	completed			planned
The Bahamas			underway	
Turks and Caicos Islands			scheduled	

Notes: 1/ Calendar year of the assessment mission(s)

2/ review = assessment is undergoing the Fund's internal review

3/ comments = awaiting comments from authorities.

4/ scheduled = either a date or month has been agreed with the authorities

5/ underway = first mission has taken place

6/ planned = scheduling is under discussion or to be discussed with authorities.

7/ As Bahrain has had a Basel Core Principles Assessment in 2000 before the start of the OFC program, the scope of the assessment is under discussion.

Table 2. Status of FSAPs in Countries with International Financial Centers

Jurisdiction	Year of Assessment Mission 1/				
	1999	2000	2001	2002	2003
Africa					
Mauritius				planned ^{5/}	
Asia and the Pacific					
Hong Kong SAR				scheduled ^{3/}	
Singapore					planned
Middle East					
Lebanon ^{6/}	completed				
Morocco				underway ^{4/}	
Europe					
Ireland ^{6/}		completed			
Luxembourg			review ^{2/}		
Malta				planned	
Switzerland			review		
United Kingdom				underway	
Western Hemisphere					
Barbados				planned	
Costa Rica			review		

Notes: 1/ Refers to calendar year; FSAP scheduling is subject to change.

2/ review = Bank's/Fund's internal review process

3/ scheduled = either a date or month has been agreed with the authorities.

4/ underway = first mission has taken place.

5/ planned = scheduling is under discussion or to be discussed with the authorities.

6/ Both Ireland and Lebanon had FSAPs before the start of the OFC program. The FSAP for Lebanon, which is a regional financial center, was updated in 2001. Results of the core principle assessments of these 2 jurisdictions are not reflected here.

8. Following the November 2001 Board discussion that developed an Action Plan on AML/CFT,⁷ the staff has accelerated the OFC assessment program. Twenty-two jurisdictions have been contacted for Module 2 assessments, and four jurisdictions are discussing or scheduling FSAPs. Jurisdictions are in general cooperating in attaining the goal of 20 Module 2 or FSAP assessments in 2002 (Section V).

III. RESULTS OF THE ASSESSMENTS

9. **This discussion of the findings from the assessments takes account of Module 1, Module 2, and FSAP assessments,** with more stress being placed on the Module 2s and FSAPs, which include detailed core principles assessments and are reviewed internally. While Module 1 self-assessments are prepared with the assistance of a consultant or staff, sectoral standards are

⁷ See BUFF/01/176, November 14, 2001.

not assessed in detail. The jurisdictions and sectors assessed⁸ are listed in Appendix VI Tables 8 and 9. The financial structures of the jurisdictions are sketched in Appendix VI Tables 10 and 11. This section summarizes the main findings of the assessments.

A. Findings on Regulatory and Supervisory Systems

10. Of the 19 jurisdictions considered here, 11 have incorporated offshore banks and insurance companies under distinct legislation that, in general, provides for an international license permitting business only with nonresidents, and only in foreign currencies. Despite these legislative differences, in 15 of the jurisdictions the banking supervisor is responsible for both the domestic and offshore sectors. Five of the jurisdictions do not require banks to have a physical presence. Several jurisdictions also had international insurance legislation but had few companies licensed under the relevant laws. In addition, most OFCs allow for the registration of international business companies (IBCs) and exempt companies, which can conduct both licensed⁹ and unlicensed financial business.

11. **There was significant variation in the scope and quality of oversight and supervision across the sectors with banking being the best organized, and companies, trusts and their service providers the least structured.**¹⁰ Experience to date appears to confirm initial understandings with regard to quality of supervision.¹¹ Supervisory systems are better where domestic and international institutions share the same prudential supervisor, where the center has been long-established, and where per capita GDP is higher. There is generally better supervision of banking which, since the 1980s, has been receiving increasing attention in the domestic market, even in small, poor economies. To the extent that the international sector shares the same supervisor, it also benefited from improved supervisory practices. Jurisdictions whose offshore or international banking facilities were set up in the 70s, 80s, or before, also had markedly better supervision than countries where these facilities have been established more recently, reflecting the time required to develop supervisory systems. However, with increasing international pressure for improved supervision, or the regulatory requirements of EU accession, countries are revising their laws and systems.

⁸ While Andorra is listed in Table 1, information from its Module 2 assessment is not reflected in the following discussion, since the Module 2 mission has only just been completed.

⁹ For businesses which require a license, banking, for example, the IBC legislation is typically superceded by the legislation for the regulated entity.

¹⁰ It should, however, be emphasized that the oversight of company service providers does not occur outside of OFCs, and there are no accepted standards on whether and, if so, how, they should be regulated.

¹¹ Although the current sample does not include the major OFC jurisdictions.

Banking supervision

12. **The Basel Core Principles (BCP) assessments¹² indicate that the areas where compliance tends to be weakest** are: money-laundering risk (discussed below), independence and resources, supervision of market risks management, and onsite and offsite supervision (see Table 3)¹³ The main weaknesses found were as follows.¹⁴

- **Independence and resources of the supervisor and related issues:** Government's role in the supervisory agency, and, in some cases, the government's legislative authority to determine even prudential regulation, were cited. While this did not always interfere with supervisory operations, heads of supervision did not have sufficient security of tenure, and, in at least one case, the minister assumed too great a role in decisions. Lack of resources was a virtually universal problem (see below).
- **Licensing and supervisory approval for changes in ownership structure or organization:** The role ministries play in licensing banks was the major shortcoming. In some small, recently-established jurisdictions, supervision and promotion of financial services are sited in the same agency with resulting conflicts of interest in licensing.
- **Supervision of bank policies and procedures regarding risk:** The shortcomings here related to inadequate monitoring of compliance with procedures, reflecting insufficient staff resources; excessive dependence on quantitative risk indicators, rather than qualitative evaluation, and a lack of, or unsatisfactory prudential guidelines on, risk were also found. The lack of comprehensive risk management was a widespread issue.
- **Methods of ongoing supervision:** There was a very general need for improvement in on- and off-site supervision for which both staff resources and tools, such as manuals, were missing. Lack of authority for consolidated supervision and the domestic sharing of information were also cited.

¹² Since the sample of detailed assessments (Module 2 and FSAPs) is small, apparent outliers (relative to both Module 1 and detailed assessments) are not highlighted here.

¹³ In a small proportion of jurisdictions shortcomings were also found in the legal framework, enforcement powers, licensing, investment criteria, credit policies, additional areas of risk management, consolidated supervision, and accounting. Results were similar in the less-structured framework of the Module 1 assessments where deficiencies were found in licensing and methods of ongoing supervision such as procedures for off- and on-site surveillance.

¹⁴ For more details, see Appendix I and Appendix VI, Table 12.

13. **The general degree of compliance with the BCP is comparable to early experience with assessments of banking supervision** (see Table 4).¹⁵ Individually, seven out of nine jurisdictions were compliant or largely compliant with at least 22/25 of the BCP.¹⁶ Nevertheless, the shortcomings in some basic features of supervision in the OFCs, particularly those related to ongoing supervision, risk monitoring, and AML can have wider significance from a prudential or market integrity viewpoint. Without effective inspection, supervisors are unable to properly monitor whether regulations are being observed, identify potential problems, and obtain independent verification of reporting.

Table 3. Basel Core Principles for Banking Supervision: Areas of Weakness

Principles with which Jurisdictions are either Materially Noncompliant or Noncompliant 1/		
4/9 Jurisdictions	3/9 Jurisdictions	2/9 Jurisdictions
Money laundering	Independence and resources Market risks On-site and off-site supervision	Legal framework Enforcement powers Licensing Investment criteria Credit policies Country risk Other risks Consolidated supervision Accounting

Notes: 1/ Each section indicates the principles with which the stated proportion of jurisdiction fail to be compliant.

¹⁵ SM/00/77 of April 12, 2000, which reviewed two years' experience with BCP assessments, noted that, paragraph 22, "The results of the assessments analyzed show that compliance with the majority of individual BCPs is far from satisfactory".

¹⁶ One jurisdiction was an outlier with compliance in only 4 principles because of the absence of consolidated regulation; another was compliant with 18 of the 25 BCP. This takes account only of jurisdictions where the BCP was assessed in detail.

Table 4: Profile of Overall Compliance with 25 BCPs

Number of BCPs with Weak Compliance	26 Initial Countries		9 Financial Centers	
	Number	Proportion	Number	Proportion
20-25	0	0	1	11
14-19	6	23	0	0
10-13	6	23	0	0
6-9	9	35	1	11
0-5	5	19	7	78

Source: Detailed assessments and Table 2 in SM/00/77, April 12, 2000, *Experience with Basel Core Principle Assessments*

Insurance supervision

14. **There were fewer detailed assessments of the insurance sector supervisory arrangements and the IAIS Core Principles.** This reflected the smaller size of the insurance sectors in relation to banking, especially in the international sector, and that jurisdictions had only recently begun to focus on their insurance supervision. Several jurisdictions were in the process of reforming their insurance laws and arrangements for both domestic and international activity. In some jurisdictions, although there was no formal assessment of observance of the IAIS Core Principles, an informal evaluation was made of the supervision. These discussions suggested shortcomings similar to those found in the detailed assessments. Generally, the Module 1 assessments found deficiencies similar to those identified in the Module 2 and FSAP assessments (see Table 5).

Table 5. IAIS Core Principles for Insurance Supervision: Areas of Weakness

Principles of which Jurisdictions are Materially Nonobservant or Nonobservant	
3/6 Jurisdictions	2/6 Jurisdictions
Market conduct	Corporate governance
On site inspections	Internal controls
	Reinsurance
	Coordination and cooperation

Source: Detailed Assessments of Observance

15. **Observance of the IAIS insurance core principles (ICP) was less satisfactory than for the BCP assessments.** Three of the six jurisdictions assessed were nonobservant of market conduct, and on-site inspections; two or more had weaknesses in corporate governance, internal controls, reinsurance, and coordination and cooperation. The weaknesses identified were related to:¹⁷

- **Insufficient supervision of market conduct** resulted from a lack of rules or codes of conduct, failure to oversee insurance brokers, and a lack of resources for monitoring;
- **On-site inspection** suffered from unstructured visits and insufficient resources;
- **Corporate governance** requirements were not established by the supervisor, or their observance was not verified,
- **Internal controls of insurance companies** were not adequately overseen because the supervisor lacked the legislative authority or did not set guidelines.
- **Reinsurance carried by insurance companies** was not adequately reviewed by the supervisor; and
- **Coordination and cooperation among supervisors** suffered from a lack of information exchange, either domestically or internationally, because formal procedures or legislative authority was lacking.

