

INTERNATIONAL MONETARY FUND

**OFFSHORE FINANCIAL CENTERS**

The Assessment Program

A Progress Report and the Future of the Program

Prepared by the Monetary and Financial Systems Department  
(In consultation with other Departments)

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## LIST OF ACRONYMS AND ABBREVIATIONS

AML	Anti-money laundering
BCCI	Bank of Credit and Commerce International
BCP	Basel Core Principles
BIS	Bank for International Settlements
CARTAC	Caribbean Regional Technical Assistance Center
CFT	combating the financing of terrorism
CPIS	Coordinated Portfolio Investment Survey
CY	calendar year
FATF	Financial Action Task Force on Money Laundering
FIRST Initiative	The Financial Sector Reform and Strengthening Initiative
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
FSF	Financial Stability Forum
FSRB	FATF-style regional bodies
FY	fiscal year
IAIS	International Association of Insurance Supervisors
ICP	IAIS Insurance Core Principles
IOSCO	International Organization of Securities Commissions
JSA	Japanese Technical Assistance Sub-Account
MFD	Monetary and Financial Systems Department, IMF
MOU	memorandum of understanding
NCCT	non-cooperative countries and territories
OECD	Organization of Economic Cooperation and Development
OFC	offshore financial center
OGBS	Overseas Group of Banking Supervisors
PFTAC	The Pacific Financial Technical Assistance Centre
ROSC	Reports on the Observance of Standards and Codes
SCP	IOSCO Objectives and Principles of Securities Regulation
TA	technical assistance
TCSP	trust and company service providers

## EXECUTIVE SUMMARY

Since the offshore financial center (OFC) program started in June 2000, it has addressed two broad concerns about potential risks posed to other financial systems by activities undertaken in offshore centers—adequacy of supervision and data availability. This paper reports on the first round of OFC assessments, now almost complete, and presents proposals for going forward.

The OFC assessment program has focused primarily on assessing implementation of financial supervision, regulation, and integrity standards in OFCs. The assessments found that, following significant reforms, initiated in part in response to the OFC program, larger, wealthier jurisdictions meet high supervisory standards while many developing country jurisdictions must continue to make a considerable effort to improve their supervision. Technical assistance has been provided to help authorities address assessment recommendations.

Assessment results, as well as a May 2003-roundtable discussion among standard setters and onshore and offshore supervisors, confirm the benefits of the program in promoting stronger supervisory and financial integrity standards. The assessment results and the roundtable conclusions support the following proposals for the future of the assessment program:

- regular monitoring of OFCs through offsite analysis, and risk-focused and periodic assessment missions;
- enhancing the transparency of OFC supervisory systems and activities by reclassifying assessments as staff reports;
- providing technical assistance in collaboration with bilateral and multilateral donors to strengthen supervisory and regulatory systems; and
- collaborating with the standard setters and supervisors to strengthen standards and exchanges of information.

In addition to the contributions of the Fund, onshore and offshore supervisors will continue to have the key responsibilities for ensuring the adequacy of the supervisory and regulatory regimes governing financial institutions in OFCs.

## I. INTRODUCTION

1. The offshore financial center (OFC) program was initiated in June 2000 by the Executive Board in the context of the Fund's responsibility to help members identify and reduce vulnerabilities stemming from weaknesses in their financial systems (BUFF/00/98). Directors noted that only limited evidence was available thus far on the direct risks posed by OFCs for the global financial systems. However, Directors considered that where standards of financial supervision are inadequate and comprehensive risk analysis is hampered by a lack of reliable data on the activities of OFCs, there can be potential risk for financial stability. They noted that the OFC assessments would build on the financial system work undertaken by the Fund. Directors agreed that once experience was gained, it would be important for the Executive Board to revisit the subject of OFCs with a view to ensuring that the Fund's role evolves in a manner consistent with its mandate, expertise, and resources. This paper reports on the progress of the first round of OFC assessments, which is now almost complete, and presents proposals for going forward. The paper does not review the statistical component of the program.<sup>1</sup>

2. The paper is organized as follows. The next section provides some background to the OFC program. Section III describes the design and results of the assessment program and analyzes assessment findings. Section IV discusses the issues and proposals with regard to the future role of the Fund vis-à-vis OFCs. Section V outlines the resource implications of taking the program forward. The final section presents issues for Directors' consideration.

## II. BACKGROUND ON OFC PROGRAM

3. **The Fund embarked on an OFC program in June 2000 in response to concerns about potential risks posed to other financial systems by activities undertaken in offshore centers.** Two broad concerns were to be addressed—adequacy of supervision and data availability. Inadequate supervision could encourage regulatory arbitrage and facilitate fraudulent activities, including money laundering. Moreover, weak supervision could impede effective consolidated supervision by the home countries of financial institutions with operations in those OFCs. Second, analysis of cross-border risks is hindered by the lack of information about the range and level of activities conducted in the OFCs.

4. **These concerns are material because the volume of financial transactions booked in OFCs is substantial.** For example, the Bank for International Settlements' (BIS) locational banking statistics show that reporting jurisdictions recorded \$2.8 trillion in claims on (assets located in) OFCs at end-2002 (see Appendix I), representing 20.9 percent of total cross-border claims, and \$2.5 trillion at end-2001. The IMF's Coordinated Portfolio Investment Survey (CPIS) data show \$1.8 trillion in cross-border investment claims (equity

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<sup>1</sup> The first round results of the statistical component of the program are described in *Offshore Financial Center Program—A Progress Report*, March 2003 (SM/03/97).

and debt securities, excluding securities that comprise direct investment) against OFCs at end-2001, representing 14 percent of total cross-border holdings of securities reported in the survey. For banking, a more useful measure of risk exposure is provided by the BIS consolidated banking statistics which net out intragroup lending, and also identify ultimate risk. The consolidated banking statistics show net claims on OFCs of \$1.8 trillion at end-2002, which reduces to \$1.7 trillion in claims on OFCs on an ultimate risk basis (or 5.3 percent of world output).<sup>2</sup> The reduction in consolidated claims reflects the fact that the business in OFCs is largely conducted by the affiliates of banks headquartered elsewhere.

**5. Activities in OFCs are centered around international banking, asset, and risk management aimed mainly at large corporate entities and high net worth individuals.** Financial services encompass banking, mainly in the form of interbank transactions and private banking, collective investment schemes, including both hedge funds and publicly marketed funds and, more generally, asset management by both banks and investment firms. Incorporation of special purpose vehicles and the establishment of trusts play important roles in structured financing arrangements and securitization, as well as in wealth and estate management for individuals. Insurance facilities for, in the main, corporate clients are also significant with reinsurance and captive insurance as major specialties of offshore markets.

**6. Concerns about the risks posed by OFCs gave rise to other international initiatives in 2000,** including by the Financial Stability Forum (FSF), the Financial Action Task Force on Money Laundering (FATF), and the Organization of Economic Cooperation and Development (OECD). The FSF report on offshore centers highlighted potential prudential and market integrity concerns arising from impediments to effective supervision and cooperation.<sup>3</sup> Based on discussions with market participants, and selected supervisors, and a survey of onshore and offshore supervisors, the FSF classified 42 OFCs into three groups by perceived level of supervisory standard. The FATF reviewed available information on some jurisdictions' AML measures and identified 12 OFCs as "noncooperative countries and territories" (NCCTs).<sup>4</sup> The OECD's "harmful tax practices" initiative identified 31 OFC

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<sup>2</sup> World output is measured at market exchange rates. See *World Economic Outlook*, April 2003.

<sup>3</sup> See "Report of the Working Group on Offshore Centers," Financial Stability Forum, April 2000. The report further went on to recommend that the Fund take responsibility for developing, organizing, and carrying out an assessment process for OFCs.

<sup>4</sup> See FATF, "First Review to identify Non-cooperative Countries or Territories," June 2000. Since August 2002, the FATF has agreed not to undertake a further round of the NCCT initiative, at least during the 12-month pilot project that involves using the common methodology in assessing the AML/CFT regimes of jurisdictions (see SM/02/349).

jurisdictions that met the OECD tax haven criteria.<sup>5</sup> These initiatives relied on blacklisting to spur reforms.

### A. Risks Posed by OFCs

7. **The major risks OFCs could pose for the international financial system are associated with prudential and financial integrity concerns.** Both concerns stem from OFCs' links to major "onshore" financial centers where onbalance sheet and offbalance sheet positions in OFCs are generally invested.

8. **The institutions most likely to generate stability concerns are banks that have a large presence in offshore markets.** Firstly, as a result of their potential susceptibility to runs and their role in the payments system, banks are the most common source of prudentially-caused instability. Secondly, globally important banks are usually present in most major OFCs. Conglomerates are a related potential source of risk—their nonbank affiliates in OFCs, carrying out asset management, for example, could transmit risk through the banking subsidiaries located onshore. Where nonbank intermediary activity is significant, it can also raise concerns, e.g., hedge funds located offshore, and where onshore insurance companies rely on offshore reinsurance.

9. **OFCs are a potential conduit for the proceeds of crime to gain access to, and to be laundered through, global financial markets.** Characteristics such as the anonymity of financial transactions, opaqueness of the operations of offshore corporations, and legal protections in OFCs have helped to make the centers vulnerable to financial abuse—money laundering, fraud, and tax evasion. Financial abuse in an OFC can have negative effects on both the international financial system and the jurisdiction itself. Financial centers that do not put arrangements in place to deter fraud and money laundering, harm their reputation. They also risk being deprived of financial relations with major institutions and markets, and losing their clientele. Even with increasing customer due diligence, the association of OFCs with secrecy may serve to attract less principled players.

10. **Concerns about possible risks posed by OFCs are exacerbated by the lack of information about their operations.** Lack of information on OFC activities restricts our ability to fully understand global financial flows and analyze their potential stability effects. OFCs' competitive positions reflect, *inter alia*, innovation in financial instruments and operations, and information about innovative activities can be proprietary and is not broadly disseminated. However, lack of information about OFC operations in itself creates stability concerns onshore.

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<sup>5</sup> See "Harmful Tax Competition: An Emerging Global Issue," OECD (1998) and "Toward Global Tax Co-operation," OECD (2000). In 2002, six OFC jurisdictions were blacklisted as noncooperative; one has subsequently been delisted.

## B. Response to the Risks

11. **Where financial institutions are headquartered onshore, the potential prudential risk in OFC operations can be mitigated through effective consolidated supervision by home country supervisors supported by good host supervision.** Banks, in the large majority of OFCs, are affiliates of banks from industrial and emerging markets. Minimum standards for global consolidated supervision were developed in 1992 in response to the 1991 Bank of Credit and Commerce (BCCI) failure, demonstrating the role standards implementation is expected to play. But the 2002 review of Basel Core Principles compliance<sup>6</sup> continues to identify consolidated supervision and global consolidated supervision as areas of concern in over half and one-third, respectively, of the 60 countries assessed. Weaknesses in consolidated supervision have also been recognized as a concern in addressing risks in financial conglomerates, including those that have nonbanking subsidiaries in offshore centers.

