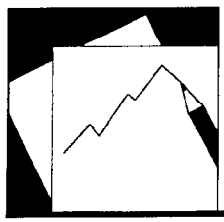
WP/02/88



IMF Working Paper

Caribbean Offshore Financial Centers: Past, Present, and Possibilities for the Future

Esther C. Suss, Oral H. Williams, and Chandima Mendis

INTERNATIONAL MONETARY FUND

 WP/02/88

IMF Working Paper

Western Hemisphere Department

Caribbean Offshore Financial Centers: Past, Present, and Possibilities for the Future

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Authorized for distribution by Jorge P. Guzmán

May 2002

Abstract

The paper reviews the development of offshore financial activities in the English-speaking Caribbean islands and takes stock of the size and status of these sectors today. In view of the heightened concerns of the international community about money laundering, the costs and risks to countries of having or establishing offshore sectors have risen considerably.

JEL Classification Numbers: G2, F3

Keywords: offshore financial sectors, Financial Action Task Force, money laundering, development strategies

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I. INTRODUCTION

The English-speaking countries of the Caribbean are, in general, small, very open economies, making them vulnerable to external shocks. In light of ongoing trade liberalization and economic integration, a challenge facing these countries is to implement appropriate structural changes in their economies to achieve higher real growth.

Although many of these economies have shifted away from agriculture toward tourism and other services, the loss of access to preferential markets in the current environment of free trade is likely to have significant adverse effects on employment and the external current account. Further diversification of the economies will require new investments, inter alia, in infrastructure and training of the labor force. The countries that have shifted the structure of their economy toward tourism are finding that growth in this sector has become insufficient to sustain continued per capita growth in the future owing to increased competition from new countries entering the market, the need for investments in infrastructure, and vulnerability to natural disasters, such as hurricanes.[2] As a result, many of these countries have looked to establishing activities in other services or in niche industries, such as offshore financial centers (OFCs), internet gaming, and other electronic services.

This paper reviews the current structure and status of offshore financial sectors in various English-speaking Caribbean countries and makes an estimate of what might be the cost of compliance with international standards. The paper concludes that, under current international best practices, costs associated with these sectors have increased. Thus, the prospects for significant net economic benefits from development of this sector for new entrants appear to be limited.

The remainder of this paper is structured as follows: a brief history of offshore centers in the Caribbean, and a description of services provided by offshore centers generally is given in Section I; a brief summary of international concerns about OFCs in the context of money laundering is given in Section II; an analysis of the role of the offshore sectors in these Caribbean economies in terms of composition, size, and economic contribution is given in Section III. The conclusions and suggestions for further research are presented in Section IV. Some of the background information used in this paper is included in various annexes: Annex 1 contains the list of criteria used by the Financial Action Task Force to define a noncooperative country or territory, and Annex II presents a table listing the noncooperative countries as of September 2001. Finally, a short, more detailed discussion of each country's offshore sector is presented in Annex III.

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[2] Tourism can become an invasive activity and, in this case, preservation of the main attractions for tourism may require putting limits on both the development of infrastructure and the number of tourists.

II. ESTABLISHMENT OF OFCS IN THE CARIBBEAN

The first offshore operations in the Western Hemisphere were established in The Bahamas in 1936 by British and Canadian interests to provide management services for the investments of wealthy international clients. These operations eventually became a wholly owned subsidiary of the National Westminster Bank, which was consolidated into the private banking operations of its parent company.[3] Within a short period of time, these financial operations expanded to other British overseas territories, such as Anguilla, the British Virgin Islands (BVI), and the Cayman Islands. After observing how several countries in the region (e.g. The Bahamas, Cayman Islands, the British Virgin Islands, and Panama) enjoyed significant benefits from large offshore sectors arising from employment creation and revenue for the respective governments and authorities, other countries in the Caribbean viewed the establishment of offshore centers as a possible engine of growth for their economies. The establishment of an OFC does not require large capital investments other than a modern communications system, and frequently in recent times, there has not been need for a large skilled labor force. Within the Eastern Caribbean Currency Union (East Caribbean Central Bank, ECCB) countries,[4] offshore companies began appearing in Antigua and Barbuda in 1982, soon followed by companies in Nevis. Grenada has had an active offshore sector for quite a number of years, and Dominica started fostering the sector much later in 1996, while St. Lucia and St. Kitts have just introduced with legislation for the start-up of offshore companies.

Offshore financial centers provide a number of legitimate and important services, that can be broadly grouped into three categories: (i) **private investments,** in which investments are managed in order to minimize potential tax liabilities and maximize protection granted under statutory confidentiality provisions; (ii) **asset protection**, in which the use of an international jurisdiction separate from the client's residence allows for the protection of income and assets from political, fiscal, and legal risks; and (iii) **estate planning** in which the administration of assets is done in the most favorable legal and fiscal jurisdiction.[5] The various types of financial institutions and/or vehicles that can be used for these services include international business corporations (IBCs), offshore corporations, commercial banks, insurance companies, mutual funds, and more recently, gaming companies.

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[3] Higgins, J. Kevin, 2000, "Offshore Financial Services: An Introduction," *TheEastern Caribbean Banker*, Vol. 2 (July), pp. 7–8.

[4] The East Caribbean Currency Union membership is comprised of Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines, and two British dependent territories, Anguilla and Montserrat.

[5] op.cit. Higgins, J. Kevin.

Box 1. Uses of Offshore Financial Centers[1]

The list below gives the most important, or predominant vehicles through which OFCs can provide services, but is by no means meant to be exhaustive.

- **Offshore banking**: Corporations or banks may open offshore banks to handle foreign exchange operations or financing needs; an individual may open an account in an offshore bank. The advantages of the offshore bank include no capital, corporate, capital gains, dividend or interest taxes, no exchange controls, and lighter supervision and reporting requirements.

- **International Business Corporations (IBCs)**: IBCs are limited liability companies that may be used to operate businesses, or raise capital through issuing shares, bonds, or other instruments. In many OFCs the cost of setting up an IBC is minimal and they are exempt from all taxes.

- **Insurance companies**: Commercial operations may establish an insurance company in an OFC to manage risk and minimize taxes, or onshore insurance companies may establish an offshore company to reinsure certain risks in order to reduce reserve and capital requirements for the onshore company. The advantages of the OFC are favorable income/withholding/capital tax regimes and low (or weakly enforced) reserve requirements and capital standards.

- **Asset management and protection**: Individuals and corporations in countries with weak economies and/or fragile banking systems may want to keep assets abroad to protect them against the possible collapse of the domestic currencies and banks, and free from any exchange controls; when confidentiality is desired, then an OFC is the choice for placing the assets. Individuals who face unlimited liability in the home jurisdiction may restructure the ownership of their assets through offshore trusts to protect those assets from domestic lawsuits.

- **Tax planning**: Multinational firms may route transactions through OFCs to minimize total taxes through transfer pricing. Individuals can make use of favorable tax regimes in, and tax treaties with, OFCs often in the form of trusts and foundations.

- **Money laundering**: proceeds from illegal activities such as drug trafficking, are processed through offshore centers to conceal the true source of the funds.

[1] Source: "Report of the Working Group on Offshore Centers," *Financial Stability Forum*, April 5, 2000, p. 14.

The benefits of OFCs in terms of financial development and growth to both an individual economy, and the global economy have been discussed in the literature.[6] The benefits of establishing an offshore sector reaped by the early entrants, e.g. The Bahamas and the Cayman Islands came from several areas and developed over time. These economies realized development opportunities because the offshore sector required a trained and educated labor

[6] Doyle, Michelle and Anthony Johnson, 1999, "Does Offshore Business Mean Onshore Economic Gains," *Central Bank of Barbados*, Working Papers.

force, which was largely undertaken by the foreign company or companies establishing the sector. At first, these foreign institutions hired local staff only in lower level positions using workers from the home country for many of the professional positions, but over time realized that it was to the benefit of all to train the local staff to take over the professional responsibilities. Also, in general, as the financial services grew in the local economy, there were positive spillover effects to other sectors of the economy, such as services, (hotels, restaurants and catering) and infrastructure (telecommunications, transport, etc), which need to be upgraded and expanded. The publicity that accompanied the promotion of the offshore sector benefited other sectors and eventually led to additional foreign investment in the economy. Finally, there is the possibility of the development of a capital market to facilitate investments.[7] All of these benefits had multiple effects on the development of an economy, and thus, it is easily understood why other countries would want to share in the benefits of this industry, the size of which is estimated at US$10–12 trillion and to grow at an average annual rate of 15 percent.[8] For the Caribbean countries, significant benefits could arise from obtaining just a small part of this industry.

