Final report of the independent Review of British offshore financial centres

Michael Foot

October 2009

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Foreword

The three Crown Dependencies and six Overseas Territories within the scope of my Review are facing the worst global economic downturn for over 60 years and intense international focus on the operation of their respective financial centres.

The smallest economies are particularly exposed to the downturn, but none of the nine jurisdictions I have reviewed can afford to be complacent. Most are heavily reliant on financial services and tourism for economic output, government revenue and employment.

It was clear early in the Review process that economic decisions taken by some of the jurisdictions during the long period of economic growth had weakened their resilience in a downturn. Events have proved this to be the case.

Some now face difficult decisions and will need to look afresh at options for controlling public expenditure and increasing revenue. Even those jurisdictions which are not under immediate fiscal pressure may wish to consider whether existing tax regimes expose them to international pressure which might ultimately have a material impact on their economic sustainability whilst potentially also reducing their 'tax take' more than necessary.

Meeting international standards on tax transparency, financial sector regulation and financial crime is an absolute must if the jurisdictions wish to continue to hold themselves out as internationally active financial centres, but international pressure must also be maintained on competitor jurisdictions to raise their standards.

A number of the jurisdictions I have reviewed have a good story to tell, but there is no room for complacency. Others have more to do, particularly on regulation and tackling financial crime.

Some will need technical assistance to help with the fight against financial crime, but the local governments must first demonstrate that they are committed to taking the action necessary to secure the benefits of this assistance in the long-term. There can be no second chances.

At a domestic level, the jurisdictions must take all possible steps to prevent the collapse of financial institutions of systemic importance to the local economy and have workable resolution plans if a collapse cannot be prevented.

The recommendations in my Report addressed to the jurisdictions provide benchmark standards against which each can assess itself. I invite the jurisdictions I have reviewed to consider what action they may need to take to achieve these standards.

I also invite the UK government to discuss and consider governance arrangements with the jurisdictions to ensure that there is a shared understanding of respective responsibilities and expectations.

Michael Foot

1 Overview

Introduction

1.1 This Review was commissioned by the Chancellor of the Exchequer in December 2008 to work co-operatively with the three Crown Dependencies (Guernsey, Isle of Man and Jersey) and six Overseas Territories (Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Gibraltar, Turks and Caicos Islands) to identify the opportunities and challenges generated by turmoil in the financial markets and the subsequent impact on the world economy[1].

1.2 The Review was commissioned against the backdrop of:

- worldwide economic and financial sector difficulties, and specifically the collapse of Icelandic banks impacting on Guernsey and the Isle of Man;
- a report by the Public Accounts Select Committee[2] which concluded that the Overseas Territories had not reached the regulatory standards attained by the Crown Dependencies across the areas of banking, insurance, securities and money laundering; and
- the G20's commitment to raise regulatory standards in the financial sector and a developing focus on the role of offshore 'tax havens' (of which there are many around the world) in facilitating tax evasion and financial crime.

Approach

1.3 The financial centres in the nine jurisdictions have distinct characteristics. Understanding these characteristics, and the reasons for them, has formed an important part of the open and constructive dialogue the Review has had with the jurisdictions.

1.4 Preparing a detailed explanation of the differences between the jurisdictions would not, however, have served well the objective of delivering a report of value to the United Kingdom authorities and the governments of the jurisdictions. The Review has, therefore, pursued the thematic approach set out in the Progress Report published in April 2009 and which provided the basis for consultation with a range of stakeholders.

1.5 The Review has benefited from the willingness of non-governmental organisations (NGOs), financial services providers and individuals to give generously of their time to explain their views during the consultation.

1.6 The thematic approach has inevitably produced recommendations for action that will require more significant action by some jurisdictions than others. But those recommendations addressed to the jurisdictions are intended to provide benchmark standards against which each can assess itself and a basis for considering what action may be necessary, in some cases with technical assistance, to ensure a sustainable future.

[1] The terms of reference for the Review are reproduced in Annex A to the Report.

[2] Foreign and Commonwealth Office: Managing Risk in the Overseas Territories, HC 176, published 1 May 2008.

1.7 The jurisdictions already publish information relevant to their performance against the standards in some of the Review's recommendations. The jurisdictions should consider incorporating this into a single document, published periodically, reporting on how the benchmark standards are being met, or on how and when they will be met.

International significance

1.8 Many of the jurisdictions have developed important niche positions in international financial markets; but their importance in global terms, as measured by financial flows through the banking system, is modest.

Box 1.A: Niche positions in international financial markets

- The Cayman Islands are the world's leading centre for hedge funds and also a significant wholesale banking centre, with high volumes of overnight banking business from the United States.
- Bermuda is the third largest reinsurance centre in the world and the second largest captive insurance domicile, with firms based in the jurisdiction writing significant volumes of business in the United Kingdom and the US.
- The British Virgin Islands are the leading domicile for international business companies, with much business coming from the Far East in addition to strong business links with the US.
- Gibraltar offers a gateway to the European single market.
- The Crown Dependencies provide a gateway to route funds to other financial centres, including London; and they also service the financial needs of many UK nationals living abroad.

1.9 Within the offshore market (as defined in chapter 2), the nine jurisdictions account for over 60 per cent of total financial flows through the banking system. However, this total is significantly inflated by short-term US dollar flows routed through the Cayman Islands in response to prohibitions on the payment of interest on demand deposits in the US.

1.10 Financial flows involving the other eight jurisdictions are broadly equal in total to those recorded for Switzerland.

Significance to the UK

1.11 The significance of the nine jurisdictions to the UK arises from financial flows between them and the UK, and the reputational and financial risks resulting from the UK's responsibility for ensuring the good governance of the Crown Dependencies and Overseas Territories (including meeting international standards) and representing their interests in international fora.

Financial flows

1.12 The UK has consistently been the net recipient of funds flowing through the banking system from the nine jurisdictions, with large regular inflows from the Crown Dependencies partly offset by net outflows to the Cayman Islands.

1.13 The Crown Dependencies make a significant contribution to the liquidity of the UK market. Together, they provided net financing to UK banks of $332.5 billion in the second quarter of calendar year 2009, largely accounted for by the 'up-streaming' to the UK head office of deposits collected by UK banks in the Crown Dependencies.

1.14 Financial flows are also generated by insurance business and fees earned by UK based asset managers, accountants and lawyers. For example, Bermuda insurers and reinsurers reportedly wrote 30 per cent of the 2008 premium at Lloyd's of London, a total of £5.4 billion.

Constitutional relationship

1.15 The UK's constitutional relationship with the Crown Dependencies and Overseas Territories exposes it to reputational risks if, for example, a jurisdiction fails to meet international standards on taxation, financial regulation or fighting financial crime. The UK is also responsible for Gibraltar's compliance with European Union requirements and the financial consequences of any compliance failure might ultimately fall on the UK.

1.16 The UK's degree of financial risk exposure to the other eight jurisdictions varies. There is no track record of the UK providing a subsidy to the Crown Dependencies for crystallised financial risks and no expectation in the Crown Dependencies that the UK would provide financial support should they get into difficulties.

1.17 The UK has, however, taken action in the past to support its Overseas Territories and the National Audit Office has concluded that 'the UK bears the ultimate risk from potential liabilities' arising from the actions of Territory governments[3]. The precise nature of the constitutional relationship (discussed in Annex C and which varies between the jurisdictions) is likely to have a bearing on the degree of financial risk exposure.

1.18 The Foreign and Commonwealth Office (FCO) monitors the Territories' public finances and seeks to mitigate fiscal risk by requiring all the Overseas Territories (with the exception of Gibraltar) to obtain approval by the Secretary of State when seeking to borrow. Borrowing guidelines are set for a number of the Territories which require their respective governments to keep within agreed levels of indebtedness and to maintain a minimum level of liquid reserves.

1.19 The effective operation of this regime is, however, sometimes hampered by the absence of up-to-date and reliable financial data and a consistently proactive approach by the FCO to working with the local governments to ensure that emerging risks are detected early and credible responses developed and implemented.

1.20 The assumption made by some Overseas Territories that there are circumstances in which they should be entitled to financial support may also act as a disincentive to take the difficult decisions that may sometimes be required to meet the objectives of the regime.

1.21 One of the Overseas Territories suggested to the Review that the UK should act as lender of last resort in the event of a shock to a jurisdiction's financial system and economy which was beyond the resources of that jurisdiction to deal with in the short-term. This would be a significant undertaking by the UK and it would be important to ensure that local governments had a strong incentive to put in place and enforce measures to reduce the risk of such circumstances arising.

1.22 If the UK Government wished to explore a loan facility, it would most likely be broadly similar to the kind of facilities that would be available to these jurisdictions if they were eligible for membership of the IMF. The circumstances in which a loan would be provided and the conditionality attached would need to be clear.

1.23 Even if such a facility is not explored, the UK government should discuss and consider governance arrangements with the jurisdictions to ensure that there is a shared understanding

[3] Paragraph 1.1 of the National Audit Office report Foreign and Common Wealth Office, Managing risk in the Overseas Territories , HC 4 Session 2007-2008, 16 November 2007.

of respective responsibilities and expectations. In particular, there is scope to discuss and clarify with the jurisdictions:

- how responsibility for delivering good governance is shared between the jurisdictions and the UK;
- the circumstances (if any) in which the UK might be prepared to provide financial support to a jurisdiction; and
- how risks will be managed to reduce the exposure of the parties.

Managing economic risks

1.24 One way of reducing risks is to ensure that action is taken to improve the resilience of each jurisdiction's economy during periods of economic stress.

1.25 The global economic downturn has tested the resilience of the nine jurisdictions. Although the impact has not been uniform, most have seen public revenue fall below expectations and upward pressure on public spending.

1.26 The negative impact on public revenues has so far been greatest in those jurisdictions where tourism and construction (which is often closely related to tourism) represent a significant proportion of the economy. In some cases, this has combined with a downturn in a jurisdiction's respective financial sector niche.

1.27 The impact has been pronounced in Anguilla, the Cayman Islands and the Turks and Caicos Islands resulting in depleted public sector cash reserves. Bermuda and the British Virgin Islands have also experienced a decline in government income, but the impact has been less severe. Revenues have held up better in the Crown Dependencies and Gibraltar.

1.28 Past economic decisions taken by the local governments in the jurisdictions have inevitably had an impact on their resilience during the downturn. For example, the Crown Dependencies' decision to build up reserves in recent years during a period of rapid economic growth has served to increase their resilience. They had also invested effort in improving the quality of data they obtained, compiled medium-term economic forecasts and 'stress-tested' against economic shocks.

1.29 Decisions taken by some of the Overseas Territories to use increased revenues to raise current and capital public spending, sometimes combined with insufficient attention to data quality and the absence of robust medium-term planning, has left local governments facing difficult short-term choices to restore the public finances. This is clearly illustrated by recent events in the Cayman Islands.

1.30 The lasting impact of the economic downturn will to a large extent depend upon its length and severity. While there is reason to hope that some pressures (particularly on tourism) will ease as the global economy picks up, many of the longer term effects on the financial sector may not have been felt fully as many large financial services firms have yet to implement the results of strategic reviews of their future geographical 'footprint' and product ranges.

1.31 In any event, the global downturn has provided a sharp reminder of the need for some of the jurisdictions to take urgent measures to ensure that robust economic planning and fiscal control measures are in place and observed.

1.32 The UK should satisfy itself that each jurisdiction indeed has a framework capable of identifying and responding to external shocks and encourage local governments to undertake responsible adjustment programmes. Where these programmes are realistic and there is a clear commitment to take the necessary measures, there is a place for allowing suitably controlled additional public sector borrowing to facilitate adjustment.

1.33 None of the jurisdictions can afford to be complacent. Many of the economic responses to a downturn available to sovereign states are not available to them and the significance of the financial services, construction and tourism sectors in the economies of the majority of the nine jurisdictions combine to suggest the need for a cautious approach to economic planning. Each jurisdiction needs to identify the main changes in the external environment to which it could be vulnerable and plan accordingly.

1.34 Chapter 3 makes a number of recommendations to the jurisdictions which provide benchmark standards against which to review current practice and consider what action might best deliver improved economic resilience and hence sustainability.

1.35 The Review also commends these benchmark standards to the Ministry of Justice and the FCO for the purposes of discharging their oversight of the Crown Dependencies and Overseas Territories respectively. Enactment will not provide a 'quick fix' to current public sector finance problems but should help jurisdictions in their short-term efforts and, importantly, limit the risk of future problems.

The role of tax

1.36 The recommendations in chapter 3 include giving consideration to developing a diversified tax base (where this does not already exist) to maximise sources of revenue to complement measures to increase efficiency in government. Each jurisdiction will need to take its own decisions based on a detailed analysis of its current and future revenue needs.

1.37 Most – if not all – jurisdictions in the developed world seek to make their tax regimes internationally competitive. The jurisdictions would, therefore, also need to consider the impact on their position in this competitive landscape of any decision to broaden the tax base.

1.38 At a practical level, any jurisdiction considering introducing new taxes (or fees) must have the ability to administer them to ensure that they are not avoided. It would be in the UK's interest to provide technical assistance were it requested by a jurisdiction.

1.39 An evaluation of the importance of the Crown Dependencies and Overseas Territories in tax avoidance by UK corporates commissioned by the Review and conducted by Deloitte (see Annex E) should be a useful input into the thinking of any jurisdiction considering tax changes to ensure sustainability.

1.40 As part of that evaluation, Deloitte explored the extent to which the nine jurisdictions' business models depended on tax competition strategies which stood outside the growing international consensus on tax policy norms.

1.41 Deloitte tentatively concluded that the Crown Dependencies and the Overseas Territories were distinguished within the developed world by differentiating themselves from the international consensus, sometimes through tax rates but more often through the absence or near absence of certain forms of taxation. Whilst there were other drivers for doing business in these jurisdictions (including, for example, a stable legal environment and authorities who were responsive to market developments), tax was an important motivating factor.

1.42 Deloitte considered the scope for the jurisdictions moving towards consensus models in the areas of Value Added Tax (VAT) and corporation tax (CT), should local governments wish to consider doing so.

1.43 Deloitte concluded that there was a compelling case for those of the nine jurisdictions which do not already operate VAT or Goods and Services Tax (GST) to consider introducing such a system to increase the sustainability of their business models by broadening their revenue bases. Deloitte noted that this would be of particular importance for the Overseas Territories should the global trend for reducing reliance on customs duties continue.

1.44 Deloitte also concluded that the Crown Dependencies' industry bases were sufficiently diverse that they had the potential to raise worthwhile levels of revenue from a CT system more aligned with international 'best practice' than the regimes currently in place. By contrast, some of the Overseas Territories' focus on a narrower financial sector niche suggested that the introduction of a broad-based CT would offer less scope for a significant tax take.

1.45 Deloitte concluded that, in any event, the downside of a properly constructed 'best practice' CT system would appear to be relatively limited and would bring the jurisdictions more into the mainstream of the international community. It might also curtail some scope for tax avoidance, but Deloitte estimated that the amount of UK tax avoided by UK corporates using the nine jurisdictions was likely to be significantly lower than estimates produced by previous studies have suggested.

Meeting international standards

1.46 Improved tax transparency is one of three important and inter-related elements of international standards which have been considered by the Review (discussed in chapter 4).

1.47 The principles of transparency and exchange of information developed by the Organisation of Economic Co-operation and Development's (OECD) Global Forum have been endorsed by countries around the world. The G20 London Summit in April 2009 continued the push to implement the minimum standard of each jurisdiction signing at least 12 tax information exchange agreements (TIEAs) with other countries that would allow the latter to obtain information about income earned by their taxpayers outside of their home jurisdiction.

1.48 This renewed international focus on tax transparency encouraged leading international financial jurisdictions such as Switzerland and Singapore to commit to the standard for the first time.

1.49 By the G20 meeting in April 2009, the Crown Dependencies were all considered to have 'substantially implemented' the agreed standard. Bermuda, the British Virgin Islands, the Cayman Islands and Gibraltar have subsequently also 'substantially implemented' the standard, with the remaining two jurisdictions making progress towards it.

1.50 It is anticipated that standards in this area will continue to rise and even those of the nine jurisdictions within the scope of this Review that have met or exceeded the current standard of 12 TIEAs should continue to enter further agreements with relevant countries. This imperative is well understood and it is appropriate that the commitment to tax transparency shown by a number of the jurisdictions has been recognised in statements by the UK Government.

1.51 The nine jurisdictions must show a commitment not just to the letter but also the spirit of international standards. Effective implementation will be an important test of this and evidence will be provided by the OECD's Global Forum through a monitoring and peer review process. It is vital that competitor jurisdictions show the same commitment.

1.52 In the longer term, the trend for greater transparency is likely to result in pressure to move to a system of automatic exchange of information with the aim of combating tax evasion by individuals on a cross-border basis. This is already the objective under the European Union Savings Directive (EUSD) agreed in 2003, although some EU Member States have taken advantage of a transitional arrangement to instead levy a withholding tax on interest payments of 20 per cent (increasing to 35 per cent in July 2011). There is, however, pressure to remove the withholding tax option and a proposal to apply the EUSD to a broader range of savings income.

1.53 The Crown Dependences are outside the EU but participate in the EUSD framework under Savings Agreements with the Member States. The Crown Dependencies apply the transitional withholding tax option, which under their Savings Agreements they must give up in favour of automatic exchange of information when the three Member States applying withholding tax move to automatic exchange.

1.54 The Isle of Man has committed to moving to automatic exchange of information by July 2011. Guernsey is reviewing its position and Jersey has said that it is ready to introduce automatic exchange of information as soon as the EU brings the transitional period to an end. The Review encourages both jurisdictions to announce a firm date for a move to automatic exchange. At the same time, the UK should call on all EU Member States and third party countries which currently apply the withholding tax option to also make a similarly firm commitment.

1.55 Of the Overseas Territories, Gibraltar is directly subject to the EUSD and in most cases applies automatic exchange. Anguilla and the Cayman Islands have adopted the EUSD and apply automatic exchange. The British Virgin Islands and the Turks and Caicos Islands have adopted the withholding tax option. Again, the Review encourages all the Territories within the scope of this Review to commit to moving to automatic exchange.

1.56 During the course of the consultation, a number of NGOs raised concerns about the extent to which international standards still permit a lack of transparency in the ownership of corporate vehicles in the jurisdictions. This, they feared, facilitated financial crime (including tax evasion).

1.57 The Review shares these concerns (which are discussed in chapter 7), but such transparency issues also arise to a greater or lesser extent in most major jurisdictions.

1.58 The G20 recognised the need to prioritise work to strengthen standards on customer due diligence, beneficial ownership and transparency at its meeting in Pittsburgh in September 2009.

1.59 Although attractive in principle, action by the UK and the nine jurisdictions ahead of changes to international standards would be likely to result in a loss of business to other jurisdictions rather than a resolution of the underlying concerns. The Review has therefore concluded that the UK should take the lead internationally in encouraging improvements to:

- 'know your customer' international minimum standards (particularly in respect of the role of 'eligible introducers');
- the monitoring of 'politically exposed persons' (PEPs); and
- the transparency of beneficial ownership of companies and trusts.

1.60 The third aspect of international standards that was of particular concern to the Review was raising regulatory standards in the financial sector and on measures to tackle financial crime (discussed in chapters 5 and 7 respectively). Reviews by the International Monetary Fund and the Financial Action Task Force have been critical components of a long-standing attempt to raise international standards in these areas. The Review drew heavily on work done by these bodies which was followed up in discussions with the jurisdictions concerned.

1.61 The majority of the jurisdictions have a good story to tell though, as minimum standards continue to rise, there is no room for complacency. Others have more to do.

1.62 Action by some of the Overseas Territories to improve governance arrangements within their regulator (in part by recruiting external experts to the board), and to separate responsibility for promotion from the regulator in both letter and spirit, may present relatively quick improvements.

1.63 Increasing the quantum and expertise of resources available to the Financial Services Commissions in Anguilla and the Turks and Caicos Islands to bring them up to international standards may take longer. These jurisdictions must, however, explain how and when they will provide these resources. Delivering these commitments is a necessary condition if these jurisdictions wish to continue to offer themselves as international financial services centres.

1.64 At a domestic level, the Review identified several jurisdictions containing locally owned banks which are large in the context of the local economy. Problems in any of these banks could cause significant economic disruption and might lead to requests to the UK Government for liquidity or capital assistance to avoid it. The Review offers a recommendation in chapter 6 on how the risk of such disruption crystallising might be kept to a minimum.

1.65 Anguilla, the British Virgin Islands and the Turks and Caicos Islands recognise that the technical and human resources to fight financial crime also need to be boosted. Bermuda must also remain focussed on continuing to address deficiencies in its approach to tackling financial crime identified in the IMF's Review published in October 2008. Gibraltar and the Isle of Man have more to do to improve compliance with the FATF's 'key and core' recommendations in particular.

1.66 The priority in the fight against financial crime is to provide human and technical assistance to those jurisdictions most in need of it. This must, however, be accompanied by a clear commitment from the local government to tackling financial crime by ensuring that legislation keeps pace with developments and gives both the regulator and the investigating authority the powers they need to detect and prosecute financial crime. The local government must also make a commitment to fund the provision of sufficient resources to secure the benefits of the technical assistance they receive. Again, this is a necessary condition for these jurisdictions continuing to operate as international financial services centres.

1.67 Where such commitments are forthcoming, the UK should discuss with the relevant jurisdictions what mechanisms might be put in place to deliver them in practice. One option would be to establish a unit, recognised by both the jurisdictions and the UK, whose functions might include quality assurance to ensure that the full benefits of technical assistance are secured on a long-term basis. These discussions could also be extended to those jurisdictions which are not in need of immediate technical assistance to discuss how they might contribute to and benefit from any such unit.

1.68 In summary, some of the jurisdictions have consciously chosen to move ahead of the pack of their international rivals and raise their standards further and faster than the minimum international standards now required. It is important that those that move swiftly are seen to benefit from improved international acceptance. It is crucial that international political pressure is maintained on key competitors as the absence of co-ordinated action would generate arbitrage opportunities and encourage a shift of business away from jurisdictions which have met international standards.

Dealing with the retail sector

1.69 Two issues in this area were brought to the Review's attention during the consultation process.

1.70 First, a growing number of the jurisdictions have, or plan to have, a deposit protection scheme for retail bank deposits. Sensibly, those that have introduced such schemes have recognised that the jurisdiction must not face a potentially unlimited liability and that the banks there will also not accept such a commitment. The result has been that some jurisdictions have capped the aggregate amount of compensation that can be paid in any given period. Chapter 6 provides some observations on the risk of confusing depositors to which this may lead.

