

Challenges and Developments in the Regulatory Environment

Address by:

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Financial Services Commission

MEET THE REGULATOR FORUM

27 January, 2009

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Ladies and Gentlemen,

I am delighted to have this opportunity to speak to you at the start of this New Year in what the Financial Services Commission intends will be the first in a series of annual public addresses on the state of the local financial services industry and the developmental challenges that confronts it.

Within the world of international finance, 2008 proved to be a most turbulent and troubled year for business and there is every prospect of an even tougher year to come. All over the world, the climate against so-called tax havens is hardening as a result of the growing need for countries everywhere, particularly OECD countries, to boost tax revenues at a time when the recession is cutting their tax take.

Even more than in past years, for offshore financial centres in general, and particularly those like the BVI who are associated with the UK, these are challenging, daunting and stressful times. Phrases like credit crunch, corporate standards, financial crisis, declining stock market, subprime loans, meltdown, financial bailout and economic recession have become not only media headlines, but also widely used parts of the collective everyday vocabulary.

The turmoil within the global financial markets has placed the activities of offshore financial centres under greater international scrutiny and has given the enemies of the offshore world a fillip, a renewed platform from which to intensify their attacks against OFCs.

A decade ago, with a view to eliminating the number of OFCs across the globe, the developed countries of the G7 and the supranational bodies they control turned up the political heat on OFCs through a series of interlocking and coordinated initiatives. The OFCs were stigmatised as uncooperative, poorly regulated and secretive havens that provided shelter for money launderers, tax evaders, fraudsters and conmen. OFCs were threatened with a series of coordinated punitive sanctions, including denial of access to the financial institutions and clearance systems of the developed world.

Only a few OFCs have ever actually been named as uncooperative by the Organisation for Economic Cooperation and Development, which led the anti-OFC attack (the three currently named are all European, being Andorra, Liechtenstein and Monaco). However, an OECD list drawn up in 1998 of 35 potential tax havens has been widely and in many cases willfully misinterpreted as being a blacklist. The list thus became part of a naming and shaming scheme to disparage the reputation, appeal and competitiveness of the named jurisdictions.

At that time the future of OFCs, like the BVI looked bleak. The consensus then was that only 8-10 OFCs would survive this geo-political onslaught and BVI was not expected to be one of the survivors. Yet, over the past decade our local financial services industry has thrived and flourished. This did not happen by accident. It has been largely achieved as a result of the determination of BVI public and private sector stakeholders to ensure our industry's continued success, prosperity and competitiveness.

These stakeholders have undertaken meaningful, proactive and joined-up engagement with the champions of the initiatives and the international standard setters.

They have worked hard and been canny and innovative. They have committed themselves both to complying with and – very importantly – to implementing relevant international regulatory standards, and to maintaining a pragmatic, proportional and prudent “right-touch” regulatory regime, based on consistent collaboration between the public and private sectors.

And by doing all this, they have ensured that the BVI’s finance sector has not just survived but thrived.

Ladies and gentlemen, until recently, it was tempting to think that the international onslaught had run out of steam. If this ever was the case, it no longer is now. Economic warfare has been re-declared on OFCs. It is “déjà vu” all over again!

The phrase “global warming” has acquired special meaning within the circles of international finance. It is getting warmer and warmer in planet offshore. All the evidence suggests it is not about to cool down any time soon.

The alarm bells should be ringing for us all. We may very well be seeing the preconditions for a perfect storm bearing the down on OFCs. If we here in the BVI do not act promptly, pragmatically and sure-footedly to demonstrate that we are a legitimate, convenient, compliant and cost-effective jurisdiction with zero tolerance for the ethically challenged, for tax cheats, fraudsters and for any form of white collar crime, the threatening tsunami could sweep us off the offshore map.

Increasing fiscal deficits in OECD countries, the near collapse of global banking systems and the failure of a number of blue-chip firms perceived as being of such systematic importance as to warrant bailout by government: all these have evinced the fragility of the world’s financial, stock and currency markets.