16. Generally, the degree of observance of the ICP was broadly similar to the general group of countries assessed relative to the ICP under the FSAP, as Table 13 illustrates.

Securities regulation

17. A full-scale assessment of the **IOSCO principles of securities regulation** was done for only three jurisdictions, reflecting the fact that many of the jurisdictions do not have securities markets, or have only very small markets. Therefore, the findings on the IOSCO principles are not reported. However, securities regulation was informally assessed where relevant, and those discussions are also summarized here. The securities arrangements regulated were collective investment schemes or investment fund management, both often being run by banks, with the oversight carried out by the banking supervisor. Independence of the regulator, and lack of staffing resources, experience and skills in securities market regulation, were identified as areas of concern. A further problem was the lack of legislative provisions for sharing information, or the fact that the laws set limits on the ability of the supervisor to share information. In smaller jurisdictions assessed, there were sometimes mutual funds in the offshore sector that were not subject to oversight.

¹⁷ For more details see Appendix II and Appendix VI, Table 13.

B. Issues Raised by the Assessments

18. **In conducting the assessments, staff has noted the issues that require more attention on the part of jurisdictions, standard-setters, and the international financial institutions (IFI).** Jurisdictions and the international financial institutions will need to focus their work, and technical assistance, respectively, on areas of weakness highlighted by the assessments: AML regimes, supervisory resources, and cross-sectoral, cross-border supervisory cooperation. In addition, there are activities and features of offshore markets which have elicited warnings, but where there are few internationally accepted standards to guide advice: these include the oversight of company and trust service providers, and the stance to be adopted with respect to bearer shares, and the advice to be given on physical presence. These three are issues in the OFC context because of their possible association with market integrity issues.

Weaknesses in AML

19. The initial assessments reviewed AML issues largely in accordance with principles, or in the framework, drawn from the sectoral standard setters: the Basel Committee, the IAIS and the IOSCO, and informal reference to the Financial Action Task Force (FATF) recommendations. In April 2001, the Board of the Fund endorsed the development of a new methodology to intensify the focus on AML elements. In October 2001, the Fund piloted implementation of a draft Fund/World Bank AML Methodology Document for use in FSAPs and OFC assessments, and in November 2001 the Board requested expansion of that methodology to include aspects relating to combating the financing of terrorism, and legal and institutional frameworks. In February 2002, an expanded draft Fund/World Bank AML/CFT Methodology became available for assessments.¹⁸

20. **In all the jurisdictions assessed, an AML legal and regulatory framework is in place for at least some of the financial services sectors.** Generally, the banking, insurance, and securities sectors are covered by AML legislation and are supervised by a regulatory authority. In some countries other sectors may also be subject to AML requirements and regulatory oversight.

21. **In only five of the nine countries whose supervisory standards were assessed by a Module 2 or FSAP, was banking sector supervision found to be compliant or largely compliant with BCP 15 on anti-money laundering.** More frequent on-site inspections, and more resources for supervision were common recommendations. There is a notable exception: one country has been so traumatized by blacklisting that 20-30 percent of its onsite banking examiner resources are dedicated to AML.

22. **Six of the nine countries had financial intelligence units (FIUs), four of which are members of the Egmont group of FIUs.** An issue raised in several assessments was the scarcity of suspicious transactions reports. In response, assessors advised more training to increase awareness of AML requirements among employees, more objective criteria for transactions

¹⁸ See BUFF/01/176.

subject to reporting requirements and, in one country, building better trust between financial institutions and law enforcement agencies. In several instances, better sharing of information among domestic and foreign supervisory agencies, and FIUs was recommended.

23. **Improvements to the legal framework on AML were frequently recommended.** For example, in some countries it was recommended that the law be amended to be more inclusive by, for example, criminalizing the laundering of all assets, not just money, gold and securities; or including other financial institutions, such as money changers and foreign exchange companies. Other recommendations concern improving the know-your-customer rules by, for example, amending the law to define satisfactory evidence of identity.

24. **Several recommendations were made to strengthen the rules governing, and oversight of, corporate service providers.** All of the countries had offshore corporate entities which generally are not subject to active supervision, but may be governed by some AML legal requirements. Recommendations included the advice that customer due diligence regulations should be extended to CSPs, including lawyers and accountants.

25. Assessors found the authorities almost uniformly highly cooperative and cognizant of the importance of appropriately addressing AML issues or deficiencies.

Inadequate supervisory resources

26. **Resource constraints were encountered in all the jurisdictions assessed, especially with respect to the numbers, skills, and experience of the staff to conduct on-site and off-site inspections.** Even where there was well-qualified staff overall, additional analytical and enforcement staff needs were noted, although training programs were sometimes in place. In one particularly acute case, some 40 banks were supervised by an agency with four professional staff, including only one bank supervisor. Staff shortages were especially marked in insurance supervision, reflecting in part the fact that insurance supervision tends to be located in the Ministry of Finance, and financed from the general budget and priority may not have been attached to it. Rising costs of recruiting and retaining staff has strained the budgets of agencies, requiring in some cases transfers from the government to supplement the supervisory budget, together, in one case, for plans to change fee regulations. In European jurisdictions where there is a tradition of using auditing firms to supplement official staff, more formalized quality oversight of their work was called for.

27. **The assessments noted that as the necessary legislative changes are made to meet international standards, and supervision improved, the supervisory requirements will grow in all sectors, particularly the insurance and companies and trusts sectors.** Apart from the inspection weaknesses noted earlier, the lack of skilled staff can lead to poor licensing procedures and ineffective enforcement. The supervisory needs are greater where the jurisdiction is the home supervisor. Among the proposals to address the shortages of resources in supervision are (i) the harmonization of the supervision of domestic and international sectors, although this will in many cases also require an upgrading of staff, since domestic supervision also required improvement; (ii) where appropriate regional institutions exist, some small jurisdictions can choose to share a regional supervisor, allowing for the pooling of resources and focused technical assistance; (iii) in some cases where earnings from the sector seem unlikely to justify

increased expenditure on supervision, jurisdictions were advised to consider exiting from the activity. (One small jurisdiction has taken the assessor's advice and exited from a sector of its offshore business); and (iv) in the longer term, by increasing the volume of training programs for supervisors.

Information-sharing and cross-border cooperation

28. **The assessments indicate that cross-border information sharing has improved in banking. However, difficulties remain with the cross sectoral sharing of information.** Box 2 discusses factors that explain the importance attached to information-sharing and cross-border cooperation in international finance. In banking supervision, the improving level of cooperation is illustrated by the assessment of full compliance found in eight of the nine jurisdictions assessed. In insurance supervision, of the six jurisdictions assessed for observance of the ICP, two were materially nonobservant of the principle of Cooperation and Coordination. While some jurisdictions were in the process of addressing this deficiency through AML legislation, problems remain for prudential supervision. For example, where there are separate supervisory bodies for insurance they may have no legal basis to establish memoranda of understanding (MOUs) for information sharing. Nor is it clear whether cross-sectoral information exchange can always be accomplished cross-border.

29. Many jurisdictions consult supervisors in other jurisdictions for licensing purposes and have good working relationships with external supervisors, and most of the larger jurisdictions allow home supervisors of foreign banks to do on-site inspections. In two cases, information could not be exchanged with respect to individual deposits mainly because of legal constraints on access to account information. Several jurisdictions had MOUs or mutual legal assistance treaties (MLATs) in place with jurisdictions with whom they had important ties, but in some cases the exchange of information about companies required a court order. Arrangements to facilitate exchange of information with securities regulators and insurance supervisors were often found to be inadequate. Addressing these shortcomings would often require amendments to applicable legislation.

Box 2. Cross-Border and Cross-Sectoral Exchanges of Information

Cross-border exchanges of information are central to all the international regulatory standards that have been developed in recent years, but have been advanced the most by the Basel Committee in the context of the consolidated supervision of international banks. The issue has been very closely linked to transparency of market information and cross-border cooperation, and historical weakness in these areas has brought particular criticism upon the OFCs by bodies such as the FSF and the FATF. The greater focus on measures to counter money laundering and terrorist financing has increased the pressure to implement effective cross-border cooperation and information exchange mechanisms.

Information sharing is required at two levels: administrative and judicial. The former is necessary primarily to assist the regulatory agencies to carry out their responsibilities with respect to prudential oversight and regulatory investigations. Judicial cooperation may be required for the purposes of both criminal investigation and prosecution, and is usually governed by specific statute or treaty (e.g., legislation on international cooperation in criminal matters or MLATs). There is no significant difference of approach between civil and common-law jurisdictions.

An essential feature of any regulatory regime (whether for domestic or international finance) is the **general duty of confidentiality imposed on the regulator** as regards information acquired in the course of its activities. Therefore, in order to permit the disclosure of information to other regulators, **statutory provisions (or “gateways”) must define in what circumstances exchanges may take place, and with whom.** These provisions must override any general secrecy constraints that might exist. Typically, such gateways empower the regulator to respond to requests for information in its possession and to take the initiative to share information that it believes will be of assistance to a foreign counterpart. Such information usually relates to routine matters concerning the prudential supervision of institutions in which the regulators have a common interest.

More controversial for some jurisdictions is the power that may be vested in the regulator to compel information from institutions in response to a foreign request. In many cases this power extends beyond the regulated sector to encompass any person or entity which, in the opinion of the regulator, has information that might assist in responding to a request. The use of such procedures is probably most common in relation to specific investigations that might lead to regulatory enforcement action or civil or criminal prosecution.

In view of the general duty of confidentiality, the **conditions under which information can be exchanged** at an administrative level must be clearly defined. Usually these require that: the recipient must be an agency fulfilling functions equivalent to those of the provider, or be a named counterpart; the recipient should be bound by a general duty of confidentiality at least equivalent to that of the provider; the use of the information must be limited to the purpose for which it was requested; and the recipient must have an ability to co-operate on a reciprocal basis.

