Emerging economies require flexibility from global financial reforms

The individual needs of developing economies differ from those of their larger counterparts – an important consideration when banking and investment reform is debated. Only a two-tier system will offer such countries the conditions to grow

By Hyoung-Tae Kim, president, Korea Capital Market Institute

Since the 2008 financial crisis, the G20 has played a pivotal role in discussions about global financial reforms. It is trying to build a comprehensive and common platform for all countries. However, this does not mean that every country must adopt the same regulatory system. Reforms need to be not only universal, but also flexible enough to accommodate the differences in each country's financial market.

As the new regulatory paradigm takes shape, the discussion thus far has focused heavily on advanced financial markets. For the G20 reforms to be successful, they must also reflect and accommodate emerging economies' needs and economic conditions.

Reforms for the financial services industry

The subprime crisis showed that the universal banking system can have serious, and even fatal, problems, particularly in a crisis-prone economy. Under this system, commercial banking and investment banking can take place in the same firm. For individual financial institutions, operating an investment-banking business with deposit money is attractive. However, this model increases systemic risk to the financial system as a whole.

To address this problem, the investment functions need to be separated from commercial banks. The G20 is going in this direction with its proposed reform of the financial services industry, as is the Dodd-Frank Wall Street Reform and Consumer Protection Act in the US. For emerging economies, the mixture of investment and commercial banking is not that serious. But for the sake of reducing systemic risk, the in-house operation of both should be prohibited. In the case of a financial institution in an emerging economy wanting to engage in both investment and commercial banking, the best organisational structure is the financial holding company. In Korea, the only way for a commercial bank to carry out an investment-banking business is to use a subsidiary or a financial holding company.

> "Unlike their global counterparts, investment banks in emerging economies are in a position to take more risks"

In addition, investment-banking industries in emerging economies are fundamentally different from those in advanced economies. Global investment banks took excessive risks. In contrast, those in emerging economies took very little risk, relying instead on agent businesses such as brokerage.

In the post-crisis era, investment banks need to strike a balance between agent fees and the principal investment business. Unlike their global counterparts, investment banks in emerging economies are in a position to take more risks. Therefore, regulations like the Dodd-Frank Act may not be optimal for emerging economies, considering the development stage of their financial industries.

Over-the-counter derivatives markets

Global financial reforms will also affect the markets for over-the-counter (OTC) derivatives. The basic idea of reforms in this area is to build a centralised clearing platform. This platform can minimise counterparty risk associated with OTC derivatives, which was regarded as the main cause of systemic risk in the subprime crisis. Another key reform tackles the complexity of derivatives products and strives to standardise them.

Both reforms are in the right direction and may significantly reduce systemic risk related to OTC derivatives. However, most emerging economies do not have active OTC derivatives markets. Some countries do not have one at all. Although the global reforms sound reasonable, an overemphasis on centralised clearing platforms and standardisation might stifle the innovative spirit in emerging economies. Therefore, the application process should take a two-tier approach, in which advanced markets face stricter regulations, but developing markets have less stringent requirements.

A derivative product is born, grows and matures. In the beginning, an investment bank comes up with a new derivative product, which is at first contracted upon in the

OTC market. As people become familiar with the product, it becomes standardised and is then traded in the exchange market. The emerging capital markets are not yet well developed, so overstressing standardisation could prevent products from following their natural life cycle and slow market development. For the emerging economies, a regulatory environment that encourages brave ideas from market players is essential. The optimal position between innovation and stability in emerging economies is far different from that of well-developed economies.

Managing systemic risk

The most important lesson that has been learned from the recent crisis is that managing systemic risk is crucial. However, it is easy to forget that the source of systemic risk is different between emerging and developed economies. In emerging economies, too-big-to-fail institutions are not the main source of systemic risk. Korea, instead of having systemically important financial institutions, has systemically important financial markets: the foreign exchange market and the dollar-based financing market.

Because Korea is deeply connected with overseas markets, systemic risks come from abroad in the form of sudden stops of loans or reversal of capital flows. The problem is not unique to Korea, as many emerging economies are in a similar position. Capital inflows and outflows are especially volatile in economies that have free-floating foreign exchange systems and fully open capital markets. As a result, the foreign exchange market is the main channel for overseas risk to come into Korea. In some markets, it is more critical to deal with the systemic risk from outside caused by high volatility in capital flows than to regulate systemically important financial institutions.

