14 International Cooperation in the Securities Sector: The Legal Position and Practice in Bermuda

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1. Bermuda's Approach

1.1. This chapter makes some general comments on Bermuda's framework for regulatory cooperation, with specific regard to international cooperation in the context of Bermuda's investment regulation.

1.2. Bermuda is the home for a very substantial financial services industry operating internationally, notably in banking, insurance, and investment business. It is, in particular, a major jurisdiction for insurance and reinsurance business and a principal center for the captive industry, and also has a very large regulated mutual fund sector. The Bermuda Monetary Authority (BMA) acts as the independent licensing and regulatory body for virtually the whole of Bermuda's financial business sector.

1.3. In Bermuda, we have aggressively worked to ensure that our regulatory legislation meets both the letter and the underlying objectives of the policy framework that the international standard setters for financial regulation have put forward, including with regard to the requirements to be met for international regulatory cooperation.

1.4. In this chapter, I describe our experiences in regulator-to-regulator assistance and also address a number of particular difficulties or conflicts we have identified.

2. Obstacles to Cooperation

2.1. Although most authorities (and all reputable authorities) are committed to proper cooperation and information exchange and now have the nec-

essary powers and gateways, we are very conscious of the fact that there may be practical obstacles and delays involved, reflecting a wide range of legal and administrative issues.

2.2. The experience of the BMA in both making and receiving requests for information is that it is now rare for a request for supervisory assistance to be directly refused. The problems that remain in international cooperation are mainly manifested in the form of delays in making an adequate response to a request for assistance.

2.3. While delays can, of course, be used as a "soft" alternative to outright refusal, the BMA's observations tend to indicate that delays are much more typically the result of genuine legal issues or practical matters, such as a lack of relevant or adequate resources in the supervisory authority concerned, than of any lack of willingness, in principle, to cooperate.

2.4. In considering the type of problems that arise, we find it helpful to distinguish between (1) requests for information that is already in the hands of the requested authority, and (2) those for which the requested authority itself needs to take steps to acquire information from other bodies or persons in its jurisdiction.

2.5. The former are by far the more straightforward, since, where the information is already held by the supervisors, it is likely to have been obtained because of a genuine regulatory or supervisory need for the information in question. As a result, it is easier for the requested authority to make a judgment as to whether the material in question is genuinely relevant for the regulatory or supervisory purposes of the requesting authority.

3. Developing Relationships

3.1. In all cooperation requests, the existence of a previous cooperative relationship with the requesting authority is extremely helpful in ensuring an appropriate and timely response. For this reason, most authorities spend considerable time and resources cultivating links, both bilaterally and through attendance at relevant international meetings, with their opposite numbers in other jurisdictions.

3.2. For many years, Bermuda has devoted significant resources to ongoing discussions and cooperation with other regulators internationally. The BMA is a member of a number of key standard-setting bodies, notably the Offshore Group of Banking Supervisors (operating in close collaboration with the Basel Committee), the International Association

of Insurance Supervisors (IAIS), the International Organization of Securities Commissions, the Council of Securities Regulators of the Americas, and the Offshore Group of Collective Investment Scheme Supervisors.

3.3. At the same time, the BMA continues to be closely involved with a number of important international working groups operating under the aegis of the various standard-setting bodies, such as the IAIS Reinsurance Technical Committee, the IAIS Task Force on Transparency and Disclosure in the Reinsurance Sector, and the Basel Committee's Cross Border Banking Group.

4. Value of Memoranda of Understanding

4.1. Generally, the BMA sees no need for our relationships with individual regulators to be reflected formally in the development of memoranda of understanding (MoUs) or other exchanges of letters. Putting in place appropriate MoUs almost always involves extensive time and efforts on the part of both parties, something we find is generally not a particularly good use of scarce resources. Moreover, with a wide variety of MoUs in place, it can then become an added burden for an authority to constantly seek to ensure that it is compliant with the varying commitments entered into in the different texts. In our case, therefore, we would rarely see an overriding need for an MoU to be put in place to document mutual commitments. We are, however, perfectly willing to enter into MoUs where others prefer this approach and we can see a practical need. (And, indeed, we do have a small number of MoUs in place where needs have been identified.)

4.2. Time and practice have proven that the existence of previous links between the institutions, and ideally personal acquaintance between supervisors, is the best guarantee of timely and appropriate cooperation, regardless of whether or not an MoU is in place.