12. **In view of these identified weaknesses, effective supervision requires a coordinated approach involving both onshore and offshore monitoring and the supervisors of different sectors.** Ways to reduce potential risk include effective information exchange among onshore and offshore supervisors and across sectors, as well as a clear delineation of supervisory responsibilities.<sup>7</sup>

13. **Money laundering is an international problem, and, to be effective, the international standards against money laundering and terrorist financing need to be applied worldwide, especially in large financial centers.** Working with the FATF and other bodies, the Fund and the Bank have developed a comprehensive methodology to assess AML/CFT regimes and together with the FATF and FATF-style regional bodies (FSRBs) have been applying this methodology to identify vulnerabilities in AML/CFT regimes in jurisdictions assessed under the FSAP or OFC programs.

14. **Additional guidance for the oversight of OFC activity has recently been provided, or is being developed, by standard setters.** For example, the Basel Committee on Banking Supervision provided guidance for the licensing and supervision of shell banks, booking branches, and parallel banks. The revised FATF 40 Recommendations approved by

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<sup>6</sup> See IMF, *Implementation of the Basel Core Principles for Effective Banking Supervision, Experiences, Influences and Perspectives*, September 2002 (SM/02/310).

<sup>7</sup> For example, better internal controls and communication among supervisory authorities in the United Kingdom, Japan, and Singapore might have provided an early warning of the unsustainable positions taken by Barings on the futures markets before its 1995 collapse. The Barings incident led to the Windsor Declaration of 1995, through which regulators and exchanges agreed to step up their cooperative efforts. See IMF, *International Capital Markets: Developments, Prospects, and Key Policy Issues*, September, 1996.

FATF in June 2003 contain explicit provisions for trust and company service providers (TCSPs) and for third-party participation in customer identification, an important feature of the TCSP business. The IAIS issued principles for the supervision of reinsurance (including captive reinsurance) in 2002. IOSCO has developed a multilateral MOU covering a wide range of regulatory assistance.

15. **Technical assistance for upgrading supervisory systems has been increased to address the risks in OFCs.** Since 2001, both multilateral and bilateral donors with close ties to vulnerable regions have increased their technical assistance in collaboration with the Fund. Such technical assistance has included both general advice on supervision and specific advice on OFC supervisory issues.

16. **Concerns about lack of information on OFC activities have been addressed through onsite visits and data initiatives.** A considerable effort has been made to persuade OFCs to participate in the IMF's CPIS, which supplements the BIS's international banking statistics. Together, these databases provide a substantial tool for assessing the importance of OFCs in international banking and securities markets, and for examining cross-border issues.<sup>8</sup> The OFCs could do more themselves to disseminate information on their financial activities through the provision of statistics and descriptive material in Annual Reports and on their websites.

### III. THE OFC ASSESSMENT PROGRAM

#### A. Design of the Program

17. **The program has two broad components: assessment and technical assistance.** The assessments were designed to complete, through a step-by-step process, reviews of observance of supervisory and integrity standards and financial vulnerabilities. Standards assessments were to be carried out through the Module 2 assessments, and reviews of vulnerabilities and potential cross-border risks were to be covered in the context of more comprehensive Module 3 or FSAP assessments (Appendix II). Assessments were to be voluntary and sufficiently flexible to accommodate for each jurisdiction's specific situation.<sup>9</sup>

18. **Assessment of most OFCs potentially falls within the scope of Fund work relevant to surveillance; but the program was designed to be voluntary, operating outside the terms of the Fund's formal surveillance mandate.** The Financial System Stability Assessment (FSSAs), derived from FSAP findings and Article IV consultations, is the main tool for identifying financial system vulnerabilities, contributing to the bilateral Article IV surveillance of member countries. With the consent of a Fund member, the FSSA

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<sup>8</sup> See SM/03/97 for a discussion of the CPIS.

<sup>9</sup> See *Offshore Financial Centers—The Role of the IMF*, June 2000 (SM/00/136).

can also be used to assess dependent territories of members.<sup>10</sup> In the event, a broader approach was adopted for the OFC program, allowing all participating jurisdictions, including nonmembers,<sup>11</sup> to select among a set of uniform assessment options. These options included FSAPs which are conducted jointly with the World Bank (Appendix II).<sup>12</sup>

19. **The program also envisaged the possibility of visits to home country authorities of offshore establishments to review, *inter alia*, the effectiveness of consolidated supervision.** Accordingly, visits to home country supervisors were undertaken as part of the assessments for a number of OFCs. In addition, FSAPs in countries with important bank representation in OFCs examined the home country consolidated supervision. These findings are also reflected as appropriate (see below).

20. **Reports are generally finalized and published on the Fund's website within 9–12 months of the assessment missions; but, the post-mission (report revision) stage has sometimes proven to be more protracted.** Authorities, mindful of reputation risk, have provided feedback only after addressing some weaknesses identified during the assessment mission in order to ensure that the report reflect their actions. In some instances, this has resulted in delay as jurisdictions have had to enact legislative changes. Most OFC jurisdictions are expected to agree to publish as they view publication as an important element in maintaining their reputations as financial centers.

21. **Technical assistance was viewed as making an important contribution to the improvement of supervisory standards in OFCs and of consolidated supervision onshore.** It could be provided at any stage in the assessment process, including for the completion of the initial assisted self-assessment (Module 1 assessments).

## B. Results of the Program

22. **Forty-four jurisdictions were contacted in the context of the assessments.** While there is no widely agreed definition of an OFC,<sup>13</sup> nor a definitive list of offshore

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<sup>10</sup> According to Article XXXI, Section 2(g), a Fund member is responsible for its dependent territories' compliance with membership obligations: "*By their signature of this Agreement, all governments accept it both on their own behalf and in respect of all their colonies, overseas territories, all territories under their protection, suzerainty, or authority, and all territories in respect of which they exercise a mandate.*"

<sup>11</sup> While nonmembers are not subject to any obligations under the Fund's Articles of Agreement, the Fund may provide policy advice and technical assistance if so requested by the nonmember jurisdiction.

<sup>12</sup> The FSAP was still in its pilot phase when the OFC program was initiated.

<sup>13</sup> For a discussion of possible definitions see SM/00/136.

jurisdictions, the jurisdictions contacted were those known to have significant cross-border business addressed to nonresidents or with offshore financial legislation. Jurisdictions that had recently participated in the FSAP were not contacted for assessment.

23. **Forty-one of the 44 jurisdictions contacted have had, or will have by end-2003, staff-led Module 2 assessments or assessments under the FSAP** (Appendix III, Tables 1 and 2).<sup>14</sup> The large majority of jurisdictions have had Module 2 assessments (i.e., that evaluated compliance with supervisory standards). The response from jurisdictions has been broadly positive. In line with the Board's directive in BUFF/01/176, the pace of assessments accelerated in 2002, and 22 assessments were undertaken compared with nine in 2001. As a result, the current phase of the program is near a very satisfactory completion. Assessment status is summarized below (for details see Appendix III).

Summary Status of OFC Assessments	
Jurisdictions contacted since start of assessments	44
Assessments completed, ongoing, or under review	33
By the FSAP	8
By Module 2	25
<i>Of which:</i> Finalized or being finalized	20
<i>Of which:</i> Published or to be published 1/	15
Assessments scheduled or planned for CY 2003	8
Assessments expected in CY 2004	1
Jurisdictions offered TA in lieu of assessments	2
<i>Of which:</i> Response awaited	1
Total	44

1/ Includes both jurisdictions that have requested publication and staff estimates.

### C. Assessment Findings

24. **This section provides the results of the findings on compliance with standards assessed in banking supervision and AML/CFT, as well as, where appropriate, insurance and securities regulation.**<sup>15</sup> These findings reflect assessments in virtually all

<sup>14</sup> Table 2 lists all jurisdictions with international or regional financial centers which have had FSAPs. Two of these, Morocco and the United Kingdom, are not considered in the context of the program.

<sup>15</sup> The oversight of companies and trusts was assessed in five jurisdictions on the basis of pilot use of a format developed by the Overseas Group of Banking Supervisors (OGBS). Much of the questionnaire duplicated items assessed by the AML/CFT methodology and included items whose assessment goes beyond the usual work of the Fund. It was therefore decided that further extending the scope of the assessment would not be useful.

important OFCs, with one exception scheduled for later in 2003, and the other, which is presently underway. The detailed results are provided in Appendix IV. A brief description of the technical assistance to OFCs is also provided.<sup>16</sup>

25. **In general, OFC assessments have identified supervisory deficiencies that are similar to those in the overall population of countries that have been assessed by the Fund in its financial sector work.** They include shortcomings in the independence of the regulator and constraints on both the level and quantity of technical supervisory skills. The increasing complexity of financial instruments and structures, including rules governing AML/CFT, are further increasing the pressure on supervisory capacity in many OFCs. Weakness in onsite and offsite inspections is a general theme of the assessments in banking, insurance, and AML/CFT in many OFCs. These inspections are the backbone of supervision and several of the noncompliant jurisdictions have begun implementation of an upgrading exercise which will need to be monitored.

26. **Larger, wealthier jurisdictions generally meet very high supervisory standards while the developing countries with OFCs must make a considerable effort to improve their supervision.** Many of the wealthier jurisdictions, concerned about reputation risks, implemented significant reforms to strengthen their supervisory or regulatory systems ahead, or as a result, of the initial OFC assessments, and before finalization of the assessment reports. Significant shortcomings against international standards were identified in poorer jurisdictions, and lacking resources, several have responded in part by reducing their offshore activities (Appendix V provides examples of actions taken by jurisdictions as a response to the assessments).

### ***Banking supervision***

27. **Compliance with the 25 Basel Core Principles (BCP) was found to be quite strong in the majority of jurisdictions.** Two thirds (20) of the assessed OFCs satisfy over 21 BCPs (Table 3).

28. **Eleven of these OFCs are advanced economies whose supervision compares favorably with that of other advanced economies assessed to date.** As noted above, these jurisdictions have made major, and generally successful efforts to improve their supervision. All of the 11 high-income OFCs meet the licensing, money laundering, global consolidated supervision, and host country supervision principles, and most comply with the supervision of foreign bank establishments, these being the principles judged most relevant to their reputations as financial centers. Shortcomings in compliance with standards were found in areas such as oversight of banks' market and other risk controls; but, in view of the type of

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<sup>16</sup> Technical assistance missions have been judged a cost-effective alternative to assessment in two small jurisdictions whose deficiencies are already known.

businesses undertaken, assessors judged the shortcomings of limited materiality to the jurisdictions' banking business.

29. **One third of the assessed OFCs complied with fewer than 15 BCPs, and these are mainly poorer jurisdictions.** Areas requiring strengthening were (Tables 4 and 5):

- onsite and offsite supervision where more formal procedures and training were required;
- supervisors' monitoring of banks' risk-management systems; and
- operational independence of, and resources allocated to the supervisor.

30. **Concerning home country consolidated supervision,** FSAP results show that advanced economies are largely compliant with the BCPs related to cross-border consolidated supervision (including licensing, the supervision of banks' country-risk management, consolidated supervision of the banking group, supervision of the overall operations of the international banking group, and supervision of the local operations of foreign banks). However, shortcomings in consolidated supervision were identified in many assessments of emerging-market economies.