They have also drastically increased the need for OECD governments to raise revenue for their ambitious public expenditure programmes and have given the IMF new life and purpose.

Plans are already underway for a revitalised OECD initiative against so-called tax havens, with a clear distinction between countries that have effectively implemented the standards and commitments on transparency and exchange of information on tax matters. The OECD is now said to be compiling revised green and black lists of OFCs, based on progress or lack of progress in entering into Tax Information Exchange Agreements (TIEAs) with OECD countries. OECD members are meeting in Berlin, Germany in the summer to review the list and decide on the next steps. The OECD is also encouraging its member countries to develop their own blacklists and take retaliatory measures against laggard and recalcitrant OFCs.

Here in the BVI, our two recently signed TIEAs should serve us in good stead but much more needs to be done urgently to safeguard the hard-won benefits of public and political recognition from the international community.

A new factor we must take into account is the growing impact of the European Union. Over recent years, the EU has become a significant global standards-setter in financial services regulation and practice. Increasing EU-creep now means we have to learn how to navigate the choppy waters of EU initiatives targeting OFCs. In doing so, we also need to be aware that, when it comes to getting support from Her Majesty's Government, HM Treasury is the department calling the shots and their first priority is their home-based financial centre, the City of London. Evidence from the EU Savings Directives and the 3rd Anti-Money Laundering Directive vividly demonstrates that when it comes to protecting and safeguarding the interests of the City, the UK is prepared to sacrifice the financial centres of the BVI and the other Overseas Territories up to the EU.

The EU has made an explicit link between tax and AML/CFT and is stepping up its efforts to tackle international tax evasion. The “Liechtenstein affair” has led to a determination to implement over as broad a geographical area as possible the EU’s self-proclaimed principles of good governance in the tax area, which include transparency and exchange of information.

Last April, EU member states agreed to the publication of a list of third countries whose AML/CFT regime were deemed to be of an equivalent standard to the EU’s for the purposes of the 3rd Anti-Money Laundering Directive. The UK Government fought for the Crown Dependencies to be included in the list and they are in the footnote, while Gibraltar is in the body of the list as it is within the EEA and directly subject to the requirements of the Directive.

However, the BVI, the other Caribbean overseas territories and Bermuda are excluded. In May, the UK then published its own equivalent list, which is the same as the EU list. Not being on these lists is more than a little irritating, given that the BVI’s AML/CFT standards exceed those of some EU member states, as well as of Russia, Japan, Argentina and Mexico, not to mention Australia and Canada, who are all on the list.

More importantly, however, our absence from the list is politically damaging to our reputation and could have deleterious consequences for the competitiveness of our industry, its products and services, which could all face more onerous due diligence tests within the EU area than competitors from the listed countries. The BVI International Affairs Secretariat has expressed the BVI’s keen disappointment to both the UK Government and the European Commission that the EU and UK lists were issued without our being consulted or having the opportunity to demonstrate our case for equivalence.

The UK agreed that the BVI’s case for being on the list should be considered “on its merits” upon the submission of detailed evidence of AML/CFT standards and the forthcoming CFATF Mutual Evaluation Report.

Now that the CFATF 2008 Review has independently confirmed the robustness of our regime and its essential compliance with FATF standards, it is hoped that the UK will now place the BVI on its own list and champion our inclusion in the EU one.

As regards the EU Savings Directive (EUSD), the EU is not satisfied with their tax take from it, and is revisiting the initiative with a view towards expanding the directive from the savings of individuals towards corporate vehicles, including trusts.

It may be both prudent and timely for the BVI to consider switching voluntarily from the transitional withholding tax option to the automatic exchange of information option.

Evidence suggests that an unforeseen and unintended consequence of the EUSD has been capital flight from OFCs caught by the Directive to third countries like Singapore and Hong Kong. Accordingly the EU is now said to be considering how to extend the Directive to those third countries. Exactly how this could be done is still the subject of conjecture but it is on the table and the EU has now produced a list of corporate vehicles in jurisdictions across the world it wishes to embrace within the Directive.