The evolution in market and regulatory structures can pose challenges to this traditional model, particularly where there are **cross-sectoral interests.** For example, a banking supervisor seeking information from a securities regulator to assist in its oversight of a financial conglomerate may not be adequately defined as fulfilling an equivalent function to that of the securities supervisor. In some cases requests may be directed to the banking counterpart which can then acquire the information on behalf of the overseas supervisor using internal domestic gateways, but in others the problem may be more intractable. Also, the ability of a recipient to provide assurances that the information will only be used for the purposes for which it was requested may be limited. This might occur when information provided for prudential purposes gives rise to concerns by the recipient that an offence may have been committed, thereby prompting it to pass the information to the law enforcement agencies or to use it to support its own criminal or civil prosecution powers.

Companies and trusts sector

30. **Companies, trusts and their service providers**¹⁹ have only relatively recently come under scrutiny for supervisory purposes since they do not involve funds of the general public or those of the small, unsophisticated investor, but rather the activities of wealthy individuals, or corporations, assumed in market economies to have the resources and information to make independent decisions (Box 3). However, the lack of information about their activities could permit companies to be used for fraudulent purposes and in laundering criminal proceeds. As a result, there have been growing calls to license the company formation agents or company and trust service providers (CSPs). The most well-known discussions of the use of these “corporate vehicles” and/or trusts have been three official reports.²⁰ These described various measures that could be used to limit the illicit use of these vehicles, and the OFC assessments have been conducted on the basis of guidelines drawn from these reports. Basic desirable features for the sector from the AML viewpoint include: the licensing of CSPs subject to their satisfaction of fit and proper criteria, legally enforceable codes of conduct, a regulator or licensing agent with powers to inspect, obtain information, and enforce compliance; and required reports of material changes. It should be noted that there is as yet no consensus on the appropriate degree of oversight.

31. **The information acquired in the assessments suggests that the oversight of CSPs is increasing.** This discussion covers the assessments (both Module 1, Module 2 and FSAPs) of 19 jurisdictions. Of these, 12 jurisdictions have legislation and arrangements in place, or have begun to reform their legislation to provide for oversight of CSPs. However, other arrangements are not always adequate. There may be inadequate enforcement powers, due diligence for companies directors may be less than desirable, or there was insufficient inspection to verify compliance. Concerns were also expressed about the degree of independence of the regulator or company registrar. In one or two jurisdictions, the registrar is run by private companies for a portion of the fee revenue, and has minimal oversight; the registrar may itself be an IBC, or affiliated with a CSP, creating possible conflicts of interest. The lack of staff to carry out adequate fit and proper examinations, and ongoing review were also commented upon. Planned legislation was not always judged adequate.

32. In the absence of further study of corporate vehicles, it is not clear what degree of oversight would be efficient. However, it is generally thought that more oversight is necessary. In part in response to the Fund’s assessment program, the Offshore Group of Banking Supervisors (OGBS)²¹ has established a working group to develop and propose a set of

¹⁹ Companies here refer to “exempt” or “international business companies” (IBCs), so-called because they are often exempt from the requirements of domestic company law. See Box 3 for a very basic description of this sector.

²⁰ The UK-commissioned studies cited earlier, and the OECD's *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*, 2001.

²¹ The OGBS is a group of bank supervisors representing 19 offshore centers. Conditions on membership relate to having principles of effective banking supervision in place. Started in 1980, it has been chaired since 1981 by the Chairman of Jersey’s financial service regulator.

guidelines for the oversight (both regulatory and for AML) of company and trust service providers. The target is to produce a document for wider consultation by mid-2002. Various non-OFC jurisdictions, and international organizations,²² including the IMF, are participating in the working group.

Box 3. Companies, Trusts, and Company and Trust Service Providers

International business companies (IBCs) or exempt companies or their equivalent are the most common means of establishing legal domicile for corporate tax purposes. They include partnerships, companies incorporated in the jurisdiction under specialized legislation, and branches of companies incorporated abroad. They are often exempt from the requirements of domestic company law, and benefit from special tax arrangements. They are used for a wide variety of purposes: trading functions, ship ownership, leasing, treasury functions for banks, collective investment schemes, and, most frequently, asset holding. They are also used as special purpose entities (SPEs) (or equivalently, special purpose vehicles, SPVs) in, for example, securitization in structured financing arrangements, and the issue of bonds for catastrophe insurance. As Table 11 in Appendix VI shows, jurisdictions register thousands of companies.

Trusts are common law relationships by which a person or company transfers legal title and control of assets to another (trustee) for the benefit of another (beneficiary). Trusts are used for wide-ranging purposes, from estate planning to shareholding in structured financing arrangements.

Company service providers are typically responsible, on behalf of their clients, for the incorporation and subsequent administration of IBCs. The service normally includes the provision of registered office facilities, nominee shareholders and secretarial duties, and may extend to direct management responsibilities where the service provider acts as a director of client companies. **Trust services (acting as a trustee)** are usually provided by trust companies; they are licensed under banking legislation, or separately, in several jurisdictions, whereas company service providers have usually fallen outside the regulatory net. However, while the services are distinct in nature and legal responsibility, they give rise to very similar issues of fiduciary responsibility and conduct of business, and are often performed within the same company.

The provision of company and trust services is a major feature of OFC markets. These services are not unique to offshore markets but are less important onshore. In part as a result, there are no internationally recommended standards for their oversight.

Other issues

Bearer shares

33. The issue of shares in bearer form results in the **ownership of those shares being vested, in principle, in whoever can establish legitimate physical possession of the certificates.** There is traditionally no obligation to maintain a register of ownership, and hence they are of concern in the AML context. The ability to issue bearer shares in respect of offshore companies has been a key factor in many financial centers—most of those assessed had legislation permitting bearer shares. In the offshore market, bearer shares have been seen as an instrument to promote anonymity, although they also feature in special purpose vehicles used in structured financing schemes such as asset securitization and project financing. There is no agreed international

²² The organizations include FATF and the OECD. Since a major part of the financial services offered by corporate vehicles relates to security issue and insurance, consideration should be given to including IAIS and IOSCO in the working group.

standard on bearer shares. In onshore jurisdictions, especially in continental Europe, bearer shares are widely used to permit the (tax) efficient transfer of ownership of family enterprises, and to allow closely-held companies to seek external investors without losing control of the registered voting stock.

34. **The FATF sees bearer shares as posing a specific problem in combating money laundering**, and is considering their treatment in the revision of the 40 recommendations. The primary concern is the ability to identify the beneficial owner of the company in the event of an investigation. Three alternatives have been proposed (i) a requirement that detailed records should be maintained by a licensed company service provider (or other agent) of the location and ownership of the shares; (ii) a procedure to “immobilize”²³ the share certificates themselves; and (iii) a requirement that there should be a central registrar of holders of bearer shares (this would effectively abolish them). Each of these options will require a facilitating mechanism.

Physical presence

35. **Many OFCs license institutions that maintain no meaningful physical presence in the jurisdiction.** The institutions are required to have a registered office and an approved agent in the OFC, but the effective “mind and management,” books and records will be located elsewhere. There are four broad categories of banks without a physical presence: locally incorporated institutions with private ownership; booking branches of foreign banks; wholly-owned booking subsidiaries of foreign banks; and “parallel” banks which have common shareholders with another bank(s), but are not subsidiaries of that bank.

36. **There is currently no agreed international standard on these structures.** However, there appears to be a consensus emerging that private, locally-incorporated banks without a physical presence are particularly vulnerable to abuse for fraud and money laundering. “Booking” branches and subsidiaries do not appear to pose an increased money laundering risk if they are effectively supervised by the home regulator. However, they do require special arrangements for cross-border cooperation between the home, host, and where relevant, the intermediate supervisors, including a clear allocation of responsibility for on-site examination.

IV. CORRECTIVE MEASURES BY JURISDICTIONS, RECOMMENDATIONS, AND TECHNICAL ASSISTANCE

37. **The assessments have served not only to provide an understanding of the gaps in the regulatory and supervisory system, but also to encourage corrective actions by the jurisdictions, following the recommendations made by assessors, and to provide a framework for technical assistance on the measures needed to correct weaknesses.**

²³ Bearer shares are “immobilized” when they are held in custody by specifically designated or authorized persons. Custody may also involve record keeping of the identity of beneficial owners of such shares, and of the directors of the companies concerned.

Corrective measures by jurisdictions

38. **Assessments have encouraged some countries to begin a program of action to address weaknesses identified in the assessments.** In one case, a country revised its AML regulations to address identified weaknesses in customer due diligence and suspicious transactions reporting procedures, and began work to strengthen its AML framework, in the interval between the initial and second missions of the assessment. The opportunity to obtain a higher degree of compliance in the final report clearly provided a strong incentive to undertake the necessary reforms.

39. In another case the **detailed technical advice provided in the context of the assessment spurred one jurisdiction to implement an action plan** explicitly based on bringing its supervisory practices into full compliance with all the core principles. In the area of ongoing supervision, for example, the action plan called for preparation of written procedures, training and risk-focused supervision. Almost a year after the assessment, that action plan continues to be implemented, with progress updated quarterly and monitoring by the Article IV consultation mission.

40. **Several jurisdictions have taken legislative and regulatory action to address issues raised in the assessments:**

- two small jurisdictions are strengthening their AML laws, and including CFT elements;
- three small jurisdictions have passed FIU legislation, and made budgetary provisions for the creation of FIUs;
- two small jurisdictions are immobilizing or voiding corporate bearer shares, requiring custody and records on beneficial owners;
- two jurisdictions are starting AML awareness and training programs for the private sector and supervisors;
- a large jurisdiction is requiring that auditors review AML/CFT compliance and controls; and
- three small jurisdictions are establishing regional cooperation agreements for supervision of international finance.

Recommendations

41. **Recommendations for corrective actions are in many cases similar to those usually made in the context of BCP and ICP assessments.** For example, early BCP recommendations were to strengthen the supervisor's powers to take remedial action, introduce methods that mitigate against forbearance, improve the functioning and independence of the supervisory authority. The ICP commonly made recommendations related to the numbers and training of

staff, and licensing.²⁴ More specific recommendations in the context of the OFC assessment program include legislative arrangements which provide for enhanced information-sharing domestically, internationally, and cross-sectorally, with measures to improve and harmonize licensing procedures among competing jurisdictions. Also important are enhanced AML/CFT regulations and guidelines integrated into the improved supervisory system.