### *Insurance supervision*

31. **Insurance has proved an important area of offshore innovation,** and supervisory standards are still evolving in some categories. Insurance facilities such as captive insurance, protected cell companies, producer-owned reinsurance companies, and general reinsurance, all have large or even their major operations in offshore locations.<sup>17</sup>

32. **The generally high rates of compliance seen for the banking sector are not found in insurance supervision which in OFCs, as more generally, lags behind banking supervision.** The assessments of insurance are conducted against the IAIS Principles. These principles, however, apply imperfectly to some OFC activity e.g., reinsurance and captive insurance.<sup>18</sup> Standards for reinsurance supervision are in the process of adoption by the IAIS. Nevertheless, 80 percent of the 19 jurisdictions assessed were observant of the current

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<sup>17</sup> A captive insurance company is a separate legal entity which provides insurance for a noninsurer parent company's, and other corporate group members' risks. Protected cell captives, or rent-a-captives, enable several insured to share captive facilities with the businesses segregated from each other into cells. Reinsurance provides insurance for insurance companies' risks and producer-owned reinsurance companies are a specialized form of reinsurance captive.

<sup>18</sup> However, there is an emerging view in the IAIS that captives should be supervised on the same basis as other companies.

principles most important to offshore business—licensing, cross-border business operations, and coordination and cooperation. The most widespread weaknesses were found in the following (Tables 6 and 7):

- onsite inspections, which were affected by inadequate staffing and insufficiently detailed examinations; and
- internal controls supervision, which was impeded by a lack of guidelines and onsite inspections.

### *Securities regulation and supervision*

33. **Securities regulation and supervision is reasonably effective but has some notable shortcomings.** Securities regulation was assessed against the IOSCO Objectives and Principles in only the 15 advanced and middle-income OFCs with significant securities activity. The important principles in OFC securities business are those addressing information sharing and cooperation, market intermediation, and collective investment schemes. About two-thirds of jurisdictions had implemented the principles related to information sharing and cooperation, as well as the entry, prudential, and management principles for market intermediary regulation (Tables 8 and 9). Collective investment scheme regulation was well implemented in about 80 percent of the concerned OFCs. Shortcomings were noted in the following areas:

- lack of an effective compliance program;
- inadequate supervisory powers arising from limited legislation and a lack of resources; and
- insufficient provisions for market intermediary failure—there was no contingency plan and inadequate regulatory powers.

### *Anti-money laundering and combating the financing of terrorism*

34. **Most of the 13 jurisdictions assessed using the October 2002 methodology had a developed AML/CFT framework, although shortcomings in implementation and in laws addressing the financing of terrorism were noted.**<sup>19</sup> In some cases, strengthened anti-money laundering measures require improved regulation and better supervision, including more staff and systems for effective compliance monitoring. The main areas that require strengthening are (Tables 10 and 11):

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<sup>19</sup> The assessments rate a total of 35 of the FATF 40+8 Recommendations because some recommendations relate to areas that are not assessable. These assessments form part of the pilot program of assessments under the methodology, which will be reported on in early-2004.

- attention to unusual transactions, transactions with risky countries, and supervision of implementation of AML measures;
- procedures to verify the identity and background of customers; and
- consistent establishment and implementation of AML/CFT laws and regulation across all sectors.

35. **Compliance with recommendations against terrorist financing was weaker than those against money laundering**, in part, because shortfalls in legal measures to deal with terrorist financing affected all areas. Work was required on:

- increased assistance in international efforts against terrorist financing through removing, for example, impediments in their extradition legislation; and
- ratification of the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism and implementation of Security Council resolutions to prevent terrorist financing.

#### ***Technical assistance***

36. **Technical assistance has been provided to help authorities address assessment recommendations.** Technical assistance has been provided to 19 jurisdictions and has addressed chiefly banking and AML/CFT regulation and supervision. Key areas include resolution frameworks for problem banks to help jurisdictions exit from offshore banking; enhancing bank supervision *inter alia* through training; upgrading bank regulations; strengthening the AML/CFT regime; and assistance to conduct self-assessments. Where TA has focused on legislative drafting, the Legal Department has taken the lead. In many cases, TA has been provided on a regional basis through technical assistance centers that have been established by the Fund in partnership with bilateral donors and other international institutions, or in the form of workshops in cooperation with bilateral and multilateral agencies. A few (lower income) jurisdictions have also received TA in the form of long-term resident experts to help build their supervisory capacity.

#### IV. GOING FORWARD

37. The Board Decision of 2000 (BUFF/00/98) requested that the staff revisit the subject of OFCs to consider how the role of the Fund should evolve consistent with its mandate, expertise, and resources. This section examines how the program could evolve. Section V discusses the resource costs and implications.

38. Actions in anticipation of, and in response to the assessments, as well as a May-2003 roundtable discussion among standard setters and onshore and offshore supervisors,<sup>20</sup> confirm the effectiveness of the program in upgrading supervisory and financial integrity standards. Assessment results and the roundtable discussions identified the maintenance and/or upgrading of compliance with international supervisory and integrity standards; enhancing cooperation and information sharing between OFCs and the onshore jurisdictions; and improving information dissemination by OFCs as priorities for future OFC work. While onshore and offshore supervisors have primary responsibility for ensuring effective supervision and regulation in OFCs, participants in the roundtable affirmed the important role that the Fund has played in conducting assessments and providing technical assistance, and supported making the OFC program an integral part of the work of the Fund.

39. Accordingly, and given the priorities indicated for OFC work, staff proposes that the Fund's role would involve the following four elements elaborated below:

- regular monitoring of OFCs through offsite analysis, and risk-focused and periodic assessment missions;
- improving the transparency of OFC supervisory systems and activities;
- providing technical assistance in collaboration with bilateral and multilateral donors to strengthen supervisory and regulatory systems; and
- collaborating with the standard setters and the onshore and offshore supervisors to strengthen standards and exchanges of information.

These elements draw on key areas of Fund expertise and experience, as well as on existing initiatives.

##### A. Monitoring OFCs

40. **Monitoring of OFCs' activities and their compliance with supervisory and integrity standards would become a standard component of the financial work of the Fund.** The major elements of the monitoring program would be:

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<sup>20</sup> The roundtable discussion involved onshore supervisors from the G7, major OFCs, and standard setting bodies (Basel Committee, IOSCO, IAIS, and FATF).

- **Development and maintenance of information on the main activities in OFCs** and their significance to the international financial system. Staff would maintain and update a list of jurisdictions classified by their size and type of cross-border financial activity. This would help identify jurisdictions for assessment and updates (see below). Factual classifications of jurisdictions by size and activities would also help to avoid negative connotations from inclusion on an “OFC list.”
- **Immediate priority would be given to completing the current round of assessments and to updating AML/CFT assessments.** Staff would propose updating AML/CFT assessments of jurisdictions that received assessments prior to the current comprehensive methodology.<sup>21</sup>
- **Risk-focused<sup>22</sup> assessments of jurisdictions tied to issues of specific concern.** Risk-focused assessments and monitoring visits could target jurisdictions identified as having weak supervisory or AML/CFT regimes, and address concerns related to the evolution of new instruments or practices. They could also be triggered, for example, by significant increases in capital flows observed through offsite monitoring. Such assessments or visits would be coordinated with Article IV missions, where relevant.
- **Periodic Module 2 assessments of all OFCs not subject to FSAPs** to update findings on compliance with international supervisory and financial integrity standards. These would focus on a jurisdiction’s most significant sectors, consistent with the ROSC process, and the selectivity and streamlining agreed by the Board in the FSAP context (BUFF/03/43 and BUFF/03/42, respectively). Periodic assessments could be scheduled approximately every four years for jurisdictions not covered by Article IV consultations and FSAP assessments, and could include Module 3 assessments (i.e., comprehensive vulnerability assessments) at the jurisdiction’s request.
- **Close coordination with the FSAP program to identify weaknesses in consolidated supervision.** Both OFC assessments and FSAPs would pay particular attention to verifying the adequacy of home supervision, and to strengthening consolidated supervision.
- **Assessments of OFCs would continue to be voluntary, with the support of members to ensure the success of the program.** Voluntary participation has rarely

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<sup>21</sup> Earlier assessments either predated the methodology with more limited coverage of AML/CFT issues, or were based on an earlier version.

<sup>22</sup> Risk-focused assessments, analogous to risk-based supervision, stress assessment of those areas which are judged to pose the greatest cross-border risk, aiming to ensure that the jurisdiction is taking the appropriate measures to mitigate those risks.

proved a difficulty. In the case of members, issues can be taken up if necessary in the context of Article IV surveillance. Member countries that have important bilateral, especially financial, links with the OFCs have supported and encouraged both member and nonmember OFC jurisdictions to participate in the assessments, and such bilateral support would continue to be critical for the success of the program.

- **The OFC initiative would continue for the time being as a separate program from the FSAP.** This has the following advantages. It would continue to allow for a focused program drawing on the synergies involved in assessing a group of jurisdictions that raise common concerns for the international financial system. Many OFCs are nonmembers, or the dependent territories of members, which do not have Article IV consultations. Monitoring on a more frequent cycle than the roughly ten-year cycle foreseen for comprehensive FSAPs (SM/03/77) is warranted by the continuing concerns about OFCs' compliance with supervisory standards. In addition, the main products of the program, the Module 2 or Module 3 assessments, add value compared to stand-alone ROSCs by providing an overview of the supervisory arrangements and prioritized recommendations for strengthening these arrangements that take account of the overall business activity in the jurisdiction. OFCs have raised a concern about the consequences to their reputations of maintaining a separate OFC program. Staff would address this concern by modifying the classification of jurisdictions (i.e., to focus on factual descriptions of jurisdictions' size and activities as outlined above). Future evaluations of the OFC and FSAP programs would review the relationship between the programs.

## **B. Promoting Transparency in OFC Activities**

### **41. Improving transparency in OFC activities helps market discipline and provides incentives for OFCs to meet international supervisory and integrity standards.**

Publication of the assessment report on the Fund's website informs the market and external supervisors about the state of supervision in the jurisdiction assessed, allowing them to make better-informed financial and supervisory decisions. The following procedures could help improve transparency in the findings of OFC assessments during the next phase of assessment:

- **To enhance transparency, staff would propose to reclassify the Module 2 main reports as staff reports.**<sup>23</sup> Under current technical assistance procedures, Module 2

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<sup>23</sup> Module 2 reports currently have two volumes—a main report, Volume I, akin to the FSSA, that includes summary assessments of compliance with codes and standards, and Volume II, the detailed assessments of standards. As staff reports, Module 2 main reports would contain a description of financial center activities and of the supervisory system, ROSCs, and prioritized recommendations for correcting any deficiencies identified in ROSCs. The ROSCs would conform fully to ROSC specifications.

main reports and summary assessments of compliance with standards can be made available to the Board for information with the approval of the jurisdiction. As staff reports, all Module 2 main reports would be circulated to the Board, including the ROSCs. They would be subject to a policy of voluntary publication, as are FSSA reports and ROSCs. Summaries of any stand-alone assessments of codes and standards prepared, for example the updated AML/CFT assessments, would also be circulated to the Board in the form of ROSCs. Reports on other technical assistance provided to the jurisdiction, e.g., to prepare for assessments, would continue to be handled under the standard technical assistance guidelines.

