Interview with Barry Johnston

IMF's offshore assessments probe for weak links in global financial system

Amid rising concerns that offshore financial centers might be a weak link in the international financial system, the IMF was asked in 2001 to assess the adequacy of the regulation and supervision of these centers. In November 2003, the IMF's Executive Board commended the "significant progress" that had been achieved by the Offshore Financial Center Assessment Program and called for continued regulatory monitoring as well as steps to bolster transparency, enhance technical assistance, and encourage greater collaboration to improve standards and facilitate the exchange of information. Barry Johnston of the IMF's Monetary and Financial Systems Department talks with Sheila Meehan of the *IMF Survey* about the program and its priorities.

IMF Survey: Since offshore financial centers were established in the 1960s and 1970s, there have been periodic concerns about laxly regulated centers being used for tax evasion and money laundering. What prompted the IMF's membership to ask it to take a closer look at these centers?

Johnston: Offshore centers originally evolved through regulatory arbitrage—in effect, transactions moved offshore in response to monetary policy measures and regulations in major industrial countries. The chief question after the financial crises of the 1990s was whether these offshore jurisdictions—many of them nonmembers of the IMF or dependent territories—could contribute to potential vulnerabilities in the global financial system. Specifically, the IMF was asked to examine whether there might be weaknesses in regulatory and supervisory systems or financial integrity concerns.

In response to heightened concerns about the stability of the global financial system, the IMF was already placing greater emphasis on financial supervision and regulation worldwide. It was natural to extend our efforts to the offshore centers. We knew we needed more statistics and more background on the centers. The fear was that, in the absence of surveillance, vulnerabilities would go undetected.

IMF Survey: Critics have argued that the IMF assessments are meant to squeeze the offshore centers and

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that smaller offshore centers are scrutinized more closely than larger onshore centers.

Johnston: There seemed to be some concern that we would apply different standards to offshore centers, but the IMF takes a global approach to financial sector assessments and uses uniform instruments. When we review banking systems, we use the Basel Core Principles. When we evaluate anti–money laundering efforts, we apply the [Financial Action Task Force] FATF-40 recommendations. And over the past two years, while we were assessing the Cayman Islands, The Bahamas, Jersey, Guernsey, and the Isle of Man, for example, under the offshore financial centers program, we also undertook assessments under the FSAP [Financial Sector Assessment Program] for the United Kingdom, Germany, Japan, Switzerland, Hong Kong, and Singapore, among others.

I'd also like to add that offshore financial centers, while geographically small, account, by our calculations, for about 20 percent of total cross-border banking flows. The concern about offshore centers has always been that they can attract business in two ways: by delivering more efficient services or by offering a weaker, less costly regulatory structure. We are finding that the more established, wealthier centers do compete on the basis of efficient services, but newer, smaller, and poorer centers have not yet had the time to develop the skills, the depth of expertise, and the knowledge base to support an efficient financial industry and thus have weaker regulatory systems. The world has changed, and there is a much lower tolerance now for weak regulatory standards. A jurisdiction that is not following minimum international standards could raise the prudential risk of financial instability. Plus, criminals are extremely good at finding loopholes—which is why you need global standards to combat money laundering and financing of terrorism.

IMF Survey: There has been criticism of the quality and effectiveness of efforts to prevent the financing of terrorism. From the IMF's perspective, how far along are we in this effort?

Johnston: First, let me be clear that the IMF does not chase the criminals. We help jurisdictions set up the necessary legal and financial infrastructure, provide technical assistance to draft laws and regulations, work with the authorities to develop the required expertise and set up the financial intelligence units needed to gather information from the financial services indus-

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try, and ensure that there are trained staff to implement the laws and regulations.

Has all of this been accomplished in all jurisdictions? No, but then FATF only adopted its special recommendations on countering the financing of terrorism in the autumn of 2001. By contrast, countries have had 10–15 years of experience with the anti–money laundering regulations. What we can say at this juncture is that a very high degree of attention, training, and technical assistance is being given to this issue globally.

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IMF Survey: What exactly is the relationship of the offshore assessments to those done under the FSAP? Why not simply conduct an FSAP assessment for these centers?

Johnston: IMF member countries can request an assessment under the FSAP rather than under the Offshore Financial Center Assessment Program. One difference between the two is that the offshore program covers 17 jurisdictions that are not IMF members or are dependent territories. Another difference is that the offshore assessments look exclusively at financial regulatory systems, reflecting, at least in part, the concerns about the risks to the international financial system and cross-border financial flows. FSAP assessments also look at the vulnerability of the domestic financial system.

IMF Survey: Now that the IMF has assessed 40 of the 44 offshore financial centers—and will likely assess the remaining 4 over the next year or two—will the focus of the program change?

Johnston: The IMF's Executive Board has asked us to continue our regular assessments. What has changed is that, in addition to our regular assessments every four or five years, we will conduct risk-focused assessments that can be triggered by concerns arising from, for example, growth of activity; a new type of business; or specific events that raise questions about the adequacy of the regulatory framework. This will give us greater flexibility to respond to developments.

IMF Survey: The Board asked the program to encourage greater transparency. How will this be done?

Johnston: One priority is to get the centers themselves to publish more information on their activities, and the IMF will help by developing minimum publication guidelines. Centers are currently reluctant to publish, partly because they fear that competitors will use the information they release. Having the IMF develop minimum publication guidelines will, in effect, level the playing field.