42. Recommendations for more recently-established centers typically involve the following key elements:

- Training program for supervisory staff focusing on special features for offshore finance;
- Enhancement of laws and regulations to provide:
 - adequate firewalls between promotional and supervisory activities;
 - reasonable operational independence for the regulator;
 - comprehensive licensing requirements for all financial service firms;
 - comprehensive auditing requirements that would cover criminal activity, and AML laws and regulations; and
 - adequate enforcement measures, including ladders of compliance.
- Development of comprehensive and systematic supervisory arrangements focusing on
 - on- and off-site inspection;
 - procedures for inspection; and
 - fit and proper procedures.

Technical assistance

43. Technical assistance is being delivered or prepared in the following areas:

- revision of AML/CFT legislation, and the general reform of financial sector legislation in one jurisdiction following a Module 2 assessment;
- general supervisory systems and AML/CFT measures in three small jurisdictions following Module 1 assessments;
- reform of the insurance sector supervision in one jurisdiction in the context of a Module 2 assessment; and
- preparation of model AML/CFT legislation for four jurisdictions.

44. Technical assistance advice has also been provided on procedures for the resolution of problem institutions. Countries revising their regulations, especially with regard to fit and proper criteria and licensing procedures find themselves with institutions which are unable to

²⁴ See SM/00/77 and SM/01/266.

meet tighter requirements and must be closed. Countries exiting from the OFC business require advice to ensure that companies and banks are effectively wound up.

45. **Staff is working to combine the knowledge and efforts of all of the groups involved in work related to the offshore sector assessment process.** In particular, meetings have been convened with the World Bank, FATF, the United Nations, and the Egmont group to ensure coordinated technical assistance on AML/CFT. These meetings will facilitate the sharing of information on technical assistance needs and resource availability, and help in the rational allocation of technical assistance resources.

V. FUTURE OF THE ASSESSMENT PROGRAM

A. The Accelerated OFC Assessment Program

46. **Staff is in the process of implementing an accelerated offshore financial center assessment program,** targeting 20 Module 2 or FSAP assessments in 2002. Staff has contacted or renewed contact with 22 jurisdictions, requesting that they undertake Module 2 assessments. In addition, 4 FSAPs to countries with significant international financial centers have been included in our planning. In the case of the 22 jurisdictions:

- one assessment has been completed;
- three assessments have started with initial missions;
- eight jurisdictions have scheduled assessment missions. Three of these jurisdictions are already receiving technical assistance to upgrade their domestic supervisory arrangements, and the assigned experts are also assisting with the international financial centers; and
- ten jurisdictions have agreed on missions in 2002 with dates to be confirmed.

Of the four countries where FSAPs have been discussed:

- one country has agreed on the initial mission date, and another country has agreed on timing which is to be confirmed;
- one country asked for a postponement because of ongoing changes in their supervisory structure and will be contacted shortly to reschedule this year; and
- one country is still considering the question.

47. Work is in progress with seven small jurisdictions which had Module 1 assessments in the last quarter of 2001. The status of this work is as follows:

- one jurisdiction has accepted the assessor's advice to exit a portion of its offshore business; TA will be necessary to improve the regulatory framework for the remaining offshore business, conditional on the decision of the authorities;

- six jurisdictions were invited to a follow-up meeting to discuss the assessments, plan for TA, and encouraged to undertake a Module 2 assessment in 2002:
 - five of these attended and were requested to prepare action plans;
 - four of those attending have effected legislative changes and, in two cases, begun training or other actions to review their supervisory framework, as advised by the Module 1 consultants; three of these four have also requested TA to prepare action plans, and expressed an interest in Module 2 assessments; and
 - one has questioned and expressed strong disagreement with the assessment process.

48. **In summary, since the start of the program, the staff has been in contact with 44 jurisdictions with international financial centers and has reached agreement on assessments with virtually all.** 19 have had Module 1 or 2 assessments, 22 are scheduled for Module 2 or FSAPs in 2002; the remaining jurisdictions, as well as those which have only had Module 1 assessments are discussing, or will be approached to discuss, the scheduling of Module 2 or FSAP assessments in 2003.²⁵

B. Lessons Going Forward

49. **Staff is prioritizing assessments in jurisdictions where there is evidence of significant international financial activity or where it appears that the supervisory structure requires upgrading.** In 2003, subject to the agreement of the authorities concerned, it is intended to conduct Module 2 assessments of countries which have already had Module 1 assessments, as well as arranging assessments for countries which have had neither. Some of the latter group have not yet been contacted.²⁶ Complete coverage is expected to require approximately another 20 Module 2 assessments after the 2002 program, and on present plans, this will be accomplished by end 2003, subject to the agreement of the jurisdictions.

50. **Staff is including domestic sector assessment as a standard feature of the assessments.** This has been the practice in most Module 2 assessments and reflects the commonality of the supervisory arrangements for domestic and offshore activities in many jurisdictions, and concern to avoid possible regulatory arbitrage between the domestic and offshore centers.

²⁵ In some cases, jurisdictions have already had sectoral assessments.

²⁶ There are several jurisdictions where some international financial activity is present however, they have not been contacted as they appear to be relatively small centers. Staff has also recently learned of additional jurisdictions with offshore financial centers.

51. **Assessment reports are being streamlined to provide a more operational focus on follow-up actions**, with the recommendations laid out and sequenced in a way to assist a country in determining priorities. In particular, guidance would be provided in the AML/CFT area, emphasizing those areas most likely to achieve results, such as know-your-customer, reporting of suspicious transactions, and the ability to disclose and share information. Follow-up on technical assistance is expected to intensify as an increasing proportion of jurisdictions are assessed.

52. **Technical assistance requirements are proving to be greater than originally anticipated.** Jurisdictions view the program as a resource for bringing their supervisory systems to international standards, and the heightened importance the Fund is according to AML/CFT work, together with the shortcomings found in AML regimes, dictate that their requests should be prioritized. Technical assistance cannot be confined to the drafting of legislation and regulations, but must also build institutional capacity for implementation.

53. **In all but the largest jurisdictions, priority is being given to providing technical assistance to improve financial regulation after Module 2 assessments, rather than following up immediately with a more comprehensive examination of risks under Module 3 or an FSAP**, as originally envisaged by the program. In smaller jurisdictions shortcomings in the regulatory framework and supervision may be their most immediate source of financial vulnerability.

54. **From a sectoral viewpoint, the assessments suggest that technical assistance should be focused on strengthening the regulatory and supervisory regimes for the insurance sector and company service providers.** In virtually every country these two sectors had the weakest oversight. In particular, better CSP oversight will contribute to the AML/CFT efforts.

55. A cooperative and complementary effort will be required from jurisdictions, standard-setters and IFI to address the issues raised by the assessments. Jurisdictions will need to devote budgetary resources to improving their legislative framework and supervisory systems, with particular attention to AML/CFT areas, the insurance sector and the international corporate sector. Where it would be inefficient to meet the costs of raising supervisory standards to international levels, they should consider exiting from the business. The standard-setters will need to provide guidance on how to oversee corporate service providers, taking account of the corporations' sectoral significance, as well as guidelines on the treatment of bearer shares. The Fund, in cooperation with other international institutions and donors, will need to complete the assessment program, and continue its coordination of the rising volume of technical assistance work.

VI. PARTICIPATION IN INTERNATIONAL STATISTICAL COLLECTIONS

56. **In its outreach program in the past year, staff held discussions through workshops or staff visits with 26 of the 42 OFCs listed by the FSF.**²⁷ Of the remainder, no discussion was needed with Ireland (regarding the Dublin International Financial Center), as Ireland was a full participant in the first (1997) Consolidated Portfolio Investment Survey (CPIS) and in the BIS locational banking statistics, or with 15 OFCs whose cross-border holdings of portfolio investment assets were believed to be minimal.²⁸ The 26 countries with whom discussions on statistics were held included 2 industrial countries (Luxembourg and Switzerland), 3 emerging market economies (Hong Kong SAR, Malaysia (Labuan), and Singapore), and 21 small economies with international financial centers (SEIFiCs).²⁹ In 2001,³⁰ two workshops were held with SEIFiCs, one on CPIS collection systems and the other on macroeconomic statistics, both with support from Japan under the Administered Account for Selected Fund Activities.

57. **Seventeen of the 21 selected SEIFiCs are participating in the 2001 CPIS, and all 11 that meet the BIS reporting threshold are participating or considering participating in the BIS locational banking statistics.** The selected SEIFiCs and the status of their participation in the 2001 CPIS and the BIS locational banking statistics are shown in Table 6.

58. Luxembourg, Hong Kong SAR, Malaysia, Singapore, and Switzerland all have OFCs. Hong Kong SAR, Malaysia, and Singapore are participating fully in the 2001 CPIS. **Switzerland may limit its participation in the 2001 CPIS to outward portfolio investment by banks** (about 5 percent of total cross-border portfolio investment by residents of Switzerland)³¹ and **Luxembourg is participating with full coverage of portfolio investment holdings outside the European Monetary Union (EMU) and on a best efforts basis with regard to cross-border**

²⁷ The full FSF list is given in *Offshore Financial Centers—Background Paper*, SM/00/136 Supplement 1, Table 2.

²⁸ These were Andorra, Anguilla, Antigua and Barbuda, Belize, Cook Islands, Liechtenstein, Marshall Islands, Monaco, Nauru, Niue, Samoa, Seychelles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines. (Of these, the Fund member countries were invited to participate in the 2001 CPIS.)

²⁹ For the remainder of this paper, the term SEIFiCs will be used to refer to the 21 countries or jurisdictions with which discussions were held (selected SEIFiCs) and the 15 OFCs whose cross-border holdings of portfolio investment assets were believed to be small (other SEIFiCs). The term “SEIFiC” is distinguished from “OFC” in that the former refers to the entire country or jurisdiction, not just the OFC part of the economy.