- **Staff would provide, for Board information and subsequent posting on the Fund's website, periodic updates of the number and types of assessments carried out.** These periodic updates would replace the current six-monthly progress reports to the Board on the OFC program.
- **Staff would work with OFCs to improve information dissemination by the jurisdictions themselves.** Jurisdictions acknowledge that the lack of information is a source of international disquiet. They have asked the Fund to assist them in their dissemination efforts.

### C. Strengthening Technical Assistance

42. **In lower-income jurisdictions, extended technical assistance, in collaboration with bilateral and multilateral donors, will be needed to build the necessary institutional capacity for effective supervision.** Technical assistance by the Fund would need to be judiciously extended. The one third of jurisdictions that have weak supervisory arrangements are, in the main, countries with low income and few resources. Staff is examining how best to address supervisory and regulatory requirements in small jurisdictions, including, whether there is scope for possible outsourcing of these functions with bilateral assistance from members with important financial links to the jurisdiction. In cases where jurisdictions conclude that the costs of achieving the internationally required supervisory standards exceed the benefits, if requested, staff would provide technical assistance to advise on the process for winding up. Bilateral and multilateral TA programs will continue to form a major component of technical assistance to OFCs.<sup>24</sup>

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<sup>24</sup> This includes regional technical assistance agencies (CARTAC and PFTAC), the JSA, FIRST Initiative, and other funds provided by bilateral donors (e.g., The Netherlands).

#### **D. Collaboration with Standard Setters and the Role of Onshore and Offshore Supervisors**

43. **The success of the OFC program would continue to rely on close collaboration with the standards setters and the onshore and offshore supervisors.** Key elements include:

- **The continuing development of relevant standards and best practices** by the standard setters. Going forward, staff would continue to identify areas from its assessments that may require further guidance from the standard setters.
- **Strengthening information sharing arrangements.** The Fund with its broad constituency could facilitate discussions on how to strengthen information exchange in collaboration with the standard setters and onshore and offshore supervisors. The work would focus initially on identifying the major impediments to effective information exchange and possible solutions.<sup>25</sup>
- **Future roundtables.** Continuation on a 12-month cycle of roundtable discussion among onshore and offshore supervisors and standard setters would contribute to the goal of strengthened cooperation.

44. **Notwithstanding the contributions of the Fund, onshore and offshore supervisors will continue to have the key responsibility for upgrading supervisory and integrity standards in OFCs.** Onshore supervisors have key responsibilities for:

- **Enhancing their home country consolidated supervision,** especially in emerging markets.
- **Incorporating the findings of the OFC program into their work,** e.g., by giving special attention to the operational and money laundering risks of banks engaged with counterparts in OFCs that do not have adequate AML/CFT provisions in place.
- **Cooperating with the offshore supervisors** to develop effective lines for communication.

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<sup>25</sup> While extensive guidance from standard setters is available, outstanding issues that have been identified include (a) finding ways to share information while protecting legitimate rights to privacy and supervisors' confidentiality obligations; (b) sharing information among supervisors of different sectors (e.g., between banking and securities regulators); (c) sharing information for regulatory, compliance, and law enforcement purposes; (d) the complexity of multiple gateways for information exchange; and (e) consistency in the treatment of information exchange in international standards.

Offshore supervisors have the key responsibilities to upgrade their supervisory and regulatory systems to meet the international standards and to cooperate with onshore supervisors.

## V. RESOURCE IMPLICATIONS

45. **The cost of the OFC program to MFD in FY2003 is estimated at approximately \$3.4 million** (Table 12). This represents approximately 7 percent of MFD's total budget in FY2003.<sup>26</sup> This total is comprised of costs related to assessments (excluding FSAPs), technical assistance, policy work, and overhead with assessments and technical assistance comprising approximately 90 percent of the total costs. The average cost per Module 2 assessment is estimated at about \$150,000, including costs associated with time spent at headquarters related to the assessments.

46. **The cost of the OFC program in FY2004 is expected to decline relative to FY2003.** This reflects a drop in expert costs related to a smaller number of assessments compared with the previous year, given the near completion of the original round of assessments—only 3 Module 2 assessments are planned for FY2004 compared with 14 in FY2003. Some of this decrease in assessments will be offset by an increase in technical assistance—technical assistance missions are expected to increase to 12 in FY2004 from 5 in FY2003. In addition, other elements of the work plan include: (a) the completion of the outstanding OFC assessments; (b) update of AML/CFT assessments in jurisdictions assessed prior to adoption of the comprehensive methodology; and (c) development of information on main OFC activities.

47. **In the steady state, if the monitoring of OFCs becomes a regular component of Fund work, the annual resource needs are projected at about the average of costs in FY2003 and FY2004.** Staff proposes to rebalance its use of resources by reducing the number of annual full assessments (in which supervision in all significant sectors is assessed) compared to FY2003 while introducing offsite monitoring of OFC activities combined with risk focused assessments (in which issues of specific concern are addressed) that are less resource intensive compared to full assessment missions. Provision of technical assistance will focus on poorer jurisdictions, and staff will encourage them to seek more bilateral support.

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<sup>26</sup> The cost of travel and short-term experts of the Legal Department in OFC work, related mainly to AML/CFT in FY2003, was approximately \$139,000.

## VI. ISSUES FOR DISCUSSION

48. In considering how the OFC program should evolve, Executive Directors may wish to comment on the proposals outlined by staff in paragraphs 40–44:

- *Do Directors support making the monitoring of OFCs an integral part of the work of the Fund? Do Directors agree with the proposed approach as outlined in paragraph 40?*
- *Do Directors agree with the proposals to increase transparency of assessment results and jurisdictions as outlined in paragraph 41?*
- *Do Directors support continued technical assistance to OFCs as described in paragraph 42?*
- *Do Directors agree with the proposals on collaboration with standard setters and onshore and offshore supervisors and the critical responsibilities of onshore and offshore supervisors outlined in paragraphs 43–44?*

### Significance of OFCs in the International Financial System

The BIS and CPIS statistics provide information on the relative size of cross-border financial activity that is undertaken through entities in OFCs. The BIS statistics include gross and net positions of international claims and liabilities of banks in reporting jurisdictions vis-à-vis banks and nonbanks in other jurisdictions. Participants in the CPIS report their cross-border holdings of equities and long- and short-term debt securities at current market prices together with a geographic breakdown according to the country of residence of the issuer. The table below shows the claims of jurisdictions reporting to the BIS and CPIS vis-à-vis OFCs.

Claims on Offshore Financial Centers as reported in BIS and CPIS Statistics.<sup>1</sup>

	(In trillions of US dollars)	
	End-2001	End-2002
BIS		
Locational <sup>2</sup>	2.5	2.8
Consolidated <sup>3</sup>	1.7	1.8
Ultimate risk <sup>4</sup>	1.6	1.7
CPIS <sup>5</sup>	1.8	...

Sources: Bank for International Settlements (BIS); Coordinated Portfolio Investment Survey (CPIS); and staff estimates.

#### Notes:

<sup>1</sup> The OFCs included in these calculations are the jurisdictions for which data is available and that are assessed under Module 2 and the FSAP shown in Tables 1 and 2 in Appendix III, with the exception of Morocco and the United Kingdom.

<sup>2</sup> Gross on-balance sheet asset and liability positions of banks in (currently 36) banking centers vis-à-vis banks and non-banks in other jurisdictions. The reporting basis of the statistics is residence of the reporting bank.

<sup>3</sup> Intragroup positions are netted out by the consolidated banking statistics which report international financial claims by nationality of bank head offices in jurisdictions. The reduction in consolidated claims is likely to be underestimated because only 27 of the 36 reporting jurisdictions provide such data. The consolidated banking statistics measure only contractual claims.

<sup>4</sup> Ultimate risk claims take account of guarantees and collateral, to identify the jurisdictions whose resident (bank counterparty) will be ultimately responsible for repayment of the claim. However, this definition is not yet consistently applied by all reporting jurisdictions. See BIS, *Guide to the international financial statistics*, February 2003.

<sup>5</sup> The CPIS, which was conducted in 1997 and 2001, is now an annual survey. In 2001, 67 countries participated in the survey. The reporting basis for the data is the residence of the reporting institution. Data for end-2002 will be available later in 2003. See SM/03/97 and <http://www.imf.org/external/np/sta/pi/cpis.htm>.

## Design and Scope of Assessments

The OFC program was designed to be a step-by-step process and sufficiently flexible to adapt to requirements of various jurisdictions. Prior to the start of assessments, an outreach exercise in which virtually all OFCs participated, was undertaken in August/September 2000. The program offered jurisdictions the option of beginning with a self-assessment (Module 1) with the scheduling of a Fund-led assessment dependent on (a) the authorities' need to balance limited resources; (b) mutually acceptable assessment timing; and (c) an adequate preparation period. The program also took account of the fact that assessments would involve not only members but their dependent territories and nonmembers. Depending on the circumstances, the Fund staff-led assessments take the form of, either a Module 2 assessment or of an assessment under the FSAP (or Module 3 assessment in the case of nonmembers).

**Module 1.** Authorities carry out a self assessment of compliance with particular standards to be undertaken with technical assistance as needed. The resulting assessment is the responsibility of the jurisdiction.

**Module 2.** Typically, it involves assessing the compliance of supervisory and regulatory systems with international standards in the banking sector, and, if significant, in the insurance and securities sectors. It also evaluates the effectiveness of the anti-money laundering and combating of the financing of terrorism (AML/CFT) regime. Banking supervision is assessed relative to the Basel Core Principles for Effective Banking Supervision (BCP), insurance supervision is assessed relative to the International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP), and securities regulation is assessed relative to the International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation (SCP).

**Module 3 or FSAP.** This is the most comprehensive form of assessment. Besides assessing the observance of supervisory and regulatory standards as described in Module 2, it would also involve assessing cross border and domestic risk and vulnerabilities.

**The scope of the AML/CFT regime assessment has evolved since the start of the OFC program.** The initial aim was to assess all supervisory aspects of money laundering covered by the BCP, ICP, and SCP. Assessments could also include some reference to FATF recommendations but would not cover law enforcement aspects. In April 2001, the Board endorsed the development of a methodology that would enhance the assessment of financial standards relevant for countering money laundering, and which could be used for preparing reports in FSAP and in the OFC program (BUFF/01/54). Subsequently, in November 2001, the Board supported expanding the AML methodology to include aspects relating to combating the financing of terrorism (CFT), legal, and institutional structures (BUFF/01/176). The first draft methodology became available for use in assessments in October 2001, an expanded version that included aspects related to CFT in February 2002, and the final methodology (for use in the 12-month pilot program) in October 2002. Since October 2002, the assessments have used the final methodology endorsed by the Executive Board, which provides a comprehensive method for assessing the implementation of the

AML/CFT regime relative to the international standard—the FATF 40+8 Recommendations. As the methodology has evolved, the most current version has been used by assessors in the program.