It is within this profoundly challenging environment that the anti-offshore movement continues to gain momentum. Led by the NGO the Tax Justice Network, a well-orchestrated media campaign is developing to win the hearts and minds of policymakers throughout the developed and developing world in opposing offshore activity, starting by replacing “offshore” with “secrecy space” and “tax haven” with “secrecy jurisdictions”. The Tax Justice Network contends that secrecy results in three evils:

- (a) It permits crime;
- (b) It promotes tax evasion; and

- (c) It promotes living off the proceeds of crime by the so-called secrecy providers, i.e. bankers, lawyers, accountants and the governments of the so-called secrecy jurisdictions.

The Tax Justice Network has come together with Oxfam UK, Friends of the Earth, Global Witness and Christian Aid to step up global action against tax havens and offshore activity. They have enlisted the support of countries like Norway, Brazil, Spain, France and Germany, contending that the blame for significantly declining aid to sub-Saharan Africa and consequently poverty rests squarely with the OFCs who have robbed the developed world of the taxes that would have resulted in the much-needed aid. They also blame OFCs for enabling corrupt rulers to steal millions in aid and other money from their own citizens. Even Pope Benedict has joined the growing anti-tax haven chorus, blaming the OFCs for the inadequacy of development funding and calling for a crackdown on their activities. It should thus not be surprising to learn that developing countries joined the backlash at a recent UN Meeting in Doha, putting OFCs under fire for fuelling capital flight.

The challenges to our industry will be given new impetus by developments in the USA. Notwithstanding the euphoria here in the BVI and around the globe that greeted Barack Obama's historic and crushing victory in the US Presidential elections and his inspiring inauguration last week, it must be acknowledged that his arrival provokes perhaps the greatest cause of anxiety as he has pledged to take very tough actions against so-called secrecy jurisdictions and those who use them.

As a Senator, Mr. Obama was one of the principal sponsors of the Stop Tax Haven Abuse Act and helped launch the Incorporation Transparency and Law Enforcement Assistance Act. Now as President, his agenda was set out on the White House website within a day of his taking office and it reconfirms his intention of targeting tax havens.

OFCs have always had to deal with the spectre of the US applying its laws extraterritorially. The US Treasury already has authority under the Patriot Act to impose sanctions on jurisdictions found to be of prime money laundering concern. The Stop Tax Haven Abuse Act would broaden those powers to include jurisdictions considered to be impeding US tax enforcement and would require any financial institution opening an account or creating an entity for a US client in any of the listed 34 jurisdictions to report it to the US authorities.

BVI already has a TIEA with the US and the BVI authorities have engaged the sponsors of the Act with a view to having the BVI removed from the list, which does not distinguish between, on one hand, compliant cooperative jurisdictions that operate to international standards and, on the other, rogue uncooperative jurisdictions. The Incorporation Transparency and Law Enforcement Assistance Act would make it easier for investigators to see through opaque corporate structures including hedge funds. Press reports already suggest that some of our sister OTs are worried by the fact that a number of US companies are fleeing them for the apparently safer havens of Switzerland and Singapore.

In short, President Obama's victory and the overwhelming Democratic Congress at this pivotal time will give added impetus to the anti-tax haven agendas of the OECD, G20 and G7 and must be considered a clear and present danger that OFCs must adroitly handle.

In the face of such challenges, what can we do? First, we must not lose our heads.

Nor must we stick them in the sand. Acting together, our private sector and public bodies have effectively safeguarded the BVI's finance sector to date, and acting together, we must do so with redoubled vigour.

The BVI financial services industry's long-term success is dependent on our international reputation.

This means that our biggest risk is reputational risk. In turn, our reputation is heavily reliant on our compliance with international regulatory standards. Yes, there is more to be done to ensure that all international policymakers recognise this compliance. But above all, the compliance must exist in the first place.