However, OFCs could bring some disadvantages, such as making small open economies and their domestic financial systems, in particular, vulnerable to sharp changes in global financial flows through the transmission of financial and banking crises. The operations of OFCs have recently come under increased scrutiny by international policy regulators, especially after the recent wave of financial crises in global markets and the subsequent debate on financial restructuring, regulatory reform and institutional capacity building. The role of OFCs in money laundering has also contributed to the heightened scrutiny. The fact that transactions through OFCs have increased significantly over the last decade has made their impact non-trivial. According to the Bank for International Settlements (BIS), the total value of OFC cross border transactions in the English-speaking Caribbean totaled about US$0.9 trillion dollars in 1999, which is several times the combined GDP of the Caribbean Community (CARICOM) region.[9]

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[7] Bannister, Tina, 2000, "Offshore Financial Services: An Overview," *The Eastern Caribbean Banker*, Vol. 2 (September), pp.10–12.

[8] Op.cit. Higgins, J. Kevin, 2000.

[9] CARICOM is a regional group of Caribbean countries that includes, Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Haiti, Jamaica, Montserrat, St. Lucia, St. Kitts and Nevis, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago. The group seeks greater economic cooperation through the formation of a single market and economy.

III. INTERNATIONAL CONCERNS ABOUT OFCS

In the late 1990s, enhanced concerns of the international community with money laundering and tax evasion have led to a number of concerted efforts being undertaken by various international committees. The fact that many OFCs exist in loosely defined regulatory and supervisory environments has increased the focus of policy makers and regulators on the possible role played by OFCs in the process of tax evasion and money laundering. This focus has become even more intensified since the events of September 11, 2001, as officials attempt to identity sources of terrorist financing. The two principle forums engaged in the international attack on money laundering are: (1) the Financial Stability Forum (FSF), and (2) the Financial Action Task Force (FATF).[10] Both the FSF and FATF have established criteria for identifying countries that facilitate money laundering and have proposed the imposition of sanctions. As a result, the costs of an offshore sector to an individual country have increased, reflecting the need to have appropriate supervisory and regulatory agencies. In the absence of these agencies, the risk of sanctions being imposed by the international community has increased significantly.

In April 1990 the FATF issued a report containing a set of 40 recommendations,[11] which provided a set of counter measures against money laundering and are related to the criminal justice system and law enforcement; the financial system and its regulation; and international cooperation. The basic issues addressed by these recommendations[12] relate to (i) the criminalization of money laundering; (ii) international cooperation in investigating, prosecuting, and extraditing of crime suspects; (iii) the existence of adequate supervisory policies, practices and procedures, including "know your customer" rules which would shield banks from being used by criminal elements; and (iv) the international exchange of information regarding suspicious information.

In mid-2000 both the FSF and the FATF issued reports on the state of money laundering with a focus on various offshore financial centers, using various criteria to determine the degree of

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[10] The FSF, established by the G-7, was convened in April 1999 and operates under the auspices of the Bank for International Settlements (BIS). The FATF is an inter-governmental body initially established by the G-7 in 1989 (but now has the full OECD as its membership) with the responsibility of examining money laundering techniques and trends, reviewing actions already taken at national and international levels, and setting out additional measures to be taken to combat money laundering.

[11] These recommendations were revised in 1996 to take into account changes in money laundering trends; for details on the recommendations, see "Financial Action Task Force on Money Laundering, The Forty Recommendations", at www.oecd.org/fatf.

[12] "Enhancing Contributions to Combating Money Laundering: Policy Paper," Annex II, prepared by the IMF and the World Bank, April 26, 2001.

"cooperation" and/or the adequacy of legal and supervisory systems relative to international standards. However, since the FATF criteria were more straightforward in many areas than those used by the FSF, this paper deals only with the countries addressed by the FATF in its June 2000 report, with updates as of September 2001.

In the June 2000 report, the FATF evaluated 26 nonmember countries or territories using 25 criteria drawn up on the basis of the 40 recommendations.[13] These criteria can be grouped into four main areas: (i) loopholes in financial regulations; (ii) obstacles raised by regulatory requirements; (iii) obstacles to international cooperation; and (iv) inadequate resources provided for dealing with money laundering activities. Of the 26 countries and territories initially evaluated, (9 were English-speaking Caribbean countries), 15 were declared to be noncooperative (NCCT). From the English-speaking Caribbean, these were The Bahamas, the Cayman Islands, Dominica, St. Kitts and Nevis, and St. Vincent and the Grenadines, and they met between 11 criteria (The Bahamas) and a maximum of 19 criteria (St. Kitts and Nevis).[14] Grenada was added to the NCCT list in late 2001. Annex II lists the initial 26 countries, plus the four countries added in 2001, and the results for each of the 25 criteria.[15]

In general, being declared cooperative did not exclude the need to improve on measures to address money laundering, e.g. legislation, supervision, regulation, but rather that the country or jurisdiction had been taking measures to address any shortcomings. The report identified detrimental rules and practices that obstructed international cooperation against money laundering.

The bulk of the reasons for the five Caribbean countries being declared uncooperative related to (i) secrecy provisions regarding institutions, particularly in making public the owners and shareholders of institutions; (ii) lack of an appropriate system for reporting suspicious transactions; (iii) inadequate legal requirements for registering business and legal entities; and (iv) the existence of obstacles to international cooperation in investigating money laundering activities. In recent years, competition for international capital has resulted in some new entrants to the offshore financial market offering broad banking secrecy as one way to attract funds away from already established OFCs. Although professional secrecy in banking activities can be justified, to an extent, by the need to protect business secrets from

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[13] See Annex I for the list of criteria used. For member countries, the FATF evaluated their offshore sectors on the basis of the 40 recommendations.

[14] Grenada was added to the NCCT list in September 2001.

[15] Meeting a criterion indicated a shortcoming in the relevant country being evaluated. For each criterion that the FATF judged met by a country, a value of one was given; if the FATF judged that the country "partially" met a criterion, a value of 0.5 was given. In this way we could analyze which criteria were met most often as well as determine which countries had the most shortcomings in addressing issues of money laundering.

rivals, this need cannot be allowed to take priority over the supervisory responsibilities and the investigative powers of the authorities.

Table 1 gives the institutions (bodies) responsible for supervising the various financial institutions in each ECCU member country. In general, the countries just beginning to create offshore sectors seemingly are lacking in terms of institutions which can regulate and supervise the offshore bodies; in many of these countries, the same agency is assigned the responsibility for regulating all the various offshore activities. In the new international architecture, increased secrecy or confidentiality is no longer an acceptable option, and the current atmosphere is one in which sanctions can be imposed on countries which do not conform, or at least work seriously toward conforming to international standards in the operations of OFCs. Succinctly stated, in the case of the banking sector, the standards for supervising and regulating of offshore banks should be the same standards as for domestic banks; in areas where there do not yet exist international standards, such as mutual funds, then best practice guidance should be implemented. What this implies is that countries will need to improve supervision, regulation, and sharing of information with other countries, and generally will need to promulgate and staff more institutions for these purposes, as well as broaden the scope of those that exist. One major development is the need for additional professional staff, such as auditors and supervisors, which will require additional expenses for training, or for paying for consultants in the meantime. One new institution, which can illustrate current thinking, is the Financial Intelligence Unit (FIU), which should be established to follow and share information on suspicious transactions with domestic bank supervisors and official enquirers.

Since the issuing of the FSF and FATF reports in 2000, several countries have indicated that their financial sectors and/or economies have suffered owing to the adverse publicity. Although Antigua and Barbuda received a good report from the FATF, the relatively poor evaluation of the FSF (even prior to the publication of the report) resulted in financial advisories issued by the United States and United Kingdom under which the banks in these countries were warned to refrain from doing business with financial institutions in Antigua and Barbuda. Banks that undertook transactions with financial institutions in Antigua were subjected to increased scrutiny by supervisors in their home country. The FATF recommended that financial institutions pay special attention to transactions with noncooperative countries, essentially increasing the scrutiny paid to these transactions that are more likely to be related to money laundering.

In light of heightened scrutiny following the reports issued by the FSF and the FATF, many countries took measures to address the concerns raised so as to avoid the imposition of sanctions. In June 2001 the FATF reviewed the progress made by the countries identified as noncooperative and at that time, inter alia, The Bahamas and Cayman Islands were removed from the list. In the meanwhile, Dominica, St. Kitts and Nevis, and St. Vincent and the Grenadines, as well as Grenada, which was added in September 2001, remained classified as noncooperative beyond end-2001.