³⁰ Of the selected SEIFiCs, Lebanon does not have the features commonly associated with SEIFiCs. Discussions were also held with the United Arab Emirates (UAE), which is not on the FSF list but is an important regional OFC.

³¹ This decision is under review by the Swiss authorities at the time of writing.

portfolio investment in other EMU countries. Luxembourg, Switzerland, Hong Kong SAR, and Singapore are all participants in the BIS locational banking statistics and Malaysia is currently considering participation.

Table 6. Participation in International Statistical Collections by the Selected SEIFiCs

Country/Jurisdiction	Association with Fund	Participation in 2001 CPIS	Publication in BIS International Locational Banking Statistics
Aruba	Netherlands Dependency	Yes	No
Bahamas, The	IMF member	Yes	Yes
Bahrain	IMF member	Yes	Yes
Barbados	IMF member	No	No
Bermuda	U.K. Overseas Territory	Yes	Under Consideration
British Virgin Islands	U.K. Overseas Territory	No	No
Cayman Islands	U.K. Overseas Territory	Yes	Yes
Costa Rica	IMF Member	Yes	No
Cyprus	IMF Member	Yes	Yes (from 2002)*
Gibraltar	U.K. Overseas Territory	No	No
Guernsey	British Crown Dependency	Yes	Yes (from 2002)
Isle of Man	British Crown Dependency	Yes	Yes (from 2002)
Jersey	British Crown Dependency	Yes	Yes (from 2002)
Lebanon	IMF Member	Yes	No
Macao SAR	Special Administrative Region of China	Yes	No
Malta	IMF Member	Yes	No
Mauritius	IMF Member	Yes	No
Netherlands Antilles	Netherlands Dependency	Yes	Yes
Panama	IMF Member	Yes	Under Consideration
Turks & Caicos Islands	U.K. Overseas Territory	No	No
Vanuatu	IMF Member	Yes	No

* Data submitted by Central Bank of Cyprus refer to government-controlled area only.

Sources: Data provided by the countries/jurisdictions.

A. The Coordinated Portfolio Investment Survey

59. **The CPIS collects internationally harmonized data from individual countries and jurisdictions on their cross-border holdings of portfolio investment assets (equity and debt secretatives) broken down by the individual countries and jurisdictions that issue the securities.³² It is intended to significantly improve the coverage and accuracy of global statistics on cross-border portfolio investment assets and liabilities.** It was conducted for the first time with respect to end-1997 and is being repeated for end-2001. Its establishment on an annual basis starting with the 2001 CPIS will, over time, provide an invaluable database for the

³² A geographic breakdown is not included in the standard components of balance of payments and international investment position statistics given in the fifth edition of the *Balance of Payments Manual (BPM5)*, but the importance of supplementary bilateral statements is recognized. As noted later, many countries do collect and disseminate such statistics.

analysis of developments in global financial markets. Some background on the CPIS and the results of the 1997 CPIS is given in Appendix III.

60. **The 2001 CPIS will include all industrial countries, a selection of emerging markets, and all of the most important SEIFiCs (except the British Virgin Islands).**³³ The survey has also been expanded to include short-term debt securities, in addition to the equities and long-term debt securities covered for 1997. The coverage of the 2001 CPIS for the selected SEIFiCs is shown in Appendix IV.

61. **Based in large part on the experience of Bermuda, which was the only SEIFiC to participate in the 1997 CPIS, the selected SEIFiCs were asked to include all cross-border portfolio investment by banks, insurance companies, and mutual funds legally domiciled in their jurisdiction, for the 2001 CPIS.** All entities were to be included regardless of their designation as onshore or offshore (or whether or not they had a physical presence, e.g., in the form of an office, employees, or records). In addition, other financial sector entities likely to have significant cross-border holdings of portfolio investment assets (such as central banks, pension funds, and provident funds) were also to be covered. However, it was conceded that data on holdings by IBCs and trusts would not be collected.³⁴ The second edition of the Fund's *Coordinated Portfolio Investment Survey Guide* provides specific guidance for SEIFiCs.³⁵

62. **In most cases, the 2001 CPIS is being undertaken in SEIFiCs by the regulatory authorities (such as the financial services commission) rather than by the national statistical office.** This is partly a reflection of resources and the regulatory authorities' better knowledge of the offshore financial sector. A consequence is that the 2001 CPIS is mostly being undertaken on a voluntary basis, as the regulatory authorities generally lack legal authority to undertake statistical collections. As a result, there is likely to be some degree of nonresponse. This is especially so in the case of entities without a physical presence, which means that the CPIS compiler has had to establish contact directly with the accounting centers abroad.

³³ The decision not to participate by the British Virgin Islands reflected concerns about introducing statistical reporting by the very large number of registered mutual funds (some 2,200, of which only about 200 are regulated). Data collection is difficult because the fund managers are located elsewhere and the funds do not have a local physical presence.

³⁴ Data on companies and trusts can be difficult to collect because, in addition to the characteristics described in Box 3, in most cases, IBCs are brass plate companies (companies that have no physical presence but are represented by a company service provider that may have hundreds of such clients). They include SPEs, which are defined by their structure and purposes and can be expected to fall within the definition of direct investment enterprises. Data may therefore be more easily collected in the home countries of investors that own SPEs.

³⁵ The final version of the *Guide* (subject only to editing) was placed on the IMF's external website in December 2001.

63. Based on available information, it seems likely that holdings by banks, insurance companies, and mutual funds in The Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey, the Isle of Man, and Jersey are some \$ 800 billion.³⁶ **Had this amount been included in the 1997 CPIS, this would have placed these countries, collectively, as the fourth largest cross-border holder of long-term portfolio investment securities (after the United States, the United Kingdom, and Japan).**

B. The BIS International Locational Banking Statistics

64. The BIS international locational banking statistics gather quarterly data on international financial claims and liabilities of bank offices resident in the reporting countries broken down by currency, sector, and country of residence of counterparty. Banks are asked to report, inter alia, their external assets and liabilities by country, currency, and sector.

65. **Staff have worked closely with the BIS in expanding the coverage of the statistics to include additional SEIFiCs.**³⁷ All of the SEIFiCs listed in Table 6 as not participating in the BIS collection fall below the BIS threshold. Statistical reporting to the BIS by the selected SEIFiCs is described in Appendix V.

VII. THE ADEQUACY OF PARTNER COUNTRY STATISTICS ON SELECTED OFCs

66. **A number of countries compile statistics for several types of cross-border financial account transactions and positions with geographic breakdowns that identify individual SEIFiCs.** Investigations were undertaken on the availability of data from a selection of major industrial countries. For direct investment, it was found that data are available for the stock of inward and outward investment and related transactions with some individual SEIFiCs. For portfolio investment, countries with settlement-based balance of payments reporting systems (such as France, Germany, Italy, and Japan), data are available for various financial account transactions with individual SEIFiCs. For the United States, data are available for transactions in domestic and foreign portfolio investment equities and long-term debt securities with individual SEIFiCs (from surveys of brokers and dealers) and for levels of portfolio investment liabilities to individual SEIFiCs (from surveys of domestic custodians). All these countries report claims on individual SEIFiCs in their CPIS.

67. **Many of the industrial country data sources suffer from deficiencies with respect to geographic data.** For example (i) data on transactions in portfolio investment liabilities may identify the country of a foreign intermediary or transactor, rather than the country of the end-investor, because financial intermediaries are used, or data may fail to take account of noncash

³⁶ Based in part on information in the Edwards Report and the KPMG Reports (Footnote 4).

³⁷ Bermuda, Malaysia (Labuan), and Panama were encouraged by staff to participate in both the CPIS and BIS locational banking statistics. At the time of the staff visits, a decision had already been made by the Isle of Man, Guernsey, and Jersey to participate in the BIS locational banking statistics.

transactions such as stock swaps resulting from mergers and acquisitions; (ii) data on the stock of portfolio investment liabilities based on custodian reporting may identify a nominee or trustee located in a financial center rather than the end-investor (beneficial owner); (iii) there may be no common basis for determining the residence of special purpose entities (SPEs)³⁸ (which are likely to be important vehicles for direct investment in SEIFiCs) in statistics for direct investment; and (iv) there is no internationally agreed definition of SEIFiCs as a group, and data for individual SEIFiCs may fall below country reporting or publication thresholds.

68. Staff concluded that there was a lack of comprehensiveness and consistency of presentation in industrial country data concerning their relationships with SEIFiCs, so that international coordination would be required if these data sources were to provide more useful insights into the role of SEIFiCs in the international financial system.

VIII. THE ADEQUACY OF MACROECONOMIC STATISTICS COMPILED BY SELECTED OFCS

69. Efforts are under way to apply the Fund's General Data Dissemination System (GDDS) to small economies. Of the selected SEIFiCs, Barbados, Malta, Mauritius, and Panama are participants in the GDDS. Regional approaches have been adopted for small-island economies. Member countries of the East Caribbean Central Bank (ECCB) that are also IMF member countries have become participants in the GDDS following a regional workshop organized by the Fund in cooperation with the ECCB. For fiscal year 2003, a regional project to assist small-island economies to participate in the GDDS is being developed in cooperation with the Pacific Financial Technical Assistance Center (PFTAC). Following the drafting of GDDS metadata, it is expected that follow-up technical assistance will be provided to implement plans to improve statistics within a GDDS framework.³⁹ For the United Kingdom overseas dependencies and British Crown dependencies, there has been no assessment by staff of the adequacy of statistics and little technical assistance or training has been provided.⁴⁰ Their statistical needs were not addressed in the *Edwards* and *KPMG Reports*. Moreover, because they are not Fund members, they have had limited access to Fund training courses or technical assistance.

³⁸ SPEs is a generic label applicable to financing subsidiaries, conduits, holding companies, base companies, and regional headquarters (Source: *OECD Benchmark Definition of Foreign Direct Investment*, paragraph 70). They are a subset of IBCs (see Box 2).

³⁹ All countries that are not subscribers to the Special Data Dissemination Standard (SDDS) are encouraged to participate in the GDDS, and to adopt good statistical practices based on their own priorities and proceeding at their own pace. It is recognized that small-island economies wishing to participate in the GDDS may have capacity constraints that need to be taken into account as they proceed toward the objectives of the GDDS.

