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Fraudsters respect no borders

Country financial regulators need to boost cooperation, information exchange

With financial markets becoming more integrated and financial services becoming more international, cross-border cooperation among national regulators has become key to financial sector supervision. As part of its efforts to strengthen this cooperation, the IMF's Monetary and Financial Systems Department hosted a conference on July 7–8 to examine the current state of "Cross-Border Cooperation and Information Exchange." Participants were drawn from onshore and offshore supervisory bodies; agencies combating money laundering and terrorist financing; standard setters in banking (Basel Committee on Banking Supervision), insurance (IAIS), securities (IOSCO), and anti-money laundering and combating the financing of terrorism (FATF); the Egmont Group of financial intelligence units; and the Financial Stability Forum (FSF).

Why convene a conference on cooperation and information exchange? Barry Johnston, Assistant Director in the IMF's Monetary and Financial Systems Department, explained that while each of the standard-setting agencies has provided extensive guidance on cooperation and information exchange, considerable work remains to be done in finding ways to share information, while protecting legitimate rights to privacy and supervisors' confidentiality obligations. The pending issues include sharing information among different sectors (for example, between banking and securities regulators); solving the complexity of multiple gateways for information exchange; and addressing possible differences in the standards' treatment of information sharing.

Why cross-border cooperation matters

Financial markets are global, financial institutions do business beyond their geographical boundaries, and fraudsters respect no borders, Ethiopis Tafara (U.S. Securities and Exchange Commission) and Tom Snow (U.S. Department of Justice) observed. Nevertheless, regulators' and law enforcement agencies' authority stops at national frontiers. The resulting gap between global financial markets and crime, and the limits of national authority create a loophole that can only be plugged by cross-border cooperation and information exchange among national supervisors. Cooperation fosters financial stability and integrity by helping supervisors acquire a consolidated view of the financial institutions they oversee, regardless of the geographical location of their branches and subsidiaries.

Barriers and gateways to cooperation

The most common impediments to cooperation are secrecy, confidentiality conditions placed on requests, and supervisors' lack of power to collect the information, according to the preliminary results of a survey presented at the conference by Mary Zephirin (IMF's Monetary and Financial Systems Department).

Henry Schiffman and Richard Pratt (consultants) noted the conflict every regulator faces: promoting the public interest in sharing information versus protecting individual civil rights and the confidentiality of commercial transactions. These considerations have shaped the powers and cooperative gateways that legislators have granted to financial supervisors. However, each jurisdiction's legal and regulatory framework has approached the issue somewhat differently, and the gateway provisions therefore differ—hence the need for formal and informal arrangements to bridge the disparities among jurisdictions.

Wide variations in sectoral cooperation

To learn from experience, the conference devoted considerable time to reviewing the procedures, and the constraints, in each of the major financial sectors.

Banking. In banking, Charles Freeland (Basel Committee on Banking Supervision) pointed out that the Basel Committee did not recommend a particular mechanism or formal agreement for information sharing. Both Yiu-kwan Choi (Hong Kong Monetary Authority) and Eva Hüpkes (Swiss Federal Banking Commission) explained that their jurisdictions do not require a formal agreement to share information with overseas counterparts, provided the recipient authorities are subject to adequate secrecy provisions in their own jurisdiction—a practice that other panelists endorsed.

Chris Gaskell (Australian Prudential Regulation Authority) noted the difficulty for a supervisor (whether home or host) in disclosing information to overseas counterparts in the context of looming problems in a particular bank. The concern in disclosing such information is that it could trigger premature action that could compromise recovery efforts.

A particular challenge to small jurisdictions, Rochelle Delevaux (Central Bank of The Bahamas) indicated, is "asymmetry" in relations with larger

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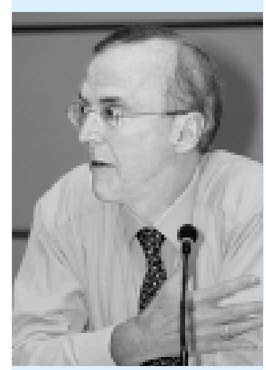

Carse: In some cases, a foreign offense related to market manipulation can be investigated only if it constitutes an offense under the laws of the authority that has been asked to provide such information.