Table 1. Eastern Caribbean Countries: Regulatory Bodies for the Offshore Sector

	International Business Corporations	Offshore Banking	Money Laundering	Trust Companies	Insurance Companies	Gaming Establishments
Antigua and Barbuda	International Financial Sector Authority	International Financial Sector Authority	Office of the National Drug and Money Laundering Policy	International Financial Sector Authority	International Financial Sector Authority	Free Trade Zone
Dominica	International Business Unit of the Ministry of Finance, Industry and Planning	International Business Unit of the Ministry of Finance, Industry and Planning	International Business Unit of the Ministry of Finance, Industry and Planning	International Business Unit of the Ministry of Finance, Industry and Planning	International Business Unit of the Ministry of Finance, Industry and Planning	International Business Unit of the Ministry of Finance, Industry and Planning
Grenada	Grenada International Financial Services Authority	Grenada International Financial Services Authority	Grenada International Financial Services Authority	Grenada International Financial Services Authority	Grenada International Financial Services Authority	Grenada International Financial Services Authority
Nevis	Financial Services Commission	Financial Services Commission	Financial Services Commission	Financial Services Commission	Financial Services Commission	Financial Services Commission
St. Kitts	Financial Services Commission	Financial Services Commission	Financial Services Commission	Financial Services Commission	Financial Services Commission	Financial Services Commission
St. Lucia	Financial Services Supervisory Unit, Ministry of International Financial Services	Financial Services Supervisory Unit, Ministry of International Financial Services	Financial Services Supervisory Unit, Ministry of International Financial Services	Financial Services Supervisory Unit, Ministry of International Financial Services	Financial Services Supervisory Unit, Ministry of International Financial Services	
St. Vincent and the Grenadines	Ministry of Finance	Ministry of Finance	Ministry of Finance	Ministry of Finance	Ministry of Finance	Offshore Financial Authority

Sources: International Financial Sector Authority, Antigua and Barbuda; Ministry of Finance, Dominica; Nevis Financial Services Department; Financial Services Supervision Unit--Ministry on International Financial Services, St. Lucia; Ministry of Finance, St. Kitts; KPMG, Review of Financial Regulation in Caribbean Overseas Territories and Bermuda, October 2000; Offshore Financial Authority (OFA), St. Vincent and the Grenadines.

Both The Bahamas and Cayman Islands enacted significant modifications to existing legislation as well as new laws to address their identified deficiencies.[16] In the case of The Bahamas, a major improvement was the establishment and adequate staffing of a financial intelligence unit to oversee the offshore sector. In addition, the existence of anonymous accounts and bearer shares, as well as anonymous ownership of IBCs, was banned, and measures taken to improve international cooperation. In the case of the Cayman Islands, a more ambitious financial inspection program has been initiated, identification of all pre-existing accounts required, and all banks licensed in the Caymans must maintain a physical presence. In February 2001 the Cayman authorities ordered 62 private banks to open and staff offices in the Caymans and to maintain records there if they wanted to remain licensed.[17] Although Dominica, a late entrant, had enacted a Money Laundering Prevention Act in January 2001, there remained several major issues to be addressed, particularly in the areas of customer identification, record keeping, and the ability to share information. While both St. Kitts and Nevis, and St. Vincent and the Grenadines had enacted some modifications to their legislation since June 2000, both countries continued to have major outstanding issues in the areas of owner identification and international cooperation. As mentioned above, Antigua and Barbuda received a poor evaluation from the FSF (they were included on the list of deficient countries) notwithstanding their positive evaluation by the FATF, and to address these issues, several modifications to the existing legislation were enacted after mid-2000. In particular, activities other than drug trafficking were made illegal in the context of money laundering.[18] In May 2001 new provisions were added to the Prevention of Money Laundering Laws that (i) make it easier to freeze property belonging to offenders, and (ii) make it simpler for prosecutors in Antigua and Barbuda to introduce relevant information from other countries before the courts. Largely reflecting these measures, the number of licensed banks in Antigua was reduced from 58 in 1997 to 22 at end-2001. In December 2001 the Antiguan and United States governments signed a treaty facilitating the exchange of information on a range of financial and tax issues. For each of the countries covered in this paper, a brief summary of the major legislation addressing offshore issues is given in Table 1, Annex III.

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[16] See the FATF, "Review to Identify Non-Cooperative Countries of Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures," June 22, 2001, for a detailed description of the relevant legislation in each country.

[17] Reuters World Service, "Crime-Laundering-Caymans," June 22, 2001.

[18] In July 2001 the United Kingdom lifted its advisory, citing significant progress made by the authorities to address shortcomings in the offshore sector. In August 2001 the United States also lifted its advisory citing the enactment of new laws and the beginning of effective implementation.

IV. Structure and Benefits of the Caribbean Offshore Financial Sectors

The size of the OFCs in the Caribbean region varies significantly from one country or territory to another, and the nature of the offshore sectors—in the sense of area of specialization—also varies across the region. Table 2 shows the number of various institutions registered in each country or jurisdiction as of end-2000/2001 for which data were available. Of the older, established sectors, the British Virgin Islands (BVI) is the largest register of IBCs, and is estimated to account for 48 percent of global IBC incorporations. The Cayman Islands, estimated to be the fifth largest OFC in the world,[19] has fewer registered IBCs, but significantly more banks, insurance companies and trusts registered. However, the Caymans was the market leader in the Caribbean in terms of the number of offshore banks registered. With regard to entrants from the ECCU to the OFC sector, St. Kitts and Nevis has the largest number of registered IBCs, while Antigua and Barbuda has the most diversified sector—having registered not only IBCs, but also banks, trusts and gaming companies.

There has been very little measurement of the contribution of OFCs to the general economy. One reason has been the limited availability of reliable, comparable data across countries. which is the reason why the contribution of OFCs to the economy used in this paper is based primarily on the fees collected by the central government.[20] The fee structure for various services offered in the offshore sectors of these countries is given in Table 3.

The importance of the offshore sector to the general economy can be measured broadly by the extent to which it generates employment opportunities. In many cases where only offshore banks are established, and then with no real physical presence, they do not use large amounts of labor, and thus do not mitigate problems of unemployment or underemployment. Limited data were available on employment in these sectors in the various countries, as well as on wages and other relevant variables, such as taxes paid by these employees. The estimated employment in 2000 by the OFCs for which data are available, was 100 persons in Dominica (0.5 percent of the labor force); 940 persons in the Bahamas (1 percent of the labor force); 2,500 persons in Antigua and Barbuda (about 8 percent of the labor force); and 942 persons in the BVI (about 15 percent of the labor force). The high number of employees in Antigua and Barbuda is associated with internet gaming. With the exception of Dominica, the contribution of this sector to overall employment is significant. However, it was not

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[19] The Cayman Islands is ranked behind Hong Kong SAR, London, New York, and Tokyo, with an estimated US$750 million under management of its financial institutions, according to Cayman banking officials.

[20] The BVI was the only territory with an estimate of total fees paid to both central government and registered agents. Total fees were approximately three times that collected by the central government.

Table 2. Size of the Offshore Financial Sectors, 2000 and 2001 1/

	Number of International Business Companies	Number of Offshore Banks	Number of Offshore Banks with Onshore	Number of Offshore Insurance Companies	Number of Trust Companies	Number of Gaming Companies	Foreign Sales Corporations	Mutual Funds
ECCB Area								
Anguilla	1,876	1	0	18	6	0	0	0
Antigua and Barbuda 2/	8,000	22	1	0	6	77	0	0
Dominica 2/	7,536	5	0	2	5	6	0	
Grenada 2/	3,400	44	0	6	11	0	0	...
St. Kitts and Nevis 2/	22,450	1	1	0	2,020	9	75	0
St. Vincent and the Grenadines 2/	10,135	45	0	3	902	0	0	4
Rest of the Caribbean								
The Bahamas	100,092	415	0	0	0	0	0	600
Barbados	3,399	45	0	239	0	0	2,857	0
British Virgin Islands 2/	314,158	0	0	395	0	0	0	2,013
Cayman Islands	49,456	450	51	502	25,000	190	0	2,298

Sources: International Financial Sector Authority, Antigua and Barbuda; Ministry of Finance, Dominica; Nevis Financial Services Department; KPMG, Review of

1/ St. Lucia has not commenced activities in the offshore sector and is therefore not included in the table.
2/ Reflects data for 2001.