4.3. Where there is no previous history, matters are likely to take longer, often for perfectly valid reasons. Time is required

4.3.1. to identify the appropriate person to contact;

4.3.2. for the BMA, as the requested authority, to conduct necessary checks to ensure that we can properly cooperate with the requesting authority; and

4.3.3. to ensure that the specific request is a valid one.

5. Equivalence

5.1. I am sure that many authorities (as we must do under Bermudian legislation) have to satisfy themselves that the requesting authority is an equivalent regulatory body and that confidential information that is put into the hands of that body will be at least as well protected from onward disclosure as it would be in their own hands. Where there is no previous history, these matters can take time and require further correspondence to establish.

5.2. The question of the need for such "equivalence" requirements in legislation is a difficult one. National parliaments have put in place strict requirements domestically to constrain the disclosure of confidential regulatory information. It is therefore natural for them to wish to ensure that very different standards could not apply to the information in the hands of another regulator to which it is legitimately passed. It is equally important, however, that legal restrictions not be so inflexible that necessary disclosures are inhibited and that legal challenges to the exercise of an authority's powers do not proliferate.

5.3. Requested authorities, very properly, always retain discretion over whether or not to cooperate in a particular case. A key consideration in that regard is normally the need for the requested authority to be satisfied that the requesting authority has a genuine supervisory purpose in seeking the information in question. Such decisions are much easier to make when the requested authority has previous knowledge of the requesting authority and its regulatory approach, and is able to readily comprehend the supervisory rationale for the request.

5.4. In particular, examining in detail the legislation in the other jurisdiction to ensure that the relevant confidentiality provisions are satisfactory and that suitably narrow gateways are specified for onward disclosure of any information passed on to the other authority is normally an important prior condition for information exchange. Inevitably, this involves a need to obtain and review the legal provisions in the legislation governing the functions of the requesting authority, a process which frequently necessitates discussions between the two authorities to deal with any queries.

6. Obtaining Information for Foreign Authorities

6.1. By contrast, the greatest difficulties in conducting practical international cooperation arise in relation to requests for information not

already held by the requested authority. This is also the cause of the typically quite different experience of international cooperation from the point of view of securities regulators as compared with those of banking or insurance supervisors.

6.2. In sharp contrast to its experience in banking and insurance supervision, the BMA's experience of cooperation requests in the securities sector is that the relevant information is virtually never already in the hands of the regulators. This reflects the fact that the bulk of securities-related requests arise not out of institutional supervision of intermediaries but out of market surveillance—in other words, investigation of market price movements appearing to reflect insider dealing or improper price manipulation. So, almost inevitably, the requested authority has to serve notice on an institution in order to obtain the relevant information. Moreover, the information requested will generally relate not to the prudential supervision of a licensed institution but to the affairs of individual customers of that institution.

6.3. As a result, for securities regulatory purposes, international cooperation necessarily tends to involve a much more complex and time-consuming process whereby regulators need to exercise statutory powers to obtain information; and such cases require extensive review and considerable care, since, in all our jurisdictions, the legal powers to collect information, under compulsion, relating to legal or natural persons that are not themselves regulated are constrained and conditioned in certain ways.

6.4. In Bermuda's case, for example, the BMA needs to be satisfied as to certain matters before we can give assistance. Requests must come from a regulatory body carrying out corresponding functions; we must also be satisfied they are for a genuinely regulatory purpose, and that the information in the hands of the requesting authority will remain tightly restricted in terms of the use that can be made of it and the persons to whom it may be communicated.

6.5. Consequently, such cases are often time-consuming for the requested authority, which needs to obtain sufficient information to satisfy itself that the relevant conditions for use of its powers to compel information are met and can be demonstrated to be met in the event of a subsequent challenge. Resources are then needed to draft the requisite legal notices, to serve them on institutions, to deal with any court challenges, and to review material received in response to notices in order to determine what information should be passed to the requesting authority. Understandably, against that background, delays are almost inevitable.

But, again, our observation suggests that most authorities seek to deal expeditiously with requests, and we have seen extremely little evidence of delays masking a general unwillingness to cooperate.