**Assessments involve a three-stage process: pre-mission preparation, mission, and report revision, followed by publication.** The sectors to be assessed are decided after a review of activities in the jurisdiction and after consultation with authorities. The assessment team includes either specialist Fund staff, or, more frequently, supervisors from peer jurisdictions, and often takes account of recommendations from the standard setter. The mission is generally two weeks long; at its end, a draft report is left with the authorities on the understanding that its contents are subject to revision. The report is reviewed by the specialist divisions at MFD, functional and area departments at the Fund, and external reviewers as appropriate. The authorities are given an opportunity at every stage to comment.

Table 1. International and Offshore Financial Center Module 2 Assessments

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

Notes: Table 1 updates the information in Table 1 of Executive Board Paper SM/03/97.

1/ Refers to calendar year. The categories in the table have the following meanings:

completed = assessment mission and review have been completed;

scheduled = either a date or a month have been agreed with the authorities. Scheduling is subject to change;

planned = scheduling is under discussion or to be discussed with authorities;

review = assessment undergoing IMF's internal review, receiving comments from authorities, or report being finalized.

2/ Converted to technical assistance mission.

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

4/ See Table 2 for FSAPs.

Table 2: International and Offshore Financial Center FSAPs

Jurisdiction	Year of Assessment Mission 1/				
	1999	2000	2001	2002	2003
Africa					
Mauritius				review	
Asia and the Pacific					
Hong Kong SAR				published	
Singapore				underway	
Middle East					
Lebanon 2/ 3/	completed				
Morocco 3/				published	
Europe					
Ireland 2/ 3/		completed			
Luxembourg			published		
Malta				review	
Switzerland			published		
United Kingdom 3/				published	
Western Hemisphere					
Antigua and Barbuda					planned
Barbados				published	
Costa Rica			published		
Dominica					scheduled
Grenada					scheduled
St. Kitts and Nevis					scheduled
St. Lucia					scheduled
St. Vincent and the Grenadines					scheduled

Notes: Table 2 updates information in Table 2 of Executive Board Paper SM/03/97.

1/ Refers to calendar year. The categories in the table have the following meanings:

review = assessment undergoing IMF/World Bank internal review, receiving final comments from authorities, or report being finalized.

underway = missions are underway, or reports are being prepared for review.

completed = missions and review have been completed.

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

scheduled = either a date or time period has been agreed with the authorities. Scheduling is subject to change.

2/ 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.

3/ These countries have not been contacted since the start of the OFC assessments, or are not included among jurisdictions being assessed under the program.

### Details of the Assessment Results

This Appendix and tables in the Statistical Appendix describe the detailed assessment findings on areas of weak compliance found in banking, insurance, securities, and AML/CFT regulation and supervision. Weak compliance is defined as a finding of noncompliance or of material noncompliance (respectively, nonobservance, or non-implementation for insurance and securities), and is described in terms of the individual principle.

The tables in the Statistical Appendix provide the detailed compliance findings for each standard. The results are provisional, since some of the reports are still being reviewed. Thus, for banking (Basel Core Principles), Table 3 provides the distribution of compliance among OFC jurisdictions, with, for comparison, the distribution found among all jurisdictions assessed.<sup>27</sup> Table 4 shows the rate of compliance by individual principle for all principles, and Table 5 reports the proportions of noncompliance found. Tables 6 and 7 show rates of observance and areas of weak observance, respectively, in insurance supervision relative to the IAIS Core Principles. Tables 8 and 9 show rates of implementation and areas of weak implementation, respectively, in securities regulation relative to the IOSCO objectives and Principles. Tables 10 and 11 show rates of compliance and areas of weak compliance, respectively, in AML/CFT supervision, relative to the FATF 40+8 Recommendations.

The following sections describe, principle by principle for each sectoral standard, viz, Basel, IAIS, IOSCO, and the FATF 40+8 Recommendations, the areas of weakness. These are listed by order of the proportion of jurisdictions found to be noncompliant, for all principles where 30 percent (20 percent in the case of banking) or more of jurisdictions were found to have weaknesses. Thus, for the Basel Core Principles, the section below begins with BCP 12 followed by BCP 16 where the largest proportion of jurisdictions (14 of the 30 and 13 of the 31 jurisdictions assessed, respectively) exhibited weak compliance (Table 5).

#### **Basel Core Principles: Areas of Weak Compliance<sup>28</sup>**

- **Market risk, BCP 12:** Most jurisdictions falling short in this area had no policy on market risks, failed to issue guidelines to banks, or did not monitor banks' own controls. In several cases, additional expertise would be required for adequate supervision, Materiality was, however, questioned in some cases.

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<sup>27</sup> There is some overlap with the OFC assessments, but the latter include assessments that are being finalized while the general databases take account, with a lag, only of completed reports.

<sup>28</sup> Areas of weak compliance are reported for principles with which 20 percent or more of jurisdictions were found to be noncompliant.

- **Onsite and offsite supervision, BCP 16:** Other principles, such as the supervision of credit risk were cited in this context. In general material noncompliance resulted in (a) inadequate quality, stemming from, for example, a lack of formal procedures for the inspectors, a lack of staff training, and a lack of sufficiently detailed information; and (b) quantity, for example, infrequent onsite visits because of a lack of resources and trained staff. In two cases, the high proportion of shell banks prevented effective supervision.
- **Credit policies, BCP 7:** A lack of guidelines, procedures for evaluation, and inadequate review resulting from infrequent onsite visits, or a failure to verify audit work were frequently cited. In several cases, new supervisory systems had not yet implemented relevant procedures. The presence of shell banks and the lack of staff resources restricted supervision in other cases.
- **Other material risks, BCP 13:** Jurisdictions had no supervisory arrangements, financial reporting, or prudential requirements in place. In some cases, the assessor noted that there was too little information about the banks to assess the materiality of the principle. In other cases the shortcomings were the absence of detailed testing techniques or guidelines for special risks.
- **Country risks, BCP 11:** In most cases of noncompliance, neither country nor transfer risk were monitored or no guidance was provided to banks. In one case, the legal framework did not provide a sufficient basis for the supervisor to define and control these risks.
- **Loan evaluation and loan-loss provisioning, BCP 8:** The weaknesses stemmed from supervisors' failure to issue specific guidelines for loan classification, for procedures for asset quality evaluation, or for regulations requiring banks to adhere to adequate practices. Insufficient verification of loan policies and credit risk, mainly due to infrequent onsite visits, were also cited.
- **Independence and resources, BCP 1.2:** Ministers/government officials were too often involved in key decisions, or were able to instruct, ignore advice, or exert budgetary control. In other cases, legislation did not provide sufficient safeguards for supervisory independence and resources. Insufficiently trained or senior staff, as well as understaffing, were also cited.
- **Acquisitions and investments, BCP 5:** Laws did not provide the supervisor with the power to approve major investments, and no guidelines were provided to banks. In addition, no, or too narrowly defined, criteria were established for reviewing major acquisitions, and in other cases the existence of unsupervised companies allowed banks to evade prudential limits, or the supervisor did not review banks' acquisition, though authorized to do so.

- **Connected lending, BCP 10:** In some jurisdictions, no restrictions were placed on connected lending, or information on lending to connected parties was not reported. Other jurisdictions did not have adequate definitions of related parties, or the supervisor did not have the authority to judge a loan connected. Shortcomings also resulted from the narrow scope of the regulation.
- **Capital requirements, BCP 6:** In the majority of noncompliant cases, capital adequacy ratios were not applied to offshore banks. In other cases of noncompliance, the calculation of risk-weighted capital did not take account of market risk, or reporting was not on a consolidated basis, or the required ratio was too low.
- **Large exposures, BCP 9:** In most cases no guidelines on exposure limits were provided to banks, or reporting did not provide sufficient information for concentrations to be identified. In addition, closely related parties were not defined, or the supervisor had insufficient discretion in determining them. In two jurisdictions with shell banks, no limits were set on large exposures.
- **Accounting and disclosure, BCP 21:** Accounting standards in audit procedures to be used by banks were not laid down by the supervisors. In two jurisdictions, offshore banks were not obliged to publish their annual accounts, or branches published only group accounts. In other cases, material noncompliance reflected the supervisors' lack of the necessary legal authority to ensure verification of banks' accounts or did not have sufficient interaction with the auditors.
- **Independent validation, BCP 19:** Independent validation was mainly found to be prevented by the absence of coherent onsite inspection programs and independent monitoring of the auditor. In other cases, banks' prudential returns were not checked. In one case, the supervisor did not have the requisite authority to inspect offshore banks.
- **Information sharing, BCP 1.6:** Explicit legal gateways for information sharing cross-sectorally with both domestic and foreign supervisors setting out the conditions for sharing customer information, were required in most cases of noncompliance. The need for more details on the conditions for information sharing were also cited. In two cases, secrecy laws blocked information sharing.
- **Internal controls, BCP 14:** Noncompliant systems had no guidelines, regulations, or laws regarding the responsibilities of boards of directors. Other supervisors conducted onsite visits too infrequently or in too little detail to adequately monitor internal controls.
- **Money laundering, BCP 15:** Supervisors' surveillance required improvement to ensure banks' compliance, legislation, and its enforcement required improving, and better outreach and communications with the industry were required.

### IAIS Core Principles: Areas of Weak Observance<sup>29</sup>

- **Onsite supervision, ICP 13:** Onsite inspections were not undertaken, or included insufficiently detailed examinations. In some cases, this resulted from inadequate resources.
- **Internal controls, ICP 5:** Supervisors did no appraisal of internal controls—either at licensing or through onsite supervision. Regulations were also found to be inadequate.
- **Market conduct, ICP 11:** There was no legal provision for regulating market conduct only for prudential supervision. In other cases, supervisors had not issued guidelines or codes of conduct for market intermediaries and/or brokers.
- **Corporate governance, ICP 4:** Even where the legislation appeared to permit the supervisor to regulate for corporate governance, supervisors had not issued guidelines or regulations to the industry.
- **Organization of an insurance supervisor, ICP 1:** The main reason for nonobservance here was excess involvement of the government in the directorship or management of the supervision agency. In addition, staffing was inadequate and/or the supervisor’s resources were dependent on the government budgetary process.
- **Derivatives and “offbalance-sheet” Items, ICP 9:** Supervisors did not require companies to report offbalance sheet items and/or did not regulate them. In some cases they set no disclosure requirements or rules for auditors.

### IOSCO Objectives and Principles of Securities Regulation: Areas of Weaker Implementation<sup>30</sup>

- **Effective compliance program, SCP 10:** In both markets where the deficiency was found, it resulted from the lack of proactive inspections of market participants, partly because of a lack of staff and training (new regulatory agency), and partly, as a result of the low volume of activity.
- **Equal property rights, SCP 15:** Legislation made insufficient provision for fair and equitable treatment of security holders in one jurisdiction. Partial implementation

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<sup>29</sup> Areas of weak observance are reported for principles of which 30 percent or more of jurisdictions were found to be nonobservant.

<sup>30</sup> Results are reported for all nonimplemented principles or for those principles which 30 percent or more of the jurisdictions had only partially implemented.