Table 3. Schedule of Fees for Offshore Services

(In U.S. dollars)

	Antigua and Barbuda	Dominica	St. Kitts and Nevis	St. Vincent and the Grenadines	British Virgin Islands	Cayman Islands
International Business Companies	**300**	**90**			**300 - auth. capital < $50,000**	
Annual Renewal	300	150			1000- auth. capital > $50,000	
Offshore Banking	**15,000**	**8,000**	**20,000**	**...**	**20,000**	**102,500-123,000**
Annual Renewal		8,000	20,000	...		
Application Fee			1,500			
Licence						
Offshore Trust Companies	**7,500**	**4,000**	**1,000**	**...**	**200-500**	**102,500-123,000**
Annual Renewal		4,000	1,000	...		
Application Fee			1,500	...	200	
Due Diligence Fee			600 per shareholder			
Licence						102,500-123,000
Internet Gaming		**15,000**	**...**	**...**		
Annual Renewal	US$75,000 for sports betting and US$100,000 for casinos	The maximum of 5 percent of gross revenue or US$50,000 or a flat fee of US$75,000	...	...		
Exempt Insurance	**10,000**	**2,500**	**...**	**...**	**500**	
Annual Renewal		2,500	...	...		
Management Company		**2,500**	**...**	**...**		
Annual Renewal		2,500	...	...		
Holding Company		**2,500**	**...**	**...**		
Annual Renewal		2,500	...	...		
Mutual Funds					**500**	

Sources: International Financial Sector Authority, Antigua and Barbuda; Ministry of Finance, Dominica; Nevis Financial Services Department; KPMG, Review of Financial Regulation in Caribbean Overseas Territories and Bermuda, October 2000; Offshore Financial Authority (OFA), St. Vincent and the Grenadines.

possible to obtain information on wages, and thus it is not possible to comment on the size of the wage bill generated by this employment.

Within the ECCU, fees from the OFC have increased in importance since 1995 (Table 4). Fees collected by central governments were small relative to GDP for this group of territories by end-2000, with only Dominica and Antigua and Barbuda obtaining more than 1 percent of GDP. However, the importance of these fees relative to government current revenues[21] is larger. As of end-2000, Antigua and Barbuda derived over 7 percent of central government current revenue from offshore sector fees, followed by Grenada at 4.5 percent and Anguilla at 3.6 percent. In Antigua and Barbuda, the majority of the fees are derived from internet gaming companies that are established in a Free Trade Zone.

The more established jurisdictions for which data were available differed in the degree of reliance on fees from the OFC. The BVI, which is the world market leader in incorporation of IBCs, was the most dependent on fees from the offshore financial sector, with fees collected accounting for almost 55 percent of government revenue or 13 percent of GDP by end-2000. The economy of the BVI is heavily dependent on the offshore financial sector and extremely vulnerable to adverse developments in the sector. The Cayman Islands also relies heavily on fees collected from offshore banks, but to a lesser degree than the BVI, as these fees accounted for 14.5 of government revenue by end-2000. In contrast, the governments of The Bahamas and Barbados were less dependent on offshore sector fees, which amounted to about 1 percent of government revenue and between 0.2 percent and 0.4 percent of GDP, respectively. The various fees for offshore services are given in Table 4.

The above measurement of the contribution of the offshore sector to the domestic economies is overstated to the extent that relevant costs of the sector are not taken into account. Data on the costs associated with these sectors is difficult not only to obtain, but also to compare across countries and type of financial activities. Currently, only the banking industry has international standards elaborated, while for other financial services, such as mutual funds or trusts, there are only international best practices available for monitoring purposes. Data from several sources (in order to insure confidentiality of data provided), have been used to estimate what might be the cost associated with maintaining an offshore sector largely in compliance with international standards. has been estimated from data obtained from several sources. We assume that the cost of auditing a bank (as part of the supervisory requirements) is US$15,000; the cost of "auditing" a mutual fund is US$8,000, and general business costs for the center—e.g. advertising, office supplies, utility payments, are US$25,000 per year. Assumptions have been made about the costs of hiring (where needed) additional general staff, as well as additional professional staff, such as supervisors or auditors. In the beginning at least, the salaries of these professionals would need to be competitive with those employed in countries such as The Bahamas or Cayman Islands, and if new staff can not be hired, then

[21] In this section, all references to revenue are to central government current revenue, unless otherwise stated.

Table 4. Annual Fees Collected by Governments

	1995	1996	1997	1998	1999	2000	Costs 1/ 2000	Net revenue 2000
	(In millions of EC dollars) 2/							
ECCU Area								
Anguilla	...	...	2.1	2.0	2.4	2.4		2.4
Antigua and Barbuda	4.5	4.7	12.3	11.7	23.1	23.1	3.7	19.4
Dominica 3/	0.0	4.6	10.1	9.9	9.7	5.2	2.1	3.1
Grenada	...	...	...	...	10.0	13.3	4.4	8.9
St. Kitts and Nevis	1.9	2.8	3.9	5.2	6.3	7.4	2.1	5.3
St. Vincent	...	...	1.5	2.2	3.5	3.9	4.2	-0.4
Rest of the Caribbean								
Bahamas	23.8	23.0	23.0	21.6	25.9	20.8	5.2	15.6
Barbados	6.8	7.0	19.8	28.9	25.0	48.1	3.5	44.6
British Virgin Islands	121.5	145.3	172.5	199.0	222.5	261.3	6.5	254.8
Cayman Islands	74.5	80.7	85.6	98.8	128.3	134.2	7.1	127.1
	(As a percentage of central government revenue)							
ECCU Area								
Anguilla	...	...	3.8	2.4	3.6	3.6	...	...
Antigua and Barbuda	1.6	1.4	3.8	3.4	6.7	7.2	...	...
Dominica	0.0	0.7	1.6	1.5	1.4	0.7	...	...
Grenada	...	...	...	...	3.7	4.5	...	...
St. Kitts and Nevis	1.0	1.3	1.7	2.2	2.5	2.8	...	...
St. Vincent	...	...	0.6	0.8	1.3	1.4	...	...
Rest of the Caribbean								
Bahamas	1.3	1.2	1.1	1.2	0.9	...	...	...
Barbados	0.3	0.7	1.1	1.4	1.1	2.1	...	...
British Virgin Islands	40.1	42.2	44.0	51.7	52.5	54.6	...	...
Cayman Islands	13.2	12.8	10.9	12.3	14.5	14.6	...	...
	(As a percent of GDP)							
ECCU Area								
Anguilla	...	...	0.9	0.8	0.8	0.8	0.0	0.8
Antigua and Barbuda	0.3	0.3	0.8	0.7	1.3	1.3	0.2	1.1
Dominica	0.0	0.7	1.6	1.5	1.4	0.7	0.3	0.4
Grenada	...	...	...	...	1.0	1.2	0.4	0.8
St. Kitts and Nevis	0.3	0.4	0.5	0.7	0.8	0.8	0.2	0.6
St. Vincent	...	...	0.2	0.3	0.4	0.4	0.5	0.0
Rest of the Caribbean								
Bahamas	0.3	0.2	0.2	0.2	0.2	0.2	0.0	0.2
Barbados	0.1	0.2	0.4	0.4	0.4	0.7	0.1	0.6
British Virgin Islands	9.9	10.7	11.5	12.1	12.3	13.1	0.3	12.8
Cayman Islands	3.0	3.1	3.1	3.4	4.2	4.1	0.2	3.9

Sources: International Financial Sector Authority, Antigua and Barbuda; Ministry of Finance, Dominica; Nevis Financial Services Department; KPMG, Review of Financial Regulation in Caribbean Overseas Territories and Bermuda, October 2000; Offshore Financial Authority (OFA), St. Vincent and the Grenadines; and Fund staff estimates.

1/ Fund staff estimates using data from national authorities.

2/ EC$2.7=US$1.

3/ Excludes revnues arising from the economic citizenship program.

professional services would need to be obtained through consultants. These estimated theoretical costs and resulting "net revenues" are given in Table 4.

Taking the estimated costs of complying with international standards into account reduces the overall revenues by about 0.3 percent of GDP. Of course, this does not take into account the need to close institutions, which most likely would result in a larger decline in income than in costs. Thus, the net benefits, assuming compliance with international standards, to the ECCU countries ranged between nil and 1.1 percent of GDP at end-2000.