1.71 Second, in the Crown Dependencies, where UK nationals (often 'ex-pats') purchase many financial products, one important element of consumer protection in the UK is typically missing. Only in the case of the Isle of Man does an Ombudsman complaints scheme exist along the lines of that in the UK. The jurisdictions should consider whether such a scheme is justified.

Recommendations

1.72 The following chapters consider in more depth the issues discussed in this overview. For ease of reference, the main recommendations made are set out below.

1 The UK should discuss and consider governance arrangements with the jurisdictions to ensure that there is a shared understanding of respective responsibilities and expectations.

2 The quality and extent of financial planning in the jurisdictions should be aligned with that in the best performers (the Crown Dependencies). In particular, jurisdictions should implement a prudent approach to managing government finances by developing: a diversified tax base to maximise sources of revenue; mechanisms to measure and control public spending; and by building financial reserves during periods of economic growth.

3 The UK should be proactive in satisfying itself that the Overseas Territories in particular have frameworks capable of identifying and responding to external shocks and encouraging local governments to undertake responsible adjustment programmes where these are necessary.

4 To meet international standards, jurisdictions which have not already done so should:

- meet the international standard on tax transparency set by the OECD and continue, even after meeting the current minimum of 12 TIEAs, to negotiate further TIEAs, giving priority to those jurisdictions with which they have significant financial links;
- set up the administrative procedures necessary to ensure full delivery of the OECD standard, to a level of compliance that will satisfy the peer review process that is being put in place;
- make an early commitment, with a timetable for implementation, to automatic exchange of tax information under the EU Savings Directive;
- ensure that the regulatory authorities have the necessary resources and expertise to implement and enforce international financial sector regulatory standards;
- move to amend laws and procedures as necessary to achieve compliance with the FATF 16 'key and core' Recommendations.

5 At an international level, the UK should press for improvements in 'know your customer' minimum standards and promote moves towards improved transparency of beneficial ownership of companies and trusts and the monitoring of politically exposed persons.

6 All jurisdictions should ensure that:

- governance arrangements in their regulatory authorities are sufficient to maintain the integrity and independence of all decisions taken;
- responsibility for promotion of the financial centre is separated from the regulator in both letter and spirit.

7 Those jurisdictions that offer (or propose to offer) protection to retail depositors must ensure that compensation schemes can be understood by those depositors.

8 Jurisdictions that lack an Ombudsman scheme should consider whether one is justified.

9 Any jurisdiction that has not already done so should undertake a thorough examination of the range of powers to resolve a crisis in its financial services sector.

10 Local governments should require the regulator to maintain close oversight of any large locally incorporated financial institutions, the failure of which might lead to requests for financial help from the UK. This should be backed by the option of a periodic independent and external review, paid for by the institution itself, commissioned by the local authorities on their own initiative or at the request of the UK.

11 The UK should discuss with those jurisdictions in need of technical assistance to fight financial crime how that assistance might be delivered and the benefits of assistance secured in the longer-term.

2 Financial flows

Introduction

2.1 Many offshore financial centres are closely integrated into global financial services markets. Financial flows are generated by activities that are booked and often carried out in offshore financial centres such as banking, fund management and insurance business. Whilst on an individual basis most offshore centres account for only a small share of global financial flows, some have developed niche positions which give them a significant international profile.

2.2 This chapter examines:

- the international significance of the nine jurisdictions within the scope of this Review both in terms of their niche positions and financial flows through the banking system;
- the significance of the nine jurisdictions to the UK in terms of financial flows between them and the UK; and
- discusses evidence provided to the Review on other income that accrues to the UK from the financial service sectors in these jurisdictions.

International significance

2.3 Many of the jurisdictions have developed important niche positions in international financial markets which underlines the need for each jurisdiction to meet international standards. But to understand the relative importance of these jurisdictions in global financial markets also requires an analysis of financial flows.

Box 2.A: Niche positions in international financial markets

- Bermuda is the third largest centre for reinsurance in the world and the second largest captive insurance domicile. It is the leading non-United States supplier of reinsurance to US insurers and reportedly wrote 30 per cent of the 2008 premiums at Lloyds of London (a total of £5.4 billion).
- The Cayman Islands are the world's leading centre for hedge funds and also a significant wholesale banking centre, with high volumes of overnight banking business from the US.
- The British Virgin Islands are the leading domicile for international business companies, with much business coming from the Far East in addition to strong links with the US.
- Gibraltar offers a gateway to the European single market.
- The Crown Dependencies provide a gateway to route funds to other financial centres, including London; and they also service the financial needs of many UK nationals living abroad.

International financial flows

2.4 International financial flows through the banking system are captured on a point in time basis by data collected by the Bank of International Settlements (BIS). Banks in 42 jurisdictions[1] ('BIS reporting banks') report the claims they have on individuals and entities located in specific jurisdictions. Most claims are in the form of loans made by banks to these individuals and entities.

2.5 The same banks also provide data on their liabilities. Most liabilities are in the form of deposits placed with the banks by individuals and entities located in other jurisdictions.

2.6 By way of example, the data shows that at the end of 2008 banks in the other 41 BIS reporting jurisdictions had claims of just under $5.3 trillion on individuals and entities located in the US and liabilities of just over $4.0 trillion to individuals and entities in the US. So, in broad terms, loans made to residents in the US exceeded deposits made by US residents with banks in other countries by $1.3 trillion.

2.7 The BIS classifies about 20 centres as being 'offshore', including eight of the jurisdictions within the scope of this Review[2]. The Review has made one small amendment by classifying the Turks and Caicos Islands as an offshore centre, rather than, as in the BIS data, part of the Latin America/Caribbean region.

Claims on offshore centres

2.8 Cross-border financial flows into the offshore financial centres, as measured by claims by BIS reporting banks on individuals and entities resident in them, amounted to $3.6 trillion at the end of the fourth quarter of 2008. Chart 2.A shows each offshore centre's percentage share of this total.

[1] There are 42 BIS reporting countries – Australia, Austria, Bahamas, Bahrain, Belgium, Bermuda, Brazil, Canada, Cayman Islands, Chile, Chinese Taipei, Cyprus, Denmark, Finland, France, Germany, Greece, Guernsey, Hong Kong SAR, India, Italy, Ireland, Isle of Man, Japan, Jersey, Luxembourg, Macao SAR, Malaysia, Mexico, Netherlands, Netherlands Antilles, Norway, Panama, Portugal, Singapore, South Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States

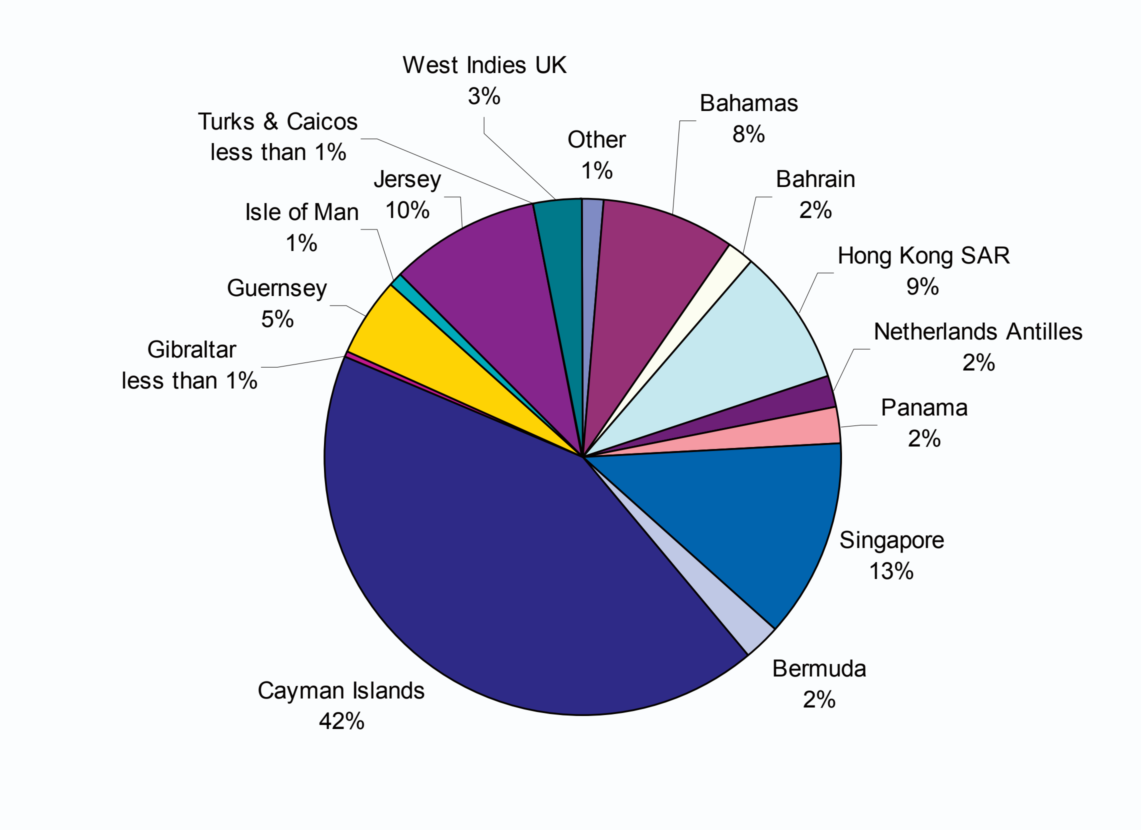
[2] BIS defines the following jurisdictions as offshore centres: Aruba, Bahamas, Bahrain, Barbados, Bermuda, Cayman Islands, Gibraltar, Guernsey, Hong Kong SAR, Isle of Man, Jersey, Lebanon, Macao SAR, Mauritius, Netherlands Antilles, Panama, Samoa, Singapore, Vanuatu and West Indies UK. West Indies UK includes Anguilla and the British Virgin Islands plus four other jurisdictions.

2.9 The aggregate claims by BIS reporting banks on the nine jurisdictions covered by this Review amounted to $2.3 trillion at the end of the fourth quarter of 2008, about 63 per cent of the total claims on all offshore centres. The balance of around 37 per cent was primarily accounted for by claims on Hong Kong, Singapore and the Bahamas.

2.10 BIS reporting banks' claims on the Cayman Islands at the end of 2008 amounted to $1.5 trillion, about 42 per cent of the total. This was higher than any other offshore centre and inflated by the long-standing consequence of US Federal Reserve regulations. Since 1933, the US Federal Reserve has not allowed the payment within the US of interest on overnight (demand) deposits. One result has been that US banks and other residents have routed such deposits through the Cayman Islands, where interest can be paid. It is not possible to estimate precisely the total size of this effect but it may account for more than one-third of the banking funds being placed through the Cayman Islands at any point in time.

2.11 Of the remaining eight jurisdictions within the scope of this Review, all but Guernsey and Jersey had a 3 per cent share or less of the total claims.

Chart 2.A: Claims by BIS reporting banks on offshore centres – Q4 2008



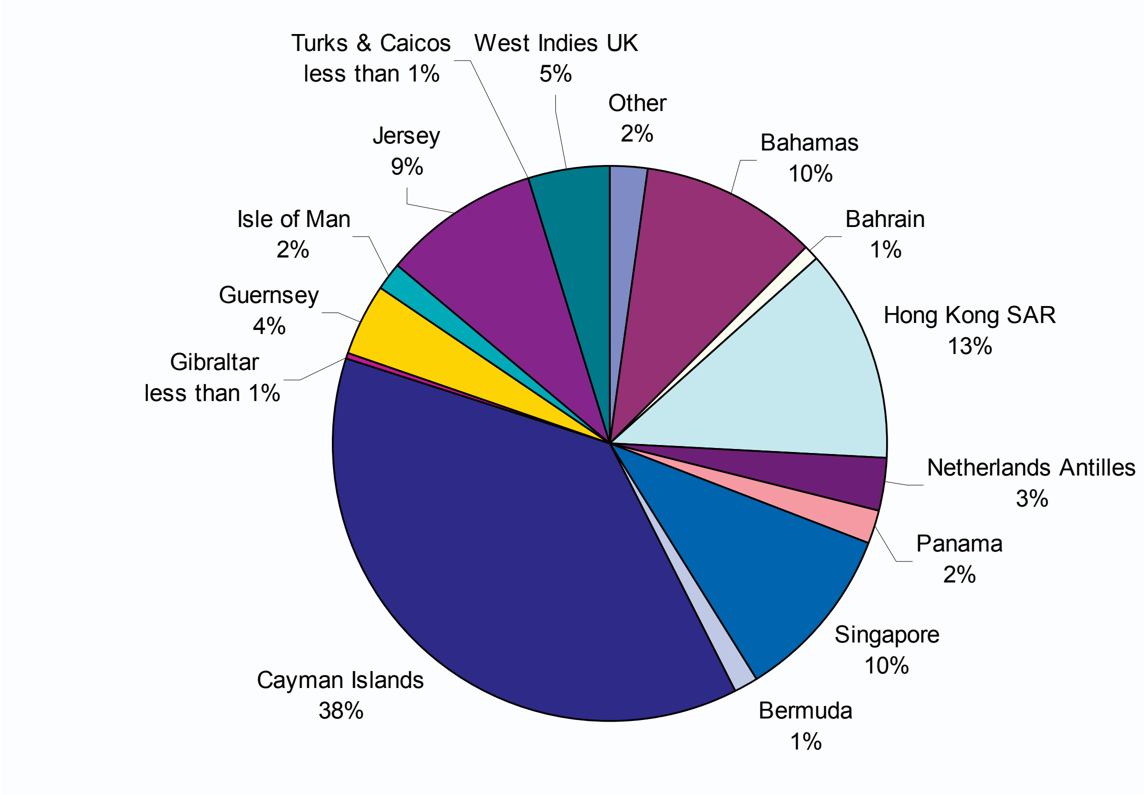
Claims by offshore centres

2.12 Cross-border financial flows from the offshore financial centres to banks in other BIS reporting countries, as measured by claims on individuals and entities resident in other BIS reporting countries, amounted to $4.8 trillion at the end of 2008. Chart 2.B shows each offshore centre's percentage share of this total.

2.13 The nine jurisdictions within the scope of this Review had claims of around $2.8 trillion, some 58 per cent of the total. Again, a significant element was represented by claims from the Cayman Islands ($1.8 trillion or 37 per cent of the total) much of which is likely to be the recycling back to the US of the demand deposits described in paragraph 2.10 above.

2.14 Of the remaining eight jurisdictions covered by the Review, all but Guernsey and Jersey had a 2 per cent share or less of the total.

Chart 2.B: Claims by offshore centres on BIS reporting banks – Q4 2008



A wider comparison

2.15 In summary, the BIS data shows that, excluding the Cayman Islands, financial flows to and from the jurisdictions within the scope of this review are modest within the offshore market. It was, however, suggested to the Review that this comparison would not give a global perspective of the relative importance of the financial centres.

2.16 Undertaking such a wider comparison inevitably requires a selection of other jurisdictions to be made. The Review has chosen Ireland, Luxembourg and Switzerland as three jurisdictions mostly frequently cited during consultations as key competitors of many (but not all) of the nine jurisdictions. Including these competitors in the analysis further illustrates that, in terms of financial flows through the banking system, the importance of the majority of the jurisdictions within the scope of this Review is modest. As Table 2.A shows, financial flows involving eight of the British jurisdictions in aggregate were broadly equal for those recorded for Switzerland at the end of 2008.

Table 2.A: Summary of BIS reporting banks' claims on and liabilities to offshore centres and their 'competitors' at end-2008

	Claims of BIS reporting banks $ trillion	Liabilities of BIS reporting banks $ trillion
Cayman Islands	1.5	1.8
Other 8 British jurisdictions	0.8	1.0
All other 'offshore centres'	1.3	2.0
Ireland	1.2	0.6
Switzerland	0.7	1.2
Luxembourg	1.0	0.9
Total	**6.5**	**7.5**

Significance to the UK

2.17 The Bank of England produces detailed data on the claims by UK banks on the nine jurisdictions covered by this Review and their liabilities to these jurisdictions. This data includes flows between, on the one hand, banks resident in the UK and both banks and non-banks resident in the jurisdictions.

2.18 Claims by banks resident in the UK on banks and non-banks in the jurisdictions (the closest match to the claims numbers quoted in paragraphs 2.8-2.11 above) totalled $413.9 billion at the end of June 2009[3]. The largest claims by banks in the UK were on the Cayman Islands ($243.6 billion) and on Jersey ($95.7 billion).

2.19 Table 2.B below summarises the claims by UK banks on entities in the nine jurisdictions. It shows a rapid increase in balances between 2002 and 2007, followed by a sharp drop after the onset of the financial crisis.

Table 2.B: Claims by UK banks on entities in the nine jurisdictions

	Q2 2009 $billion	Q4 2008 $billion	Q4 2007 $billion	Q4 2005 $billion	Q4 2002 $billion
Bermuda	13.1	16.6	32.2	16.6	7.5
Cayman Islands	243.6	240.2	372.2	228.5	90.9
Gibraltar	4.2	3.6	3.5	2.7	1.4
Guernsey	18.0	18.7	21.9	9.1	6.4
Isle of Man	16.5	14.3	19.1	6.5	4.1
Jersey	95.7	97.7	127.7	78.3	27.3
Turks and Caicos	0.3	0.3	0.1	0.1	0.1
West Indies UK	22.5	27.1	26.2	18.0	8.6
Total	**413.8**	**418.5**	**602.9**	**359.8**	**146.3**

[3] The Bank of England (BoE) defines loans from UK resident banks to non-residents as claims. It includes the reporting institutions' loans and advances to non-residents; claims under sale and repurchase agreements to non-residents; commercial bills and other negotiable paper drawn on non-residents; lending under ECGC special schemes for exports including amounts refinanced; sterling acceptance given on behalf of non-residents; and assets leased out under finance leases and holdings of certain investments outside the UK with an original maturity of one year or more.

2.20 Claims by the nine jurisdictions on banks resident in the UK (the latter's 'liabilities') totalled some $670.9 billion at the end of June 2009[4] (see table 2.C below). The largest creditors were Jersey ($314 billion), Cayman Islands ($172.5 billion), Guernsey ($92.1 billion) and the Isle of Man ($56.6 billion).

2.21 Again, claims rose sharply in most cases between 2002 and 2007 and have fallen back since. The end-June 2009 aggregate figure was around 28 per cent below the level at end-2007.

Table 2.C: Claims on UK banks by entities in the nine jurisdictions

	Q2 2009 $billion	Q4 2008 $billion	Q4 2007 $billion	Q4 2005 $billion	Q4 2002 $billion
Bermuda	16.9	17.4	42.4	17.6	8.5
Cayman Islands	172.5	228.0	316.2	223.1	71.1
Gibraltar	3.5	5.1	8.4	4.7	2.6
Guernsey	92.1	88.0	80.0	53.0	36.4
Isle of Man	56.6	39.2	55.3	32.7	21.7
Jersey	314.0	328.8	407.9	203.1	134.6
Turks and Caicos	0.5	0.5	0.1	0.2	0.1
West Indies UK	14.7	15.9	18.2	13.1	7.5
Total	**670.8**	**722.9**	**928.5**	**547.5**	**282.5**

Net position

2.22 Claims by UK banks on these nine jurisdictions less their liabilities to the nine jurisdictions is a measure of the net financing provided by the jurisdictions to the UK. In aggregate, the UK was a net recipient of funds from the nine jurisdictions of $257 billion at end-June 2009. While this was down significantly from $304.3 billion at end-2008 and $325.6 billion at end-2007, it conforms to the long-standing pattern that the UK has consistently been a net recipient of funds. Much of the decline over the last 2 years in the net position has come from changes in flows to and from the Cayman Islands, which is likely to be connected with the problems of the hedge fund industry over that period.

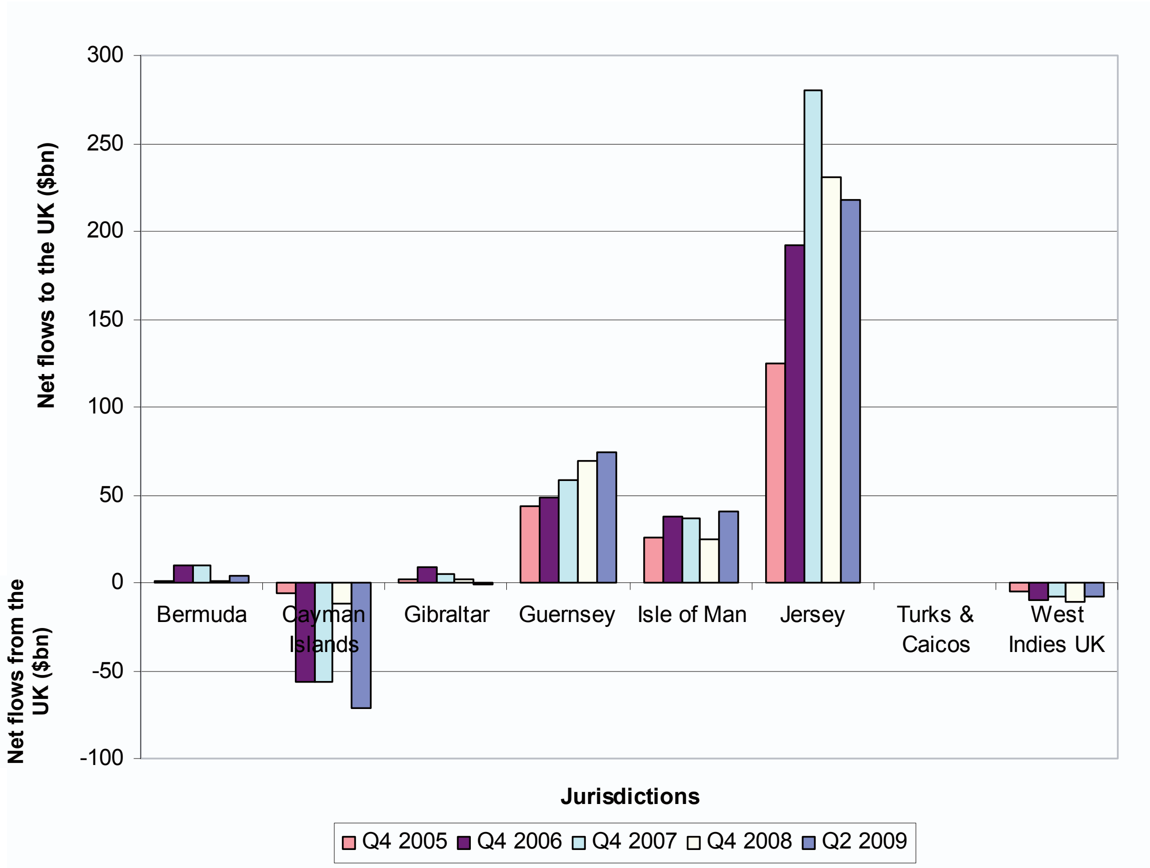
2.23 Typically, UK banks lend net to entities in Cayman Islands and receive a larger volume of funds net from entities in the Crown Dependencies. At end-June 2009, UK banks had net financing of approximately $218.3 billion from Jersey, $74.1 billion from Guernsey and $40.1 billion from the Isle of Man.