⁴⁰ The British Virgin Islands and the Turks and Caicos Islands are currently receiving technical assistance in national accounts statistics from other sources.

70. **All of the selected SEIFiCs compile estimates of GDP and gross national income in current and constant prices.** Many of them are able to compile estimates based on income tax records and regulatory and administrative sources (usually with some delay). For most of them, entities legally domiciled in the jurisdiction but without a physical presence are treated as nonresident (i.e., as if they were residents of another economy). As a general rule, those SEIFiCs that treat offshore entities with a substantial physical presence as resident of their own economy measure output as the sum of local purchases of goods and services, labor, and taxes on profits. A consequence is that the gross operating surplus component of output of offshore entities is excluded from GDP.

71. **A number of SEIFiCs that use as legal tender the currency issued by other countries do not compile balance of payments statistics.** Those that do compile such statistics generally follow the same principles of residence as followed in their national accounts. The value of output (derived as the sum of local purchases of goods and services, labor, and other costs) is treated as the export of services and the offshore sector's gross operating surplus is omitted. Only a few SEIFiCs compile international investment position statistics⁴¹ (and those that do use the same basis of residence as their balance of payments statistics). The compilation of national accounts, balance of payments, and international investment position statistics is shown in Table 7.

⁴¹ The international investment position deals with the stock of external financial assets and liabilities at a specific point in time.

Table 7. Macroeconomic Statistics Compiled by the Selected SEIFiCs

Country/Jurisdiction	Gross Domestic Product and National Income	Balance of Payments	International Investment Position
Aruba	Yes 2/	Yes 2/	Yes 2/
Bahamas, The	Yes 1/	Yes 1/	No
Bahrain	Yes	Yes	Yes
Barbados	Yes	Yes 1/	No
Bermuda	Yes 1/	Yes 1/	No
British Virgin Islands	Yes 1/	Yes 1/	No
Cayman Islands	Yes 1/	Yes 1/	No
Costa Rica	Yes	Yes	No
Cyprus	Yes 2/	Yes 2/	No
Gibraltar	Yes 2/	No 2/	No
Guernsey	Yes 2/	No 2/	No
Isle of Man	Yes 2/	No 2/	No
Jersey	Yes 2/	No 2/	No
Lebanon	Yes 3/	Yes	No
Macao SAR	Yes 2/	Yes 2/	No
Malta	Yes 2/	Yes 2/	Yes 2/
Mauritius	Yes 1/	Yes	Yes
Netherlands Antilles	Yes 2/	Yes 2/	No
Panama	Yes	Yes	Yes
Turks & Caicos Islands	Yes 2/	No	No
Vanuatu	Yes 1/	Yes	No

Sources: Data provided by the countries/jurisdictions.

1/ Offshore entities with or without physical presence treated as nonresident.

2/ Offshore entities without physical presence treated as nonresident.

3/ Data provided by the Lebanese authorities are unofficial estimates.

72. **Few of the selected SEIFiCs try to estimate the impact of their offshore sectors on the rest-of-the-world.** They indicate that they have little incentive to do so beyond meeting the needs of their regulatory authorities. Should they wish to do so, an appropriate framework would be an international investment position statement for the offshore sector with a geographic breakdown to show the sources and uses of funds. In such a statement, the residents of the offshore sector would comprise all entities legally domiciled in the jurisdiction that are otherwise treated as nonresident for statistical purposes. However, to collect these statistics would place a major reporting burden on SEIFiCs, as it would require the introduction of statistical reporting by all entities that establish residence for tax purposes. Given the large numbers of such entities in any single jurisdiction (commonly ranging from 5,000 to 100,000 or more in the selected SEIFiCs), even an attempt to establish reporting based on thresholds (by size or type of financial assets or liabilities) and sampling would still be a major exercise.

IX. STA'S WORK PROGRAM WITH SELECTED OFCS

73. The main focus of STA's work with SEIFiCs in 2002 will be to (i) expand the coverage of SEIFiCs in the 2002 CPIS; (ii) investigate what steps can be taken to improve the coverage and accuracy of data published by industrial countries for claims of their direct investors on SEIFiCs (with particular regard to the treatment of SPEs) and their portfolio investment

liabilities to SEIFiCs; and (iii) undertake further work on international statistical guidelines relevant to SEIFiCs regarding the interpretation of residence and the treatment of IBCs and trusts.⁴²

A. Improving the Coverage of the CPIS for Selected OFCs

74. Drawing on SEIFiCs experience with the 2001 CPIS, **efforts will be made to find ways to improve the coverage of mutual funds.** The use of statistical methods to address problems of nonresponse will be explored (for example, sampling coupled with more intense follow-up, or estimation based on data for respondent enterprises with similar characteristics).

75. **Efforts will also be made to secure the participation of the British Virgin Islands in the 2002 CPIS.**⁴³

76. **For those SEIFiCs willing to investigate the scope for introducing statistical reporting by IBCs, STA will provide advice on issues of survey design and sampling.** As the interests of IBCs are represented by local company service providers, the intention would be to build on existing statistical reporting by company service providers (as company service providers already report statistics on their own-account transactions needed for compiling GDP). Company service providers could be asked to report information on their client IBCs, such as on the type of activity, direct investment relationships, the value of assets held, the value of debt securities issued, and the country of residence of beneficial owners. It is recognized that only a few SEIFiCs would be in a position to do this. Such an initiative would help to remedy the present situation in which SEIFiCs have no knowledge of the financial activities in which IBCs are engaged.

77. **To address problems of nonresponse that result from conducting the CPIS on a voluntary basis, STA will advise SEIFiCs on steps that can be taken to ensure that the relevant agency or agencies have adequate legal authority to conduct statistical collections.** The best practice would be to ensure that the same authority extends to the compilation of international investment position statistics and to the compilation of CPIS statistics. One possible approach would be to ensure that the agency responsible for the regulation of offshore financial service providers should also be charged with responsibility for collecting statistics, as this would draw on the synergies that come from “knowing the industry.”

⁴² Expansion of standards for supervision of companies, trusts, and their service providers is discussed in Section III of this paper. For the expansion of statistical coverage, it would be necessary that company service providers supply data on assets held by client trusts and companies, not just on their own financial positions.

⁴³ Efforts will also be made to reduce the gaps in coverage for Luxembourg and Switzerland that were noted above.

B. Improving the Coverage of Selected OFCs in Industrial Country Statistical Collections

78. **Three initiatives can be taken to improve the quality of data on SEIFiCs collected by industrial countries for their financial claims on, and transactions with, SEIFiCs.** The first is to reach agreement on guidelines for determining the residence of SPEs and their treatment in direct investment statistics. The second is to reach agreement on the geographic classification used in industrial country collections that would permit the identification of individual SEIFiCs. The principal focus should be on direct investment statistics because of interest in the use of IBCs (and especially IBCs that are SPEs) by direct investors. The third is to explore with countries that rely on reporting by custodians the possibility of collecting data on portfolio investment liabilities to SEIFiCs.

79. **A related question is whether it would be useful for industrial countries in their direct investment statistics collections, having identified claims by their direct investors on IBCs in SEIFiCs, to request further information in respect of the activities conducted by these offshore entities.** It may be argued that the direct investor is better placed to provide information, if needed by industrial countries as users of statistics, than the SEIFiC where the IBC is domiciled. STA plans to hold discussions with selected industrial countries to determine how SEIFiCs are treated in their direct investment statistics and the scope for collecting useful information on IBCs.

C. Further Work on International Statistical Guidelines

80. **The current international statistical guidelines for determining the residence of entities determine residence in relation to production and do not provide clear guidance on the residence of entities that are cross-border asset holders** that individually make little contribution to production in the host economy (but collectively may make a significant contribution). For cross-border asset holders, a more appropriate determinant of residence is the country/jurisdiction of legal domicile. Such an interpretation would avoid the reporting gaps that currently result in global balance of payments and international investment position totals when entities are not regarded as resident in the balance of payments statistics of any country/jurisdiction and ensure consistency across the countries/jurisdictions involved (Box 4).

81. **Further work is planned on the statistical treatment of trusts with a view to establishing that trusts be treated as separate institutional units within the financial sector,** and that cross-border trusts (where the beneficiary is resident in one country/jurisdiction and the trustee in another) should be treated as institutional units owning the entrusted assets that are resident in the country of domicile of the trustee.⁴⁴

⁴⁴ Following discussion with SEIFiCs, a paper is being prepared by STA on *The Legal Structure, Economic Function, and Statistical Treatment of Trusts* that will be released as a Fund Working Paper in 2002.

Box 4. Statistical Guidelines Need Updating to Account for SEIFiCs

Principles for the determination of the country of residence of statistical units are a foundation of economic statistics because they determine whether units are treated as part of an economy or as external to it. The definitions of residence in the statistical guidelines, such as the 1993 *System of National Accounts*, the *Balance of Payments Manual*, fifth edition, currently refer to physical production and links with the rest of the economy, but statistical work with SEIFiCs has highlighted the limitations of those definitions when units have limited physical presence or restricted links with the rest of the economy. For instance, in SEIFiCs, the following is common:

- Production of some financial services, including banking, insurance, and mutual fund operation, does not require any physical presence because the assets are intangible and the administration and management can be contracted out;
- Some offshore entities are not permitted to undertake transactions with local residents and so lack connections with the domestic economy and have been excluded from domestic statistics by some jurisdictions as well as from the statistics of the country of residence of the owner;
- Some offshore entities do not undertake any production but are simply vehicles to hold financial assets.

STA has fostered discussion on these issues with a view to updating the international statistical guidelines. The emerging solution in these cases is that the guidelines should define residence with reference to registration and incorporation.