There are other costs or disadvantages of offshore sectors. OFCs have the potential to affect the liquidity and stability of the financial system, particularly where local banks have offshore entities. A financial crisis affecting an OFC in one country could have massive implications for regional economies. Apart from sudden reversals of capital flows and liquidity, the adverse performance or insolvency of an offshore branch of a domestic bank may seriously undermine the stability of the domestic financial system. The greater the reliance on fees, the more vulnerable the economy becomes to movements in the offshore sector. In the case of the BVI, it seems that the tax base has been eroded with the increased reliance IBC fees—accounting for well over 50 percent of current revenue. Also, in an environment of inadequate supervision and "firewalls" separating the onshore and offshore sectors, offshore banks can lend to onshore clients for projects such as construction and general investments. While this lending could have a positive impact on real economic activity, it can also adversely affect resource allocation and governance issues. This is likely to be the case, the greater the extent to which these loans are a vehicle for money laundering. Additionally, if domestic banks become involved in these activities, possible defaults on these loans would have a negative impact on the deposits of residents and the overall fiscal accounts if the government would need to intervene. A prime example of this kind of development was the failure in 1991 of the Bank of Credit and Commerce International (BCCI) that significantly disrupted the financial markets of many countries throughout the world.

V. Conclusions

Many of the Caribbean islands depend heavily on tourism or are moving from a predominately agriculture base toward tourism, and are looking to other means of diversifying their economies. To this end, offshore financial sectors are attractive to these countries in the context of diversification. This sector has been viewed as a growing industry with the potential to provide significant growth in developing economies; it is seen as being able to generate large revenues without large investments in physical infrastructure. Under current international standards, these views are no longer widely held. There are certain stigmas associated with offshore centers to the extent that they are perceived to be involved in money laundering or other illegal activities.

The more established centers have been able to generate significant amounts of revenues (and perhaps employment). These economies, such as The Bahamas, the Cayman Islands, and the British Virgin Islands, have also developed relatively strong and extensive legislative

and regulatory frameworks to address these sectors. However, even in these countries, additional measures have been required by the various international fora looking into the problems of money laundering. For the newer entrants to this sector, the benefits are not so clear-cut—and this does not even take into account the costs of setting up the required supervisory regulations and institutions together with the training of professional staff. Additional work should focus on refining the measurement of the benefits and costs.[22] For example, in the Caribbean region, the scope of measuring the contributions or value-added of the OFC to the economy encompasses fees paid to government and registered agents, rental of office space, wages paid to local workers, utilities and other ancillary services. More detailed information on the gross contributions to the economies would need to be accompanied by more specific actual data on costs, and in this regard, the national authorities should undertake strong efforts to obtain, and provide these data to researchers.

The increased competition resulting from more entrants into this activity implies greater product differentiation or price reductions (i.e., lower fees or enhanced services). However, one of the major competitive factors—increased secrecy from even local supervisors—is no longer a viable option. As shown in Table 3, the fees offered by the various countries do not vary significantly, and it is most likely that the major competitive factor in the current international environment is a country's established reputation. All in all, in light of the higher costs associated with an offshore sector and thus, the net gains limited, country authorities will need to evaluate carefully a decision to establish, or to expand any existing, offshore sector.

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[22] One approach used in the measurement of traditional commercial banking output that may be of interest is the value-added approach, which explicitly uses all operating costs, such as labor and capital to model inputs (see Berger and Humphrey (1990)). This method was partially applied to make a crude assessment of the contribution of the OFCs to the respective economies, with the value-added or income defined value as:

Value added = gross output - Intermediate consumption = operating surplus + employee compensation + depreciation

In the Caribbean region, the scope of measuring the contributions, or value-added, of the OFC to the economy encompasses fees paid to government and registered agents, rental of office space, wages paid to local workers, utilities and other ancillary services (the income approach).

Annex I. Criteria Defining Noncooperative Countries or Territories[23]

The criteria given below were used by the FATF in evaluating the offshore centers in 26 countries in 1999 and early 2000, as well as the additional reviews of OFCs undertaken in September 2000, and during 2001.

The criteria which were met[24] most often relate to:

(i) loopholes in financial regulation, particularly the lack of adequate rules for the licensing and creation of financial institutions (criterion 5). In this regard, shortcomings in background checks for managers and owners of financial institutions were also deemed relevant.

(ii) Excessive secrecy provisions regarding the financial institutions (criterion 10) and a lack of an efficient system for reporting suspicious transactions (criterion 11).

(iii) Inadequate means for identifying and making available relevant information related to financial institutions (criterion 15), such as identity of directors, which might restrict the ability of and institution to exercise due diligence; and

Providing inadequate resources for addressing the problems of money laundering, in particular, insufficient resources (financial, human, or technical) to the administrative and judicial authorities to allow them to exercise their functions properly (criterion 23), and the lack of a centralized financial intelligence unit (FIU) that deals specifically with anti-money laundering controls and the enforcement of measures in place (criteria 25).

A. Loopholes in Financial Regulations

No or inadequate regulations and supervision of financial institutions

1. Absence or ineffective regulations and supervision for all financial institutions in a given country or territory, onshore or offshore, on an equivalent basis with respect to international standards applicable to money laundering.

Inadequate rules for the licensing and creation of financial institutions, including assessing the backgrounds of their managers and beneficial owners

2. Possibility for individuals or legal entities to operate a financial institution without authorization or registration or with very rudimentary requirements for authorization or registration.

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[23] Source: Report of the FATF, February 2000.

[24] Meeting a criterion indicated a shortcoming in the relevant country being evaluated. For each criterion that the FATF judged met by a country, a value of one was given; if the FATF judged that the country "partially" met a criterion, a value of 0.5 was given. In this way we could analyze which criteria were met most often as well as determine which countries had the most shortcomings in addressing issues of money laundering.

3. Absence of measures to guard against holding of management functions and control or acquisition of a significant investment in financial institutions by criminals or their confederates.

Inadequate customer identification requirements for financial institutions

4. Existence of anonymous accounts or accounts in obviously fictitious names.

5. Lack of effective laws, regulations, agreements between supervisory authorities and financial institutions or self-regulatory agreements among financial institutions on identification by the financial institution of the client and beneficial owner of an account: no obligation to verify the identity of the client; no requirement to identify the beneficial owners where there are doubts as to whether the client is acting on his own behalf; no obligation to renew identification of the client or the beneficial owner when doubts appear as to their identity in the course of business relationships; no requirement for financial institutions to develop ongoing anti-money laundering training programs.

6. Lack of a legal or regulatory obligation for financial institutions or agreements between supervisory authorities and financial institutions or self-agreements among financial institutions to record and keep, for a reasonable and sufficient time (five years), documents connected with the identity of their clients, as well as records on national and international transactions.

7. Legal or practical obstacles to access by administrative and judicial authorities to information with respect to the identity of the holders or beneficial owners and information connected with the transactions recorded.

Excessive secrecy provisions regarding financial institutions

8. Secrecy provisions which can be invoked against, but not lifted by competent administrative authorities in the context of enquiries concerning money laundering.

9. Secrecy provisions that can be invoked against, but not lifted by judicial authorities in criminal investigations related to money laundering.

Lack of efficient suspicious transactions reporting system

10. Absence of an efficient mandatory system for reporting suspicious or unusual transactions to a competent authority, provided that such a system aims to detect and prosecute money laundering.

11. Lack of monitoring and criminal or administrative sanctions in respect to the obligation to report suspicious or unusual transactions.

B. Obstacles Raised by Other Regulatory Requirements

Inadequate commercial law requirements for registration of business and legal entities

12. Inadequate means for identifying, recording and making available relevant information related to legal and business entities (name, legal form, address, identity of directors, provisions regulating the power to bind the entity).

Lack of identification of the beneficial owner(s) of legal and business entities

13. Obstacles to identification by financial institutions of the beneficial owner(s) and directors/officers of a company or beneficiaries of legal or business entities.

14. Regulatory or other systems which allow financial institutions to carry out financial business where the beneficial owner(s) of transactions is unknown, or is represented by an intermediary who refuses to divulge that information, without informing the competent authorities.

C. Obstacles to International Cooperation

Obstacles to international cooperation by administrative authorities

15. Laws or regulations prohibiting international exchange of information between administrative anti-money laundering authorities or not granting clear gateways or subjecting exchange of information to unduly restrictive conditions.

16. Prohibiting relevant administrative authorities to conduct investigations or enquiries on behalf of, or for account of their foreign counterparts.

17. Obvious unwillingness to respond constructively to requests (e.g. failure to take the appropriate measures in due course, long delays in responding).

18. Restrictive practices in international cooperation against money laundering between supervisory authorities or between FIUs for the analysis and investigation of suspicious transactions, especially on the grounds that such transactions may relate to tax matters.

Obstacles to international cooperation by judicial authorities

19. Failure to criminalize laundering of the proceeds from serious crimes.

20. Laws or regulations prohibiting international exchange of information between judicial authorities (notably specific reservations to the anti-money laundering provisions of international agreements) or placing highly restrictive conditions on the exchange of information.

21. Obvious unwillingness to respond constructively to mutual legal assistance requests (e.g. failure to take the appropriate measures in due course, long delays in responding).