2.24 'Up-streaming' allows deposits to be gathered by subsidiaries or branches in a number of different jurisdictions and then concentrated in one centre, in this case the UK, where the bank has the necessary infrastructure to manage and invest these funds. This model is followed by many large banks around the world and is not confined to 'British' jurisdictions. All the major UK clearing banks have significant deposit-gathering capacity in the Crown Dependencies as, of course, did some Icelandic banks up to October 2008.

[4] BoE defines deposits received by jurisdictions as 'UK liabilities'. These comprise deposits and advances received by reporting institutions from non-residents, liabilities arising from acceptances given on behalf of non-residents and certificates of deposit issued in London by reporting institutions and held by non-residents.

2.25 Chart 2.C below provides a summary of the UK's net financing position with the nine jurisdictions.

Chart 2.C: UK's net financing position



2.26 To provide a broader picture, Table 2.D below provides a summary of the UK's financing position with the three 'competitor' jurisdictions identified in paragraph 2.16.

Table 2.D: Summary of net financing position for 'competitor' jurisdictions

	Q2 2009 $billion	Q4 2008 $billion	Q4 2007 $billion	Q4 2005 $billion	Q4 2002 $billion
Ireland	-77.8	-97.5	-134.6	-63.0	-29.9
Luxembourg	-9.9	-18.2	-12.3	-14.3	11.7
Switzerland	8.4	-36.4	137.1	134.2	122.0
Total flows to/(from=-) UK	**-79.3**	**-152.1**	**-9.8**	**56.9**	**103.8**

2.27 Over the period from end-2007 to end-June 2009, Ireland and Luxembourg were consistently the net recipient of funds from the UK, although this net position has decreased from $134.6 billion and $12.3 billion respectively at end-2007 to $77.8 billion and $9.9 billion at end-June 2009. Conversely, the UK has typically been the net recipient of funds from Switzerland ($8.4 billion at end-June 2009, down considerably from $137.1 billion at end-2007).

Other flows of business between the UK and the nine jurisdictions

2.28 During the consultation, the Review was provided with indicative information on other business flows between the UK and the nine jurisdictions.

2.29 Bermuda insurers and reinsurers support the UK's global position as a centre for specialty insurance services through their involvement with the Lloyd's Market. Insurance groups controlled by Bermudian interests reportedly wrote 30 per cent of the 2008 premium at Lloyd's of London, a total of £5.4 billion.

2.30 The Association of Investment Companies (AIC)[5] submitted research they had carried out on fees generated by UK service providers who provide support services to their offshore members.

2.31 The AIC estimated that 108 companies, which they regarded as being investment companies and which are domiciled in the Channel Islands and Isle of Man, paid management fees into the UK of over £300 million a year in recent years.

2.32 Significant UK fund management fee income is also likely to be earned from firms based in jurisdictions such as Bermuda and the Cayman Islands, but aggregate data is not available.

2.33 The Review was also provided with evidence showing the importance of the provision from the UK of auditing and accounting services, tax compliance and transaction advice and legal advice. It is not possible to aggregate this information to provide a central estimate of the annual net total of fees received; but it is clear that the UK professions earn a significant net income from work generated in the jurisdictions.

Conclusions

2.34 In summary, many of the nine jurisdictions covered by this Review have successfully developed niche positions within the global financial services market; but their importance in global terms, as measured by banking flows, is relatively modest.

2.35 Within the offshore market, the nine jurisdictions do account for over 60 per cent of total financial flows. However, this total is significantly inflated by short-term US dollar flows routed through the Cayman Islands in response to prohibitions on the payment of interest on demand deposits in the US. Financial flows involving the other eight jurisdictions in aggregate are broadly equal to those recorded for Switzerland.

2.36 The UK has consistently been the net recipient of funds flowing from the nine jurisdictions, with a large regular inflow from the Crown Dependencies, offset in part by net outflows to the Cayman Islands.

2.37 There are also other significant business flows between the nine jurisdictions and the UK, generated by activities such as asset management. Sizeable net fees are also earned from the provision out of the UK of legal, accounting and other professional services to these jurisdictions.

[5] The AIC represents closed-ended investment companies with shares traded on UK markets.

3 Identifying and managing economic risks

Introduction

3.1 The world is experiencing the worst economic downturn for over 60 years. Economic growth, jobs and government finances have all suffered as a result. The nine jurisdictions covered by this Review are not immune from these impacts, but the extent and severity of the impact has not been uniform.

3.2 The ability of each jurisdiction to deal with these challenges differs and to a large extent has been influenced by the approach to financial planning each has adopted.

3.3 This chapter examines:

- the structure of the economies of the nine jurisdictions;
- the impact of the economic downturn on their respective public finances; and
- the measures which local governments should consider putting in place to improve the resilience of their respective economies during periods of economic stress.

Structure of economies

3.4 The economies in the nine jurisdictions vary significantly in size, with total output ranging from £161 million to £4.3 billion[1] in 2007-2008 (fiscal year ends vary between jurisdictions so direct comparisons should be made with caution[2]). Financial services and tourism are typically major generators of economic output, government revenue and employment. In some jurisdictions, the economy is built almost wholly round these two sectors.

3.5 According to local government statistics, the combined contribution of financial services and tourism to the economy ranges from 35 per cent of gross domestic product (GDP) in Anguilla to 74 per cent in the Cayman Islands. The proportion of government revenue generated by these two sectors is around 50 per cent for the majority of jurisdictions, whilst they account for between 23 per cent and 48 per cent of employment. In the Caribbean, the construction sector is also closely linked to the state of the tourism sector.

[1] The local currency is used for all jurisdictions except Anguilla and the Cayman Islands. The exchange rates used for 2008 are: Anguilla: £1:EC$3.940; US$1:EC$2.70; and the Cayman Islands: US$1:CI$1.2.

[2] Year ends: 31 December: - Anguilla, British Virgin Islands, Guernsey, Jersey; 30 June – Cayman Islands; 31 March – Bermuda, Gibraltar, Isle of Man, Turks and Caicos Islands.

Chart 3.A: Sources of GDP by jurisdiction, 2007-8[3]

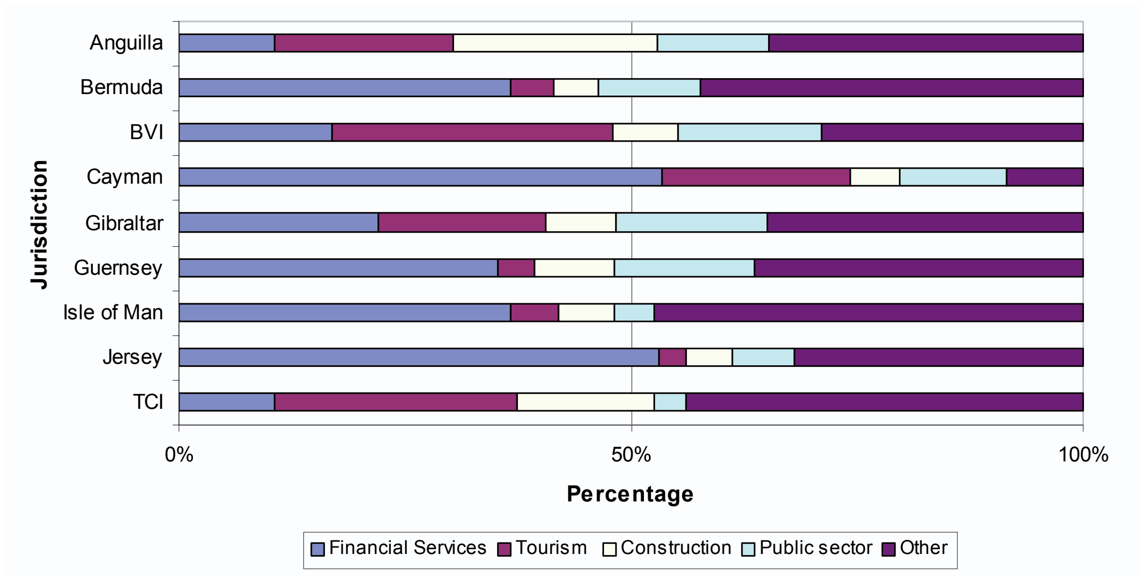
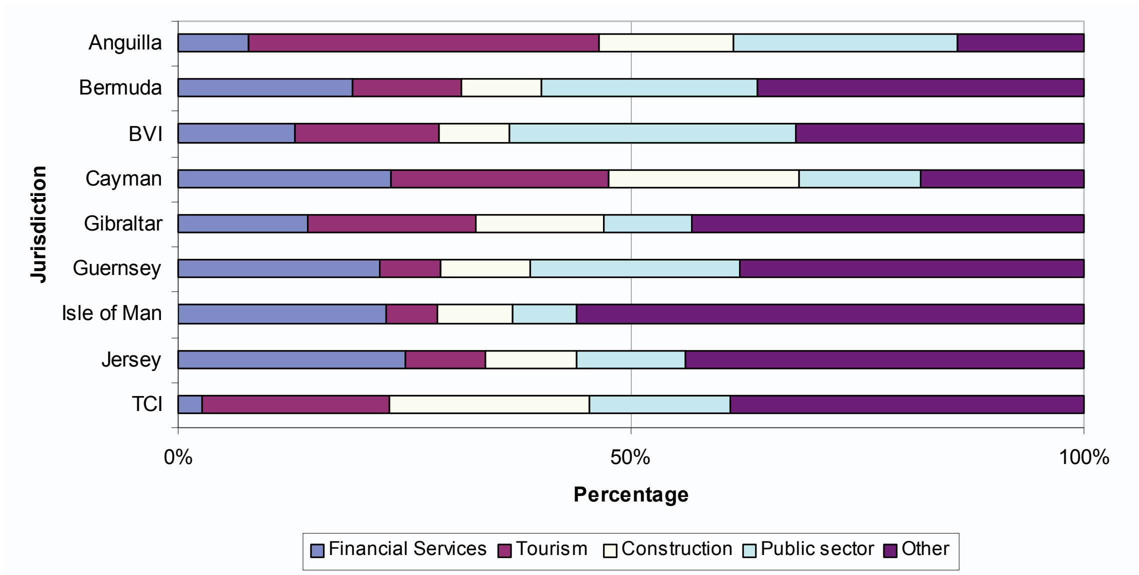


Chart 3.B: Sources of employment by jurisdiction[4]



3.6 Government revenue in the Caribbean Territories[5] and Bermuda is mainly derived from a combination of import duties, financial sector licence fees and other specific charges (including payroll taxes in some of the jurisdictions). There are, however, no taxes levied on income, profits and capital gains, and no sales or value added taxes.

[3] Based on 2007-8 year end official government statistics. Categorisation of sectors is not consistent between jurisdictions and therefore some approximations have been made based on available data. The Cayman Islands sector data is based on the preliminary estimates presented in the inaugural report 'The Cayman Islands' System of National Account 2006-2007.' Estimates are subject to future revisions.

[4] Based on 2007-8 year end official government statistics apart from Anguilla (2001) and British Virgin Islands (2005). Categorisation of sectors is not consistent between jurisdictions and therefore some approximations have been made based on available data.

[5] Defined as Anguilla, British Virgin Islands, Cayman Islands and Turks and Caicos Islands.

3.7 The Crown Dependencies have a wider tax base but the rates of tax charged, on employment income for example, are lower than those applied in the UK. Gibraltar has a fiscal policy closest to the growing international consensus on tax norms identified by Deloitte and discussed in chapter 4.

3.8 Public sector running costs typically account for a significant proportion of government expenditure across the jurisdictions. For example, 43 per cent of government expenditure in the British Virgin Islands in 2008 was on salaries, benefits and pensions for the civil service.

3.9 The concentrated structure of the economies of the majority of the nine jurisdictions leaves them particularly exposed to economic shocks. They also have fewer responses available to them than to sovereign states. Their respective currencies are typically tied to sterling or the United States dollar; and depreciation, even where technically feasible, would be of little or no value given the nature of the jurisdictions' economies. Nor do the jurisdictions have the option of an independent interest rate policy.

Economic growth and employment

3.10 The nine jurisdictions all experienced a period of sustained economic growth between 2004 and 2007. None of the jurisdictions is immune from the impact of the global economic downturn, but the reversal in fortunes has been most pronounced in the Caribbean Territories.

3.11 The economies in the Crown Dependencies have grown strongly in recent years, recording growth of around 5 per cent in real terms. However, all are now forecasting a contraction of their economies or a slowing of growth. Jersey has forecast a decline in real Gross Value Added (GVA) of between 4 per cent and 6 per cent in 2009 and between 1 per cent and 3 per cent in 2010. Growth in GDP is expected to slow in Guernsey to 1 per cent in 2009, while the Isle of Man has forecast real GDP growth of 2.5 per cent in 2009-10, down from 6 per cent growth in 2008-09.

3.12 There have also been increases in unemployment in the Crown Dependencies, though it has generally stayed at relatively modest levels. Guernsey has seen an increase in unemployment from 0.8 per cent at 30 June 2008 to 1.3 per cent at 30 June 2009. There has also been an increase in unemployment in the Isle of Man to 2.3 per cent at 31 August 2009, up 0.7 per cent over a year. Unemployment in Jersey increased from 2.0 per cent in June 2008 to 2.7 per cent in June 2009.

3.13 Gibraltar has also recorded strong growth in recent years and to date appears less affected by the downturn. The Government of Gibraltar estimated in its 2009 budget that growth in GDP to the year ended 31 March 2009 was almost 6 per cent and employment was rising 'to record levels'. This robust position may in part be explained by the fact that Gibraltar has one of the most diversified economies of the nine jurisdictions.

3.14 Real GDP growth in Bermuda averaged 4.4 per cent a year between 2003 and 2007. Official figures recorded a fall of 2.2 per cent in real GDP growth in 2008 and GDP is projected to decline by between 1.0 per cent and 1.5 per cent in 2009. Bermuda has close economic ties to the United States and has been affected by the downturn there. This has been offset by the buoyant insurance sector (Bermuda's major financial sector niche), although there has been a sizeable fall in the number of new insurance companies incorporating in Bermuda, which may reflect the maturity of the market. Employment appears to have held up relatively well in Bermuda, but employment data for 2009 was not available to verify this.

3.15 Growth in the Caribbean economies has been strong in recent years, ranging from average real GDP growth in the Cayman Islands of over 3 per cent to almost 14 per cent in Anguilla in the five year period 2003-7 (according to local government statistics). However, all four jurisdictions are now projecting a slowing in growth or a decline in GDP. Although no precise forecast is available, the British Virgin Islands expect a contraction in GDP in 2009. The Cayman Islands is forecasting a decline in GDP of 3.3 per cent for 2009, with Anguilla and the Turks and Caicos Islands also likely to experience a contraction.

3.16 The British Virgin Islands have suffered from a synchronised downturn in the tourist sector and a sharp fall in international business company incorporations (the jurisdiction's financial sector niche). New company incorporations were down by 44 per cent between September and December 2008 compared to the same period in 2007 and recorded a year on year fall of around 20 per cent in the first quarter of 2009. The British Virgin Islands do not have up-to-date employment statistics, the most recent available data relates to 2005.

3.17 The picture in the Cayman Islands is more severe with a downturn in tourism coinciding with a decline in the hedge fund industry for which the jurisdiction is the world's leading domicile. New hedge fund launches fell by 18 per cent in 2008 and 10 per cent of all existing funds were terminated (a much higher rate than in previous years). There has also been a marginal increase in estimated unemployment from 5.2 per cent at 30 June 2008 to 5.5 per cent at 30 June 2009.

3.18 Anguilla and the Turks and Caicos Islands have suffered particularly badly from the fall in tourism and construction. Anguilla is forecasting a decline in GDP of 8.2 per cent in 2009, but does not have up-to-date unemployment statistics. The Turks and Caicos Islands do not have GDP forecasts or up-to-date unemployment statistics available.

Impact on public finances

3.19 The global downturn has also had an impact on the public finances of the jurisdictions. As with GDP, the impact has not been uniform. Most of the nine jurisdictions have, however, seen public revenue fall below expectations and upward pressures on public spending.

3.20 Past economic decisions taken by the local governments in the jurisdictions have inevitably had an impact on the resilience of the public finances during the downturn. Decisions taken by some of the Overseas Territories to use increased revenues during a period of growth to raise current and capital spending has left governments now facing difficult short-term choices.

3.21 Chart 3.C. illustrates the fiscal deficits/surpluses for the past two years and forecast for the fiscal year 2009-10. Chart 3.D illustrates the percentage increases (actual and forecast) in outstanding government debt for each jurisdiction over the same time period. Although direct comparisons between all nine jurisdictions are not possible because of the inconsistency in time periods (and variation in the reaction time of the economies to the downturn), general trends in the data can still be observed.

3.22 The Crown Dependencies are all forecasting a decline in government revenues. The Isle of Man has forecast a fall in total tax receipts of 4.5 per cent for the 2009-10 fiscal year against the prior year but expects a modest budget surplus of £0.2 million.

3.23 Guernsey has also budgeted for a downturn in revenues for 2009, but is again forecasting a modest budget surplus of £9 million. Jersey has, however, forecast deficits of £63 million in 2010 and £72 million in 2011 based on their central economic forecasts.

3.24 Guernsey and Jersey have both experienced, and are continuing to forecast, a decline in revenue following changes to the structure of business taxation. It was announced on 14 October 2009, however, that these two jurisdictions had agreed to work together to comprehensively review their fiscal strategies.

Chart 3.C: Fiscal surplus/deficit as percentage of GDP, 2007-8 to 2009-10[6]

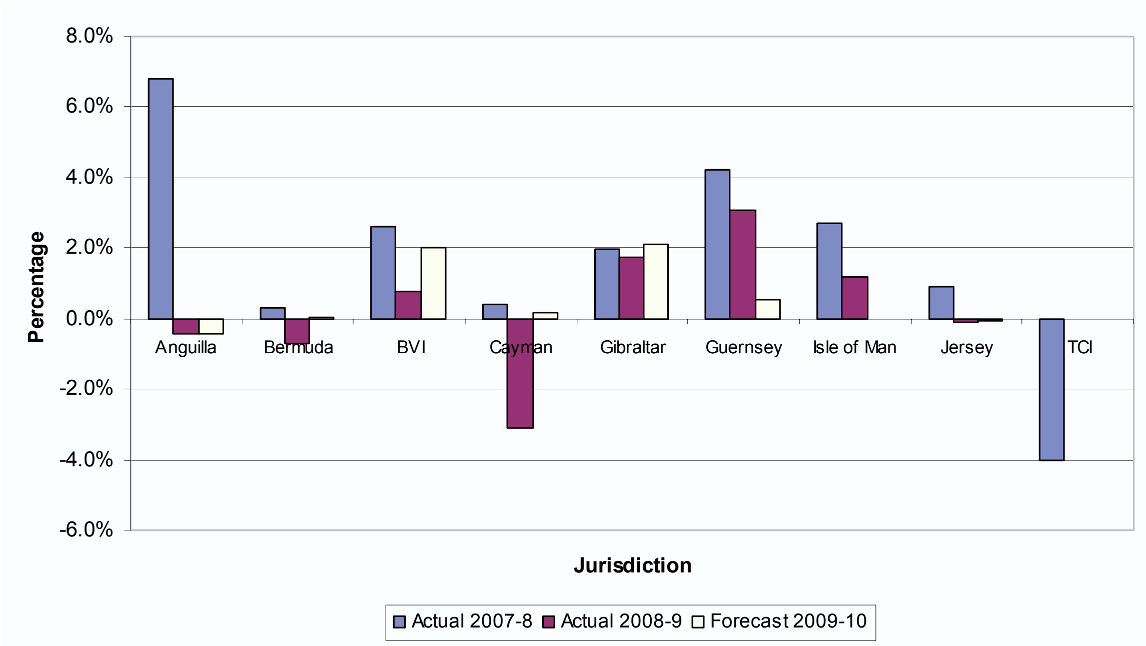
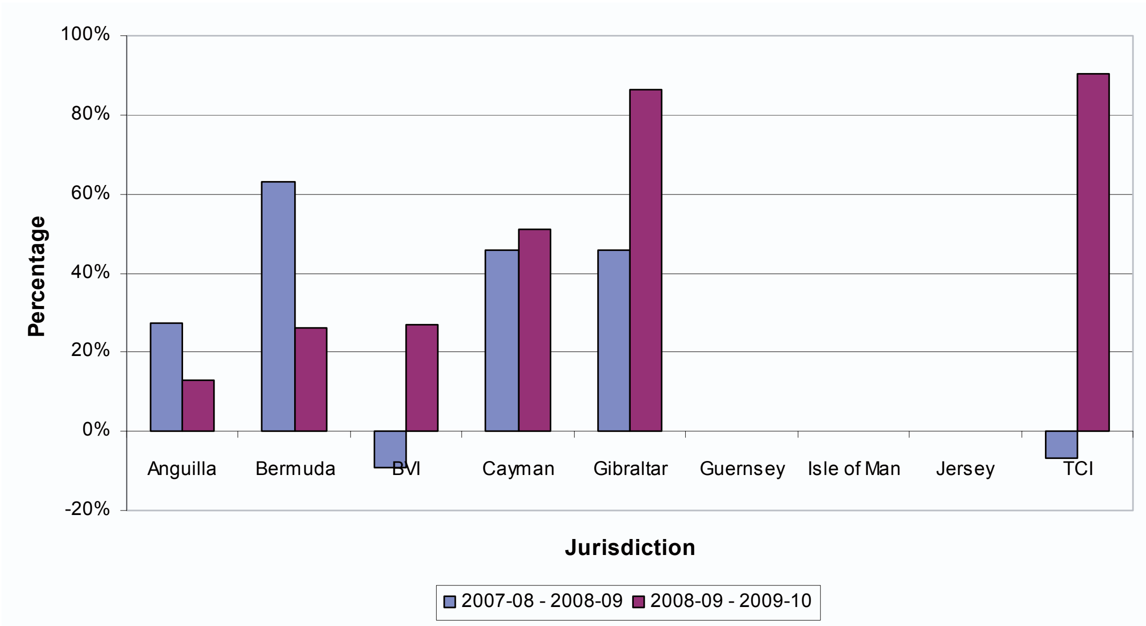


Chart 3.D: Percentage increase in borrowing by jurisdiction, 2007-8 to 2009-10



3.25 None of the Crown Dependencies have, however, taken on significant levels borrowing. This is a measure of the economic resilience achieved by pursuing a policy of building up reserves during a period of rapid economic growth to provide a cushion during a downturn. The

[6] The Turks and Caicos Islands do not have actual outcomes for the 2008-9 fiscal year or forecast data for the 2009-10 fiscal year. The figures for Jersey are expressed as a percentage of GVA.

reserves range from £582 million (at 31 December 2008) in Jersey to £221.3 million (at 31 December 2008) in Guernsey. The reserve fund in the Isle of Man stood at £337 million at 31 March 2009.

