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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