Lister: As in banking, most insurance requests fall in the area of licensing applications, consolidated supervision, and prudential issues.

Murden: The FATF is trying to find ways to enhance cross-sectoral information sharing.

jurisdictions. Small jurisdictions are subject to the demands of larger states that are sometimes unwilling to reciprocate. Giuseppe Godano (Bank of Italy) raised a similar point in the context of relationships between home and host countries.

Securities. The cooperation requested in the securities sector is often investigative in nature and frequently related to individuals, in contrast with banking and insurance, where the focus is on safety and soundness. Securities supervisors rarely have the relevant information on hand and need to take steps to acquire it, making cooperation relatively more difficult.

IOSCO has responded by developing a multilateral formal agreement. As Tafara explained, this entails the ability to share information with a foreign authority in the context of an investigation under way, conduct an investigation on behalf of a foreign authority, and safeguard confidential information. Most jurisdictions do not allow "fishing expeditions," and requests for information must be backed up by evidence of an offense. Many jurisdictions also limit cooperation and the provision of information to supervisors who are exercising the same kind of function. David Carse (Jersey Financial Services Commission) noted that, in some cases, a foreign offense related to market manipulation can be investigated only if it constitutes an offense under the laws of the authority that has been asked to provide such information.

Insurance. Information gathering and exchange are less of an issue in the insurance sector, Peter Neville (IAIS) reported. Cheryl-Ann Lister (Bermuda Monetary Authority) explained that the information that the Authority is asked for typically is already in the possession of the supervisors, which greatly facilitates sharing. As in banking, most insurance requests fall into the area of licensing applications, consolidated supervision, and prudential issues. Göbel Henning (BaFin, Germany) reported good cooperation on insurance supervision among the 25 member states of the EU, and with the U.S. Association of Insurance Commissioners. Cooperation in insurance seems also to have been facilitated by various initiatives, such as the IAIS Insurance Laws Database. But, as Henning explained, challenges to insurance supervision also arise from financial conglomerates whose solvency requirements are increasingly difficult to assess.

Combating money laundering and the financing of terrorism. The hallmark of cooperation in combating money laundering and the financing of terrorism is that a fair share of the information exchanged is either customer or law enforcement related. The issue of collection and sharing of information while protecting civil rights is relatively greater in this context. One of the most significant impediments is the requirement on the recipient supervisor not to pass on information received. However, Paul Wright (U.K. Financial Services Authority) and Jacqueline Wilson (British Virgin Island Financial Services Commission) reported cases where the requesting jurisdiction's supervisors are legally bound to pass on information to criminal authorities. This evidently limits the scope of information exchange.

One of the areas that appears most in need of improvement is cross-sectoral cooperation. Increased requests for information in the context of fighting money laundering and the financing of terrorism have enhanced the need for cross-sectoral cooperation. Wright explained that, in the United Kingdom's experience, cross-sectoral cooperation has taken place through "L-shaped" communications—for instance, a domestic regulator contacting a foreign regulator from another sector through its traditional foreign counterpart. To make progress on cross-sectoral cooperation, William Murden (FATF) reported that the FATF is in dialogue with the Basel Committee, IOSCO, IAIS, and the Egmont group to find ways to enhance cross-sectoral information sharing in general, and between financial intelligence units and banking supervisors in particular.

Road map for the future

More work is needed to facilitate cooperation and the flow of information. Standard setters have been encouraged to make more readily available supervisors' contact information. National authorities were encouraged to publicize information on their legal provisions, gateways, and cooperation requirements (indicating "how" to communicate with them), as well as to publish statistics on information sharing.

For its part, the IMF, in collaboration with the standard setters, was encouraged to take stock of existing barriers, gateways, and practices. This exercise, participants suggested, could compare the principles on information exchange that exist in the four standards, identify common elements as well as differences, and suggest ways to strengthen compliance with the standards. ■

Ahmed Zorome
IMF Monetary and Financial Systems Department

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