3.26 There is also evidence that the Crown Dependencies are taking further action to help combat the effect of reduced revenues. For example, Jersey has identified savings of £17 million in its 2010 Business Plan, whilst also implementing a public sector pay freeze.

3.27 Gibraltar has recently reported an overall budget surplus of £15 million to the year ended 31 March 2009 and has forecast a surplus of £19 million for the year ending 31 March 2010. However, total borrowing is forecast to grow to £350 million for the year ended March 2010, an increase of more than 80 per cent from 2009. This is partially offset by a forecast increase of reserves over the same period to £234 million in 2010 from £129 million in 2009. Net public debt is therefore forecast to increase by 86 per cent from £62.2m (or 7.3 per cent of GDP) in 2009 to £115.8m (or 12.9 per cent of GDP) in 2010.

3.28 Bermuda recorded a modest deficit in fiscal year 2008 and had limited borrowing totalling about 6 per cent of GDP. For the year ended 31 March 2009, the Government of Bermuda recorded a total deficit of around 4 per cent of GDP which was financed by additional borrowing that left total borrowing at around 10 per cent of GDP. Spending in most government departments is planned to reduce by 10.5 per cent in the 2010 fiscal year.

3.29 The downturn in fee income from international business company incorporations has contributed to the deterioration in the public finances in the British Virgin Islands. The national debt increased by 27 per cent to $102.4 million in 2009 and annual debt servicing obligations have grown by 34.6 per cent since 2008. Revenue is forecast to decline by 5 per cent in 2009 compared with the previous year.

3.30 The impact on the public finances in the Cayman Islands has been particularly severe. The Government has recently reported a budget deficit of $67.6 million at 30 June 2009 (compared with a small surplus in the prior year). As Chart 3.D illustrates, central government debt increased significantly on the 2007-8 fiscal year and is forecast to rise again by a further 51 per cent in 2009-10.

3.31 The Cayman Islands Government has acknowledged that the state of the public finances is 'severely challenged'. The principles of responsible financial management contained in the Public Management and Finance Law were not satisfied at the start of the financial year (1 July 2009), removing the option for the local government to increase borrowing without seeking the approval of the Foreign and Commonwealth Office (FCO) in the UK[7]. However, in return for increases in current revenue measures (forecast to bring in additional income of $105.3 million) announced in the latest 2009-10 budget, the FCO has agreed to an increase in government borrowing. The Cayman Islands Government has forecast that it will be fully compliant with all the principles of responsible financial management, despite resisting calls for a widening of the tax base.

3.32 The Government of Anguilla has not confirmed its current fiscal position. However, the latest data available to the Review show that government revenue was 15 per cent below budget during 2008 and a budget deficit in excess of the $5.7 million forecast for 2009 is in prospect (the deficit was $11.9 million at 31 August 2009). If realised, the Government's financial reserves, which totalled $13.5 million in December 2008, would be exhausted by the end of 2009. Anguilla's problems were compounded by a decision to increase public service pay by 25 per cent in September 2008. (Public service pay was subsequently cut by 10 per cent from

[7] See Annex D for an explanation of the FCO's borrowing guidelines.

July 2009.) Anguilla has pressed for an increase in government borrowing, adding to existing debt that totalled just over 25 per cent of GDP in September 2008.

3.33 The public finances of the Turks and Caicos Islands have also deteriorated significantly. The fiscal year 2007-8 was forecast to produce a small surplus but actually produced a deficit of $35.7 million; the true deficit may be higher. Government reserves have been exhausted and unpaid creditors were owed at least $50 million at 30 June 2009.

Improving economic resilience

3.34 The lasting impact of the economic downturn will to a large extent depend upon its length and severity. While there is reason to hope that some pressures (particularly on tourism) will ease as the global economy picks up, many of the longer term effects on the financial sector may not have been felt fully as many large financial service firms have yet to implement the results of strategic reviews of their future geographical 'footprint' and product ranges. In individual cases, these reviews could bring additional employment (where, for example, a financial institution chooses to reduce the number of its international operations and concentrates more work in one of the jurisdictions). However, overall the reviews are likely to lead to a net loss of employment across the jurisdictions over time.

3.35 In any event, the global downturn has provided a sharp reminder of the need for some of the jurisdictions to take urgent measures to ensure that robust economic planning and fiscal control measures are in place and observed.

3.36 The Review has identified a number of benchmark standards which will not provide a 'quick fix' to current public sector finance problems but which, if enacted, should help jurisdictions in their short-term efforts and, importantly, limit the risk of future problems.

Box 3.A: Benchmark standards

- Timely and accurate measurement of economic variables including public revenues and public expenditure.
- Effective measures to control public spending and improve public sector efficiency.
- Identification of options to maximise sources of revenue, including diversifying the tax base.
- Building sufficient reserves to improve economic resilience.
- Medium-term economic planning (ideally with independent input) to support the fiscal planning process.

3.37 The measurement and planning of economic variables, government revenues and government expenditure and the interpretation of the resulting data are fundamental to effective economic management. The absence of timely and reliable data and of the expertise to analyse trends will limit a government's ability to forecast, plan and take well-targeted action as has been seen in some of the Overseas Territories.

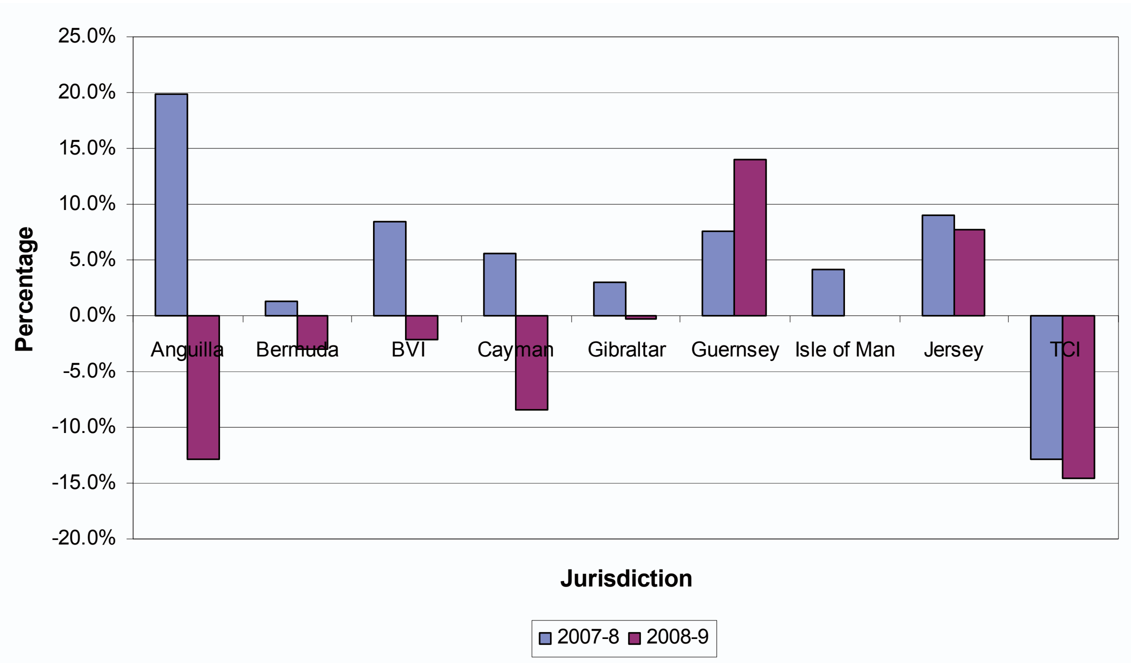
3.38 Weaknesses in data quality have been recognised is some cases. For example, the British Virgin Islands have commissioned an economic impact study better to understand the internal and external contributions of the financial services industry. However, more needs to be done to improve the timeliness and accuracy of economic and financial information. Ensuring that annual accounts for government finances are independently audited on a timely basis and made publicly available would complement efforts in this area.

3.39 Weaknesses in medium-term planning must also be addressed and the Crown Dependencies provide examples of good practice in this area. Each has built-up economic analytical capacity, sometimes involving the use of a panel of external advisors to enhance objectivity. Medium-term scenarios and possible stresses for the economy are produced as an integral aid to economic planning in several jurisdictions.

3.40 The Crown Dependencies had a better track record than other jurisdictions in forecasting future budget positions. This is illustrated in Chart 3.E, which compares forecast and actual government revenue in 2007-8 (when economic conditions were still relatively good) and 2008-9 (when conditions were worsening). Any inferences must be made with caution because the downturn was more severe in some jurisdictions than others.

3.41 However, all the governments (apart from the Government of the Turks and Caicos Islands) underestimated their revenue takes for the financial years 2007-8[8], when the global economic upturn was nearing an end. Once the global economic downturn began, there appeared to be clear differences in forecasting ability (as illustrated by the year ends 2008-9[9]). Forecasts produced by the Crown Dependencies and Gibraltar were on target or underestimated the actual revenue takes. In contrast, all the Caribbean Territories and Bermuda overestimated their revenue takes during this period, though in some cases by small amounts.

Chart 3.E: Accuracy of government revenue forecasts versus actual results for 2007-8 and 2008-9



Conclusions

3.42 The benchmark standards outlined above will only bear fruit if those local governments that have not already done so demonstrate a clear commitment to improving economic management. This is their primary responsibility.

3.43 However, the UK's interest in the good governance of the jurisdictions means that the UK should satisfy itself that each jurisdiction indeed has a framework capable of identifying and responding to external shocks and encourage local governments to undertake responsible

[8] For these purposes, this sample includes results for the year ends 31 December 2007, 31 March 2008, and 30 June 2008.

[9] For these purposes, this sample includes results for the year ends 31 December 2008, 31 March 2009, and 30 June 2009.

adjustment programmes. Where these programmes are realistic and there is a clear commitment to take the necessary measures, there is a place for allowing suitably controlled additional public sector borrowing to facilitate adjustment.

Recommendations

The Review recommends that:

- the quality and extent of financial planning in the jurisdictions should be aligned with that in the best performers (the Crown Dependencies). In particular, jurisdictions should implement a prudent approach to managing government finances by developing: a diversified tax base to maximise sources of revenue; mechanisms to measure and control public spending; and by building financial reserves during periods of economic growth;
- the UK should be proactive in satisfying itself that the Overseas Territories in particular have frameworks capable of identifying and responding to external shocks and encouraging local governments to undertake responsible adjustment programmes where these are necessary.

4 The role of tax in sustaining business models

Introduction

4.1 The international response to the global financial crises has put consideration of tax practices centre stage. Particularly close attention has been paid to the tax practices adopted by jurisdictions with offshore financial centres.

4.2 The international focus has been on whether so-called 'low tax' jurisdictions are pursuing tax practices which are harmful and on the willingness of all jurisdictions to share tax information to reduce the scope for tax evasion by companies and individuals.

4.3 How the nine jurisdictions measure up to the emerging international consensus around tax norms and international standards on tax transparency is material to their economic sustainability. In recent months, a number of multinational companies and financial institutions have announced plans to leave some of the jurisdictions, citing international pressure on tax. Even without these international pressures, the fiscal pressures discussed in chapter 3 of this Report could be expected to encourage governments to consider options for increasing revenue.

4.4 This chapter draws on an evaluation of the importance of the Crown Dependencies and Overseas Territories in tax avoidance by UK corporates commissioned by the Review and conducted by Deloitte (reproduced in full in Annex E). The evaluation did not consider tax evasion and avoidance by individuals which the international community is addressing through improved transparency.

4.5 This chapter:

- examines the extent to which the sustainability of the business models in the nine jurisdictions is dependent on the continuation of existing tax models; and
- reviews the progress that has been made by the nine jurisdictions in meeting the international standards for tax transparency.

The role of tax

4.6 The nine jurisdictions operate in a global market where most (if not all) countries seek to make their tax regimes competitive. Most developed economies raise revenues through a wide range of taxes. Treaties between different jurisdictions to avoid double taxation (i.e. the imposition of two or more taxes in different jurisdictions on the same income, asset or transaction) facilitate cross-border economic activity, although not all jurisdictions have such treaties.

4.7 At a simplified level, Deloitte has divided jurisdictions into three categories:

- 'full-tax' treaty jurisdictions which have a fully developed range of taxes levied at significant levels and extensive double taxation agreement (DTA) networks;

- 'tax arbitrage-oriented' treaty jurisdictions which have similarly well developed tax systems but which may be viewed as making their territories available for international tax arbitrage;
- 'limited/no treaty' jurisdictions which typically have fewer forms of taxation and limited DTA networks.

4.8 Deloitte tentatively concluded that the Crown Dependencies and Overseas Territories (which fall within the third category) were distinguished within the developed world by differentiating themselves from the international consensus, sometimes through tax rates but more often through the absence or near absence of certain forms of taxation.

4.9 The tax regimes in most of the Overseas Territories have not evolved beyond the imposition of specific transaction and consumption taxes: they operate a range of customs duties on imports, on which they are heavily reliant for revenue. With the exception of Gibraltar, the Overseas Territories have not introduced income taxes, corporation taxes, or value added tax (VAT) or goods and services tax (GST).

4.10 The tax regimes in the Crown Dependencies and Gibraltar have developed to include income and corporation taxes, with the latter consistently levied at a lower rate than the main rate in the UK.

4.11 The development of indirect taxes in the Crown Dependencies has been more diverse. Guernsey does not currently apply VAT or GST. Jersey introduced a system of GST in 2008 with an international services exemption fee which allows financial services companies to pay a flat fee in return for an opt-out from the regime. The Isle of Man operate VAT as part of the European Union VAT territory: receipts collected in the UK and the Isle of Man are pooled and then shared in accordance with an agreed formula.

Adapting to a changing global tax environment

4.12 Whilst there were other drivers for doing business in these jurisdictions (including, for example, a stable legal environment and authorities who were responsive to market developments), Deloitte concluded that tax was an important motivating factor.

4.13 Deloitte noted that the jurisdictions' main competitors were increasingly countries with developed tax systems and tax treaty networks such as Switzerland, Luxembourg and Ireland. The Review was keen to understand the impact on the competitive position of the nine jurisdictions should local governments wish to move closer to developing international tax norms.

4.14 Deloitte considered the scope for the jurisdictions moving towards consensus models in the areas of VAT and corporation tax (CT).

4.15 Deloitte concluded that there was a compelling case for those of the nine jurisdictions which do not already operate VAT or GST to consider introducing such a system to increase the sustainability of their business models by broadening their revenue bases. Deloitte noted that this would be of particular importance for the Overseas Territories should the global trend for reducing reliance on customs duties continue.

4.16 Deloitte also concluded that the Crown Dependencies' industry bases were sufficiently diverse that they had the potential to raise worthwhile levels of revenue from a CT system more aligned with international 'best practice' than the regimes currently in place. By contrast, some of the Overseas Territories' focus on a narrower financial sector niche suggested that the introduction of a broad-based CT would offer less scope for a significant tax take.

4.17 Deloitte concluded that, in any event, the downside of a properly constructed 'best practice' CT system would appear to be relatively limited and would bring the jurisdictions more into the mainstream of the international community. It might also curtail some scope for tax avoidance.

4.18 However, Deloitte recognised that given the diverse tax regimes and industry bases of the Crown Dependencies and Overseas Territories, a single template for all the jurisdictions might not be appropriate. A detailed impact assessment of the effect of introducing tax changes in individual jurisdictions would also need to be undertaken. (The report suggests a methodology for producing a more comprehensive impact assessment.)

4.19 At a practical level, any jurisdiction considering introducing new taxes (or fees) must have the ability to administer them to ensure that they are not avoided. It would be in the UK's interest to provide technical assistance were it requested by a jurisdiction.

4.20 It is also of interest to the UK that Deloitte concluded that were the Crown Dependencies and Overseas Territories to take action which reduced their competitiveness, the business would be unlikely to flow to the UK.

Quantifying the 'tax gap'

4.21 Deloitte considered UK corporates' use of the Crown Dependencies and Overseas Territories and identified some activities which could be considered tax avoidance. To assess the impact of these activities on the UK, Deloitte built on previous studies, which had attempted to quantify the UK corporate 'tax gap' due to tax avoidance, and estimated (based on companies' published accounts) the 'expectations gap' between the tax these companies might broadly be expected to pay and the tax actually paid. Deloitte estimated that the amount of UK corporate tax potentially avoided by UK corporates was likely to be up to £2.0billion per annum, with avoidance through the nine jurisdictions an unidentified sub-component.

Tax information exchange agreements

4.22 The principles of transparency and exchange of information developed by the OECD's Global Forum have been endorsed by countries around the world. The G20 London Summit in April 2009 continued the push to implement the minimum standard of each jurisdiction signing at least 12 tax information exchange agreements (TIEAs) with other countries that would allow the latter to obtain information about income earned by their taxpayers outside of their home jurisdiction.

4.23 This renewed international focus on tax transparency encouraged leading international financial jurisdictions such as Switzerland and Singapore to commit to the standard for the first time.

4.24 In April 2009, the OECD published a three tier list that categorised jurisdictions into those that had 'substantially implemented' information sharing agreements, those that had pledged to do so and those that had not agreed to share information.

4.25 The Crown Dependencies were all considered to have 'substantially implemented' the agreed standard. However, in general the Overseas Territories were behind the Crown Dependencies. Bermuda and more recently the Cayman Islands, British Virgin Islands and Gibraltar have subsequently 'substantially implemented' the agreed standard. The Turks and Caicos Islands have signed five TIEAs and Anguilla has signed four agreements.

4.26 It is anticipated that standards in this area will continue to rise and even those of the nine jurisdictions within the scope of this Review that have met or exceeded the current standard of

12 TIEAs should continue to enter further agreements, giving priority to those jurisdictions with which they have significant financial links.

4.27 This imperative is well understood and it is appropriate that the commitment to tax transparency shown by a number of the jurisdictions has been recognised in statements by the UK Government.

4.28 The nine jurisdictions must show a commitment not just to the letter but also the spirit of international standards. Effective implementation will be an important test of this and evidence will be provided by the OECD's Global Forum through a monitoring and peer review process. It is vital that competitor jurisdictions show the same commitment.

4.29 The peer review process will be carried out in two phases. The preliminary stage will be to monitor and review the legal and regulatory framework to identify possible domestic law obstacles to information exchange. The second phase of the review will identify any practical barriers to the effectiveness of exchange of information.

Automatic information exchange

4.30 In the longer term, the trend for greater transparency is likely to result in pressure to move to a system of automatic exchange of information with the aim of combating tax evasion by individuals on a cross-border basis. Automatic information exchange is the systematic and periodic transmission of taxpayer information by the source country to the residence country and is supported by a number of NGOs in the UK.

4.31 This is already the objective under the European Union Savings Directive (EUSD) agreed in 2003, although some EU Member States have taken advantage of a transitional arrangement to instead levy a withholding tax on interest payments of 20 per cent (increasing to 35 per cent in July 2011). There is, however, pressure to remove the withholding tax option and a proposal to apply the EUSD to a broader range of savings income.

4.32 The Crown Dependences are outside the EU but participate in the EUSD framework under Savings Agreements with the Member States. The Crown Dependencies apply the transitional withholding tax option, which under their Savings Agreements they must give up in favour of automatic exchange of information when the three Member States applying withholding tax move to automatic exchange.

4.33 The Isle of Man has committed to moving to automatic exchange of information by July 2011. Guernsey is reviewing its position and Jersey has said that it is ready to introduce automatic exchange of information as soon as the EU brings the transitional period to an end. The Review encourages both jurisdictions to announce a firm date for a move to automatic exchange. At the same time, the UK should call on all EU Member States and third party countries which currently apply the withholding tax option to also make a similarly firm commitment.

4.34 Of the Overseas Territories, Gibraltar is directly subject to the EUSD and in most cases applies automatic exchange. Anguilla and the Cayman Islands have adopted the EUSD and apply automatic exchange. The British Virgin Islands and the Turks and Caicos Islands have adopted the withholding tax option under the EUSD. Again, the Review encourages all the Territories within the scope of this Review to commit to moving to automatic exchange.

Conclusions

4.35 The governments in the jurisdictions might wish to reflect on how they measure up to the emerging international consensus around tax norms and on what this may imply for their economic sustainability to complement consideration of potential responses to fiscal pressures discussed in chapter 3.

4.36 The jurisdictions have participated in international moves to deliver greater co-operation between jurisdictions on the exchange of tax information. Efforts to improve information exchange are likely to continue. The jurisdictions within the scope of this Review must keep pace with international developments and move towards full automatic information exchange wherever possible. However, it is vital that pressure is maintained on competitor jurisdictions also to meet the standards to ensure that international objectives are delivered.