In this respect, the reform of international monetary systems is especially relevant to the emerging economies. Although the most frequently discussed topic is the key currency issue, for the emerging economies the global financial safety net is more important. Besides credit lines provided by the International Monetary Fund (IMF), emerging economies need to have regional safety nets. These safety nets should start with bilateral or multilateral swap agreements and then possibly proceed to the establishment of a regional currency.

As economies become increasingly interconnected, global collaboration is all the more necessary. The G20 is the premier platform for this purpose. However, agreeing upon solutions within the G20 is much more difficult than it appears to be.

The reason behind this problem is that the new financial regulatory paradigm must be comprehensive so that it is globally applicable, while at the same time flexible enough to reflect each country's specific economic characteristics. Financial reforms must recognise the differences between advanced and emerging economies. The success of the G20's Cannes Summit depends on whether these differences can be fully understood and reflected in the reforms. ◆

A foreign currency dealer of the Korea Exchange Bank studies screens in the dealing room. Korea is among the emerging economies at the mercy of systemic risks from overseas markets

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Why 'fix' what is not broken?

*As the G20 leaders gather in Cannes, economic growth will be high on their agenda. Yet as **Javier Perez** of MasterCard Europe argues, one significant economic driver is at risk because of possible and unnecessary regulation*

Javier Perez
President, MasterCard Europe

The present economic slowdown is a significant challenge for policymakers. With interest rates at historic lows, government spending trimmed to the bone and sovereign debt ratings heading south, there are very few macroeconomic levers left to pull in order to generate growth.

Yet there is one microeconomic mechanism that can continue to pump-prime the economy and stimulate growth even in the midst of a slowdown. This mechanism needs no government funding or central bank quantitative easing. Simply by making it easier for money to flow inside and across national borders, electronic payments via debit and credit cards create a beneficial 'multiplier' effect on money flows and stimulate commerce. Yet some regulators are trying to 'fix' what is not broken by seeking to reduce or even eliminate the interchange fees on which card payment systems are based. If this happens, there will likely be unintended negative consequences for individuals, businesses and national economies.

The interchange fees provide a transparent and necessary balancing mechanism to apportion the cost of providing a global card payment system, as well as the value it brings, in a fair way between consumers and business

A global card payment system with universal acceptance helps stimulate trade and increase the sale of goods and services. Everyone benefits: individual consumers who can make purchases more safely and conveniently, businesses which can trade more widely and efficiently, and national economies that benefit from the increase in commerce. Moreover, the system is transparent and reduces the use of cash thereby undermining the 'black economy' and further increasing government revenues.

The payments industry has created fair, efficient and ubiquitous global card processing networks which stretch from Tasmania to Lapland and Beijing to Seattle. But all these benefits could now be at risk. Clearly, these systems are part of the solution and not, as some would have it, the problem: a small group of special interests have lobbied regulators and other public authorities with the simple aim of reducing their card acceptance costs by government intervention, contending that interchange fees impose an 'unfair tax' on business.

The global payment infrastructure has evolved over decades with little help or support from government or the state. Hundreds of billions of dollars and euros of private investment, plus countless hours of business effort, have built a powerful economic payments framework that serves businesses and consumers well. But it is a fragile thing. It requires the constant cooperation of millions of private and public enterprises to maintain global interoperability and to nurture and improve electronic payments as technologies develop and consumer and business needs evolve.

The interchange fees of which some complain provide a transparent and necessary balancing mechanism to apportion the cost of providing a global card payment system, as well as the value it brings, in a fair way between the ultimate beneficiaries – consumers and businesses. If regulators give in to the pressure they face from special interests, consumers will end up paying more for electronic payments and will increasingly revert to cash. This in turn will stifle consumer spending with the result that not only businesses but also national economies will be harmed.

By not looking at the big picture or taking a long-term view, those that urge intervention risk upsetting that delicate ecosystem of card payments that helps support and drive economic growth. Interchange is not a 'tax' on commerce, rather it is an 'investment' in the future of the European and global economy. This investment adds to the 'multiplier effect' – it does not subtract from it.

Interchange is an often misunderstood concept. First of all, interchange fees are very low. Secondly, they not only ensure that merchants are guaranteed payment and finance fraud protection, but they also help pay for innovations that generate cost savings as well as increased revenue for those accepting cards. The economic value of these benefits far exceeds the cost of interchange. Nowadays we don't use just cards to make payments but can also use mobile phones and PDAs. Contactless cards have speeded up secure payments which reduces the cost of doing business. Commercial cards allow companies to manage employee spending – giving them unprecedented real-time control over their budgets. Government cards reduce the cost of distributing social benefits. Prepaid cards extend the benefits of electronic payments to the unbanked. All of this has been made possible because of the investment in innovation which – in turn – has been made possible by interchange fees. And all of this helps to drive economic growth.