- resulted from insufficient information provision to shareholders in two jurisdictions and from the need to strengthen minority shareholder rights through regulations governing related party transactions, or corporate governance rules in two others.
- **Market intermediaries: Prudential requirements, SCP 22:** A jurisdiction failed to impose adequate prudential requirements, such as risk based liquid asset requirements, for market intermediaries.
  - **Cooperation with foreign supervisors, SCP 13:** Legislation made insufficient provision for cooperation with foreign regulators in one jurisdiction.
  - **Market intermediaries: Failure, SCP 24:** In five of the jurisdictions, there was no contingency plan to deal with the failure of a market intermediary. In addition, the regulator lacked adequate powers; it had no procedures in place to deal with failure, or its role and that of other supervisors was unclear in the event of a failure of an intermediary, or there was no investment protection guarantee scheme.
  - **Oversight of self-regulatory organization (SRO), SCP 7:** Powers in this area required reinforcement, including by instituting a full licensing regime, or by clarifying the division of responsibility between the SRO and the regulator. Asset management by trustees required supervision.
  - **Supervisory powers, SCP 3:** There was a lack of resources, and the legislation does not always provide all the powers envisaged by the SCP Principles. In one instance, secrecy provisions were found to limit the ability of regulators to perform their regulatory function, and in another jurisdiction, regulatory powers are dispersed across different bodies. Other regulators required more powers to regulate or a clarification of their powers with respect to the securities depository, and clearing and settlement. Four of these jurisdictions are in the process of addressing this weakness, including through legislative steps.
  - **Management of large exposures, SCP 29:** The procedures for regulation and supervision of the exchange had incomplete coverage, or confirmation was required that existing law protects customers' trades in the event of market intermediary default, or exposure limits for brokerage firms needed to be better defined.
  - **Independence and accountability of the regulator, SCP 2:** The lack of operational independence was mainly because government retained the power for enacting rule changes and applying sanctions, or to give direction to the regulator. A further cause was reliance on government in staff appointments to the regulatory body. In addition, the lack of budgetary independence in all jurisdictions makes the regulatory body somewhat open to government influence.
  - **Clearing and settlement system, SCP 30:** The legal arrangements for the institutional infrastructure of the clearing and settlement system and its supervision

were not well-based, or oversight was faulty, with an inspection program and reporting for the system required, or the system in place had both credit and settlement risk, although a new system was planned.

- **Regulatory powers, SCP 8:** In two cases, there was a lack of adequate resources. In the remaining four jurisdictions, the law did not provide explicit or sufficient powers. For example, the law did not provide explicitly for routine inspections so the regulator conducted inspections under the authority implicitly in its general mandate, or the law did not permit entry and search, and only inspections of licensed participants were permitted. The regulator also required additional inspection and investigative powers, or authority to inspect trustees acting as asset managers. In addition, secrecy provisions in the laws of one jurisdiction limited the effectiveness of inspections.
- **Disclosure of issuers, SCP 14:** There were lags in disclosure, or insufficient disclosure, or the regulator had insufficient powers to obtain adequate disclosure from issuers who do not list.
- **Information sharing mechanisms, SCP 12:** In one case, the restrictions on information sharing also affected the setting up of mechanisms for sharing information. In another jurisdiction, although there was informal cooperation among domestic supervisory and regulatory bodies on a case-by-case basis, there was a need to formalize the arrangements. In the other two jurisdictions, there was a need to establish Memoranda of Understandings (MOUs) with key foreign counterparties—these would facilitate and permit the sharing of information under clear guidelines.
- **Market intermediaries: Management, SCP 23:** In three of the jurisdictions, there was concern about adequate investor protection. In two jurisdictions, the regulations on internal control and standards for asset managers need to be strengthened and guidelines issued. There was also concern about compliance with the issued guidelines. In addition, in one case, investor protection could be improved with additional rules on disclosure of conflict of interest.
- **Information sharing, SCP 11:** In general, sharing of information with domestic counterparts is possible. However, in two jurisdictions the legal basis, conditions under which information can be shared, and with which counterparties it can be shared, is not clear. Sharing of information with foreign counterparts faces additional obstacles. These included the requirement for court permission and the foreign counterpart's agreement not to share that information with any other authority (such as judicial authorities). Secrecy provisions in two jurisdictions also impede the sharing of information with foreign counterparts.
- **Control of manipulation and unfair trading practices, SCP 28:** There were no laws or rules to control insider trading or market manipulation, or for over-the-counter trading. In other cases, the regulator needed the proper authority to

monitor market abuses, or did not effect the market surveillance to ensure that rules are observed.

**FATF Forty Recommendations and Eight Special Recommendations on Terrorist Financing—Areas of Weak Implementation:**<sup>31</sup>

- **Special attention given to transactions with higher risk countries, FATF 21:** There was no supervisory requirement that financial institutions should pay special attention to countries with insufficient AML/CFT provisions, or no special guidelines for transactions with such countries. Legal provisions or more specific legal provisions were required.
- **Detection and analysis of unusual, large or otherwise suspicious transactions, FATF 14:** The suspicious transactions reporting system required strengthening by creating legal obligations to make a report, or to monitor and report unusual or complex transactions, and/or by expanding the statistics and analysis of suspicious transactions reports.
- **Adequate AML programs in supervised banks, financial institutions, or intermediaries; authority to cooperate with judicial and law enforcement, FATF 26:** The supervisory authorities needed the powers to mandate regulations for implementation and to carry out the offsite and onsite supervision required for compliance or, where they had such powers, needed to issue the legally prescribed regulations, and implement a full program of AML supervision. Legislation to enhance information sharing with foreign supervisors was also required.
- **Prohibition of anonymous accounts and implementation of customer identification policies, FATF 10:** Jurisdictions had not prohibited anonymous or fictitiously-named accounts or had not confirmed supervisory access to client information. In some cases supervisors should impose more specific customer identification requirements on financial institutions, or tighten provisions on beneficial ownership.
- **Obligation to take reasonable measures to obtain information about customer identity, FATF 11:** Exemptions from customer identification for transactions conducted through a regulated entity required removal. In other cases, there was a

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<sup>31</sup> Recommendations, with which 30 percent or more of jurisdictions were judged noncompliant or materially noncompliant, are reported. Only the results of assessments carried out using the comprehensive Methodology endorsed by FATF and the IMF Board (SM/02/349) are reported here. For results using earlier versions of the methodology, see SM/03/97.

need to prohibit transactions until the identification process is complete, or to introduce an explicit identification, or re-verification of identity, requirement.

- **AML rules applied to branches and subsidiaries located abroad, FATF 20:** Regulations requiring banks to have internal control procedures, and to monitor foreign subsidiaries, or to have group policy were needed. Secrecy laws may also have been an impediment in one case.
- **Provide assistance to other countries' investigations of terrorist financing, SR V:** The legislative mechanisms to allow for extradition for alleged terrorist financing were not in place or were impeded in some way. More specific provision for search and seizure was required. In one case, the failure to criminalize terrorist financing would have prevented operation of mutual assistance treaties that required dual criminality.
- **Impose AML requirements on alternative remittance systems, SR VI:** One of the two countries in which this special recommendation was assessed did not impose such requirements, but applicability was questioned.
- **Strengthen customer identification measures for wire transfers, SR VII:** Jurisdictions had not made it mandatory to effect enhanced scrutiny of wire transfers without complete originator information, or to include such information on funds transfer. Some agencies were not supervising the implementation of such scrutiny. In another instance, while a record of the information was required, wording of the regulation did not mandate that the information be kept with the wire transfer.
- **Take steps to ratify and implement relevant United Nations instruments, SR I:** The UN Convention for the Suppression of Terrorist Financing had not been ratified.

### **Examples of Actions taken by Jurisdictions in Response to the OFC Program**

**Banking sector:** In response to the assessment, the jurisdiction took steps to improve compliance with the BCP. Aware of the need to maintain a favorable reputation, in many cases the authorities have been trying to improve compliance despite having been assessed largely compliant in relation to the BCP. While some reforms are completed others are ongoing. Actions included hiring external advisors to train staff, improving mechanisms to share information between banks and supervisors, and developing an early warning system. Progress on such actions has been posted on the authority's website.

**Information sharing:** The assessment noted that there were no formal arrangements in place for sharing information across domestic agencies and across borders. The authorities established a committee following the assessment to formalize a gateway for information flow across supervisory agencies. While it adequately formalized the gateway across cross-border agencies, it did not cover all domestic agencies. Thus, information exchange across domestic agencies needs to be further formalized.

**Shell banks:** Following the assessment, the authorities enacted a new banking act for offshore banks. The new act provides a basis to establish internationally accepted supervisory practices. It provides the supervisory authorities with broad powers to issue and revoke licenses, conduct on-site examinations, request data, place limits on type and nature of business undertaken, and issue directives and prudential guidelines. As a result, a major consequence was that all banks which are not affiliated to any financial services group that is subject to effective consolidated supervision are now required to maintain a physical presence (i.e. meaningful mind and management) in the jurisdiction consistent with the recommendations on shell banks issued by the Basel Committee on Banking Supervision.

**Offshore banking:** The authorities are considering exiting from the business of licensing offshore banks based on a self assessment undertaken with assistance from experts. The jurisdiction has a relatively tiny offshore banking center with no effective prudential regulation and supervisory arrangements. The assessment indicated that to establish internationally accepted minimum standards of bank supervision, it would require substantial resources. Given the limited resources and the current size of the offshore banking sector, the authorities intend to cease offshore banking activity.

**AML/CFT:** The assessment found that while the overall framework for an AML/CFT regime was in place, there were areas that could be strengthened. For example, supervisory authorities should increase the frequency of onsite exams, specifically targeting AML inspections of underreporting institutions; amend legislation to permit information sharing among the different regulatory agencies; enhance powers of the agency that monitors suspicious transactions; the central bank should establish more stringent guidelines for enhancing scrutiny of high risk persons using private banking; and strengthen the AML regime for the insurance sector, including through training. The authorities broadly agreed with the recommendations and had adopted an action plan that would address most of the weaknesses identified by early-2004.

Table 3. Frequency of Overall Compliance with the Basel Core Principles

Number of BCPs with which jurisdictions are compliant 1/	Numbers		Proportions	
	International and offshore		International and offshore	
	financial centers 2/	All jurisdictions 3/	financial centers 2/	All jurisdictions 3/
26-30	15	5	48.4	8.3
21-25	5	5	16.1	8.3
16-20	1	6	3.2	10.0
11-15	5	12	16.1	20.0
6-10	3	11	9.7	18.3
0-5	2	21	6.5	35.0
Total	31	60	100	100

Sources: Assessment reports and Table 3 in *Implementation of the Basel Core Principles for Effective Banking Supervision, Experiences, Influences, and perspectives* (SM/02/310), September 23, 2002.

1/ Counting each of the components of BCP 1 separately.