Recommendations

The Review recommends that the jurisdictions:

- meet the international standard on tax transparency set by the OECD and continue, even after meeting the current minimum of 12 TIEAs, to negotiate further TIEAs, giving priority to those jurisdictions with which they have significant financial links;
- set up the administrative procedures necessary to ensure full delivery of the OECD standard, to a level of compliance that will satisfy the peer review process that is being be put in place;
- make an early commitment, with a timetable for implementation, to automatic exchange of tax information under the EU Savings Directive where they have not already done so.

5 Delivering effective regulation

Introduction

5.1 Effective regulation of financial services business, which is compliant with international standards, is a requirement for a sustainable business model and not an option. This is recognised by the nine jurisdictions within the scope of the Review but the standards achieved in practice have been mixed.

5.2 This chapter:

- examines the compliance of the nine jurisdictions with international regulatory standards; and
- identifies areas for improvement.

International assessment process

5.3 The nine jurisdictions within the scope of this Review are subject to the International Monetary Fund's Financial Sector Assessment Programme. The programme assesses each jurisdiction against the supervisory principles promulgated by the Basel Committee on Banking Supervision, the International Organisation of Securities Commissions and the International Association of Insurance Supervisors; and the anti-money laundering standards published by the Financial Action Task Force, which are discussed in chapter 7.

5.4 The initial phase of the programme was completed in 2005. A further round of assessments was subsequently launched and assessments of Bermuda and Gibraltar had been completed before the Review started work (both were published in 2008).

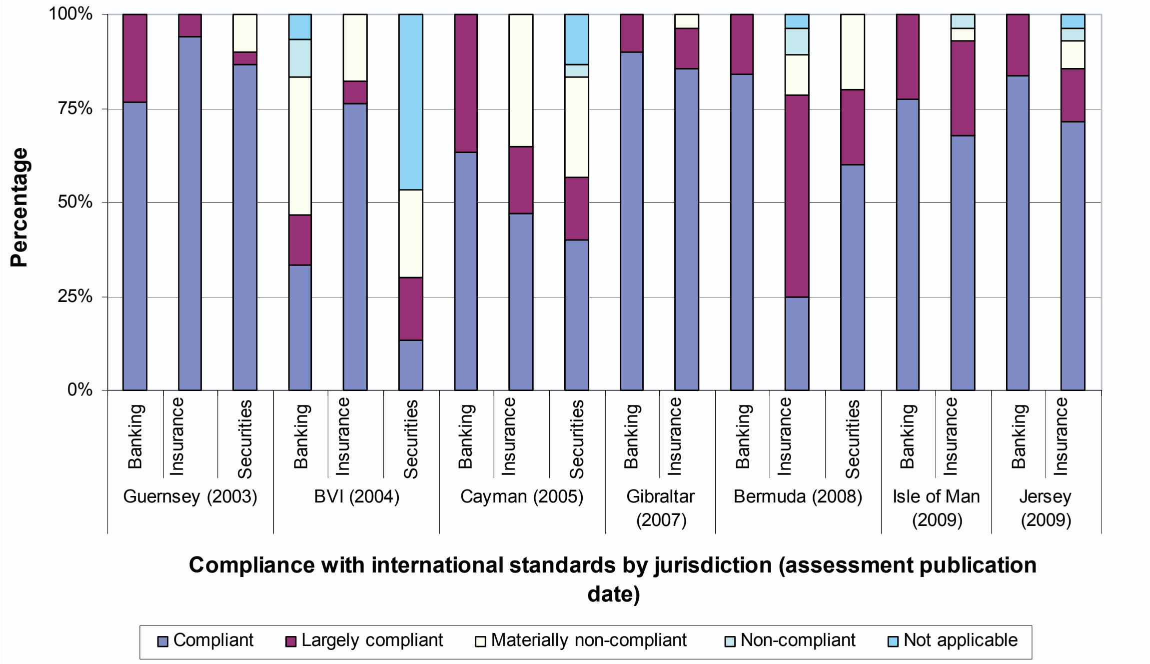
5.5 The Review drew on the findings of these detailed assessments, which were followed up in discussions with the jurisdictions.

5.6 Second round assessments of the Cayman Islands, the Isle of Man and Jersey were underway during the course of the Review and the information prepared by the authorities for this process provided a ready source of information for the Review. The IMF published its assessments of the Isle of Man and Jersey in September 2009.

Compliance with international standards

5.7 The IMF assessment programme shows a mixed picture on compliance with international regulatory standards across the jurisdictions within the scope of this Review (see Chart 5.A). The Crown Dependencies have received positive IMF assessments, but there is scope for improvement in some of the Overseas Territories. This is most evident in the smaller Territories (not shown in the chart), where compliance costs bear most heavily because of a lack of economies of scale and the difficulty of attracting staff with the necessary expertise.

Chart 5.A: Comparative levels of compliance with IMF assessed principles of regulation in banking (Basel), insurance (IAIS) and securities (IOSCO)[1]



5.8 None of the jurisdictions can afford to be complacent as international standards continue to rise. Each jurisdiction must be willing and able to co-operate with other regulatory authorities and exchange regulatory information.

5.9 The Financial Stability Board has responded to the G20's call to identify non-cooperative jurisdictions and to initiate a peer review process, and has announced that it will report on the development of a framework to strengthen adherence to international regulatory and prudential standards at the November 2009 meeting of G20 Finance Ministers and Central Bank Governors.

Resources

5.10 No regulatory authority can expect to satisfy the requirements of the peer review process unless the quantum and expertise of resources employed are sufficient.

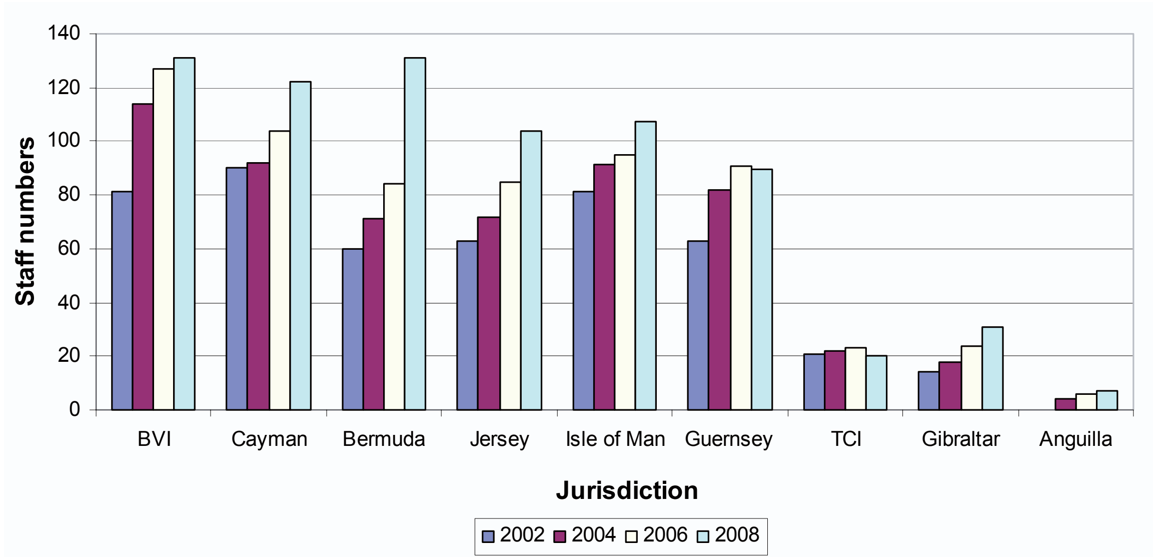
5.11 Chart 5.B gives an indication of the comparative size of the regulatory authority in each jurisdiction, although specific comparisons should be made with caution because of the variation in the functions performed by the regulatory authorities. For example, around 50 per cent of the staff employed by the Financial Services Commission in the Turks and Caicos Islands are employed in the registry of companies.

5.12 Chart 5.B shows clearly, however, that total staff numbers have generally been on a rising trend. The jurisdictions have recognised the need to increase capacity to: meet the demands of international standards; deliver effective front-line supervision; and also to secure the competitive advantages derived from being a well regulated jurisdiction.

[1] Comparisons between those jurisdictions with only first round assessments and those with second round assessments should be made with care because of developments in the methodology applied by the IMF. Gibraltar, Jersey and the Isle of Man were not assessed against IOSCO principles in the most recent assessments. The ratings shown for banking supervision and securities for Bermuda reflect the Bermuda Monetary Authority's analysis of the IMF's assessment which did not itself include compliance ratings for these areas. Anguilla and the Turks and Caicos Islands have not been included in the Chart, as the assessments published in 2003 and 2005 respectively did not provide compliance ratings.

5.13 Bermuda and Gibraltar have more than doubled the number of staff employed since 2002, whilst the British Virgin Islands and Jersey have both increased staff resources by more than 60 per cent.

Chart 5.B: Total number of staff employed by financial services regulatory authorities 2002 - 2008



5.14 Anguilla has also seen an increase in staff resources, but the picture in the Turks and Caicos Islands is more variable. However, both jurisdictions employ fewer than ten staff to supervise licensed financial services providers. This is below the 'critical mass' that can be effective in implementing prudential and anti-financial crime requirements across a range of financial institutions.

5.15 The ratio of staff allocated to the regulation of licensed entities has also outpaced the increase in licences issued in most of the jurisdictions (Chart 5.C). This crude measure does not, of course, take account of 'critical mass' requirements or factors such as the real or perceived degree of regulatory risk generated by different licence classes.

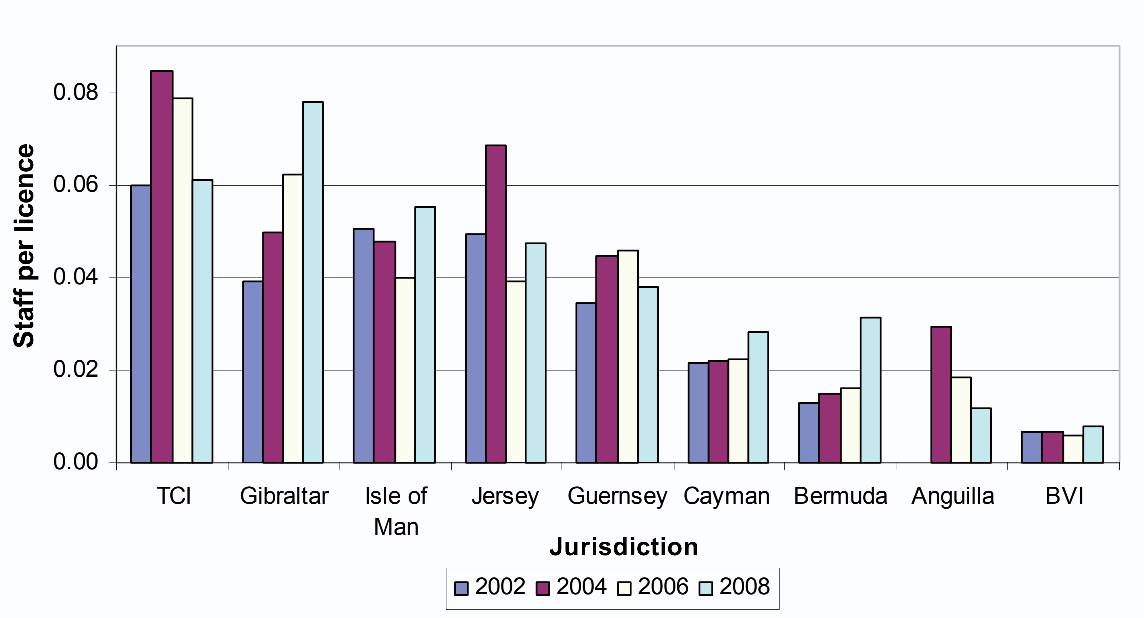
5.16 The limitations of the measure are illustrated by the results for the Turks and Caicos Islands. Whilst the Financial Services Commission appears comparatively well resourced, the burden of regulation appeared to the Review to fall disproportionately on a small number of senior staff and there is little on-site examination capacity.

5.17 The analysis for the Cayman Islands excludes almost 10,000 mutual funds (on 2008 figures) which were registered by the Cayman Islands Monetary Authority (CIMA) but did not require a licence. This suggests that the introduction of more intrusive regulation of hedge funds could put pressure on CIMA's resources.

5.18 Whatever the limitations of the analysis, the challenge for all jurisdictions will be to maintain resource levels during a period when fee income has or may reduce as the economic effects of the global downturn are felt.

5.19 The immediate challenge for the authorities in Anguilla and the Turks and Caicos Islands is to increase the quantum and expertise of resources available to their respective Financial Services Commissions. These jurisdictions must explain how and when these resources will be provided. Delivering these commitments is a necessary precondition if these jurisdictions wish to continue to offer themselves as international financial services centres.

Chart 5.C: Ratio of staff allocated to the regulation of licensed entities 2002-2008



Technical assistance

5.20 Even with a clear political commitment, recruiting additional high quality regulatory staff in Anguilla and the Turks and Caicos Islands will take some time. This raises the question of whether the UK should provide an oversight function to reinforce the regulator to reduce reputational and potential financial risks to the UK. (The Governor retains responsibility for international financial services regulation in both jurisdictions.)

5.21 The responsibility for operating an oversight function would most naturally fall to the Financial Services Authority (FSA) in the UK. In practice, the function could only be discharged by the FSA setting up an office in Anguilla and the Turks and Caicos Islands. This would confuse lines of accountability, provide a disincentive for these jurisdictions to take responsibility for their own actions and increase the UK's financial risk exposure to the jurisdictions. It would also be likely to require legislation to extend the FSA's powers. In short, it has little to commend it.

5.22 The alternative would be to provide technical assistance. This might, in the first instance, better be targeted at the fight against financial crime (see chapter 7). Such a focus would, however, permit assistance to the regulator to boost its capacity to tackle financial crime.

Regulatory co-operation

5.23 Some of the jurisdictions work closely with the UK to ensure that mutual regulatory objectives are secured. In the case of the Crown Dependencies, this co-operation is formalised in memoranda of understanding. The Crown Dependencies' concerns about how the arrangements operated in practice at the height of the banking crises have been widely reported. The Review has not sought to reach conclusions on those cases. It is, however, important that there is effective co-operation between the FSA and the regulators in the nine jurisdictions when this is required to deliver effective regulation.

5.24 There must equally be effective co-operation between the nine jurisdictions and other regulators with whom they deal, whether that is the Securities and Exchange Commission in the US or the regulator in one of the eight other jurisdictions within the scope of the Review.

5.25 The nine jurisdictions already co-operate with each other on policy development and the sharing of information. The Review considers, however, that more could be done and that a greater degree of co-operation on policy issues could help the jurisdictions to influence the debate on raising international regulatory standards.

Independence and integrity

5.26 Improvements to governance structures in the financial services commissions in Anguilla and the Turks and Caicos Islands could be achieved relatively quickly to bring them into line with best practice. This process has already started in the case of the latter.

5.27 Independent non-executive board members not linked to the local financial services industry are a necessary requirement of good governance, which typically means that some of the regulatory Commissioners should be drawn from outside the jurisdiction. Evidence across the jurisdictions is that a number of regulators are accountable to bodies that include evidently independent and external members. This involves additional travel and other expenses but the potential benefits justify this initiative.

5.28 Even where good governance arrangements are in place, the independence and integrity of regulatory decisions can come under pressure. The potential for pressure is, however, particularly high in jurisdictions such as those within the scope of the Review where the financial services industry is a major contributor to the local economy and lines of communication between government, regulator and industry are short.

5.29 The Public Accounts Committee in the UK has recognised the challenges posed for small jurisdictions where direct personal or family relationships often exist between officials and citizens[2]. And a number of NGOs in the UK saw the 'capture' of local politicians and regulators by the industry in a small jurisdiction as a major problem.

5.30 One way this pressure is likely to manifest itself is through a blurring of the line between financial regulation and promotion of the financial centre. In most cases, promotion and regulatory functions are institutionally separate, but the potential for a blurring of the boundaries is ever present. It is incumbent on the regulator and those responsible for the administration, licensing or registration of financial services business not to assume a dual role in promoting, facilitating or negotiating the introduction of business.

5.31 In the case of Anguilla, responsibility for financial promotion should be removed from the Registrar of Companies where it currently lies.

Conclusions

5.32 Those jurisdictions with high regulatory standards must remain focussed on ensuring that they keep pace with rising international standards. Jurisdictions which do not currently meet international standards must, as a matter of priority, explain how and when they expect to do so. Local governments in these jurisdictions must take responsibility for this process and show clear leadership if they wish to retain an internationally active financial services centre.

[2] Foreign and Commonwealth Office: Managing Risk in the Overseas Territories, HC 176, chapter 3.

Recommendations

The Review recommends that:

- those jurisdictions which have not already done so should ensure that the regulatory authorities have the necessary resources and expertise to implement and enforce international financial sector regulatory standards;
- all jurisdictions should ensure that governance arrangements in their regulatory authorities are sufficient to maintain the integrity and independence of all decisions taken;
- responsibility for promotion of the financial centre should be separate from the regulator in both letter and spirit.

6 Financial sector crisis management and resolution arrangements

Introduction

6.1 The importance of effective arrangements to resolve a financial crisis was very much in the public eye in the UK when this Review was commissioned. The impact of the crisis had also been directly felt in Guernsey and the Isle of Man following the collapse of two Icelandic banks.

6.2 Jurisdictions without deposit protection schemes were prompted by the crisis to consider their introduction. But experience has shown that consideration of resolution arrangements must extend beyond such schemes to consider, for example, the operation of insolvency and bankruptcy law.

6.3 The effectiveness of financial crisis management and resolution arrangements is clearly important for the jurisdictions themselves. It is, however, also of interest to the UK given its good governance responsibilities and potential financial contingent liabilities in some cases.

6.4 This chapter:

- outlines the deposit protection principles published by the Basel Committee on Banking Supervision and the International Association of Deposit Insurers (IADI);
- reviews the deposit protection schemes currently in place in the jurisdictions within the scope of this Review;
- proposes preventative measures that could be put in place to reduce the exposure of jurisdictions to risk of the failure of a major local financial institution; and
- considers the potential impact of the failure of such an institution and the sufficiency of resolution arrangements in the event of such a collapse.

Deposit protection principles

6.5 Protection of retail deposits (within defined limits) is a requirement in the European Union and is also widely provided in other parts of the world. In the immediate aftermath of the problems in the banking sector around the world, the existence of deposit protection schemes was increasingly seen as necessary to provide assurance to retail depositors. Although pressure from depositors has abated, a number of jurisdictions within the scope of this Review which do not currently have schemes are pursuing plans to introduce them.

6.6 This renewed interest in deposit protection, and the strain placed on existing schemes by large banks getting into difficulties, encouraged the Basel Committee on Banking Supervision and the International Association of Deposit Insurers (IADI) jointly to publish core principles on deposit protection. (Those most relevant to the Review are reproduced in Box 6.A below).

Box 6.A: Core Principles for Effective Deposit Insurance Systems

Principles

Mitigating moral hazard: Moral hazard should be mitigated by ensuring that the deposit insurance system contains appropriate design features and through other elements of the financial system safety net.

Governance: The deposit insurer should be operationally independent, transparent, accountable and insulated from undue political and industry influence.

Relationships with other safety-net participants: A framework should be in place for close co-ordination and information sharing, on a routine basis as well as in relation to particular banks, among the deposit insurer and other financial system safety-net participants.

Compulsory membership: Membership in the deposit insurance system should be compulsory for all financial institutions accepting deposits from those deemed most in need of protection (e.g. retail and small business depositors) to avoid adverse selection.

Coverage: Policymakers should define clearly in law, prudential regulations or by-laws what an insurable deposit is. The level of coverage should be limited but credible and be capable of being quickly determined. It should cover adequately the large majority of depositors to meet the public policy objectives of the system and be internally consistent with other deposit insurance system design features.

Funding: A deposit insurance system should have available all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims including a means of obtaining supplementary back-up funding for liquidity purposes when required.

Public awareness: In order for a deposit insurance system to be effective it is essential that the public be informed on an ongoing basis about the benefits and limitations of the system.

Early detection and timely intervention and resolution: The deposit insurer should be part of a framework within the financial system safety net that provides for the early detection and timely intervention and resolution of troubled banks.

Reimbursing depositors: The deposit insurance system should give depositors prompt access to their insured funds.

Deposit protection schemes

6.7 Some jurisdictions within the scope of this Review have compensation schemes which extend beyond deposit protection. The analysis in this chapter focuses, however, on deposit protection schemes which were the main focus of attention in the jurisdictions.

6.8 The Isle of Man has had a deposit protection scheme in operation since 1991. Compensation is paid out of levies collected from deposit takers in the jurisdiction, from sums loaned to the scheme by the Isle of Man Government and from any other sums that may be borrowed by the scheme manager. There is no standing fund (i.e. money is not collected before a bank failure).

6.9 All licensed banks in the Isle of Man are members of the scheme, which sets the compensation limit at £50,000 of net deposit for current and deposit accounts and up to £20,000 for most other categories of depositor such as companies and trusts.

6.10 The scheme manager determines the total liability under the scheme in any financial year of the scheme. The total amount which could be levied on scheme participants is currently capped at £200 million. If the total amount owed to eligible depositors was greater than £200 million, the amount per depositor would be reduced proportionately to ensure that the liability cap was not exceeded.

6.11 The scheme introduced by Guernsey in November 2008 similarly sets the compensation limit at £50,000 and includes a liability cap of £100m in any five-year period. Again, there is no standing fund but the local government has agreed in principle to assist the scheme by guaranteeing an insurance policy of £20 million (a sum it can afford) to provide liquidity to the scheme.

6.12 The scheme in Gibraltar (introduced in 1998) applies the requirements of the EU Deposit Guarantee Schemes Directive and does not include a liability cap (which would not be consistent with the terms of the Directive). Gibraltar's potential liability would be increased if the EU increases depositor compensation limits to €100,000 in 2010.

6.13 The Gibraltar authorities have stated that the absence of a liability cap poses no consequent threat because the majority of the 12 banks operating in Gibraltar are large multi-national operations, which have either significant home state public ownership or have tacit or explicit state support. The remaining banks are primarily smaller wealth managers.

6.14 The remaining jurisdictions within the scope of this Review do not currently have deposit protection schemes in place. Jersey is, however, consulting on introducing one and Bermuda and the Turks and Caicos Islands are known also to be considering the possibility of introducing schemes.