6.6. For many of us, the powers to compel disclosure of information are relatively new tools, and we are still feeling our way through some of these practical aspects. It is important to recognize the sensitivity of the issues raised in this area and, in particular, to ensure that we handle properly the conflict that can emerge between the need for relevant information to flow through regulator-to-regulator gateways and the rights of a client to have proper privacy respected with regard to his or her personal affairs. Bermuda has never had any specific secrecy legislation, but, as with other countries with a legal framework based on English law, there is a strong presumption of privacy under common law for clients' affairs. As supervisors, we have to ensure that this presumption of privacy is overridden by our regulatory powers to compel disclosure of information only in appropriate circumstances and within an acceptable framework of checks and balances governing the exercise of our powers.

6.7. As a result, we take extremely seriously the obligations on us with regard to exercising our powers to compel disclosure of information. In each case, we need to ensure that we are able to assess the appropriateness of a particular request and, in particular, that it is targeted on potential breaches of regulatory provisions. Each request is considered directly at the highest levels to ensure that, as an authority, our process of internal review of requests is subject to proper scrutiny. Once the information is received, we review the material in question and pass on whatever appears relevant to the specific request.

6.8. It is easy to become irritated at the delays and procedural complexities that can be involved in processing such requests, but I believe we all need to recognize the real sensitivities in this area and seek to strike a fair balance. We need to ensure proper enforcement of market standards, and effective information exchange is an important element in ensuring proper investigation of suspected offenses. But, ultimately, we will undermine effective regulation if we are not seen to act reasonably and fairly. Standards of cooperation have developed very rapidly in recent years. In many countries, the new regulatory gateways are not yet well known or fully understood, and we still need to overcome suspicion and to earn trust. As part of this, it will be important for regulators to be as transparent as possible in explaining the nature of the gateways

and the rationale for them. Once the objectives and the requirements are understood and recognized, greater confidence can be built. It may then become easier for regulatory authorities to seek greater flexibility and discretion in the application of the gateways for cooperation.

7. Transparency

7.1. One issue, of course, is that regulators seek to act through such regulatory gateways without transparency at the level of the specific case. If I need to pass on information about a client of a financial institution for a regulatory purpose, it is likely that the individual concerned will have no knowledge of that. Where the purpose of passing that information can be seen as necessary for the prudential supervision of the institution, there is arguably an overriding regulatory imperative. Where information is sought in relation to inquiries into possible market abuse by the customer of the institution, however, the absence of transparency becomes more troubling. Of course, the information on the innocent client is sought essentially to enable him or her to be eliminated from inquiries. And for the guilty, it may arguably handicap an investigation if the individual has to be put on notice.

7.2. Information requests of this kind are normally made on a confidential basis and are passed on to institutions on that basis. In most jurisdictions, there are no anti-tipping-off provisions, so, legally, an institution may alert its customer to a request, for example, if it concludes that it may have some obligation to put its customer on notice. I am aware that customers have been alerted in a few cases. So, the reality is that we do not have a level playing field. Neither am I sure that the right answer would simply be to enforce an anti-tipping-off provision. It may be that we, as supervisors, need to think harder about how far and in what circumstances it is legitimate to remove the rights of customers to be aware of the fact that their private affairs are to be subject to scrutiny in this way as a result of the exercise of powers to compel disclosure of information by financial intermediaries.

7.3. In addition, there are difficult questions on the distinction between the regulatory and the criminal gateways. In many jurisdictions, Bermuda included, the legal provisions continue to enforce a sharp distinction. Hence, a requested authority needs to satisfy itself that the request is for a proper regulatory purpose—something that can be even more difficult to do where the requesting authority may have powers and responsibilities that also span the criminal law. Moreover, not infre-

quently, inquiries that begin as regulatory subsequently become criminal as a result of a decision of the foreign authorities as to the proper sanctions in a particular case. Understandably, requesting authorities can find it frustrating, in such circumstances, to be told that the regulatory gateways no longer apply and that further cooperation must be sought through recourse to the preexisting mutual legal assistance provisions. It is, nonetheless, most important that they make use of the proper route. I believe it is important to avoid any perception that regulatory gateways are a quicker and easier option than mutual legal assistance provisions, where relevant, since such a development is likely to increase skepticism about regulator-to-regulator gateways and complicate the process of gaining full trust. If there are problems and concerns over the reliability or timeliness of mutual legal assistance and other established cooperation gateways, the proper course is to tackle these issues directly. The alternative, in which regulatory gateways are increasingly used to circumvent these proper avenues, would, I believe, likely be a counterproductive approach.