2/ The BCP assessments for the following jurisdictions are reflected here: Andorra, Anguilla, Aruba, Bahamas, The Barbados, Belize, Bermuda, British Virgin Islands, Costa Rica, Cyprus, Gibraltar, Guernsey, Hong Kong SAR, Isle of Man, Jersey, Labuan (Malaysia), Liechtenstein, Luxembourg, Macao SAR, Malta, Marshall Islands, Mauritius, Montserrat, Netherlands Antilles, Palau, Panama, Samoa, Seychelles, Switzerland, Turks and Caicos, and Vanuatu.

3/ Results of 60 assessments reported in SM/02/310.

Table 4. Profile of Overall Compliance with Basel Core Principles

Basel Core Principles	Proportion of jurisdictions found compliant with BCP 1/		Number of jurisdictions in which BCP assessed	
	All jurisdictions 2/	International and offshore financial centers 3/	All jurisdictions 2/	International and offshore financial centers 3/
<b>1. Preconditions for Effective Banking Supervision</b>				
1.1 Clear supervisory responsibility	87.0	83.9	60	31
1.2 Independence and resources	60.0	64.5	60	31
1.3 Legal framework	90.0	80.6	60	31
1.4 Supervisory powers	80.0	83.9	60	31
1.5 Legal protection	60.2	96.8	59	31
1.6 Information sharing	68.0	74.2	60	31
<b>Licensing and Structure</b>				
2. Permissible activities	93.0	96.8	60	31
3. Licensing	85.0	83.9	60	31
4. Transfer of ownership	73.0	90.3	60	31
5. Investment criteria	73.0	64.5	60	31
<b>Prudential Regulations and Requirements</b>				
6. Capital adequacy	65.0	67.7	60	31
7. Credit policies	60.0	61.3	60	31
8. Loan evaluation	71.0	64.5	60	31
9. Large exposures	75.0	67.7	60	31
10. Connected lending	58.0	64.5	60	31
11. Country risk	42.3	60.0	47	30
12. Market risks	52.0	53.3	60	30
13. Other risks	55.0	58.1	60	31
14. Internal controls	68.0	74.2	60	31
15. Money laundering	50.0	74.2	60	31
<b>Methods of Ongoing Banking Supervision</b>				
16. Onsite and offsite supervision	80.0	58.1	60	31
17. Understanding banks' operations	87.0	80.6	60	31
18. Off-site supervision	70.0	80.6	60	31
19. Independent validation	80.0	71.0	60	31
20. Consolidated supervision	39.8	77.3	53	22
<b>Informational Requirements</b>				
21. Accounting and disclosure	77.0	71.0	60	31
<b>Formal Powers of Supervisors</b>				
22. Corrective action	58.0	80.6	60	31
<b>Cross-Border Banking</b>				
23. Global consolidated supervision	58.3	81.0	43	21
24. Host country supervision	67.5	86.4	48	22
25. Foreign banks' establishments	71.4	85.7	59	28

Sources: Assessment reports and Table 2, *Implementation of the Basel Core Principles for Effective Banking Supervision Experiences, Influences, and Perspectives* (SM/02/310), September 23, 2002.

1/ In percentage of the number of jurisdictions in which the BCP was found to be applicable and was assessed as compliant or largely compliant.

2/ Results of 60 assessments reported in SM/02/310.

3/ See footnote in Table 3 for the jurisdictions assessed.

Table 5. Basel Core Principles for Effective Banking Supervision: Areas of Weakness in International and Offshore Financial Centers

Principles with which jurisdictions are either Materially Noncompliant or Noncompliant 1/			
Proportion of jurisdictions	Principles 2/	Proportion of jurisdictions	Principles 2/
1/31	Legal protection (1.5)	9/31	Independent validation (19)
1/31	Permissible activities (2)	9/31	Accounting and disclosure (21)
3/31	Transfer of ownership (4)	10/31	Capital requirements (6)
3/22	Cooperation with foreign supervisors (24)	10/31	Large exposures (9)
4/21	Global supervision (23)	11/31	Independence and resource (1.2)
4/28	Foreign banks' branches (25)	11/31	Acquisitions and investments (5)
		11/31	Connected lending (10)
5/31	Clear supervisory responsibility (1.1)	11/31	Loan classification (8)
5/31	Supervisory powers (1.4)		
5/31	Licensing (3)	12/30	Country risk (11)
5/22	Consolidated supervision (20)	12/31	Credit policies (7)
6/31	Legal framework (1.3)	13/31	Other material risks (13)
6/31	Understanding banks' operations (17)	13/31	Onsite-offsite supervision (16)
6/31	Consolidated reporting (18)		
6/31	Corrective action (22)	14/30	Market risk (12)
8/31	Information sharing (1.6)		
8/31	Internal controls (14)		
8/31	Money laundering (15)		

Source: Assessment reports.

1/ See footnote 2 in Table 3 for the jurisdictions assessed.

2/ BCP numbers are indicated in parentheses.

Table 6. Profile of Overall Observance of IAIS Core Principles

IAIS Core Principles	Proportion of jurisdictions in which ICP observed 1/		Number of jurisdictions in which ICP assessed	
	All jurisdictions 2/	International and offshore financial centers 3/	All jurisdictions 2/	International and offshore financial centers 3/
Organization of an insurance supervisor				
1. Organization of an Insurance Supervisor	54.5	68.4	33	19
Licensing and Changes in Control				
2. Licensing	80.6	89.5	36	19
3. Changes in control	66.7	84.2	36	19
Corporate Governance				
4. Corporate governance	25.7	50.0	35	14
Internal Controls				
5. Internal controls	38.9	57.9	36	19
Prudential Rules				
6. Assets	52.8	72.2	36	18
7. Liabilities	77.8	73.7	36	19
8. Capital adequacy and solvency	80.6	84.2	36	19
9. Derivatives and "off-balance sheet" items	53.8	68.8	26	16
10. Reinsurance	60.0	73.7	35	19
Market Conduct				
11. Market conduct	46.9	56.3	32	16
Monitoring				
12. Financial reporting	80.6	73.7	36	19
13. On site inspections	72.2	47.4	36	19
Sanction				
14. Sanctions	75.0	89.5	36	19
Cross-Border Business Operations				
15. Cross-border business operations	66.7	88.9	21	18
Coordination, Cooperation, Confidentiality				
16. Coordination and cooperation	72.2	78.9	36	19
17. Confidentiality	88.9	94.7	36	19

Sources: Assessment reports, staff estimates, and Table 3 in *Experience with the Insurance Core Principles Assessments under the Financial Sector Assessment Program (SM/01/266)*, August 21, 2001.

1/ In percentage of the number of jurisdictions in which the ICP was found to be applicable and was assessed as observed or largely observed.

2/ Results of 36 assessments reported partly in SM/01/266 (20 assessments) and staff research.

3/ The ICP assessments of the following jurisdictions are reflected here: Aruba, Barbados, Belize, Bermuda, British Virgin Islands, Gibraltar, Guernsey, Hong Kong SAR, Isle of Man, Jersey, Labuan (Malaysia), Liechtenstein, Luxembourg, Macao SAR, Malta, Netherlands Antilles, Switzerland, Turks and Caicos Islands, and Vanuatu.

Table 7. IAIS Core Principles for Insurance Supervision: Areas of Weakness in International and Offshore Financial Centers

Principles with which jurisdictions are either Materially Nonobservant or Nonobservant 1/			
Proportion of jurisdictions	Principles 2/	Proportion of jurisdictions	Principles 2/
1/19	Confidentiality (17)	5/16	Derivatives and "off-balance sheet" items (9)
2/19	Licensing (2)	5/19	Reinsurance (10)
2/19	Sanctions (14)	5/19	Financial reporting (12)
2/18	Cross-border business operations (15)	6/19	Organization of an Insurance Supervisor (1)
3/19	Changes in control (3)	7/14	Corporate governance (4)
3/19	Capital adequacy and solvency (8)	7/16	Market conduct (11)
4/19	Coordination and cooperation (16)	8/19	Internal controls (5)
5/18	Assets (6)	10/19	On site inspections (13)
5/19	Liabilities (7)		

Source: Assessment reports.

1/ See footnote 3 in Table 6 for the jurisdictions assessed.

2/ ICP numbers are indicated in parentheses.

Table 8. Profile of Overall Implementation of IOSCO Objectives and Principles

IOSCO Objectives and Principles	Proportion of jurisdictions in which SCP implemented 1/		Number of jurisdictions in which SCP assessed	
	All jurisdictions 2/	International and offshore financial centers 3/	All jurisdictions 2/	International and offshore financial centers 3/
<b>Principles relating to the Regulator</b>				
1. Clear regulatory objectives	92.0	80.0	25	15
2. Independence and accountability	44.0	53.3	25	15
3. Supervisory powers	52.0	40.0	25	15
4. Consistent regulatory processes	84.0	86.7	25	15
5. Professional regulatory staff	70.8	93.3	24	15
<b>Principles for Self-Regulation</b>				
6. Use of self-regulatory Organizations (SROs)	72.0	100.0	25	8
7. Oversight of SROs	60.9	37.5	23	8
<b>Principles for the Enforcement of Securities Regulation</b>				
8. Regulatory powers	75.0	60.0	24	15
9. Enforcement powers	52.0	73.3	25	15
10. Effective compliance program	36.0	66.7	25	15
<b>Principles for Cooperation in Regulation</b>				
11. Information sharing	64.0	66.7	25	15
12. Information sharing mechanisms	52.0	71.4	25	14
13. Cooperation with foreign regulators	58.3	66.7	24	15
<b>Principles for Issuers</b>				
14. Disclosure of issuers	48.0	61.5	25	13
15. Equal property rights	54.2	58.3	24	12
16. Accounting and auditing standards	52.0	86.7	25	15
<b>Principles for Collective Investment Schemes</b>				
17. Collective investment schemes	68.0	73.3	25	15
18. Legal framework	68.0	80.0	25	15
19. Disclosure for investors	66.7	80.0	24	15
20. Asset valuation of a collective investment schemes	58.3	80.0	24	15
<b>Principles for Market Intermediaries</b>				
21. Market intermediaries: minimum entry standards	87.0	71.4	23	14
22. Market intermediaries: prudential requirements	56.0	78.6	25	14
23. Market intermediaries: management	53.8	64.3	26	14
24. Market intermediaries: failure	50.0	35.7	26	14
<b>Principles for the Secondary Market</b>				
25. Trading systems	88.0	77.8	25	9
26. Integrity of markets	83.3	77.8	24	9
27. Transparency	84.6	88.9	26	9
28. Control of manipulation trading practices	42.3	66.7	26	12
29. Management of large exposures	76.9	50.0	26	8
30. Clearing and settlement system	69.2	50.0	26	6

Sources: Assessment reports and staff estimates.

1/ In percentage of the number of jurisdictions in which the principle was found to be applicable and was assessed as implemented or largely implemented.

2/ Results of 26 assessments.

3/ The IOSCO assessments of the following jurisdictions are reflected here: Bahamas, The Barbados, Bermuda, British Virgin Islands, Gibraltar, Guernsey, Hong Kong SAR, Isle of Man, Jersey, Labuan (Malaysia), Liechtenstein, Luxembourg, Malta, Monaco, Netherlands Antilles, Switzerland, Turks and Caicos Islands, and Vanuatu.