Issues for consideration

6.15 The liability caps which feature in the deposit protection schemes in the Isle of Man and Guernsey seek to strike a balance between providing comfort to retail depositors and not leaving banks within the jurisdiction facing a potentially unlimited liability. In practice, the liability cap means that the compensation paid to depositors in the event of a bank failure could be significantly less than £50,000 if payments at that level would exceed the cap.

6.16 The effect of the cap would be to vary the maximum payment to depositors depending on the size of the bank which had failed. Depositors with a large failed bank might receive less than £50,000 because the cap had been triggered, whilst depositors in a small failed bank would be more likely to receive compensation up to the £50,000 depositor limit.

6.17 Some depositors may not understand the implications of the liability cap. Misunderstandings could potentially result in accusations by depositors that they had been misled. Any jurisdiction within the scope of the Review which currently has, or is considering introducing, a scheme with a liability cap should therefore:

- review its scheme in the light of the Basel Committee's principles and consider in particular whether the existence of the 'cap' is or can be adequately explained to depositors, and whether clearer guidance could be introduced; and
- consider whether the future business model for that jurisdiction requires a deposit protection scheme for all depositors or whether the jurisdiction should not be seeking to attract foreign retail deposits. Reduction or elimination of these might allow jurisdictions to provide protection to local residents (who typically and reasonably want to bank locally) without the need for a liability cap.

6.18 Whatever the structure of the scheme in place, the ability to pay out quickly in the event of a bank failure is key. The Basel Committee and IADI identified the need to give depositors prompt access to their insured funds as one of their key principles. The need for the quick, efficient and transparent operation of the scheme were also lessons from the failure of Kaupthing Singer and Friedlander (Isle of Man) Limited[1].

Box 6.B Lessons from the Isle of Man

Framework: Coverage of the deposit protection scheme and to what level should be clearly defined.

Planning: Quick, efficient and transparent operation of the deposit protection scheme must be planned for robustly prior to any default, and periodically reviewed and tested rigorously.

Communication: Means of communication to key stakeholders should be clearly defined, and organised through implementation.

Funding: The deposit protection scheme should be affordable, with sources of funding identified and in place.

Legislation: Other legislation (e.g. liquidation and insolvency law) with which the deposit protection scheme may interact, should be identified, examined and reviewed.

Payment: The time period within which claims are paid out should be clearly set out and any early payment mechanisms should be carefully defined.

6.19 The Basel Committee has said that deposit protection schemes should have a means of obtaining supplementary back-up funding for liquidity purposes when required. This would be provided by an ability to borrow, including from the local government.

6.20 The availability of a loan for liquidity purposes is particularly important where there is no standing fund or where such a fund is in the early years of being built. Without it, sufficient funds may not be available to pay out quickly in the event of a bank failure.

6.21 In practice, loan finance would most likely come from the local government in the event of a significant bank failure. Jurisdictions which are considering introducing a deposit protection scheme should identify the sources of funding to deliver the prompt settlement of depositors' claims.

6.22 Jurisdictions should also review how the settlement of claims by the scheme would interact with other aspects of the legal framework such as insolvency and bankruptcy law and make any changes which might be appropriate.

Ombudsman schemes

6.23 A separate but related issue to deposit protection insurance was brought to the Review's attention during the consultation process. In the Crown Dependencies, where UK nationals (often 'ex-pats') purchase many financial products, one important element of consumer protection in the UK is typically missing. Only in the case of the Isle of Man does an

[1] In October 2008, the Isle of Man Financial Supervision Commission suspended Kaupthing Singer and Friedlander (Isle of Man) Limited ('KS&FIOM') banking licence, accordingly KS&FIOM ceased to trade as a bank. The Isle of Man Court also made a Provisional Liquidation Order in relation to KS&FIOM. The Isle of Man sought to introduce an alternative to liquidation of the company (Scheme of Arrangement) and activation of the Island's Depositors Compensation Scheme. However, this failed after the proposed Scheme of Arrangement did not gain the necessary levels of support when creditors voted on it in May. The bank was subsequently placed into liquidation in May 2009 and the DCS activated for depositors of the bank. However the Isle of Man government had already paid out £85m to depositors under the Government's two Early Payments Schemes, providing advance payments of up to £10,000 per depositor.

Ombudsman complaints scheme exist along the lines of that in the UK. The jurisdictions should consider whether such a scheme is justified.

Resolution

6.24 The Basel Committee and the IADI recognised that deposit insurance systems could not, by themselves, deal with systemically significant bank failures or a systemic crisis. In these cases, it was the responsibility of all participants (including the state) within the financial system to work together to resolve the crisis and this has been evident in responses in the UK and elsewhere to the crisis in the banking sector.

6.25 In the context of the jurisdictions within the scope of this Review, systemic risks can flow from the collapse of a foreign-owned bank with a presence in the jurisdiction and from the collapse of a locally-owned bank.

6.26 In the case of foreign-owned banks, the bulk of deposits collected in one of the jurisdictions will typically be remitted to the parent bank located elsewhere, limiting the chances of securing these deposits if the parent bank collapses.

6.27 Whilst this risk cannot be eliminated without undermining the business model which encouraged the bank to establish a presence in the first place, it can be reduced by a combination of tough licensing conditions and close contact with the parent bank's regulator. The Review was encouraged that a number of jurisdictions already give careful consideration to the type and standing of foreign-owned banks when considering licence applications.

6.28 In the case of locally-owned banks, the regulator's objective must be to limit the risk of a collapse. This is particularly the case for such banks where serious liquidity or solvency problems would have damaging consequences for the local economy were they to occur. The Review has identified a small number of locally owned banks in the Overseas Territories that are systemically important in the context of the local economy.

6.29 In one case, the Government of Bermuda acted swiftly during the course of the Review to commit $200 million to underwrite a preference share issue of a local bank. Such prompt action helped the share issue to be oversubscribed, leaving the local Government without any short-term financing obligation.

6.30 This demonstrated the importance of the regulator maintaining close oversight of systemically important banks (and other financial institutions) and being ready to act decisively in the event of problems occurring. To reinforce this process, the local authorities on their own initiative or at the request of the UK should have the power to require a periodic independent and external review of any such institution, paid for by the institution itself.

6.31 More generally, any jurisdiction that has not already done so should undertake a thorough examination of the range of powers available to resolve a crisis in its financial services sector. Jurisdictions might also consider (where they have not done so already) whether there are parts of the financial sector which should be scaled back to reduce risk exposure.

6.32 One of the Overseas Territories suggested to the Review that the UK should act as lender of last resort in the event of a shock to a jurisdiction's financial system and economy which was beyond the resources of that jurisdiction to deal with in the short-term. This could include the local consequences of the failure of a financial institution.

6.33 A lender of last resort facility would be a significant undertaking by the UK and it would be important to ensure that local governments had a strong incentive to put in place and enforce measures to reduce the risk of such circumstances arising.

6.34 If the UK Government wished to explore a loan facility, it would most likely be broadly similar to the kind of facilities that would be available to these jurisdictions if they were eligible for membership of the IMF. The circumstances in which a loan would be provided and the conditionality attached would need to be clear. But as this Review makes clear, there are a number of ways for a jurisdiction to reduce the risk of getting into a position where such a facility is needed.

Conclusions

6.35 It is important that all the jurisdictions within the scope of this Review learn the lessons from the financial crises. The means to fund deposit protection schemes must be identified and the terms of such schemes must be clear to retail depositors.

6.36 All possible steps must be taken to guard against the collapse of a financial institution of systemic importance to the economy of a jurisdiction. Contingency plans should, however, also be in place to resolve such a situation should it occur. These plans should take full account of other parts of the legal framework, particularly insolvency and company law, to ensure that the plans would be deliverable in practice.

Recommendations

The Review recommends that:

- those jurisdictions that offer (or propose to offer) protection to retail depositors must ensure that compensation schemes can be understood by those depositors;
- jurisdictions that lack an Ombudsman scheme should consider whether one is justified;
- any jurisdiction that has not already done so should undertake a thorough examination of the range of powers to resolve a crisis in its financial services sector;
- local governments should require the regulator to maintain close oversight of any large locally incorporated financial institutions, the failure of which might lead to requests for financial help from the UK. This should be backed by the option of a periodic independent and external review, paid for by the institution itself, commissioned by the local authorities on their own initiative or at the request of the UK.

7 Fighting financial crime

Introduction

7.1 One of the major concerns expressed about offshore jurisdictions is that they do not do enough to help combat cross-border financial crime. Weaknesses often cited include an excessive importance given to protecting the secrecy of beneficial owners of funds, and lack of active co-operation with overseas investigators.

7.2 The internationally active fraudster will seek out the weakest jurisdictions to conduct their business. The jurisdictions covered by this Review need to be – and to be seen to be – active in seeking out and turning away dubious financial business. If not, their reputation (and that of the UK) will suffer.

7.3 Over time, international efforts to fight financial crime have moved forward considerably but weaknesses remain in international standards.

7.4 This chapter:

- reviews the record on fighting financial crime of the nine jurisdictions within the scope of this Review;
- discusses what action should be taken by the jurisdictions, in some cases with the support of the UK; and
- considers the scope for improvements to existing international standards.

International assessment process

7.5 International standards to fight financial crime are set by the Financial Action Task Force (FATF), an inter-governmental body established to develop and promote policies to combat money laundering and terrorist financing. The FATF (or one of the associated bodies) conducts periodic reviews of jurisdictions to see how they measure up against the FATF 40+9 Recommendations to counter money laundering and terrorist financing. Sixteen of these Recommendations are designated as 'key and core'.

7.6 The IMF's Financial Sector Assessment Programme (discussed in chapter 5) includes an assessment of compliance with the FATF's Recommendations. Anguilla, Bermuda, the British Virgin Islands, the Cayman Islands and the Turks and Caicos Islands are members of the Caribbean FATF and are also subject to its peer review process.

Compliance with FATF Recommendations

7.7 Compliance with the FATF's Recommendations requires an effective partnership between the authorities in the jurisdictions, the financial services industry and those, such as lawyers, who provide support services to the industry and its clients.

7.8 Governments must demonstrate a clear political commitment to tackling financial crime. In the first instance, this can be achieved by ensuring that legislation to tackle financial crime keeps pace with developments and provides regulatory authorities, investigators and prosecutors with the powers they need. Such legislation provides an important signal to private sector practitioners and to potential criminals.

7.9 Legislation is, however, only as good as its enforcement. It will not be effective unless the financial services regulator has the resources to ensure that regulated entities are acting with due diligence and investigators have the resources and expertise to investigate suspicious activity. Prosecutors must also have the resources they need to prosecute financial crime within the jurisdictions and to assist prosecutors in other jurisdictions.

7.10 Some of the jurisdictions within the scope of this Review have made considerable efforts to tackle financial crime and have a good story to tell. Others have taken their eye off the ball or have so far failed to demonstrate the necessary commitment.

7.11 Jersey has, for example, received a positive IMF assessment of compliance against the FATF 40+9 Recommendations and was rated as compliant or largely compliant with 15 out of the 16 'key and core' Recommendations. Bermuda, on the other hand, was assessed as having considerable room for improvement as was the Turks and Caicos Islands, whilst Gibraltar and the Isle of Man have more to do to improve compliance with the 'key and core' Recommendations in particular.

7.12 In some cases, weaknesses have been recognised. For example, the Bermuda authorities' response to the IMF's assessment recognised the need to enhance and accelerate the jurisdiction's efforts to fight financial crime.

7.13 The state of play on compliance is illustrated in Charts 7.A and 7.B. The charts use IMF assessments of Jersey, Isle of Man, Bermuda and Gibraltar. CFATF assessments are used for the British Virgin Islands, the Cayman Islands and the Turks and Caicos Islands as the most recent available for these jurisdictions.

7.14 No compliance ratings have been published for Anguilla during the period covered by the charts, but the jurisdiction was preparing for a CFATF peer review when the Review visited in June 2009. Guernsey was last assessed by the IMF in 2003 but the results have been excluded from Charts 7.A and 7.B because of changes to the methodology and criteria applied since then. The IMF is expected to assess Guernsey in 2010.

Chart 7.A: FATF 40+9 compliance

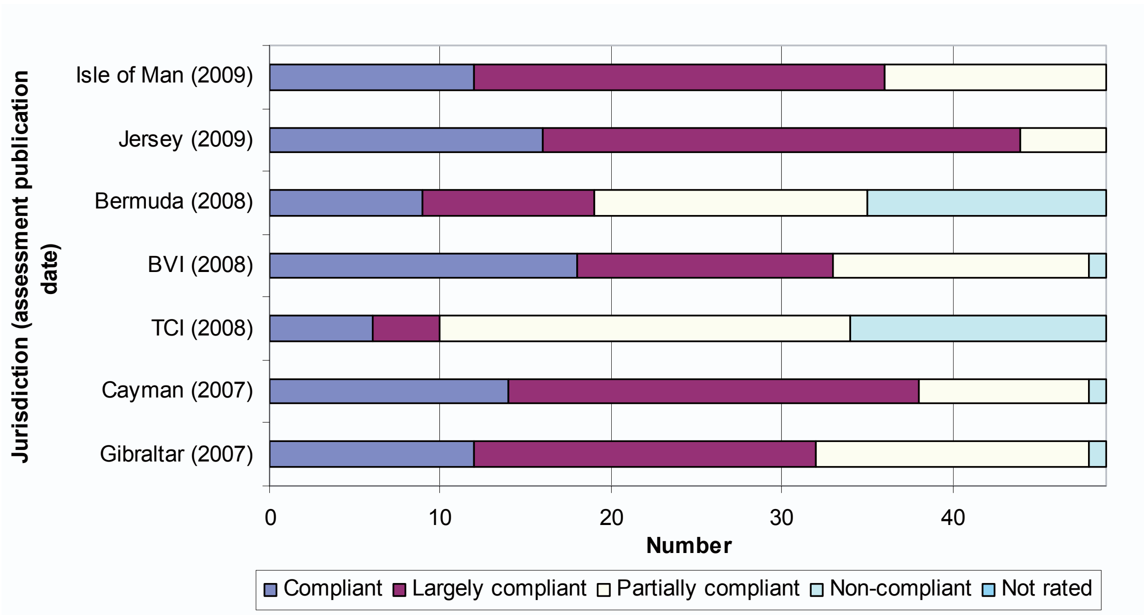
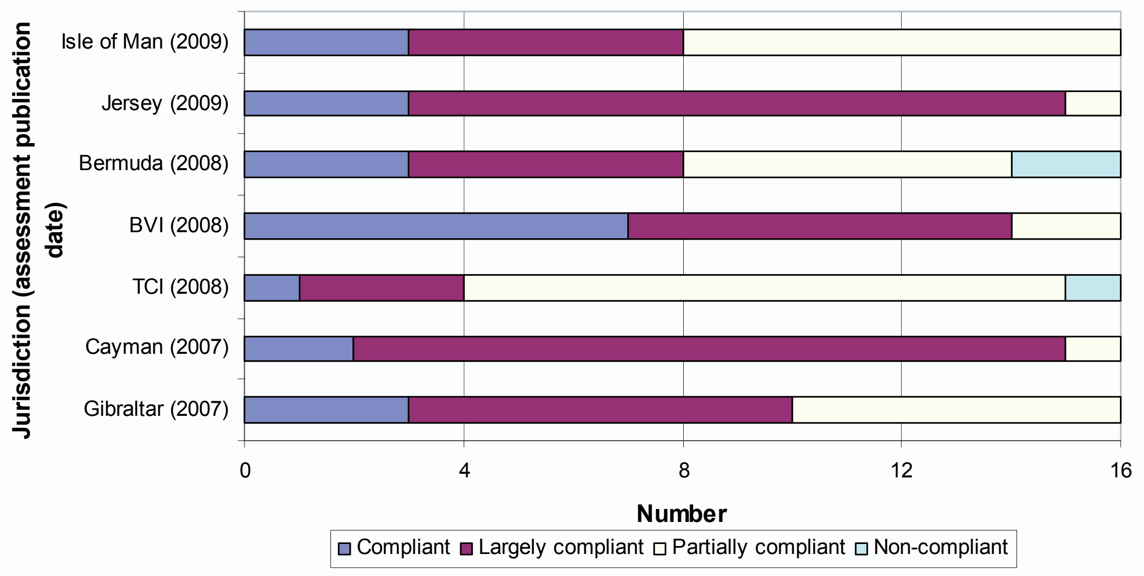


Chart 7.B: FATF 'key and core' Recommendations compliance



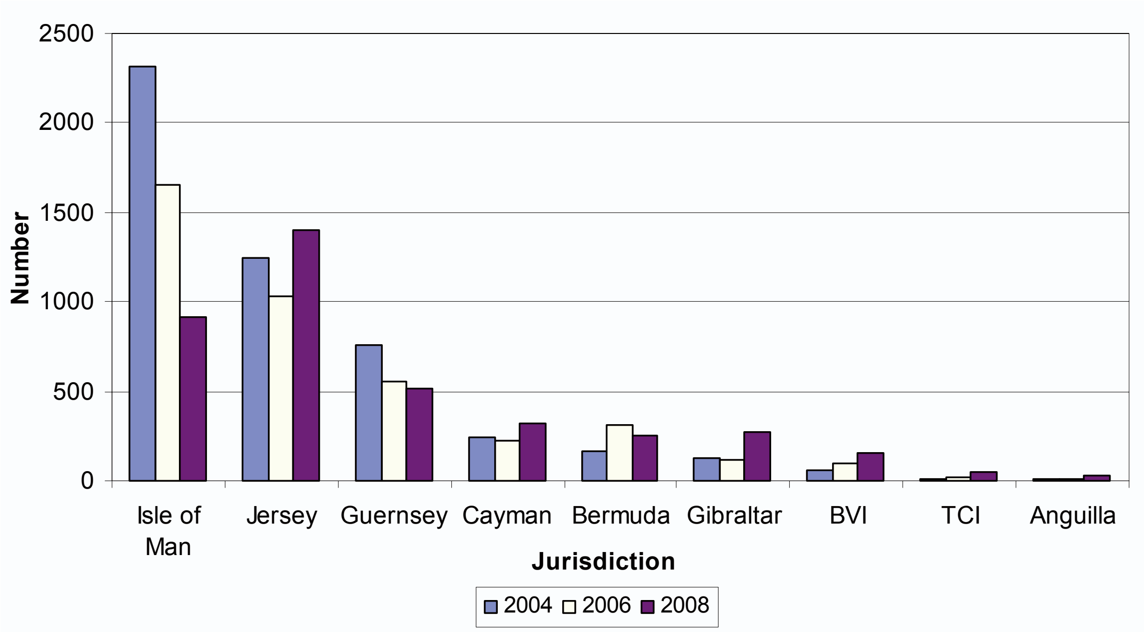
Detection

7.15 Looking at the picture in more detail, the number of suspicious transaction reports (which are mostly made by local regulated financial institutions to the local financial intelligence unit when financial crime is suspected) provides an illustration of attitudes in a jurisdiction. Although there is no 'correct' number of suspicious transaction reports (STRs), the financial sector niche in the jurisdiction can be used to provide a rule of thumb. For example, a jurisdiction with a large banking sector will tend to record more STRs than one with a small banking sector because of (a) the key role that banks play in transmitting funds and (b) the banking sector typically has more advanced techniques for identifying financial crime. It is also typical for a jurisdiction with an international business company sector to attract a higher incidence of financially suspicious activity while funds and insurance business typically have a lower incidence.

7.16 Although data provided by the jurisdictions (and reproduced in Annex D) shows that the number of STRs in the Overseas Territories are broadly on a rising trend, the numbers of STRs in 2008 were lower than might be expected in Anguilla (30) and the British Virgin Islands (153), both of which have international business companies as their international niche. On the face of it, the number of STRs in the Turks and Caicos Islands also appears low (50).

7.17 Both Guernsey and the Isle of Man were exceptions to the rising trend in the number of STRs, with the Isle of Man recording a fall of more than 60 per cent between 2004 and 2008. The Guernsey authorities attributed the fall to the 2004 figure being inflated by the effect of an international tax amnesty in a third country. The Isle of Man authorities also cited this reason combined with the education of the financial services industry producing fewer but better quality STRs. The Isle of Man anticipates, however, that the implementation of its 2008 Proceeds of Crime Act, with its wider reporting requirements, will see the return to a rising trend.

Chart 7.C: Suspicious Transaction Reports received by Financial Intelligence Units



7.18 Customer due diligence (CDD) must of course be undertaken in order to identify suspicious transactions. Again, there is a need for a number of the jurisdictions within the scope of this Review to improve compliance against the FATF's main CDD Recommendation (Recommendation 5). None of the jurisdictions has been assessed as better than partially compliant and Bermuda and the Turks and Caicos Islands were last assessed as non-compliant.

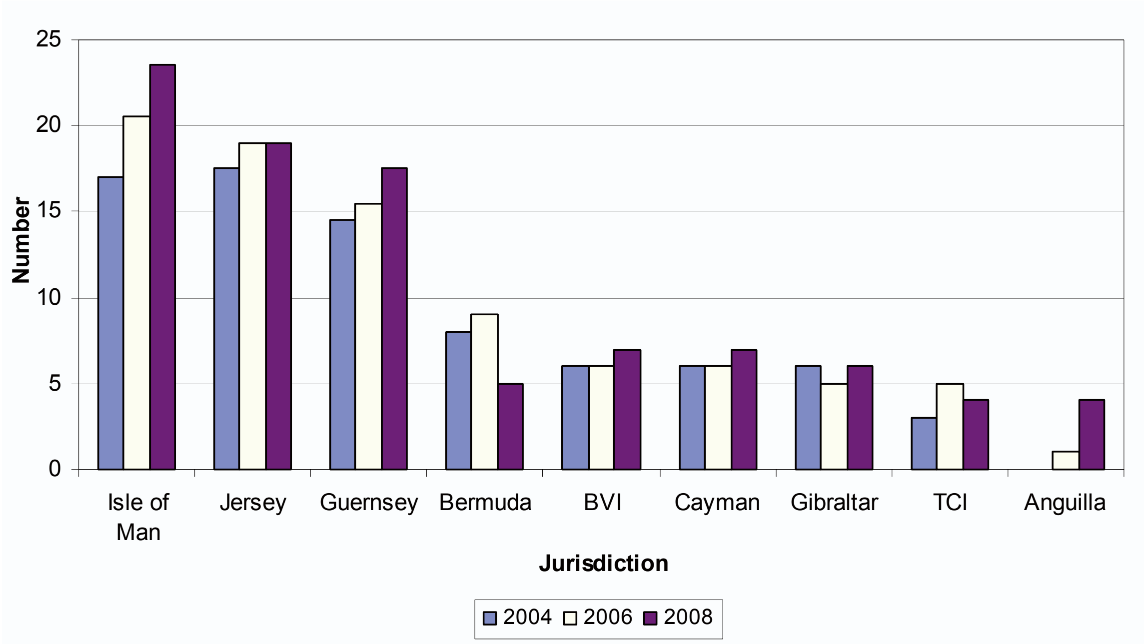
7.19 A number of NGOs in the UK were particularly concerned about the track record of some jurisdictions in complying with FATF Recommendation 6 on enhanced due diligence for politically exposed persons (PEPs). Compliance with this recommendation is important to prevent people in positions of power, often in developing countries, from misusing the financial resources of those countries for their own ends. Bermuda and the Turks and Caicos Islands were both rated as non-compliant in 2008. It is likely that Anguilla will also need to take steps to improve compliance with Recommendation 6.