Basel Core Principles: Areas of Weak Compliance

- **Independence and Resources, BCP 1.2:** The role ministries play in appointing the head of the supervisory agencies, and in some cases the government's legal ability to determine even prudential regulations, were cited in the majority of cases. Lack of resources was a virtually universal problem, usually related to inadequate supervisor skills.
- **Legal framework, BCP 1.3:** Two cases of noncompliance arose from constraints on legislative authority to inspect the accounts of offshore banks, or to request information from them.
- **Enforcement Powers, BCP 1.4:** The lack of legislative authority for consolidated supervision and the appeal process in licensing were cited.
- **Licensing, BCP 3:** Ministers' licensing authority, no requirement for consent by the home authority and limitations on the supervisor's ability to impose requirements and obtain information were the shortcomings found.
- **Investment criteria, BCP 5:** Deficiencies related to the lack of parameters or aggregate limits on equity holdings, and of overall limits on large exposures to a single entity.
- **Loan policies, BCP 7:** In large part, the shortcomings here were related to those in off-site and on-site supervision, in that the supervisor lacks the resources for adequate monitoring of compliance with procedures, or was found to be overdependent on quantitative credit risk indicators, rather than providing a qualitative evaluation.
- **Country risk, market risk, and other material risk (BCPs 11, 12, and 13):** Deficiencies in compliance were attributed to occasional lack of formal guidelines with respect to these exposures, and directives that were not fully satisfactory, or inadequately monitored. A more widespread issue was the lack of comprehensive risk management.
- **Anti-Money laundering, BCP 15:** The most common shortcomings were insufficient on-site inspections and insufficient staff resources.
- **On-site and off-site supervision, BCP 16:** The need for improvement was widespread (apart from the three cases of noncompliance, only three of the nine jurisdictions were fully compliant), either because of the lack of manuals required for consistent surveillance, or because of insufficient resources to carry out the requisite monitoring.
- **Consolidated supervision, BCP 20:** One case of deficiency arose from the failure to supervise the offshore banking arms of banking groups, and the other from the lack legislative provision for the sharing of information among different domestic supervisors.
- **Accounting, BCP 21:** Offshore banks were not obliged to publish accounts, and in one case accounting rules allowed the banks to classify similar transactions differently.

IAIS Core Principles: Areas of Weak Compliance

- **Market conduct, ICP 11:** Market conduct gaps resulted from a lack of rules or codes of conduct, failure to oversee insurance brokers, and a lack of resources for monitoring.
- **On-site supervision, ICP 13:** was found to be deficient because visits were unstructured, lacked checklists and suffered from insufficient resources.
- **Corporate governance, ICP 4:** Limited observance of this principle resulted from the failure to issue guidelines or to oversee them and, where the insurance companies were branches of international companies, to verify the corporate governance rules of the head office.
- **Internal controls, ICP 5:** In both cases, the shortcoming resulted from either the lack of legislative authority to require actions of the Board of Directors, or of guidelines for internal controls.
- **Reinsurance, ICP 10:** Weaknesses stemmed from a lack of oversight of the reinsurance carried by insurance companies, and from the failure to include reinsurance in the insurance supervision legislation.
- **Coordination and cooperation, ICP 16:** This principle suffered from a lack of information exchange either domestically or internationally, and although some legislative changes to anti-money laundering provisions were in the process of changing this, there were often no formal procedures to permit the exchange of information; in some instances, for example, the permission of the firm was required. In other cases, the law did not allow for information sharing.

1997 Coordinated Portfolio Investment Survey

1. **Because of deficiencies in data sources, efforts to track the unprecedented growth in the volume, complexity, and globalization of international financial transactions that occurred during the 1980s and 1990s identified a significant under-reporting in balance of payments statistics of cross-border portfolio investment outflows.** Studies by STA of data for cross-border portfolio investment positions indicated that this was accompanied by a significant under-reporting of portfolio investment assets. Reported cross-border portfolio investment outflows averaged about 80 percent of reported cross-border portfolio investment inflows during the 1990s. Cross-border holdings of portfolio investment assets showed a similar under-count in relation to portfolio investment liabilities.⁴⁵

2. **The first Coordinated Portfolio Investment Survey was conducted for end-December 1997 (1997 CPIS) with a view to improving the coverage of portfolio investment assets.** All participating countries agreed to (i) undertake benchmark cross-border portfolio investment asset surveys at the same time; (ii) follow the definitions and classifications of the *BPM5*; and (iii) share their experiences in determining the best methods of survey design and implementation. By asking for a breakdown of holdings of equities and long-term debt securities according to the country of residence of the issuer, the 1997 CPIS permitted the calculation of counterpart data for cross-border portfolio investment liabilities.

3. **The results of the 1997 CPIS provided a rich source of data that could be used for analysis of portfolio investment behavior and assessment of the adequacy of countries' data.** The survey identified \$6,100 billion in portfolio investment assets, which was approximately \$700 billion more than previous data. It reduced the estimated global discrepancy by approximately \$300 billion. Many countries were able to improve their international investment position and income data as a result. It allowed countries to compare and reconcile data. It also demonstrated that an organized effort toward standardized scope, timing, and definitions used in statistical collections could be successfully coordinated among a large number of countries. Further, it proved an effective vehicle for spreading best practices and developing bilateral contacts among statistical compilers on a worldwide basis.

4. **International investment position data for portfolio investment assets and liabilities at end-December 1997, taking into account the results of the 1997 CPIS, indicated that there remained a global discrepancy of \$1,700 billion, some 20 percent of global portfolio investment liabilities.** This discrepancy was attributed in part to the fact that some important investing countries did not participate in the 1997 CPIS and the poor coverage of cross-border portfolio investment by the household sector in the surveys of many of the countries that participated in the CPIS.

⁴⁵ See *Analysis of 1997 Coordinated Portfolio Investment Survey Results and Plans for the 2001 Survey*, IMF, January 2000.

5. The 1997 CPIS excluded Luxembourg, Germany, and Switzerland among the industrial countries and nearly all of the OFCs listed by the Financial Stability Forum (the exceptions being Bermuda and Ireland).⁴⁶

6. **Cross-border portfolio investment by Bermuda reported in the 1997 CPIS amounted to \$130 billion, about 3 percent of global cross-border holdings of equities and long-term debt securities.** Bermuda was the eighth largest jurisdiction measured by size of holdings. The total portfolio investment assets reported by Bermuda comprised portfolio investment held by banks, insurance companies, mutual funds, and trust companies (the latter including assets managed on behalf of clients). Insurance companies were the largest holders, followed by mutual funds, trust companies, and banks.

7. The 1997 CPIS provided information on partner countries' holdings of portfolio investment instruments issued by SEIFiCs. Some \$70 billion was reported in the form of equities issued by SEIFiCs, which includes shares issued by mutual funds. Based on the limited information available for the net asset values of mutual funds in these countries, this would indicate that partner countries were picking up only a small fraction of their residents' total holdings of shares in such mutual funds (perhaps only a quarter or less). This outcome is not surprising as most industrial countries rely on reporting by domestic custodians and their major institutional investors. Mutual funds shares are unlikely to be deposited with custodians and there are likely to be significant nonfinancial sector holdings, especially by the household sector.

⁴⁶ Malaysia and Singapore participated in the 1997 CPIS but excluded their offshore financial centers.

Coverage of the 2001 CPIS for Participating SEIFICs

Country/Jurisdiction	Financial Sector			IBCs 1/, other private companies, and other domestic holders
	Banks	Insurance Companies	Mutual Funds	
Aruba	All included	All included	There are none	All major domestic holders
Bahamas, The	All included	All included	All included	All major domestic holders
Bahrain	All included	All included	All included	All major domestic holders
Bermuda	All included	Will estimate based on largest holders	Will estimate based on largest holders	Includes pension funds
Cayman Islands	All included	Excluded	Data will be collected from about 10 of the largest mutual funds administrators	
Costa Rica	Not known	Not known	Not known	
Cyprus	Physical presence only	Physical presence only	Physical presence only	Physical presence only
Guernsey	All included	All included	All included	Special purpose vehicles included. Government and its departments included. (IBCs not applicable as Guernsey does not incorporate IBCs.)
Isle of Man	All included	All included	All included	
Jersey	All included	All included	All included	Significant special purpose vehicles and private investment companies included
Lebanon	All included	All included	There are none	All major domestic holders
Macao SAR	All included	All included	All included	All major domestic holders
Malta	All included	There are none	There are none	Will include IBCs with physical presence
Mauritius	All included	All included	All included	All major domestic holders
Netherlands Antilles	All included	All included	Will collect data from largest service providers	All major domestic holders
Panama	All included	All included	Excluded	All major domestic holders
Vanuatu	All included	There are none	All included	All major domestic holders

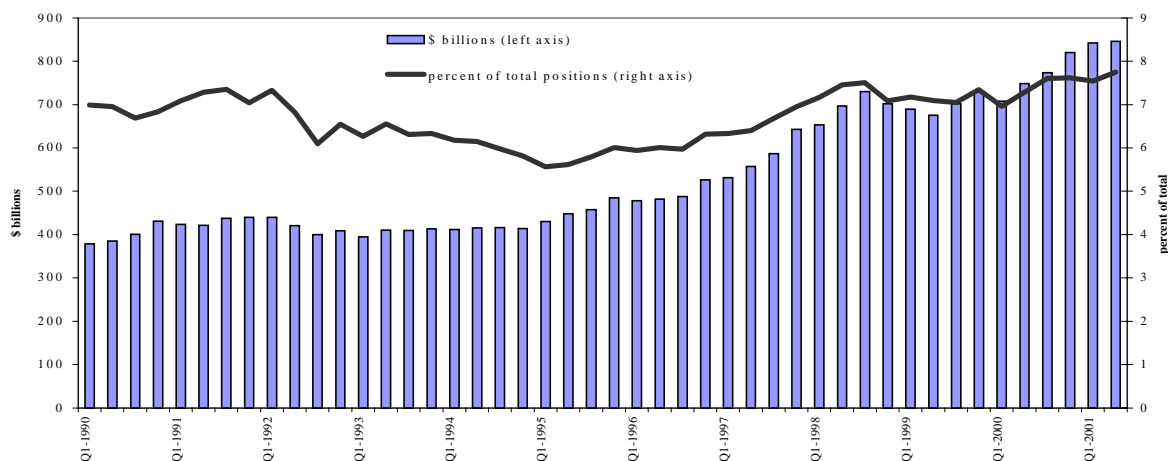
Sources: Data provided by the countries/jurisdictions.
 1/ International business companies.