Table 9. IOSCO Objectives and Principles: Areas of Weakness in International and Offshore Financial Centers

Proportion of jurisdictions	Objectives and Principles 1/	Proportion of jurisdictions	Objectives and Principles 1/
<b>IOSCO Objectives and Principles which Jurisdictions have Not Implemented 2/</b>			
1/15	Cooperation with foreign supervisors (13)	2/15	Effective compliance program (10)
1/12	Equal property rights (15)		
1/14	Market intermediaries: prudential requirements (22)		
<b>IOSCO Objectives and Principles which Jurisdictions have Partially Implemented 2/</b>			
1/15	Professional regulatory staff (5)	5/8	Oversight of SROs (7)
1/9	Transparency (27)	5/15	Information sharing (11)
		5/14	Information sharing mechanisms (12)
2/15	Consistent regulatory processes (4)	5/13	Disclosure of issuers (14)
2/15	Accounting and auditing standards (16)	5/14	Market intermediaries: management (23)
2/14	Market intermediaries: prudential requirements (22)		
2/9	Trading systems (25)	6/15	Regulatory powers (8)
2/9	Integrity of markets (26)		
		7/15	Independence and accountability (2)
3/15	Clear regulatory objectives (1)		
3/15	Effective compliance program (10)	9/15	Supervisory powers (3)
3/15	Cooperation with foreign supervisors (13)	9/14	Market intermediaries: failure (24)
3/15	Legal framework (18)		
3/15	Disclosure of investors (19)		
3/15	Asset valuation of a collective investment scheme (20)		
3/7	Clearing and settlement system (30)		
4/15	Enforcement powers (9)		
4/15	Collective investment scheme (17)		
4/14	Market intermediaries: minimum entry standards (21)		
4/12	Equal property rights (15)		
4/12	Control of manipulation trading practices (28)		
4/8	Management of large exposures (29)		

Source: Assessment reports.

1/ The numbers of the listed IOSCO Objectives and Principles are in parentheses.

2/ See footnote 3 in Table 8 for the jurisdictions assessed.

Table 10. Profile of Overall Compliance with FATF Recommendations in International and Offshore Financial Centers 1/

FATF Recommendations	Proportion of jurisdictions in compliance with recommendations 2/				Number of jurisdictions assessed
	Fully compliant	Largely compliant	Materially noncompliant	Non- compliant	
<b>The Forty Recommendations</b>					
1 – Ratification and implementation of the Vienna Convention	84.6	15.4	0.0	0.0	13
2 – Secrecy laws consistent with the 40 Recommendations	53.8	23.1	15.4	7.7	13
3 – Multilateral cooperation and mutual legal assistance in combating ML	53.8	46.2	0.0	0.0	13
4 – ML a criminal offense (Vienna Convention) based on drug ML and other serious offenses	92.3	7.7	0.0	0.0	13
5 – Knowing ML activity a criminal offense (Vienna Convention)	84.6	15.4	0.0	0.0	13
7 – Legal and administrative conditions for provisional measures, such as freezing, seizing, and confiscation (Vienna Convention)	69.2	23.1	7.7	0.0	13
8 – FATF Recommendations 10 to 29 applied to non-bank financial institutions (e.g. foreign exchange houses)	0.0	100.0	0.0	0.0	5
10 – Prohibition of anonymous accounts and implementation of customer identification policies	23.1	46.2	23.1	7.7	13
11 – Obligation to take reasonable measures to obtain information about customer identity	23.1	46.2	30.8	0.0	13
12 – Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer identification documents	61.5	15.4	23.1	0.0	13
14 – Detection and analysis of unusual large or otherwise suspicious transactions	53.8	7.7	30.8	7.7	13
15 – If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the FIU	46.2	30.8	23.1	0.0	13
16 – Legal protection for financial institutions, their directors and staff if they report their suspicions in good faith to the FIU	92.3	7.7	0.0	0.0	13
17 – Directors, officers and employees, should not warn customers when information relating to them is reported to the FIU	69.2	30.8	0.0	0.0	13
18 – Compliance with instructions for suspicious transactions reporting	66.7	25.0	0.0	8.3	12
19 – Internal policies, procedures, controls, audit, and training programs	50.0	33.3	16.7	0.0	12
20 – AML rules and procedures applied to branches and subsidiaries located abroad	30.0	40.0	0.0	30.0	10
21 – Special attention given to transactions with higher risk countries	50.0	8.3	33.3	8.3	12
26 – Adequate AML programs in supervised banks, financial institutions or intermediaries; authority to cooperate with judicial and law enforcement	46.2	15.4	30.8	7.7	13
27 – Competent authorities designated to ensure AML rules applied to other cash professions as defined by country	100.0	0.0	0.0	0.0	1
28 – Guidelines for suspicious transactions' detection	84.6	15.4	0.0	0.0	13
29 – Preventing control of, or significant participation in financial institutions by criminals	76.9	23.1	0.0	0.0	13
32 – International exchange of information relating to suspicious transactions, and to persons or corporations involved	69.2	15.4	7.7	7.7	13
33 – Bilateral or multilateral agreement on information exchange when legal standards are different should not affect willingness to provide mutual assistance	63.6	36.4	0.0	0.0	11
34 – Bilateral and multilateral agreements and arrangements for widest possible range of mutual assistance	69.2	23.1	7.7	0.0	13
37 – Existence of procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution	53.8	23.1	23.1	0.0	13
38 – Authority to take expeditious actions in response to foreign countries' requests to identify, freeze, seize and confiscate proceeds or other property	30.8	61.5	7.7	0.0	13
40 – ML an extraditable offense	69.2	7.7	0.0	23.1	13
<b>Eight Special Recommendations on Terrorist Financing</b>					
SR I – Take steps to ratify and implement relevant United Nations instruments	30.8	30.8	23.1	15.4	13
SR II – Criminalize the FT and terrorist organizations	61.5	23.1	7.7	7.7	13
SR III – Freeze and confiscate terrorist assets	69.2	7.7	15.4	7.7	13
SR IV – Report suspicious transactions linked to terrorism	63.6	18.2	9.1	9.1	11
SR V – Provide assistance to other countries' FT investigations	50.0	0.0	33.3	16.7	12
SR VI – Impose AML requirements on alternative remittance systems	0.0	50.0	0.0	50.0	2
SR VII – Strengthen customer identification measures for wire transfers	11.1	44.4	33.3	11.1	9

Sources: Assessment reports and staff estimates.

1/ The assessments of the following jurisdictions are reflected here: Anguilla, The Bahamas, Bermuda, British Virgin Islands, Guernsey, Hong Kong SAR, Isle of Man, Jersey, Liechtenstein, Malta, Mauritius, Montserrat, and Turks and Caicos Islands.

2/ In percentage of the number of jurisdictions in which the FATF recommendation was found to be applicable and was assessed.

Table 11. FATF Recommendations: Areas of Weakness in International and Offshore Financial Centers

Recommendations with which Jurisdictions are either Materially Noncompliant or Noncompliant 1/			
Proportion of jurisdictions	The Forty Recommendations <sup>2/</sup>	Proportion of jurisdictions	The Forty Recommendations <sup>2/</sup>
1/13	Legal and administrative conditions for provisional measures, such as freezing, seizing, and confiscation (Vienna Convention) (7)	3/13	If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the FIU (15)
1/13	Bilateral and multilateral agreements and arrangements for widest possible range of mutual assistance (34)	3/13	ML an extraditable offense (40)
1/13	Authority to take expeditious actions in response to foreign countries' requests to identify, freeze, seize and confiscate proceeds or other property (38)	3/13	Existence of procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution (37)
1/11	Compliance with instructions for suspicious transactions reporting (18)	3/10	AML rules and procedures applied to branches and subsidiaries located abroad (20)
2/13	International exchange of information relating to suspicious transactions, and to persons or corporations involved (32)	4/13	Prohibition of anonymous accounts and implementation of customer identification policies (10)
2/12	Internal policies, procedures, controls, audit, and training programs (19)	4/13	Obligation to take reasonable measures to obtain information about customer identity (11)
3/13	Secrecy laws consistent with the 40 Recommendations (2)	5/13	Detection and analysis of unusual large or otherwise suspicious transactions (14)
3/13	Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer identification documents (12)	5/13	Adequate AML programs in supervised banks, financial institutions or intermediaries; authority to cooperate with judicial and law enforcement (26)
		6/13	Special attention given to transactions with higher risk countries(21)
	<b>Eight Special Recommendations on Terrorist Financing<sup>2/</sup></b>		<b>Eight Special Recommendations on Terrorist Financing<sup>2/</sup></b>
1/2	Impose AML requirements on alternative remittance systems (SR VI)	4/9	Strengthen customer identification measures for wire transfers (SR VII)
2/13	Criminalize the FT and terrorist organizations (SR II)	5/13	Take steps to ratify and implement relevant United Nations instruments (SR I)
2/11	Report suspicious transactions linked to terrorism (SR IV)	6/12	Provide assistance to other countries' FT investigations (SR V)
3/13	Freeze and confiscate terrorist assets (SR III)		

Sources: Assessment reports and staff estimates.

1/ See footnote 1 in Table 10 for the jurisdictions assessed.

2/ The numbers of the listed FATF recommendations are in parentheses.

Table 12. OFC Program: Indicative Resource Costs

	Actual			Projections	
	FY2001	FY2002	FY2003	FY2004	Steady State
	<i>(In person years)</i>				
Assessments 1/	1.4	4.5	6.4	3.5	6.2
Module 1 assessments	0.7	0.2	0.0	0.0	0.0
Modules 2 and 3 assessments 2/	0.7	4.3	6.3	2.4	5.2
Risk focused updates 3/	0.0	0.0	0.0	1.1	1.1
On-going Monitoring	0.0	0.0	0.0	0.6	1.3
Technical assistance/outreach 4/	0.5	2.0	3.6	3.9	2.0
Policy, analysis, research, and Board papers	0.3	0.8	1.2	1.5	1.0
Estimated overhead costs 5/	0.7	2.2	3.3	2.8	3.0
Total person years	2.9	9.6	14.5	11.7	13.5
Staff	2.1	6.3	9.2	9.7	10.2
Experts	0.7	3.3	5.3	2.0	3.3
Total cost (in millions of U.S. dollars)	...	...	3.4	2.6	3.1
Direct cost 6/	...	...	2.5	2.0	2.4
Travel cost 7/	...	...	0.8	0.6	0.7

Sources: Travel Information Management System (TIMS) and Budget Reporting System (BRS); and staff projections.

1/ Excludes assessments undertaken by the FSAP.

2/ Projections assumes 3 assessments in FY 2004 and 7 assessments per year in the steady state. It is assumed that each mission will comprise 4 staff and 4 experts and will be for 15 days.

3/ For FY2004, 6 missions are assumed (primarily for AML/CFT updates) with 2 staff and 1 expert for 12 days. For steady state, 5 missions per year are assumed with 2 staff and 2 experts for 7 days.

4/ Includes long-term technical assistance.

5/ Estimated at 30 percent of all other costs.

6/ Based on average standard cost of \$175,000 per person per year.

7/ Based on estimated average cost of \$8,000 per person per mission.