Investigation

7.20 The financial services regulator also has an important role to play in holding regulated entities to account and supplying information to the financial crime investigatory authority, variously called the financial intelligence unit (FIU) or the financial crime unit.

7.21 Chart 7.D shows that the number of staff employed in FIUs increased or remained stable in most jurisdictions between 2004 and 2008.

Chart 7.D: Number of staff in financial intelligence units



7.22 The appropriate number of staff required for an FIU to be effective will, in part, depend on the number of STRs, which in turn may be influenced by the prevailing attitudes to fighting financial crime in a jurisdiction.

7.23 The number of staff employed in the FIUs in the Overseas Territories appears low, particularly when a complex case can consume significant resources. The FIUs in some jurisdictions confirmed to the Review that resource stretch was a concern.

7.24 The shortage of expertise in some areas was also a concern in some cases. For example, the absence or shortage of staff with the skills to undertake a forensic examination of computer hard drives would undermine the effectiveness of an FIU. As with the financial regulator, staff levels below a certain minimum are always likely to lead to problems.

Prosecution

7.25 On the face of it, prosecutions in some jurisdictions are running at a lower level than might be expected.

7.26 In 2008, there was one prosecution for financial crime in Guernsey, two in the Isle of Man and eight in Jersey. Prosecutions in the Overseas Territories in the same year ranged from 15 in Gibraltar (three for money laundering and 12 for fraud) to one (for money laundering) in Bermuda.

7.27 The jurisdictions with low prosecution rates tend to argue that the perpetrators of financial crime are typically located in other jurisdictions and so prosecutions will take place elsewhere. Those jurisdictions which have achieved high levels of compliance with the FATF Recommendations also argue that improvements in the detection of financial crime have deterred criminals from using the jurisdiction.

7.28 Whilst these arguments carry some weight, it is likely that suspicions will remain in some quarters about the vigour with which prosecutions are pursued. The direct personal relationships between officials and citizens which exist in small jurisdictions (also discussed in chapter 5) may expose prosecutors to pressure, which may be subtle, not to pursue cases against individuals who may play a prominent role in the life of the jurisdictions.

7.29 Jurisdictions should continue to make every effort to guard against such pressure and may, in some cases, wish to bring in personnel from outside the jurisdiction to limit any potential conflict of interest.

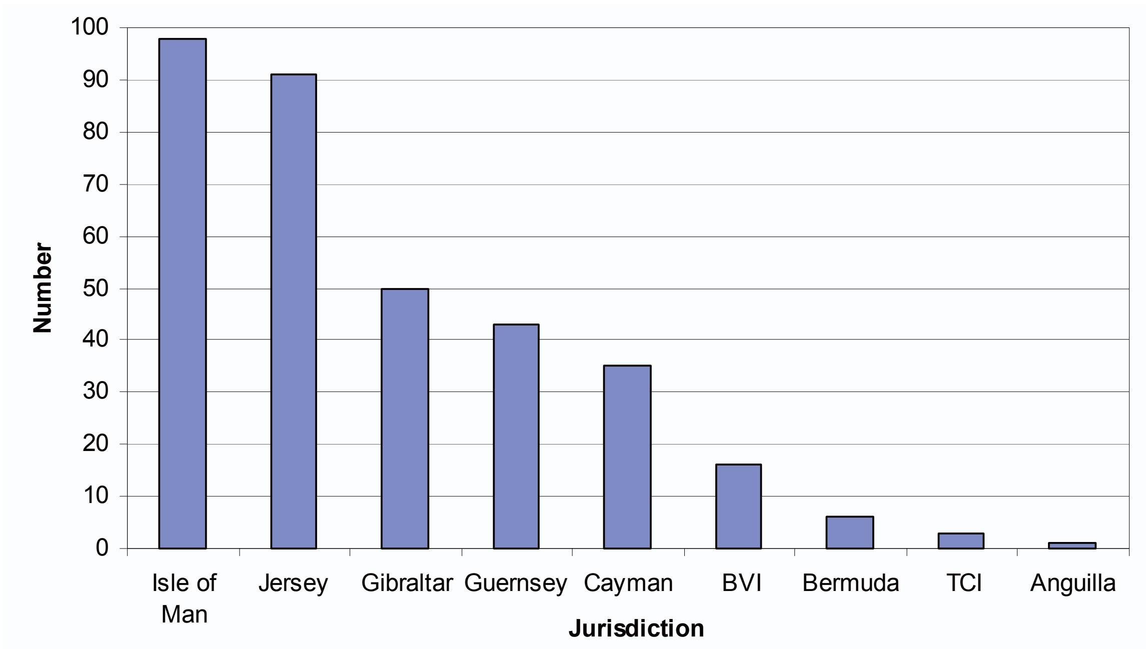
International co-operation

7.30 The nine jurisdictions must also co-operate fully with other jurisdictions to assist the prosecution process. In broad terms this can take two forms: the dissemination of information in STRs to other jurisdictions and responding to formal requests for assistance from other jurisdictions.

7.31 The dissemination of STRs to other jurisdictions is an important plank of international co-operation to tackle financial crime. The data on the number of STRs disseminated (see Annex D) shows that the jurisdictions within the scope of this Review do share information with the authorities in other jurisdictions.

7.32 All of the nine jurisdictions have received requests from other jurisdictions for mutual legal assistance (see Chart 7.E). (Some of the jurisdictions within the scope of this Review have formal mutual legal assistance treaties with other jurisdictions.)

Chart 7.E: Requests for mutual legal assistance received from overseas jurisdictions in 2008



7.33 Requests for assistance must be acted upon in a timely manner. To achieve this, jurisdictions must ensure that Attorneys General have sufficient and appropriately qualified staff at their disposal.

7.34 Fighting financial crime is expensive but in addition to the benefits of meeting international standards, tangible financial benefits can also be secured. For example, in 2007 the British Virgin Islands and Bermuda shared $46 million of forfeited assets.

Delivering improved compliance with international standards

7.35 Taking effective steps to tackle financial crime is a requirement not an option. The Review has concluded that the technical and human resources devoted to the fight against financial crime in Anguilla and the Turks and Caicos Islands need to be boosted to achieve compliance with FATF Recommendations. Bermuda must also remain focussed on addressing the deficiencies in its approach to tackling financial crime identified in the IMF's assessment published in October 2008; while in the case of the British Virgin Islands, the authorities should review carefully whether their FIU should not be more proactive in dealing with suspicions in the international business company sector.

7.36 The priority is to provide human and technical assistance to those jurisdictions most in need of it. This must, however, be accompanied by a clear commitment from the local government to tackling financial crime by ensuring that legislation keeps pace with developments and gives both the regulator and the investigating authority the powers they need to detect and prosecute financial crime. The local government must also make a commitment to fund the provision of sufficient resources to secure the benefits of the technical assistance they receive. This is a necessary condition for these jurisdictions continuing to operate as international financial services centres.

7.37 Where such commitments are forthcoming, the UK should discuss with the relevant jurisdictions what mechanisms might be put in place to deliver them in practice. One option would be to establish a unit, recognised by both the jurisdictions and the UK, whose functions might include quality assurance to ensure that the full benefits of technical assistance are secured on a long-term basis. These discussions could also be extended to those jurisdictions which are not in need of immediate technical assistance to discuss how they might contribute to and benefit from any such unit.

International standards

7.38 During the course of the consultation, a number of NGOs raised concerns about the extent to which the lack of transparency in the ownership of corporate vehicles in the jurisdictions facilitated financial crime (including tax evasion).

7.39 The Review shares these concerns, but such transparency issues also arise to a greater or lesser extent in most major jurisdictions. For example, within the UK, most trusts are not subject to financial regulation and therefore no agency monitors the ownership or behaviour of these trusts.

7.40 In the US, a more egregious loophole exists in the fact that a number of individual States, notably Delaware, permit the creation of international business companies without adequate monitoring of their beneficial ownership.

7.41 There are also understandable concerns in relation to international minimum standards with respect to 'know your customer' rules. The Review highlights two where the adequacy of existing standards is doubtful.

7.42 Both issues are complex and are described only in summary. The first relates to what are known as 'eligible introducers' of new customers. At present a regulated financial firm in jurisdiction A is allowed to take on a corporate or individual client from jurisdiction B, on the assurance from a suitably qualified intermediary in B that the client meets the necessary standards of probity and has provided the information about the client that FATF standards require. Such an intermediary providing these assurances is known as an eligible introducer.

7.43 The Review was encouraged to find that in the British Virgin Islands, home to some 800,000 international business companies, the local regulator does require that a licensed company service provider (who actually handles and services the incorporation of each company) can at any time require full know your customer (KYC) information on the client. Indeed, the local regulator goes further and requires, on a random check basis, that this KYC information be remitted back to the British Virgin Islands for checking.

7.44 Nevertheless, the current minimum standards mean that a professional intermediary many thousands of miles away may vouch for the bona fides of the company being registered in a jurisdiction like the British Virgin Islands. The Review considers that the FATF should conduct tougher checks than it currently does in its peer group reviews of the standards in these third jurisdictions. The Review also believes that there is a compelling case for all relevant KYC information to be passed to the company service agent in the jurisdiction at the time of incorporation, rather than relying on the information being passed when and if requested.

7.45 The second issue relates to politically exposed persons (PEPs). Each jurisdiction should have in place systems to detect and identify PEPs and share information with other jurisdictions. The Review supports the call by Transparency International[1] for the UK to press the FATF to raise international standards in this area.

7.46 The G20 recognised the need to prioritise work to strengthen standards on customer due diligence, beneficial ownership and transparency at its meeting in Pittsburgh in September 2009.

7.47 Although attractive in principle, action by the UK and the nine jurisdictions ahead of changes to international standards would be likely to result in a loss of business to other jurisdictions rather than a resolution of the underlying concerns. The Review has, therefore, concluded that the UK should take the lead internationally in encouraging improvements to:

- 'know your customer' international minimum standards (particularly in respect of the role of 'eligible introducers');
- the monitoring of PEPs; and
- the transparency of beneficial ownership of companies and trusts.

Conclusions

7.48 There can be no let up in the fight against financial crime. Jurisdictions within the scope of this Review should move rapidly to achieve full compliance with the FATF 'key and core' Recommendations. Some will need technical assistance to do so, but the benefits of such assistance will only be secured on a long-term basis if the local government makes and keeps a clear commitment to tackle financial crime and fund sufficient resources. There can be no second chances.

7.49 The international community has recognised the need to improve international standards to fight financial crime. The UK should take the lead in encouraging improvements. Improving compliance in the jurisdictions within the scope of this Review would strengthen the UK's hand.

[1] Transparency International UK: Combating Money Laundering And Recovering Looted Gains – raising the UK's game. Published June 2009

Recommendations

The Review recommends that:

- to meet international standards, jurisdictions which have not already done so should move to amend laws and procedures as necessary to achieve compliance with the FATF 16 'key and core' Recommendations;
- at an international level, the UK should press for improvements in 'know your customer' minimum standards and promote moves towards improved transparency of beneficial ownership of companies and trusts and the monitoring of politically exposed persons;
- the UK should discuss with those jurisdictions in need of technical assistance to fight financial crime how that assistance might be delivered and the benefits of assistance secured in the longer-term.

A Terms of reference

A.1 The UK Government's decision to commission an independent review of British offshore financial centres; their role in the global economy; and their long-term business strategies was announced in the 2008 Pre-Budget Report.

Terms of reference

A.2 HM Treasury published the terms of reference for the independent review on 2 December 2008. These are set out below:

Purpose

A.3 The Chancellor of the Exchequer has asked Michael Foot to conduct an independent review of the long-term opportunities and challenges facing the British Crown Dependencies and Overseas Territories as financial centres, which have been brought into focus by recent financial and economic events.

Scope

A.4 The review will work first with Crown Dependencies then Overseas Territories with significant financial centres to identify opportunities and current and future risks (and mitigation strategies) to their long-term financial services sector, including:

- financial supervision and transparency;
- taxation, in relation to financial stability, sustainability and future competitiveness;
- financial crisis management and resolution arrangement; and
- international co-operation.

A.5 The review will take account of Crown Dependencies' and Overseas Territories' respective constitutional relationships with the UK. Changes to the UK's constitutional relationship with Crown Dependencies and Overseas Territories are out of scope for the review.

Timing

A.6 The Review will report to the Chancellor of the Exchequer, copied to the Lord Chancellor, Foreign Secretary, and the Governments of the UK's Crown Dependencies and Overseas Territories; and will produce interim conclusions for Budget 2009; with fuller conclusions later in the year.

Financial centres covered

A.7 Only those Crown Dependencies and Overseas Territories with significant financial centres are included within the scope of the review. These are:

Crown Dependencies

- Guernsey;
- Jersey; and
- Isle of Man.

Overseas Territories

- Anguilla;
- Bermuda;
- British Virgin Islands;
- Cayman Islands;
- Gibraltar; and
- Turks and Caicos Islands.

B Consultation

B.1 The Review has consulted the authorities in the jurisdictions within the scope of the Review.

B.2 It has also consulted HM Treasury, HM Revenue and Customs, the Foreign and Commonwealth Office, the Ministry of Justice, the Department for International Development and the Financial Services Authority in the UK.

B.3 The Review has also benefited from the willingness of a wide range of other interested parties to give generously of their time. These organisations and individuals are listed below and include non-governmental organisations, financial services providers and individual members of the public:

Action Aid

Anguilla Bar Association

Anguilla Financial Services Association

Association of Bermuda Insurers and Reinsurers

Association of British Insurers

Association of Guernsey Banks

Association of Investment Companies

Association of Private Client Investment Managers

Bank of Bermuda

Bank of Butterfield

Bank of England

Bankers Association of the Turks and Caicos

Barclays Bank

Bermuda Bar Council

Bermuda International Business Association

BNP Paribas Jersey Trust Corporation Ltd

CAFOD

Cains Advocates Ltd

Capital International Ltd

Cayman Islands Bankers' Association

Cayman Islands Bar Association

Cayman Islands Fund Administrators

Cayman Islands Law Society

Cayman National Bank and Trust Company (Isle of Man) Ltd

Christian Aid

Citibank (Channel Islands) Ltd

CMI Financial Management Services Ltd

Deloitte

Depositors of Kaupthing, Singer & Friedlander (Isle of Man) Bank (KSFIOM)

Ernst & Young

Financial Ombudsman Service, UK

Global Witness Ltd

Guernsey Association of Trustees

Guernsey Society of Trust and Estate Practitioners

Guernsey Bar Council

Guernsey Society of Chartered and Certified Accountants

Guernsey Insurance Companies Management Association

Guernsey International Business Association

Guernsey Investment Funds Association

HSBC Bank International Ltd

Insurance Managers Association of Cayman

Investment Management Association

Isle of Man Finance

Isle of Man Bankers Association

Isle of Man Fund Management Association

Jersey Finance Ltd

KPMG

Linklaters

Lloyds Banking Group

Lloyd’s of London

Marsh Management Services

Michael Hardy

Mourant

National Bank of Anguilla

Ogier

Organisation of Economic Co-operation and Development

Oxfam

Ozannes

Peter Beckett and Vilma Rocha

Pricewaterhouse Coopers

Royal Bank of Scotland

Royal Anguilla Police

Society of Trust and Estate Practitioners

Tax Justice Network

TCI Bank

TCI Bankers' Association

TCInvest

TISEF Limited

TUC

Transparency International

Trustee Investment Strategy for Endowments and Foundations

Volaw Trust and Corporate Services Ltd

Walkers

C Summary of Constitutional Relationships

Crown Dependencies

C.1 Jersey, Guernsey and the Isle of Man are dependencies of the Crown. Her Majesty The Queen is Head of State of each Dependency and appoints a Lieutenant Governor as her personal representative.

C.2 The Dependencies are not part of the UK.

Domestic policies

C.3 Each Crown Dependency determines its own domestic policies through a directly elected legislative assembly. UK legislation does not extend to the Dependencies, but they may request its extension to them by an Order in Council.

C.4 Each Dependency determines its own fiscal policy and raises its own public revenue.

C.5 The Crown Dependencies also have their own legal systems and courts of law.

International representation

C.6 The UK ordinarily represents the Crown Dependencies internationally. When the UK ratifies a treaty it does so on behalf of the United Kingdom of Great Britain and Northern Ireland and any of the Crown Dependencies that wish the treaty to apply to them.

C.7 In certain circumstances, the Crown Dependencies may be authorised to represent their own interests internationally by a process of entrustment.

C.8 The UK is also responsible for the defence of the Crown Dependencies. Each makes an annual voluntary contribution towards the costs of their defence and international representation by the UK.

European Union

C.9 The Crown Dependencies are not members of the European Union. They do, however, have a special relationship with the EU. Protocol 3 of the UK's Treaty of Accession to the European Community makes them part of the customs territory of the Community, and the common customs tariff, levies and agricultural import measures apply to trade between the Crown Dependencies and non-member countries. Other Community rules do not generally apply.

Overseas Territories

C.10 The Overseas Territories are constitutionally not part of the United Kingdom. All of them have separate Constitutions made by an Order in Council. All those within the remit of this Review have Governors. Each Governor is appointed by and represents Her Majesty The Queen. The Governor both represents Her Majesty in the Territory, and represents the Territory's interests to the UK Government.

C.11 Each Governor is responsible to the Secretary of State and, through him, to The Queen and the UK government, for the security and proper governance of the Territory.

Self-government

C.12 The degree of self-government enjoyed by an Overseas Territory depends on its stage of constitutional development. In most Overseas Territories, the Governor has special responsibility for defence, external affairs, internal security, including the police, the public service, and the administration of justice. In Anguilla and the Turks and Caicos Islands this extends to international financial services. Territory governments are responsible for the proper management of their local economies.

C.13 Most Overseas Territories' constitutions provide for certain reserve powers to protect the UK Government's overall responsibility for the good governance of the Overseas Territories. These include the power of a Secretary of State to instruct the Governor in the exercise of his functions; the power to disallow Overseas Territories legislation; and (except Bermuda) the power to legislate for the peace, order and good government of the Territory by Order in Council.

C.14 Bermuda has almost full internal self-government, with a premier presiding over a cabinet, whose meetings the Governor does not attend.

C.15 In Gibraltar, which also has a large measure of internal self-government, the Governor is responsible for defence, external affairs, internal security and certain functions in relation to appointments to public offices. The Chief Minister chairs the Council of Ministers meetings, which the Governor does not attend.

C.16 Gibraltar is within the EU and so its financial centre is required to comply with EU requirements on regulation, money laundering and exchange of information.

C.17 The 2006 Turks and Caicos Islands Constitution was amended by an Order in Council on 14 August 2009[1] for the next two years. The amendment order suspended the legislature, dissolved the cabinet and scrapped the constitutional right to jury trial. In place of the previous structure the Governor may take advice from an Advisory Council and receive recommendations from a Consultative Forum. Prior to the amendment to the 2006 Constitution, the Governor was inter alia responsible for the regulation of international financial services; he now has control of all aspects of government, including finance and financial services.

International representation

C.18 Unless expressly authorised to do so by the UK Government, Overseas Territories do not have the authority to become party to treaties in their own right. The UK must, therefore, extend treaties to the Overseas Territories. This is done either at the time of the UK's ratification or later following a consultation process.

C.19 The Territory Government is, however, sometimes entrusted with authority to conclude international agreements. Bermuda and the British Virgin Islands have a standing entrustment which allows them to negotiate treaties in specific areas.

UK objectives

C.20 A UK government objective is to maintain financial stability within the Overseas Territories' financial services centres. Other objectives are to support international standards, and manage

[1] Statutory Instrument No. 701, 2009, *The Turks and Caicos Islands Constitution (Interim Amendment) Order 2009*.

the reputational risk and the risk of contingent liabilities to the UK. It is the FCO's goal that all Overseas Territories fully implement international standards of regulation and supervision.

C.21 The UK government understands that the Overseas Territories' economies are significantly reliant upon revenue from financial services business and a substantial downturn in this sector, for whatever reason, could result in pressure on the UK Government to provide direct economic aid.

Borrowing Guidelines

C.22 To mitigate the risk of excessive Overseas Territory borrowing creating contingent liabilities for the UK, the FCO has agreed Borrowing Guidelines with a number of territories. The guidelines define three ratios, which together specify a prudential framework for Overseas Territory government and government-guaranteed borrowing. The ratios impose maximum limits for the total volume of outstanding debt and the annual cost of debt-service, and a minimum level for Government reserves. If all three ratios are not met, further Overseas Territory borrowing will not ordinarily be approved by the UK Government.

C.23 The FCO has Borrowing Guidelines in place for Anguilla, the British Virgin Islands, the Cayman Islands and the Turks and Caicos Islands. The Cayman Islands have enshrined these guidelines in local legislation.

C.24 Although there are no guidelines in place for Bermuda and Gibraltar, Bermudian law limits debt to a percentage of GDP, which the FCO monitor. In Gibraltar, the law places an upper financial limit on net public debt in addition to restrictions on the percentage of GDP, recurrent revenue and the debt service ratio.

D Financial crime and regulatory resources

D.1 This Annex records data provided by the jurisdictions during the course of the Review. Where no data is given for a year, it is either not available for that year or has not been provided.