22. Refusal to provide judicial co-operation in cases involving offences recognized as such by the requested jurisdiction especially on the grounds that tax matters are involved.

D. Inadequate Resources for Preventing and Detecting Money Laundering Activities

Lack of resources in public and private sectors

23. Failure to provide the administrative and judicial authorities with the necessary financial, human or technical resources to exercise their functions or to conduct their investigations.

24. Inadequate or corrupt professional staff in either governmental, judicial or supervisory authorities or among those responsible for anti-money laundering compliance in the financial services industry.

Absence of a financial intelligence unit or of an equivalent mechanism

25. Lack of a centralized unit (i.e., a financial intelligence unit) or of an equivalent mechanism for the collection, analysis and dissemination of suspicious transactions information to competent authorities.

Annex II. FATF Criteria for Defining Noncooperative Countries

(Unless indicated otherwise, countries were listed as of June 2000)

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	Total for Country
	1 Antigua and Barbuda																										**0**
*	**2 The Bahamas 1/**					**0.5**					**0.5**	**0.5**	**1**	**1**	**1**	**1**	**1**				**0.5**	**1**	**1**	**1**		**1**	**11**
	3 Belize																										0
	4 Bermuda																										0
	5 British Virgin Islands																										0
*	**6 Cayman Islands 1/**	**1**	**0.5**	**0.5**		**1**	**1**	**0.5**	**1**		**1**	**1**	**0.5**	**1**	**1**	**1**	**1**	**1**	**1**					**1**			**15**
*	7 Cook Islands	1			1	1	1				1	1	1		1					1	1		1	1	1		1	14
	8 Cyprus																										0
*	**9 Dominica**				**1**	**1**		**1**			**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**		**1**				**1**		**1**	**14**
	10 Gibraltar, Guernsey																										0
	10 Isle of Man and Jersey																										0
*	11 Israel						0.5				1	1								1			1			1	5.5
*	12 Lebanon	1	1					1	1	1	1	1			1	1	1		1	1	1				1	1	15
*	13 Liechtenstein	1				0.5					1			0.5		1	1	1	1		1	1		1			10
	14 Malta																										0
*	15 Marshall Islands	1	1	1	1	1	1	1	1		1	1	1		1	1	1	1		1				1		1	18
	16 Mauritius																										0
	17 Monaco																										0
*	18 Nauru	1	1	1	1	1	1	1		1	1	1	1		1					1					1	1	15
*	19 Niue	1	1	1	1	1					1	1	1		1	1										1	11
*	**20 Panama 1/**							**1**	**1**		**0.5**			**1**		**1**	**1**	**1**	**1**	**1**							**8.5**
*	21 Philippines	1			1	1	1		1		1	1			1					1				1		1	11
*	22 Russia	1			1	1	0.5				1	1						1				1		1	1	1	10.5
	23 Samoa																										0
*	**24 St. Kitts and Nevis**		**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**		**1**	**1**	**1**	**1**	**1**				**1**		**1**	**19**
	25 St. Lucia																										0
*	**26 St. Vincent and the Grenadines**		**1**	**1**	**1**	**1**	**1**				**1**	**1**	**1**	**1**		**1**	**0.5**		**1**				**1**	**1**	**1**	**1**	**15.5**
*	**27 Grenada 2/**	**0.5**	**0.5**	**0.5**				**0.5**	**1**					**1**		**0.5**	**0.5**					**1**					**6**
	28 Ukraine 2/	0.5	0.5	0.5	1	0.5	0.5	0.5	1		1	1		0.5	1	1	1							1	1	1	13.5
	29 Nigeria 3/	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	n/a
	30 Guatemala 3/	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	n/a
15	**Total per criterion**	**9**	**6.5**	**5.5**	**9**	**11**	**8.5**	**7.5**	**8**	**3**	**15**	**14**	**8.5**	**8**	**10**	**12**	**10**	**7**	**7**	**9**	**2.5**	**5**	**4**	**11**	**5**	**13**	**7.3**

1/ Removed from the list of NCCTs as of June 2001.

2/ Added to the list of Noncooperative Countries and Territories in September 2001.

3/ Added to the list of Noncooperative Countries and Territories in June 2001.

ANNEX III. CASE STUDIES OF ENGLISH-SPEAKING CARIBBEAN COUNTRIES AND TERRITORIES

Barbados

The offshore sector has grown significantly in recent years. Licensed offshore entities increased from about 2,900 in 1994 to over 6,600 in 1999, (Table 1). Factors ranging from favorable tax and regulatory regimes, to political stability, modern infrastructure and skilled labor force have contributed to the growth of this sector. Majority of offshore entities comprise international business companies (IBCs) and foreign sales companies (FSCs). There are about 45 offshore banks. Offshore banks are exempt from exchange controls and taxation is limited. Government revenue arises from a license fee and taxes on profits. The Minister of Finance has the power to issue, revoke licenses and provide guarantees regarding future taxes. Exempt insurance and management companies are governed by the Exempt Insurance Act, under the Supervisor of Insurance.

Regulatory issues

Offshore banks were initially regulated by the Offshore Banking Act of 1980, and then the International Banking Act, 2000. The new Act contains a number of improvements, including the powers by the CBB to conduct on site inspections without a court license. It requires offshore banks to publish annual audited statements. The new Act seeks convergence of prudential regulation and supervision with onshore banks. Anti-money laundering legislation was adopted in 1999, requiring banks to establish the true identity of customers, keep records for at least five years of transactions and report such suspected transactions to the authorities. IBCs are governed by the International Business Companies Act.

Table 1. Barbados: Number of Active Offshore Entities, 1994–99

	1994	1995	1996	1997	1998	1999
International business companies (IBCs)	1,474	1,822	2,126	2,632	3,073	3,399
Foreign sales corporations (FSCs)	1,172	1,514	1,726	2,291	2,608	2,857
Exempt insurance companies (EICs)	194	205	193	200	200	207
Exempt insurance management companies	38	38	38	36	32	32
Societies with restricted liabilities	...	...	14	32	65	97
Offshore banks	26	33	40	44	43	45
Total	**2,904**	**3,612**	**4,137**	**5,235**	**6,021**	**6,637**
Memorandum items:						
Annual increase in number of entities, percent	24	24	15	27	15	10
Offshore banks:						
Total assets in percent of GDP	124	254	401	752	787	819
Profit before tax in percent of total assets	...	2.5	3.9	3.4	4.4	3.4
Income from financial services (BD$ millions)	...	100.5	110.3	118.4	125.6	136.5

Sources: Lybek (2000), and Central Bank of Barbados, and Supervisor of Insurance.

The Bahamas

The Bahamas has one of the largest offshore sectors in the region. The financial sector contributed about 15 percent to GDP in 2000. The majority of offshore entities take the form of international business companies, which mainly consist of mutual funds and trust funds. The Bahamas is ranked among the top 5 in the world in terms of quantity and value of mutual funds managed, and by 2000 there were over 700 mutual funds, with assets under management totaling US$100 billion.

Table (2) shows the size of the offshore sector in The Bahamas. The total number of international business companies increased from about 28,493 in 1994 to 117,520 in 2000. The number of offshore banks has remained at the same level, around 410, perhaps reflecting a saturation in this segment of the market.

In terms of economic contribution, offshore expenditure amounted to about 2.5 percent of GDP, with salaries and administrative contributing to the bulk of national expenditure. The offshore sector employed about 950 people, at the end of 2000. The offshore sector is governed by a series of Acts, including the Central Bank of The Bahamas Act, 2000, the Banks and Trust Companies Regulation Act 2000, the Financial and Corporate Service Providers Act 2000 the Financial Intelligence Unit Act, 2000, the Proceeds of Crime Act, 2000, and the Financial Transactions Act.

Table 2: Bahamas: Offshore sector, 1994–2000

	1994	1995	1996	1997	1998	1999	2000
Number of active offshore entities							
International business companies	28,493	39,035	51,192	69,889	84,540	100,092	117,520
Offshore banks	413	410	425	418	418	415	410
	(Millions of Bahamas dollars)						
Economic contribution							
Total expenditure	81.1	85	92.0	98.6	103.5	122.9	...
Operation expenses	73.4	77.4	80.5	90.4	95.3	107.7	...
Government fees	8.4	8.8	8.5	8.0	9.6	7.7	...
Salaries	31.9	33.9	34.7	39.4	41.7	46.2	...
Training	0.2	0.4	0.4	0.7	0.9	1.2	...
Other administrative expenses	32.9	34.3	36.9	42.3	43.1	52.6	...
Capital expenditure	7.7	7.6	11.5	8.2	8.2	15.2	...
	(In percent of GDP)						
Expenditure	2.4	2.4	2.5	2.4	2.5	2.6	...
Memorandum items:							
Employment	759	777	806	892	902	942	1,139
GDP at market prices, BD$	3,425	3,504	3,742	3,940	4,190	4,573	4,920

Sources: Central Bank of The Bahamas; and Fund staff estimates.