In addition, card payments are considerably more cost-effective than cash. All national bank studies comparing the cost of cash and that of card transactions conclude that cash payments are expensive. The bulk of that cost is borne by all of us through our taxes – why should we subsidise the use of cash? Not only is

cash more expensive than card payments but it cannot even begin to deliver the kinds of added value that cards bring – security, universal acceptance and the continuing innovation that creates new business opportunities. You can't book hotels and airline tickets with cash; businesses can't buy and sell goods and services globally online with cash; and the only 'loyalty' benefits you get with cash are a rubber stamp in a coffee shop. Cash is truly 'old money'.

The Reserve Bank of Australia's regulatory intervention in the payments card industry in the early part of this decade is a good example of the consequences of failing to take the long view. The RBA's forced reductions of interchange fees harmed Australian consumers by raising cardholder fees and reducing card benefits. As a result, Australian cardholders are now paying more than half a billion Australian dollars a year in additional fees for using credit cards while the value of benefits has declined by nearly a quarter. And even the RBA, in a review of its decision, admitted that it had 'no evidence' that merchants passed any of the AU$850 million in annual cost savings on to consumers. The reduction in interchange in Australia also reduced incentives to innovate – delaying, for example, the introduction of 'chip' cards.

Forty years ago, many of today's payment products were the stuff of science fiction – now they are a reality. And in 10 years' time, if permitted, the card payments industry will have developed ever more convenient, inexpensive and innovative methods of paying securely across continents and in your local shop.

The payments industry has created, nurtured and developed an efficient economic driver based on a balancing mechanism that distributes the greatest good for the greatest number. Unnecessary intervention in the system would slow down the lifeblood of commerce, which is the last thing that the economies of the world need right now. The global payments system is not broken – I would therefore call upon all regulators to pause and reflect before trying to 'fix' it.

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Rebuilding confidence through global regulation

The importance of a coordinated international approach to regulating financial institutions and markets has been highlighted throughout the ongoing crisis. Continued cooperation among countries is essential to promote greater stability

By Lida Preyma, director, Capital Markets Research, Global Finance; author, *The Preyma Report on the G20 and the Global Capital Markets: Critical Issues and Analysis*

For more than a decade, the finance ministers and central bank governors of the 19 most systemically important countries and the European Union have met annually to discuss the financial challenges before them. With the financial crisis in 2008, this forum grew in importance to address the urgent issues at hand. Now that the G20 leaders meet regularly, it has been possible to bring stability to financial markets by making unified decisions that could be deployed nationally among all members. Countries have been working hard to implement the decisions made at the G20 summits, with varying degrees of success.

Coordinated regulatory policy is the best way to maintain strong and sustainable global capital markets. Unmitigated risk and regulatory arbitrage will only lead to further crises in the future. Regulation levels the playing field, but also maintains integrity so that confidence can be strengthened – and markets cannot function properly without the confidence of their participants. Well-functioning capital markets are critical to financial stability and sustained economic growth because of their sheer size, given the number of people employed in the sector and the tax revenue generated for governments, which can then deploy social programmes for their citizens.

In a world of intense interconnectivity, transparency is more important than ever, as illustrated by the unwinding of Lehman Brothers, still going on after its collapse in September 2008. The Financial Stability Board (FSB) has been tasked with producing a plan to dismantle globally significant, systemically important financial institutions in the event of their failure in order to mitigate contagion – the biggest threat to the interconnected financial system. The global impact of such institutions must be managed carefully should an economic shock lead to their collapse. The FSB will report to the G20 at the Cannes Summit.

The fluctuating speed of reform

Regulation used to be as diverse as the countries within which it was administered. Recommendations made at the international level were not universally considered when national regulation was being formed. In the past year, reviews of Europe's Markets in Financial Instruments Directive (MiFID) and the Dodd-Frank Wall Street Reform and Consumer Protection Act in the United States have created new regulation at an unprecedented pace.