Anguilla

Table D.A: Regulatory resources[1]

	2002	2003	2004	2005	2006	2007	2008
Resources							
Total staff in post	-	-	4	6	6	6	7
Total annual revenue (US$000)	-	-	267	516	645	791	1,012
Licences							
Licences in issue	-	-	102	179	248	325	417
Licences in each class:							
Banking	-	-	7	7	7	7	7
Corporate service providers	-	-	30	30	35	42	45
Trust service providers	-	-	13	16	18	19	19
Insurance[2]	-	-	47	99	138	180	263
Collective investment schemes (Mutual Funds)	-	-	5	27	50	77	83
Inspections							
On site inspections completed	2	15	7	8	10	9	28
Inspections by licence class:							
Banking	-	3	-	-	-	3	4
Corporate service providers	2	12	6	7	7	2	14
Trust service providers	-	-	1	1	3	1	3
Investment business	-	-	-	-	-	1	7
Collective investment schemes (Mutual Funds)	-	-	-	-	-	-	-
Money transfer agents	-	-	-	-	-	2	-

[1] The Anguilla Financial Services Commission did not exist until 2004. The Financial Services Commission was preceded by the Financial Services Department which conducted onsite examinations during 2002 and 2003.

[2] As at 31 December 2008, 184 of the insurance providers were captive insurers.

Table D.B: Financial crime

	2002	2003	2004	2005	2006	2007	2008
Total staff in post	-	-	-	1	1	1	4
Suspicious transaction reports:							
Received	6	8	5	9	7	6	30
Investigated	6	8	5	9	7	6	30
Not pursued	-	-	-	-	-	-	-
Disseminated to local agencies	-	-	-	-	1	-	3
Disseminated to international agencies	-	3	-	-	-	-	6
Other types of disposal	-	4	-	2	-	1	25
International co-operation and assistance							
Letters of request for assistance	1	-	-	1	-	-	1
Number of requests made to other jurisdictions	-	-	-	1	-	-	44
Prosecutions							
Local prosecutions for financial crime	-	-	-	-	2	3	8
Prosecutions in other jurisdictions where evidence contributed	1	-	-	-	1	-	1
Proceeds of crime asset recovery							
Assets frozen (US$000)	-	-	-	-	-	-	1,476
Assets seized (US$000)	-	-	-	-	-	-	60
Assets confiscated	-	-	-	-	-	-	-

Bermuda

Table D.C: Regulatory resources

	2002	2003	2004	2005	2006	2007	2008
Resources							
Total staff in post	60	66	71	83	84	107	131
Total annual revenue (Bd$000)	10,039	12,237	15,414	23,596	22,483	28,971	29,250
Licences							
Licences in issue	2,639	2,795	2,647	2,694	2,857	2,879	2,645
Licences in each class:							
Banking	5	5	5	5	5	5	5
Investment business	52	54	52	53	57	57	61
Trust business	29	32	31	33	33	32	31
Collective investment schemes	912	1,022	1,149	1,182	1,302	1,303	1,133
Fund administrators[3]	-	-	-	-	-	-	41
Money service business[4]	-	-	-	-	-	1	2
Insurance	1,641	1,682	1,410	1,421	1,460	1,481	1,372
Inspections							
On site inspections completed	16	20	17	32	26	43	34
Inspections by licence class[5]:							
Banking	6	3	5	5	4	4	2
Investment business	10	15	7	11	2	7	4
Trust business	-	2	5	12	7	5	2
Collective investment schemes/funds	-	-	-	-	-	-	-
Fund administrators	-	-	-	-	-	-	6
Money service business	-	-	-	-	-	-	0
Insurance	-	-	-	4	13	27	20

[3] Fund administrators were required to be licensed from 7 March 2008.

[4] Money service businesses required licenses from 16 January 2007.

[5] There is no on site regime in place for investment funds. The trust business onsite programme began in 2003. The effective start date for the onsite program for fund administrators was 7 March 2008.

Table D.D: Financial crime

	2002	2003	2004	2005	2006	2007	2008
Total staff in post[6]	4	5	8	7	9	9	5
Suspicious transaction reports:							
Received	2570[7]	275	162	200	314	246	256
Investigated	42	16	26	14	1	4	24
Not pursued	-	-	-	-	-	-	-
Disseminated to local agencies	-	-	-	-	-	-	5
Disseminated to international agencies	23	50	49	39	45	37	25
Other types of disposal	2528[8]	259	136	186	314	204	232
International co-operation and assistance							
Letters of request for assistance	2	3	9	8	6	7	6
Number of requests made to other jurisdictions	-	3	4	4	4	8	6
Prosecutions							
Local prosecutions for financial crime	7	6	9	5	9	6	8
Prosecutions in other jurisdictions where evidence contributed	3	1	7	6	10	16	5
Proceeds of crime asset recovery							
Assets frozen (Bd$000)	-	-	-	-	-	-	-
Assets seized (Bd$000)	-	207	149	525	1,771	129	45,703
Assets confiscated (Bd$000)	-	121	93	467	1,724	85	22,894

[6] 2002-2007 figures relate to the Financial Investigation Unit of the Bermuda Police Service. Figures for 2008 and 2009 relate to the Financial Investigation Agency.

[7] The high number of STRs received during 2002 can be attributed to the activities of certain entities that were closed down during that period.

[8] STRs retained for intelligence value.

British Virgin Islands

Table D.E: Regulatory resources

	2002	2003	2004	2005	2006	2007	2008
Resources							
Total staff in post	81	97	114	121	127	130	131
Total annual revenue (US$000)	113,837	112,940	121,789	145,947	159,065	178,243	184,599
Licences							
Licences in issue	3013	3010	3285	3589	3836	3995	4153
Licences in each class:							
Banking	13	11	10	8	9	9	9
Fiduciary	194	221	235	232	231	234	206
Investment business	2446	2391	2613	2886	3112	3280	3534
Insurance	360	387	427	463	484	472	404
Inspections							
On site inspections completed	7	-	6	18	27	27	52
Inspections by licence class:							
Banking and fiduciary: banks	-	-	-	1	1	-	6
Banking and fiduciary: trust companies	7	-	5	5	10	14	22
Investment business	-	-	-	-	-	-	4
Insurance	-	-	1	13	16	13	14
Insolvency	-	-	-	-	-	-	5

Table D.F: Financial crime

	2002	2003	2004	2005	2006	2007	2008
Total staff in post	-	-	6	6	6	7	7
Suspicious transaction reports:							
Received	140	65	61	101	102	104	153
Investigated	140	65	61	101	102	75	104
Not pursued	-	-	-	-	-	29	49
Disseminated to local agencies	-	-	-	-	2	-	6
Disseminated to international agencies	-	-	-	-	-	-	12
Other types of disposal	-	-	-	-	-	-	-
International co-operation and assistance[9]							
Letters of request for assistance	-	-	33	52	26	33	16
Number of requests made to other jurisdictions	3	-	-	4	3	7	1
Prosecutions							
Local prosecutions for financial crime	-	-	130	12	43	21	2
Prosecutions in other jurisdictions where evidence contributed	-	-	-	-	-	-	-
Proceeds of crime asset recovery							
Assets frozen (US$000)	-	-	1,700	52,071	-	1,600	45,455
Assets seized / confiscated (US$000)	-	-	445	4,138	2,622	46,314	45,455

[9] These figures include AML and general statistics. Additional data on FSC and FIU has not been included.

Cayman Islands

Table D.G: Regulatory resources

	2002	2003	2004	2005	2006	2007	2008
Resources							
Total staff in post	90	88	92	95	104	116	122
Total annual revenue (KY$000)	10,012	5,572[10]	11,999	12,515	17,517	18,834	19,300
Licences							
Licences in issue	2,399	2,307	2,337	2,357	2,367	2,386	2,374
Licences in each class:							
Banks	382	347	318	305	291	281	278
Fiduciary Services	347	333	320	318	333	320	318
Insurance	742	786	837	871	907	940	951
Investment and securities[11]	922	835	856	856	829	838	820
Money services businesses	6	6	6	7	7	7	7
Inspections							
On site inspections completed	94	33	53	50	53	53	51
Inspections by licence class:							
Banking[12]	68	15	31	20	19	9	23
Fiduciary services[13]	19	9	12	2	4	6	3
Insurance[14]	6	8	9	12	8	11	13
Investment and securities	1	1	1	16	22	27	12

[10] The figures reflect the half-year position as the Authority transitioned from calendar year to fiscal year ending in June.

[11] Registered mutual funds are not included in the investments and securities or licences in issue total as they are not subject to licensing. These figures are: 2002 – 3,593, 2003 – 4,168, 2004 – 5,249, 2005 – 6,429, 2006 – 7,481, 2007 – 8,751, 2008 – 9,231.

[12] All fiscal years ending June, except for 2002, which was on a calendar year basis.

[13] Calendar year.

[14] Inspections have been under-reported in the past. An insurance manager may have several insurance companies under management that have to be inspected.

Table D.H: Financial crime

	2002	2003	2004	2005	2006	2007	2008
Total staff in post	-	-	6	6	6	7	7
Suspicious transaction reports:	**2002**	**2003-4**	**2004-5**	**2005-6**	**2006-7**	**2007-8**	**2008-9**
Received	443	282	244	221	219	247	320
Investigated	-	-	195	170	189	213	284
Not pursued	-	-	49	51	30	34	36
Disseminated to local agencies	-	-	36	27	28	36	87
Disseminated to international agencies	-	-	20	19	33	34	22
Other types of disposal	-	-	32	44	26	45	57
International co-operation and assistance	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Letters of request for assistance	46	55	46	46	45	27	35
Number of requests made to other jurisdictions	6	1	1	2	-	4	3
Prosecutions							
Local prosecutions for financial crime	-	-	-	3	16	14	9
Prosecutions in other jurisdictions where evidence contributed	7	5	9	2	6	4	2
Proceeds of crime asset recovery							
Assets frozen (KY$000)	7,700	64,400	31,827	178	21,376	227	298
Assets seized	-	-	-	-	-	-	-
Assets confiscated (KY$000)	-	3,604	-	-	4,677	902	103

Gibraltar

Table D.I: Regulatory resources

	2002	2003	2004	2005	2006	2007	2008
Resources							
Total staff in post	14	16	18	21	24	27	31
Total annual revenue (£000)[15]	-	913	1,279	1,237	1,464	1,591	1,708
Licences							
Licences in issue	229	231	242	258	273	307	308
Licences in each class:							
Banking	19	18	17	18	18	18	19
Insurance	58	64	73	83	88	94	97
Investment	74	71	72	75	85	108	120
Trust and company service providers	78	78	80	82	82	87	72
Inspections							
On site inspections completed	28	38	63	61	58	83	88
Inspections by licence class:							
Banking	21	15	36	21	18	16	14
Fiduciary	7	21	13	14	19	33	25
Insurance	-	-	1	13	12	12	24
Investment	-	2	13	13	9	22	25

15 Annual revenue is from the audited financial statements as at 31 March of the following years: 2002-3. 2003-4, 2004-5, 2005-6, 2006-7, 2007-8 and 2008-9.

Table D.J: Financial Crime

	2002	2003	2004	2005	2006	2007	2008
Total staff in post	7	7	6	5	5	5	6
Suspicious transaction reports:							
Received	180	130	123	108	118	142	270
Investigated	140	82	80	49	81	97	148
Not pursued	40	48	43	59	37	45	122
Disseminated to local agencies	140	82	80	49	81	97	148
Disseminated to international agencies	48	28	35	24	32	63	42
Other types of disposal	-	-	-	-	-	-	-
International co-operation and assistance							
Letters of request for assistance	-	56	32	47	50	46	50
Number of requests made to other jurisdictions	-	-	-	-	-	-	-
Prosecutions							
Local prosecutions for financial crime	25	19	14	39	39	28	35
Prosecutions in other jurisdictions where evidence contributed	15	23	19	34	36	29	42
Proceeds of crime asset recovery							
Assets frozen	-	-	-	-	-	-	-
Assets seized	-	-	-	-	-	-	-
Assets confiscated	-	-	-	-	-	-	-

Guernsey

Table D.K: Regulatory resources

	2002	2003	2004	2005	2006	2007	2008
Resources							
Total staff in post[16]	63	77	82	89	91	94.1	89.3
Total annual revenue (£000)	5,805	6,610	7,198	7,799	8,662	9,683	10,013
Licences							
Licences in issue	1,415	1,364	1,386	1,423	1,505	1,590	1,737
Licences in each class:							
Banking	67	61	54	50	50	47	48
Fiduciary	200	202	201	198	205	203	203
Investment[17]	428	428	446	486	554	636	680
Insurance	720	673	685	689	696	704	806
Inspections							
On site inspections completed[18]	133	128	123	96	107	97	115
Inspections by licence class:							
Banking	26	26	22	12	20	17	16
Fiduciary	53	52	51	48	43	40	27
Insurance	28	31	27	20	30	28	31
Investment	26	19	24	16	14	12	32

[16] Staff numbers are actual numbers until 2006 and on a full-time equivalent basis from 2007.

[17] Investment funds are not included within the investment numbers, nor within total licences in issue. These figures are: 2002 – 672, 2003 – 662, 2004 – 703, 2005 – 778, 2006 – 691, 2007 – 1,122, 2008 – 1,216.

[18] The on site inspections to licensees also cover entities managed and administered by the licensee. This applies particularly in the investment and insurance areas where, for example, a review of the effectiveness of the AML/CFT frameworks of licensed managers, also encompasses those licensed insurers which they manage. In 2008, the onsite inspections figure includes 9 inspections of registered businesses.

Table D.L: Financial crime

	2002	2003	2004	2005	2006	2007	2008
Total staff in post[19]	-	14.5	14.5	14.5	15.5	16.5	17.5
Suspicious transaction reports:							
Received	777	705	757	650	555	760	519
Investigated	638	583	634	534	383	557	418
Not pursued	139	122	123	116	172	203	101
Disseminated to local agencies	628	556	434	445	304	393	436
Disseminated to international agencies	1,174	661	617	552	370	427	543
Other types of disposal	-	-	-	-	-	-	-
International co-operation and assistance							
Letters of request for assistance	-	-	35	60	52	46	43
Number of requests made to other jurisdictions	-	-	-	-	1	1	2
Prosecutions							
Local prosecutions for financial crime	-	1	-	1	1	5	1
Prosecutions in other jurisdictions where evidence contributed	-	-	35	60	52	46	43
Proceeds of crime asset recovery							
Assets frozen (£000)	-	4,195	107,999	3,483	105,160	3,252	234
Assets seized (£000)	-	24	-	17	-	-	-
Assets confiscated (£000)	-	92	25	336	83	336	68

[19] Includes police Fraud staff outside of FIU.

Isle of Man

Table D.M: Regulatory resources

	2002	2003	2004	2005	2006	2007	2008
Resources							
Total staff in post[20]	81	88	91.5	91.16	94.76	96.76	107.16
Total annual revenue[21] (£000)	8,585	7,940	8,111	7,612	8,128	7,248	12,609
Licences[22]							
Licences in issue	515	582	607	609	676	750	778
Licences in each class:							
Banking	61	60	57	56	51	48	44
Corporate services	91	140	166	175	179	172	185
Investment	82	88	86	88	88	92	87
Trust services	-	-	-	-	26	91	120
Insurance	263	277	280	275	313	327	318
Gambling	18	17	18	15	19	20	24
Inspections	2002	2003	2004	2005	2006	2007	2008
On site inspections completed[23]	162	210	164	254	252	241	287
Inspections by licence class:							
Banking	31	22	17	19	41	48	59
Investment	52	46	33	71	74	89	47
Corporate and trust services	-	28	34	64	59	43	100
Insurance	N/C	35	41	61	33	18	37
Gambling	79	79	39	39	45	43	44

[20] Includes staff from FSC (including Companies Registry), Insurance and Pensions Authority and Gambling Supervision Commission.

[21] FSC only.

[22] Includes staff from FSC, Insurance and Pensions Authority and Gambling Supervision Commission.

[23] Includes FSC, Insurance and Pensions Authority and Gambling Supervision Commission. In the years 2005-07, joint inspections carried out by FSC for licence classes 'banking', 'investment' and 'corporate and trust services' were recorded separately. In other years, joint visits were allocated to the lead team, removing double counting.

Table D.N: Financial crime

	2002	2003	2004	2005	2006	2007	2008
Total staff in post	18	17	17	19	20.5	21.5	23.5
Suspicious transaction reports:							
Received	1,836	1,916	2,315	2,265	1,652	1,561	918
Investigated[24]	1,836	1,916	2,315	2,265	1,652	1,561	918
Not pursued	-	-	-	-	-	-	-
Disseminated to local agencies	-	-	-	376	333	262	150
Disseminated to international agencies	-	-	-	301	302	213	283
Other types of disposal	-	-	-	-	610	590	424
International co-operation and assistance[25]							
Letters of request for assistance	-	-	117	108	103	84	98
Number of requests made to other jurisdictions	-	-	-	-	85	109	153
Prosecutions[26]							
Local prosecutions for financial crime	-	-	-	3	7	7	2
Prosecutions in other jurisdictions where evidence contributed	-	-	7	3	3	4	1
Proceeds of crime asset recovery							
Assets frozen (£000s)	-	1,080	557	0	250	0	675
Assets seized	-	-	-	-	-	-	-
Assets confiscated	-	-	-	-	-	-	-

[24] Further enquiries are made with regard to all STRs/SARs; local, national and international criminal databases are checked as well as public source information. Where appropriate, they are disseminated to local/international agencies, where they may be used to supplement ongoing investigations, or may cause and investigation to be initiated.

[25] Includes: Financial Supervision Commission and Attorney General's Chambers.

[26] Includes: Financial Crime Unit and Customs & Excise Investigation Section

Jersey

Table D.O: Regulatory resources

	2002	2003	2004	2005	2006	2007	2008
Resources							
Total staff in post	63	81	72	81	85	100	104
Total annual revenue (£000)	10,930	11,727	12,297	13,463	13,928	15,179	15,850
Licences							
Licences in issue	751	754	687	800	1,078	1,034	1,097
Licences in each class:							
Banking	57	55	51	47	46	48	47
Investment	148	145	124	120	119	113	113
Trust and company service providers	245	248	190	184	279	188	186
Collective investment functionaries	126	138	158	281	359	381	438
Money service business[27]	-	-	-	-	-	5	5
Insurance[28]	175	168	164	168	275	299	308
Inspections[29]							
On site inspections completed	130	59	55	126	113	155	197
Inspections by licence class:							
Banking	-	-	-	25	25	27	26
Investment	-	-	-	24	20	23	17
Trust and company service providers	-	-	-	54	32	72	53
Collective investment schemes	-	-	-	23	22	27	19
Insurance[30]	-	-	-	-	14	6	16
Anti-money laundering unit[31]	-	-	-	-	-	-	66

[27] Money service business was not a regulated activity until 2007.

[28] Includes insurance and general insurance mediation business

[29] The Commission restructured its compliance division in 2004. Up to this time, information was recorded on the total number of inspections conducted, rather than licence classes covered by an inspection. Consequently, information in respect of inspections by licence class is not available for the years 2002-2004.

[30] Includes insurance and general insurance mediation business

[31] The Anti-money laundering unit did not start supervising compliance with AML./CFT legislation until 2008.

Table D.P: Financial crime

	2002	2003	2004	2005	2006	2007	2008
Total staff in post	17.5	17.5	17.5	19	19	19	19
Suspicious transaction reports:							
Received	1,612	1,272	1,248	1,162	1,034	1,517	1,404
Investigated	1,612	1,272	1,248	1,162	1,034	1,517	1,404
Not pursued[32]	-	-	-	-	-	-	-
Disseminated to local agencies	-	-	-	-	-	-	-
Disseminated to international agencies	-	-	-	-	-	-	-
Other types of disposal	-	-	-	-	-	-	-
International co-operation and assistance							
Letters of request for assistance	94	114	127	107	77	77	91
Number of requests made to other jurisdictions	23	17	37	10	6	16	6
Prosecutions							
Local prosecutions for financial crime	-	-	-	7	10	7	8
Prosecutions in other jurisdictions where evidence contributed							
Proceeds of crime asset recovery							
Assets frozen (£000)	843	197,978	16,921	46	15,001	49,552	3,862
Assets seized (£000)	843	197,978	16,921	46	15,001	49,552	3,862
Assets confiscated (£000)	-	-	-	-	1,113	1,595	105

[32] Information collected from 1 January 2009.

Turks and Caicos Islands

Table D.Q: Regulatory resources

	2002	2003	2004	2005	2006	2007	2008
Resources							
Total staff in post	21	22	22	21	23	18	20
Total annual revenue (US$000)[33]	N/C	4,510	4,909	6,480	6,952	7,715	7,725
Licences							
Licences in issue	67	69	71	83	89	95	98
Licences in each class:							
Banking	8	7	6	7	8	9	11
Corporate service providers	31	32	34	36	38	43	43
Trust service providers	27	28	28	29	30	30	30
Investment business	-	-	1	6	7	7	8
Collective investment schemes	1	2	2	5	6	6	6
Inspections							
On site inspections completed	-	-	1	11	20	41	8
Inspections by licence class:							
Banking	-	-	1	2	6	-	3
Corporate service providers	-	-	-	4	7	25	3
Trust service providers	-	-	-	4	4	11	1
Investment business	-	-	-	1	2	3	-
Collective investment schemes	-	-	-	-	1	2	1

[33] Annual revenue per year end: 31 March.

Table D.R: Financial crime

	2002	2003	2004	2005	2006	2007	2008
Total staff in post	4	4	3	4	5	4	4
Suspicious transaction reports:							
Received	-	-	5	5	21	36	50
Investigated	-	-	5	5	21	36	50
Not pursued	-	-	5	-	-	-	-
Disseminated to local agencies	-	-	-	-	-	5	26
Disseminated to international agencies	-	-	-	5	9	-	11
Other types of disposal	-	-	-	-	-	-	-
International co-operation and assistance							
Letters of request for assistance	-	-	-	1	3	1	3
Number of requests made to other jurisdictions	-	-	-	-	-	-	-
Prosecutions							
Local prosecutions for financial crime	-	-	-	-	-	-	-
Prosecutions in other jurisdictions where evidence contributed	-	-	-	-	-	-	-
Proceeds of crime asset recovery							
Assets frozen (US$000)	-	-	-	6,000	26	186	16,000
Assets seized (US$000)	-	-	-	6,000	-	186	16,000
Assets confiscated (US$000)	-	-	-	-	-	-	-

HM Treasury contacts

This document can be found in full on our website at: hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

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