St. Lucia

The offshore sector was established following the passing of the following Acts in November 1999 and the sector is at its infancy. As of September 2000, there were 2 international insurance companies, 8 service providers, and 61 IBCs. Presently one foreign bank has been granted the license to operate as an offshore bank. St. Lucia has been placed in the third group of the Financial Stability Forum's list of off shore centers. This comprises jurisdictions with low quality of supervision, and/or being noncooperative with onshore supervisors, and with little or no attempt to adhere to international standards. Other OECS countries listed in Group 3, include Anguilla, Antigua and Barbuda, St. Kitts and Nevis, and St. Vincent and the Grenadines.

The director of financial supervision in the ministry of international business is responsible for the supervision of offshore banks. Offshore banks are required to submit audited reports on a regular basis. Although the director of financial services responsible for offshore companies may request to inspect the books of IBCs and offshore banks, no explicit requirement relating to "on-site" inspection is present in the legislation.

The following Acts govern the offshore sector; the International Business Companies Act, (governing the establishment of IBCs); the International Trust Act, (details the regulations for the establishment of trusts and estates); the Registered Agents and Trustee Licensing Act, (sets the licensing requirement); the International Mutual Funds Act (governing mutual funds) and the International Insurance and Reinsurance Act (covers offshore insurance). The Money Laundering (Prevention and Control) Act was enacted to combat illicit transactions.

Antigua and Barbuda

Size and economic impact of the offshore sector

Antigua and Barbuda has approximately 8,000 international business companies (IBC), 22 offshore banks and 77 internet gaming companies at end-2001. The Free Trade Processing Zone (FTPZ), a statutory body responsible for licensing internet gaming companies, derived about EC$6.5 million in 1997 and 1998 from license fees. The offshore sector generates substantial revenues to the government through license and registration fees, totaling 3.8 percent and 3.4 percent of current revenues in 1997 and 1998 respectively. The sector is estimated to employ some 2,500 people.

Supervisory and regulatory framework

The enabling legislation that facilitated the beginning of the OFC was the International Business Company (IBC) Act of 1982. Under this Act offshore companies were exempt from taxes on income, capital gains and inheritance and from reserve requirements or exchange controls. During the mid-1990s, the jurisdiction was subject to international pressure alleging instances of money laundering. These reports arose in part because the IBC Act conferred anonymity on principal owners and shareholders through the issuance of bearer shares. Furthermore, bank

secrecy laws prohibited the disclosure of financial information unless there were unequivocal infractions of the laws of Antigua and Barbuda.

The authorities instituted a number of amendments to strengthen supervision and enforcement. The Money Laundering Prevention Act of 1996 (MLPA) was promulgated in 1998 to prevent and deter money-laundering activity. The IBC Act was also amended in 1998 to create the International Financial Sector Authority (IFSA)—later renamed the International Financial Sector Regulatory Authority (IFSRA), and the Office of National Drug and Money Laundering Control Policy (ONDMLCP) to separate regulatory and enforcement functions. The amendments strengthened the oversight of offshore operations through increasing minimum capital requirements, annual inspections, know your customer policies and requiring all bank directors to be natural persons. Additional amendments were made to the IBC Act in August 2001 that required registered agents to know their customers. All offshore banks are now required to have a physical presence on the jurisdiction.

British Virgin Islands

Size and economic impact of the offshore sector

Offshore financial services along with tourism are the two principal sectors of the British Virgin Islands (BVI) economy. Government derived 52 percent (US$96.7 million) of its revenue from license fees in 1999. IBCs incorporation is the main product offered and by end-2001 there were over 314,000 representing 45 percent share of the global market. The BVI also offers other financial services, particularly in the areas of banking, insurance, trusts and mutual funds. The sector is estimated to employ around 940 persons.

At end-2001 there were 2,013 mutual funds. The Financial Services Department (FSD) does not report fund size, as there is no requirement to do so. There are over 300 captive insurance companies and 59 credit life reinsurance captives. There are no offshore banks and the jurisdiction does not actively encourage applications for licenses.

Supervisory and regulatory framework

The critical legislation that has propelled the growth of the offshore industry is the IBC Act of 1984. Since then, a number of additional Acts were passed. These include the Trustee Amendment Act of 1993, Insurance Act of 1994, and the Mutual Funds Act of 1995. A legislative and regulatory regime for mutual funds was established in 1998. The responsibility for licensing, regulation and supervision of financial activities in the BVI is vested in the governor in council and the minister of finance. The governor in council is responsible for all licensing decisions relating to regulated firms and public mutual funds public funds while the minister of finance licenses nonpublic funds. The day-to-day regulation of offshore financial business is undertaken by the FSD.

The Financial Stability Forum (FSF) and Financial Action Task Force (FATF) regarded the BVI as "committed to implementing solid legislation and regulatory measures against money laundering." A recent independent assessment by the accounting firm KPMG viewed the FSD

"to be a well-run regulator with a strong commitment to achieving international standards." One shortcoming was cited and this was the apparent conflict of the governor being both responsible for licensing and enforcement.

Bermuda

Size and economic impact of the offshore sector

Bermuda offshore sector specializes in insurance services. Bermuda dominates the global captive insurance market with gross annual premiums of US$27 billion and total assets of US$115 billion. The Bermuda market is primarily comprised of captive and reinsurance business rather than being a significant retail market. As at end-1998 there were 134 long-term international life insurance, 18 domestic insurance, 1,293 captive and reinsures and 12 reinsures specializing in property catastrophe.

Supervisory and regulatory framework

The Bermuda Monetary Authority (BMA) that is operationally independent of government and supervises both offshore and onshore activity. The exceptions in independence are with respect to trust service providers where formal licensing powers is conducted by the minister of finance. This procedure will soon be amended. The other is with regard to the registrar of insurance who operates from within the ministry of finance. The BMA currently has five operating divisions which cover investment business, deposit taking institutions and trust companies, authorization and compliance, policy, research and statistics, and administration.

The legislation governing the offshore sector includes the Insurance Act (1978) (covering the registration and licensing of insurance companies); the Insurance Accounts Regulations (1980) (governing financial statements); the Insurance Returns and Solvency Regulations (1980) (covering general business and long-term business solvency margins); the Life Act (1978) (governing the rules in the life industry); and the Non-Resident Insurance Undertakings Act (1978) (which permits nonresident insurance companies to transact domestic business within Bermuda). The FATF viewed Bermuda to be effective in its supervision and regulation of financial institutions including an efficient mandatory system for reporting, monitoring and sanctioning for noncompliance in reporting suspicious transactions.

Cayman Islands[25]

Size and economic impact of the offshore sector

The Cayman Islands has specialized in offshore banking making it one of the world's largest banking centers. Currently, there are in excess of 450 banks from 65 countries with an asset base of US$671 billion at end-2000. Forty-three of the world's top 50 banks have a branch or

[25] This section on the Cayman Islands draws from the KPMG study on British Dependent Territories.

locally incorporated subsidiary. There are two categories of banks type A and B. Category A licensees can conduct domestic banking business and offshore business; and Category B licensees can only conduct offshore business. There are currently 31 Category A banks and 430 Category B license holders. Of the 430 category B license holders 51 have established physical presence in the jurisdiction.

The Cayman Islands have grown as a center for insurance and are now the second largest captive insurance center in the world with 502 captive insurance companies, largely from the U.S. market. Mutual funds are also important product offered by the jurisdiction. There were 2,298 regulated mutual funds as at March 2000, being 603 administered, 1,654 registered and 41 licensed schemes. Trusts and limited partnerships play an important role in the diversity of products offered by this OFC.

Supervisory and regulatory framework

The Cayman Islands Monetary Authority (CIMA) formed in 1996 is responsible for the supervision of banks, trust companies, mutual funds, mutual fund administrators, insurance and company managers. The Banks and Trust Companies Regulations Law (1996)—later superceded by the Bank and Trust Companies Law (2000) formed the basis of the development of this OFC as an international banking center. The FATF listed the Cayman Islands as an uncooperative jurisdiction in June 2000 with respect to customer identification and the mandatory reporting of suspicious transactions. It met in full, thirteen of the 25 recommendations introduced by the FATF February 2000 and 4 partially.