When our customers' due diligence modalities are inadequate, or the level of monitoring is low or non-existent, we put at risk the reputation of the BVI as a centre for the conduct of legitimate business. And in so doing, we put at risk not just our own business but the businesses of friends and colleagues in the sector. It is not enough to agree that compliance is good business. It must be clearly understood that non-compliance by one threatens the livelihoods of all.

- When BVI cannot facilitate international cooperation requests because the information that should be available to the BVI authorities is non-existent or not available, our hard-won reputation suffers and our sector is at risk.
- When, whether through ineptitude, indifference, inertia or deceit on the part of a licensed service provider, any one within the BVI business community fails to identify and insulate the BVI from the sharp practices of criminal and criminal groups – of those engaged in market manipulation, insider dealing, tax fraud, corruption, Ponzi schemes and the like – they put the BVI's reputation at risk and the industry's head on the block.
- And anytime an externally-driven official sting and entrapment operation reveals or permits some form of unethical behaviour in the jurisdiction and exposes the BVI to well-publicised adverse, unflattering and sensationalised international media comment, the result is a flight of good quality business that, understandably, has no desire to be associated with a tainted jurisdiction.

The good news is that, thanks in no small part to the efforts of many of you here today – of people who care about the long-term future of the BVI and of business in the BVI – the CFATF review just completed has confirmed the high level at which the BVI adheres to FATF standards.

The CFATF report was the most comprehensive and authoritative assessment that has ever been conducted of our AML/CFT regime and the BVI was not found wanting. I commend the report to your reading. It can be found on the FSC website, www.bvifsc.vg.

The bad news is that we are only as good as our last review, and very soon we will be judged against two more reviews.

First there is the IMF review, which was due to commence on 17 February but has now been pushed back to mid-year as a result of the IMF's preoccupation with the current crisis. We can expect that the IMF will look beyond AML/CFT issues to corporate governance, regulatory independence and the adequacy of the regulatory regime.

In the process, they are also likely to look at the recommendations and action points from their last review and whether we have addressed these and made adjustments to comply with the relevant international standards.

The FSC has already done a lot of work in preparing for this assessment, including commissioning a dummy assessment against the core principles. We have prepared a suite of legislative changes. To facilitate effective implementation together with the much anticipated Regulatory Code covering all aspects of the Commission's regulatory work. Following completion of consultation with the industry it is hoped that these measures will be up and running well in advance of the IMF's arrival.

The second review ahead of us is that announced by the UK Chancellor of the Exchequer, Alistair Darling, in his pre-Budget report last November. Mr. Darling has commissioned an independent review of British offshore financial centres, these being the UK Caribbean Overseas Territories and Bermuda, the Crown Dependencies of Jersey, Guernsey and the Isle of Man, and Gibraltar.

The review is being led by Michael Foot, a former Managing Director of the UK FSA and former Inspector of Banks and Trust Companies at the Central Bank of the Bahamas.

The stated aim of the far-reaching review is to enable both HMG and the respective governments to look into the immediate and long-term challenges facing these OFCs in the current economic climate. It is expected to cover financial supervision and transparency, fiscal arrangements, financial crisis management and resolution arrangements and international cooperation.

Interim conclusions are to be produced in advance of the UK budget. Hence there is some urgency in engaging with those introducing the exercise. This the Commission has sought to do, and we are expecting a response from the UK within days.

Ladies and gentlemen, the effect of the global financial turmoil on international markets and on policymakers' attitudes towards OFCs presents the BVI finance industry with perhaps as big a challenge as it has ever faced. Anyone with a stake in the industry's wellbeing cannot afford to be complacent. Nor can we bury our heads in the sand and hope that the problems and challenges will disappear. If we do that, the only thing that will ultimately disappear is us.

The Commission has engaged and will continue to engage with the BVI government, as well as with our industry organisations and associations, to ensure that we maintain a safe and sound industry here.