Another priority is the treatment of the summary assessment reports themselves, which will now be sent to the Executive Board. The program was set up under the IMF's technical assistance mandate, and, as such, the Executive Board saw our assessments only if the jurisdiction agreed to publish them. Otherwise, the reports remained confidential between the IMF staff and the jurisdiction. In fact, most jurisdictions currently do publish their reports, but from now on the summary assessment reports will always be sent to the Executive Board. In effect, these reports will be treated exactly like FSAP reports.

IMF Survey: The Executive Board seemed keen to see the IMF collaborate more with other international agencies and national authorities to improve standards and increase the exchange of information.

Johnston: Last May, the IMF sponsored a roundtable in Washington for offshore and onshore supervisors and standard setters. That meeting provided a forum to discuss issues of common interest, and it highlighted the need to strengthen information exchange among supervisors and regulators. We're planning a follow-up discussion in the next few months and a second roundtable later in the year to discuss specific proposals that could then be considered by broader groups. At this stage, we are still identifying key shortcomings. As these discussions progress, we aim to develop a road map on how to tackle the major impediments to information exchange. But some of these initiatives will clearly take time.

IMF Survey: Will the Board's request for an intensification of technical assistance entail changes in the composition or focus of the IMF's efforts?

Johnston: The demand for technical assistance to combat money laundering and terrorist financing is growing and will continue to grow, reflecting the global interest in these initiatives.

Another issue is the demand for technical assistance from the newer, poorer offshore financial centers. For the IMF, one question is whether these centers, given their size and resources, have the underlying capacity to set up the fully fledged supervisory systems needed to meet international regulatory standards. One suggestion at the Board was to look for ways to outsource some of the supervisory and managerial technical assistance needs to bilateral donors. We are looking for ways to help these centers be consistent with their own resource capacities.

IMF Survey: Ultimately, what constitutes success for the Offshore Financial Center Assessment Program?

Johnston: In the short term, the yardstick is whether jurisdictions meet international supervisory and regulatory standards. In the longer run, it is the ability to reduce or avoid a serious financial crisis or abuse originating through offshore centers. At the end of the day, our concern is to reduce global financial vulnerabilities.

Another way to measure short-term success is participation. It's voluntary and has been well received by most jurisdictions. When we started the assessment program, the offshore centers had just been through a period of intense scrutiny. The centers were quite concerned that the IMF initiative would be yet another naming and shaming exercise. As the program evolved, the centers came to understand that the IMF assessments really are voluntary, uniform, and cooperative.

The centers also came to see the IMF's approach as objective. Our assessors do a thorough job of analyzing the regulatory system and enter into a real dialogue with individual jurisdictions. That dialogue is reflected in our reports. The jurisdictions also realized that if they took action to address vulnerabilities before we finalized our reports, their steps would be reflected in our reports.

After the centers had experience with the way the IMF conducts its work, they recognized that the assessments were quite a positive step and could enhance their integrity. And there is some evidence that jurisdictions that were initially reluctant to come into the program are now much more open.

There's quite a difference of perceptions compared with those commonly held about programs supported by IMF financing. Rather than there being a stigma attached to the IMF's coming in, now there is something wrong if a jurisdiction is not assessed by the IMF. Moreover, if the jurisdiction is assessed and doesn't publish, there is a sense that something is wrong. Major jurisdictions, in response to market pressure, are publishing their assessments. It is much more preferable now to publish, identify weaknesses, and explain how the jurisdiction will deal with identified weaknesses. Markets have generally reacted favorably. What seems to matter is the willingness to recognize shortcomings and their dangers to take action to address them. Though it was not necessarily what we anticipated when we set out, in some ways the IMF's assessments have become quite an important part of the whole quest for integrity by financial centers. ■

For more information about the Offshore Financial Center Assessment Program, please see IMF Public Information Notice No. 03/138 (November 28, 2003) on the IMF's website (*www.imf.org*).

Why statistics matter: African seminars raise awareness

In 2003, the IMF began a campaign to raise public awareness of the importance of high-quality statistics and the role of the General Data Dissemination System (GDDS) in developing national statistical systems. Wipada Soonthornsima, Chief of the IMF's General Data Dissemination System Unit, reports here on the impact of National Awareness Seminars in Anglophone Africa.

It is difficult to overemphasize how critical reliable data are, Immanuel Ngatizeko, Director General of National Planning Commission of Namibia, observed at a December 10 National Awareness Seminar in Windhoek. Statistics, he said, speak all languages, affect all policies, and touch all aspects of people's lives. Policymakers are particularly indebted to timely, high-quality statistics, he added, to help guide their work, assess the impact of their policies, and change direction when needed.

It was just this sense of the power of high-quality data that prompted the IMF's Statistics Department to launch an outreach effort to raise public awareness of the role of statistics and spotlight the contribution of the GDDS in developing effective national statistical systems. The National Awareness Seminars also encourage the public to secure the information it needs to better understand and evaluate government performance.

Promotion of statistical information lies at the heart of the GDDS and its goals of helping participating countries meet international standards and disseminate timely and reliable economic, financial, and sociodemographic data to the public. Statistics, particularly in developing countries, often do not receive the recognition and the priority they

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