The Cayman Islands Legislative Assembly passed a number of legislation in 2000 to bring the anti-money laundering legislation into compliance. These were the Monetary Authority (Amendment) (International Co-operations) Law Act, the Banks and Trust Companies (Amendment) (Access to Information) Law, the Companies Management (Amendment) (Access to Information) Law Act, and the Proceeds of Criminal Conduct (Amendment) Money Laundering Regulations Law Act.

Dominica

Size and economic impact of the offshore sector

The offshore sector in Dominica was established around its economic citizenship program. The sector commenced in 1996 and by end-2000 there were 570 economic citizens, 7 offshore banks, 6,596 IBCs, 20 internet gaming companies, 2 exempt trust, 4 exempt insurance and 2 management companies. The sector currently employs 100 persons. Revenue from the sector rose from EC$4.6 million (0.7 percent current revenue) in 1996, to EC$10 million (1.7 percent current revenue) at end-1997, but gradually declined since then to $5.2 million (0.7 percent current revenue) by end-2000. The government between 1996–2000 has collected almost EC$40 million in revenue.

Supervisory and regulatory framework

The offshore sector is based on the Offshore Banking Act and the IBC Acts of 1996, the Exempt Insurance and the Exempt Trust Acts of 1997, and the re-engineered Economic Citizenship Program. The sector is supervised and regulated by the International Business Unit (IBU) based in the Ministry of Finance. The FSF placed Dominica in a group of 25 offshore centers that are "generally perceived as having a low quality of supervision." Inadequate staffing prevents the effective supervision of the entire offshore sector although the IBUs surveillance alerted authorities to the insolvency of the largest offshore bank. Supervision of offshore banks was assigned to the Eastern Caribbean Central Bank (ECCB) in 2000.

St. Kitts and Nevis

Size and economic impact of the offshore sector

St. Kitts and Nevis comprise two separate jurisdictions from a legal and regulatory standpoint. In St. Kitts, legislation is at the federal level that regulates financial services with both residents and nonresidents while the constitutional arrangement has permitted Nevis to enact local legislation designed to facilitate development of the offshore sector. By end-2001 Nevis accounted for the majority of IBCs (22,450) incorporated in both jurisdictions. There exists one offshore bank, over 2,000 exempt trusts and 3,000 limited liability companies. Revenue from offshore licenses has risen from EC$4.2 million (1.9 percent current revenue) in 1997 to EC$6.3 million (2.5 percent current revenue) by end-1999. There is one offshore bank that is a subsidiary of an indigenous bank. The sector currently employs approximately 100 people.

Supervisory and regulatory framework

The offshore sector is regulated and supervised by the directorate of financial services within the Ministry of Finance. Legislation modeled on those of the Channel Islands—The Companies Act, Limited Partnerships Act and the Trust Act of 1996 and 1997 regulate offshore activity in both islands. Although the Proceeds of Crime Act (1993) is applicable in both jurisdictions, money laundering is only punishable by law if it relates to the proceeds from narcotics trafficking. Nevis, however has several ordinances that govern offshore activity. These include: the Nevis Business Corporation Ordinance (1984), the Nevis International Exempt Trust Ordinance (1994), the Nevis Liability Company Ordinance (1995) and the Nevis Offshore Banking Ordinance (1996). The following laws were enacted in 2001 to strengthen the regulatory framework: the Companies Amendment Act No. 14; the Anti-Money Laundering Amendment Regulations No. 36; the Nevis Business Corporation Amendment Ordinance No. 3; and the Nevis Offshore Banking Amendment Ordinance No. 4.

St. Kitts and Nevis was classified by the FSF and FATF in 2000 as an offshore center with major weaknesses in supervision. This jurisdiction was deemed to be unsupervised with no procedures in place to prevent money laundering. Nonrequirement of identification for operators of a bank, strict secrecy laws, obstacles to customer identification, and the lack of international cooperation with respect to mutual legal assistance in the case of trusts, were cited.

Additional financial advisories issued by the United States and Canada with respect to money laundering laws prompted the authorities to address weaknesses in their regulatory and supervisory framework. In November 2000, a Financial Services Commission Act was passed to establish a commission as the ultimate regulatory body for financial services. In early 2001, a Financial Intelligence Unit (FIU) was established to analyze suspicious activity and initiate inquiries into suspected money laundering. The FATF recognized progress made in strengthening supervision and regulation and will review the situation in June 2002.

Grenada

Size and economic impact of the offshore sector

The sector commenced in 1997 and currently has 3,400 IBCs, 44 offshore banks, and 11 trust companies as of end-2001. The sector is estimated to employ 300 people and contributed EC$7.4 million (1.2 percent of GDP) in fees to central government.

Supervisory and regulatory framework

The development of the offshore financial sector commenced in 1997 with the enactment of The International Insurance Act, 1996, The Companies Act, 1996, The Offshore Banking Act, 1996, The International Trusts Act, 1996 and the International Companies Act, 1996. The IBC Act was however amended in 2001 to require registration and the declaration of beneficial ownership of bearer shares. Until January 2000 the Offshore Services Division of the Ministry of Finance was responsible for all aspects of the sector. However, with the collapse of First International Bank of Grenada (FIBG) an offshore bank in mid-2000, the Grenada Financial Services Authority (GIFSA) was established. GIFSA is responsible for supervising and regulating the sector. Promotion activities were vested in the Grenada Industrial and Development Corporation (GIDC). GIFSA has since revoked the licenses of 17 banks, commenced an audit of all banks by Price Waterhouse Coopers, and tightened due diligence in the issuance of licenses. The latter are now conducted by a private sector firm outside the jurisdiction.

Table 3. Existing Laws Governing the Offshore Sector

	International Business Corporations	Offshore Banking	Money Laundering	Trust Companies	Insurance Companies	Other	Mutual Funds
Anguilla	Amendments to International Business Companies Act 2000	Amendments to Offshore Banking Act 2000	Money Laundering Prevention Act 2000	Amendments to International Exempt Trust Act 2000	Amendments to Exempt Insurance Act 2000, Insurance Amendment Act 1998		
Antigua and Barbuda	International Business Companies Act 1982–ammended August 2001	Legal Assistance Treaty Act	Money Laundering Prevention Act–amended 1999, 2000, May 2001			Proceeds of Crime Act, 1996	
Dominica	International Business Companies Act 1996 - last amended January, 1998	Offshore Banking Act	Proceeds of Crime Act, Money Laundering Prevention Act, 2001				
Nevis	Nevis Business Corporation Ordinance 1984–last amended April, 1999 Nevis Limited Liability Company Ordinance 1995--last amended April, 1999	Nevis Offshore Banking Ordinance, 1996	Proceeds of Crime Act, 1993	Nevis International exempt Trust Ordinance, 1994		Offshore Service providers Supervision Ordinance, foreseen by end-1999	
St. Kitts	The Companies Act, 1997	Financial Services (Regulations) Order, 1997	Proceeds of Crime Act, 1995			Betting and Gaming Act, 1969	
St. Lucia	International Business Act, foreseen for 1999	International Banks Act, foreseen for 1999	Money Laundering (Prevention and Control) Act, foreseen for 1999	International Trust Act, foreseen for 1999	International Insurance and Reinsurance Act, foreseen for 1999	International Mutual Funds Act, foreseen for 1999; Registered Agents and Trustee Licencing Act	
St. Vincent and the Grenadines	International Business Companies Act 1996	International Banks Act 1996		International Trust Act 1996			Mutual Funds (Amendments) Act 1998
British Virgin Islands	International Business Companies Act 1984		Criminal Justice International Cooperation Act 1993 and the Proceeds from Criminal Conduct Act 1993	Bank and Trust Companies (Amendment) Act 1995	Insurance Act 1994	Partnership Act 1996	Mutual Funds Act 1996, Mutual Funds Amendment Act 1997
Bermuda			Proceeds from Crimes Act 1997 and The Criminal Justice International Cooperation Act 1994		Insurance Act 1978, Insurance Accounts Regulations 1980		
Cayman Islands		Banks and Trusts Law 2000 Revision	Proceeds from Criminal Conduct Law 1997 and Amendments in 2000 to included Anti Money Laundering Regulations	Special Trusts (Alternative Regime) Law 1997 and Trusts Law 1999 (Revision)	Insurance Law 1999 Revision		Mutual Funds Law 1999 Revision

Sources: International Financial Sector Authority, Antigua and Barbuda; Ministry of Finance, Dominica; Nevis Financial Services Department; KPMG, Review of Financial Regulation in Caribbean Overseas Territories and Bermuda, October 2000; Offshore Financial Authority (OFA), St. Vincent and the Grenadines; and Fund staff estimates.

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