BIS International Locational Banking Statistics for SEIFiCs

1. The BIS international locational banking statistics gather quarterly data on international financial claims and liabilities of bank offices resident in the reporting countries broken down by currency, sector, and country of residence of counterparty, and by nationality of banks. In the early 1990s, strong interest arose in making use of these statistics to improve the coverage and accuracy of the recording of balance of payments statistics. Following the financial crises in emerging economies in the late 1990s, the locational banking statistics became an important component of the Joint BIS-IMF-OECD-World Bank Statistics on External Debt, which were developed in response to requests for dissemination of more timely external debt statistics. For the BIS locational banking statistics, banks are asked to report, inter alia, their external assets and liabilities by country, currency, and sector. Reporting is based on the same principles of residence as the *BPM5* and the *CPIS*.

2. The Bahamas, Bahrain, the Cayman Islands, and the Netherlands Antilles participate in the BIS quarterly locational banking statistics. The survey covers licensed banks in these jurisdictions, including those without a physical presence. The BIS publishes summary information for each of the BIS-reporting countries (28 in total) for selected external assets and liabilities, but not with the geographical breakdown by reporting country. The latter information is treated as confidential and used only to derive global aggregates of flows and stocks vis-à-vis individual countries in combination with data reported by all participating countries. The published data 1/ show reporting banks' aggregate claims on each individual SEIFiC according to the domestic sector of the SEIFiC (bank and nonbank). The data include intra-SEIFiC claims. The table below shows the values and proportions of reporting banks' external asset positions with counterparties in SEIFiCs. While some of the participating countries publish their locational banking statistics with a geographic breakdown of external assets and liabilities, for the SEIFiCs the geographic breakdown is not published.

**BIS reporting banks:
Positions with SEIFiCs (all sectors)**



Source: Data provided by the BIS

Appendix Table 8. Offshore Financial Center Assessments: Sectors and Methodology

Sectors Assessed	Domestic included	Banking	Insurance	Securities	Companies, Trusts Service Providers	AML	
						Basic	Methodology
Module 1: Assisted Self-Assessments							
Asia and the Pacific							
Niue	Yes	x			x	x	
Europe							
Andorra	Yes	x					x
Monaco	Yes	x		x	x		x
Western Hemisphere							
Antigua and Barbuda	No	x	x		x		x
Aruba	No	x	x		x		x
Dominica	No	x	x	x	x		x
Grenada	No	x	x	x	x		x
Netherlands Antilles	No	x	x		x		x
Panama	Yes	x					
St. Kitts and Nevis	No	x	x		x		x
St. Lucia	No	x	x	x	x		x
St. Vincent and the Grenadines	No	x	x	x	x		x
Module 2: Standards Assessments							
Asia and the Pacific							
Macao SAR	Yes	x	x		x		x
Europe							
Andorra	Yes	x					x
Cyprus	No	x			x		x
Gibraltar	Yes	x	x	x	x		x
Western Hemisphere							
Aruba	Yes	x	x		x		x
Belize	Yes	x	x		x		x
Panama	Yes	x					x

Sources: Module 1 and 2 Assessments

Appendix Table 9. Financial Sector Assessment Program (FSAP): Sectors and Methodology

Sectors Assessed	Domestic included	Banking	Insurance	Securities	AML	
					Basic	Methodology
FSAP						
Costa Rica	NA	x				x
Luxembourg	NA	x	x	x		x
Switzerland	NA	x	x	x		x

Sources: FSAP Reports.

1/ NA = not applicable

Appendix Table 10. FSAP Countries' Financial Structure

	Banks	Insurance Companies	Stock Exchange
Costa Rica 1/	21	54	yes
Luxembourg	196	357	yes
Switzerland 2/	375	173	yes

Notes: 1/ Costa Rica's banks are groups which also offer securities and insurance services.

2/ Switzerland has a universal bank model so banks also offer securities services.

Appendix Table 11. Financial Structure of Assessed Jurisdictions

Jurisdiction 1/	Banks			Insurance companies4/		IBCs or Exempt Companies 5/	Company & Trust Service Providers	Credit unions (domestic)	Other domestic financial Institutions 6/	Stock Market
	Offshore 2/		Domestic	Domestic	Offshore					
	Domestic	Total									Of which Home 3/
Asia and the Pacific										
Macao SAR	22	1	0	24	0	12	...	...	1	no
Niue	1	3	3	0	0	6,000	1	0	0	no
Europe										
Andorra 7/	8	...	...	...	...	...	...	...	...	no
Cyprus	12	31	1	52	17	20,000	12+	360	...	yes
Gibraltar 8/	19	11	10	2	16	8,800	83	...	...	no
Western Hemisphere										
Antigua and Barbuda	...	22	2	7	0	8,000	6	...	...	regional
Aruba	5	2	0	23	6	4,600	16	2	4	no
Belize	5	4	3	18	0	15,000	40	15	...	no
Dominica	...	5	...	...	2	7,500	22	...	...	regional
Grenada	...	...	22	...	6	3,400	11	...	...	regional
Netherland Antilles	19	46	23	...	...	...	...	8	...	no
Panama	54	26	26	24	...	...	46	...	154	yes
St. Kitts and Nevis	...	1	...	...	0	22,500	76	...	...	regional
St. Lucia	...	1	...	...	7	282	10	...	...	regional
St. Vincent and the Grenadines	...	39	...	...	3	9,780	33	...	...	regional

Source : Module 1 and 2 reports.

Notes: ... indicates that institutions in category were not reported, or information uncertain.

1/ All information is for one year, the year of the assessment, or the nearest year available.

2/ Banks with licenses to operate offshore only.

3/ Locally-headquartered offshore banks.

4/ Includes both life and nonlife companies.

5/ The number of IBCs or exempt companies is usually estimated from permits granted.

6/ Includes mortgage banks, financial companies, investment banks where applicable.

7/ Andorra's banks manage funds and sell life insurance products.

8/ All banks in Gibraltar are licensed to conduct business locally and internationally. Some banks elect to serve the offshore market largely because of a more favorable tax regime.

9/ "Regional" refers to a new regional stock exchange which currently lists only domestic issues.

Appendix Table 12. Conformity with Supervisory Standards: BCP Compliance

		Proportion of jurisdictions by Degree of Compliance 1/ 2/ 3/						
		C	LC	MNC	NC	NA	C+LC	MNC+NC
Principle 1	Effective system							
Principle 1(1)	Clear supervisory responsibility	89		11			89	11
Principle 1(2)	Independence and resources	33	33	22	11		66	33
Principle 1(3)	Legal framework	78		22			78	22
Principle 1(4)	Enforcement powers	67	11	22			78	22
Principle 1(5)	Legal protection	44	44		11		88	11
Principle 1(6)	Information sharing	78	11	11			89	11
Principle 2	Permissible activities	78	11	11			89	11
Principle 3	Licensing	56	22	11	11		78	22
Principle 4	Transfer of ownership	78	11	11			89	11
Principle 5	Investment criteria	78		22			78	22
Principle 6	Capital adequacy	67	22	11			89	11
Principle 7	Credit policies	56	22	22			78	22
Principle 8	Loan evaluation	44	44	11			88	11
Principle 9	Large exposures	78	11	11			89	11
Principle 10	Connected lending	78	11	11			89	11
Principle 11	Country risk	33	44		22		77	22
Principle 12	Market risks	33	33	11	22		66	33
Principle 13	Other risks	44	33	11	11		77	22
Principle 14	Internal controls and audit	56	44				100	0
Principle 15	Money laundering	22	33	44			55	44
Principle 16	On-site and off-site supervision	44	22	33			66	33
Principle 17	Bank management contact	44	44	11			88	11
Principle 18	Off-site supervision	67	22	11			89	11
Principle 19	Validation of supervisory information	78	11	11			89	11
Principle 20	Consolidated supervision	56	11	22		11	67	22
Principle 21	Accounting	67	11	22			78	22
Principle 22	Remedial measures	44	44	11			88	11
Principle 23	Global consolidated supervision	56	11		11	22	67	11
Principle 24	Host country supervision	78		11		11	78	11
Principle 25	Supervision of foreign banks' establishments	78	11	11			89	11

Sources: Detailed Financial Sector Assessments.

1/ C=Compliant; LC=Largely compliant; MNC=Materially non-compliant; NC=Non-compliant, NA = Not applicable

2/ The grading not applicable implies that the proportions of jurisdictions may not sum to 100.

3/ The countries whose assessments are included here are Aruba, Belize, Costa Rica, Cyprus, Gibraltar, Luxembourg, Macao SAR, Panama, and Switzerland.

Appendix Table 13. Conformity with Supervisory Standards: ICP Observance

		Proportion of jurisdictions by Degree of Observance 1/ 2/ 3/						Comparable Observance	
		O	LO	MNO	NO	NA	O+LO	MNO+NO	Other Countries 4/ MNO + NO
Principle 1	Organization of an Insurance Supervisor	33	50	17			83	17	29
Principle 2	Licensing	50	33	17			83	17	10
Principle 3	Changes in control	67	17		17		84	17	17
Principle 4	Corporate governance		33	17	17	33	33	34	70
Principle 5	Internal controls	33	33	33			66	33	30
Principle 6	Prudential rules – Assets	50	50				100	0	50
Principle 7	Prudential rules – Liabilities	50	33	17			83	17	15
Principle 8	Capital adequacy and solvency	67	33				100		15
Principle 9	Derivatives and "off-balance sheet" items	67	17			17	84		44
Principle 10	Reinsurance	50	17	33			67	33	32
Principle 11	Market conduct		50	33	17		50	50	47
Principle 12	Financial reporting	50	33	17			83	17	5
Principle 13	On site inspection	33	17	50			50	50	15
Principle 14	Sanctions	50	33	17			83	17	15
Principle 15	Cross-border business operations	50	33	17			83	17	25
Principle 16	Coordination and cooperation	17	50	33			67	33	21
Principle 17	Confidentiality	83		17			83	17	5

Sources: Detailed Financial Sector Assessments.

1/ O=Observant; LO=Largely observant; MNO=Materially non-observant; NO=Non-observant; NA=Not applicable.

2/ The grading not applicable implies that the proportions of jurisdictions may not sum to 100.

3/ The countries included here are Aruba, Belize, Gibraltar, Luxembourg, Macao SAR, and Switzerland.

4/ The distribution here is taken from Table 3 in *Experience with the Insurance Core Principles Assessments under the Financial Sector Assessment Program*, SM/01/266, August 21, 2001.