From the very initial stages of the credit crunch, we have been monitoring the affairs of the BVI's banks for possible signs of weakness that could warrant pre-emptive action to be taken. We have engaged with the parent banks and their regulators in order to obtain a better picture of the health of each bank. We have also sought assurances of head office support on the same basis as that given to branches and subsidiaries in the parent country and elsewhere.

I am pleased to report that to date no signs of stress have been detected in any of the commercial banks operating within the jurisdiction. On the contrary, BVI banks have been able to ward off the difficulties faced by many of their international counterparts. That said, it must also be remembered that, as branches and subsidiaries of US and Canadian operations, our banks are unlikely to remain immune from global problems.

The BVI is a major player in the Mutual Funds, Hedge Funds arena. Unlike banking where there has been little evidence suggesting exposure to the excesses at the epicenter of the crisis, some of our funds have been affected. Evidence of this fallout is seen in the increasing number of requests for cancellation, and notifications of suspension of redemptions.

The BVI is no more immune than anyone from the harsh realities of the global credit crunch. Given the current unprecedented financial distress, volatility and turbulence within the financial markets from which our business is derived, the BVI's financial services sector must brace itself not just for increased international scrutiny but for rapid changes to its business environment.

The challenges we face are not few. Nor are they simple ones. They are many and complex. Our collective resolution and our resilience are being tested. The good news is that we have weathered the storm and navigated the choppy seas better than others. All across the offshore world there are jurisdictions that would readily exchange places with us.

We must now lay the foundations for the continued growth and prosperity in the marketplace that will emerge after the crisis. This means ensuring that our regulatory regime continues to be effective, proportionate and sensibly administered, that our institutions remain strong and that the BVI remains a relevant player in the market for cross-border financial services.

Our history vividly demonstrates that facing overwhelming challenges is in our DNA and that the strength and resilience of the BVI financial services industry and indeed the BVI as a whole come to the fore at times of greatest challenge.

Tough times are also times for differentiating, for separating out winners from whiners and the brave of heart from the weak of will. They are optimal times for new and innovative thinking and breakthroughs. As an industry, we have a strong record of learning, changing and improving to achieve success within continuously evolving financial markets. The BVIBC Act, the immobilisation of bearer shares and the PTC regime all bear testament to this.

I believe every challenge we perceive can be resolved to our mutual benefit by the combined strengths we already possess. What is wrong, together we can put right. What is weak, together we can make strong. By working together, we can forge a brighter and stronger future for the BVI's financial services sector.

So now is not the time for us to fear. It is the time for action. For action, for courage and for opportunity. Together we must develop and implement a plan for strengthening the value proposition of our financial services sector and enhancing its international competitiveness.

The first step is to ensure that our own house is in order. That means above all ensuring compliance with the international standards that underpin our regulatory laws, codes and practices.

Compliance is the touchstone of whether all financial services industries will stand or fall. Any jurisdiction perceived as not maintaining adequate supervision of those who use its services and its corporate vehicles will lose its reputation. And any hope of maintaining that it is a centre for the conduct of legitimate cross-border financial activities will be lost.

You as service providers cannot afford to put yourselves in the position of being criticised for not following them. The FSC as the regulator cannot afford to be criticised for not maintaining adequate supervision of your activities. For that way lies loss of reputation, leading to loss of decent business and even, for the BVI as a whole, blacklisting and sanctions. So ensuring compliance is the first task that faces us.

Second, we must accept that the focus is now on “right touch” regulation, not “light touch” regulation. Yes, the dangers of over-regulation are still as real as ever.

Finally, we can prepare for the changed world by ensuring that we take joined-up action to understand and respond effectively to the challenges ahead. We will need to continue to develop joint thinking and action between the industry, regulator and government here in the BVI. And we will need to spot opportunities for the leading financial services jurisdictions – whether through governments or regulators – to act collectively in defence of their common interests.

Ladies and gentlemen, we are surrounded by challenges. But these challenges are not insurmountable. We need to commit ourselves to taking them on, to being clever, consistent and, yes, courageous. If we have the courage to dare, we will succeed.

Thank you.