However, the rules are beginning to diverge and policy-making timelines differ. EU finance ministers have been unable to agree on the scope and details of the proposed rules, and the European Central Bank was concerned about central bank liquidity management if the rules were passed as drafted. During its EU presidency in 2011, Hungary proposed that clearing requirements should apply only to off-exchange over-the-counter (OTC) derivatives with mandatory reporting encompassing all types of trades. Other countries, such as the United Kingdom, wanted the rule to include all derivatives, as in the rule being drawn up in the United States. The pace of rule-making has been ambitious but unsustainable, and has led to variations in implementation. US policy-makers extended their July deadlines to the end of the year, and European regulators delayed their review of the revised MiFID until September 2011.

> "For growth to regain momentum, G20 leaders must not lose sight of the end goal of a stable global capital markets industry"

The stage had been set for international policy-making with the first two Basel accords and the International Organization of Securities Commissions (IOSCO) to create coordinated regulation that would strengthen capital markets. There was, however, no buy-in to comply with the regulation being formulated. Basel III, which was approved by the G20 at the Seoul Summit last November, would address the missing rules to strengthen firms by increased capitalisation in order to weather future financial crises, such as the current European sovereign debt crisis. Further coordination was needed to address the size of organisations that posed the greatest risk to the interconnected global economy. Contagion is the biggest threat, and moves ever faster – as witnessed by the fact that the sovereign debt crisis took months to spread from Greece to Ireland and then Portugal, but simply days and weeks to reach Italy, France and Spain. Moreover, the availability of credit from money markets funds dried up in the uncertain dog days of August, making the need to address shadow banking more urgent.

Once again, transparency in capital markets has come to the forefront. Although shadow banking was not the root cause of the financial crisis, G20 leaders know that

An electronic display in Tokyo delivers updates on the major indices. A coordinated approach to policy-making will help to reduce recent instability on the world's markets

their work must also be forward-looking. This sector must be also regulated and supervised before it creates further instability and undermines the work being done on the Basel accords and globally significant international financial institutions. The FSB is undertaking studies to formulate pertinent rules that avoid regulatory arbitrage and focus on the interconnectedness within the international banking system.

Keeping pace with innovation

High-frequency trading (HFT) also presents new challenges for regulators. Defining HFT is a moving target: technological advances have made it difficult for regulators to police. However, they need to assess the impact of HFT properly, rather than writing regulation that reflects only the past. Innovation in the industry should not be stymied by lack of knowledge.

While capital markets await the creation of firm regulation, the industry has seen anaemic volumes moving in equity markets, with reactions to events that defy historical behavioural logic, increased activity in the credit default swaps market as investors bet against the soundness of entire countries, and a general slowdown in the growth of an industry responding to the decisions being made. For growth to regain momentum, G20 leaders need to stay on track and not lose sight of the end goal of a stable global capital markets industry with reduced systemic risk. They need to renew their commitment to unified policy-making. They must not rush through inappropriate and unsustainable regulation simply to meet deadlines for forming new regulation.

Regulation will not choke an industry that creates so many jobs and brings in countless dollars in taxation if it is unified, pertinent, fair and all encompassing. Over-regulation is not the answer. The free markets need to be able to be just that – free – but with regulation that ensures that integrity is the priority in order to restore confidence and rebuild the industry. ◆

A modern European finance hub

Gibraltar has in recent years repositioned itself to become a well regulated, mainstream and successful EU domicile for financial services business

The Hon Peter R Caruana QC, Chief Minister of Gibraltar

Gibraltar is a British Overseas Territory which is self-governing in all matters – except defence, internal security and foreign affairs – and thus has its own government, parliament and judiciary. Elections to the Gibraltar parliament, in which all Gibraltar's laws are made, are held every four years.

Gibraltar has been part of the European Union since 1973, having joined as part of the United Kingdom's accession. EU law applies to Gibraltar except in three areas: Common Customs Territory (and therefore internal market rules on the free movement of goods), Common Agricultural Policy and harmonisation measures on turnover tax. All other EU measures apply to Gibraltar and are implemented through legislation passed in the Gibraltar parliament.

As an integral part of the EU, Gibraltar has financial services licensing, regulatory, and investor and depositor compensation regimes that are fully compliant with EU laws and requirements. The financial services sector thus enjoys passporting rights throughout the EU in all financial services matters, including banking, investment services, insurance, insurance mediation and reinsurance. Gibraltar-licensed financial services firms have access to a market of over 500 million people, and financial services contribute approximately 30 per cent of our gross domestic product.

During the past 15 years, our finance centre has successfully repositioned itself from tax haven to fully compliant, transparent and well regulated onshore EU finance centre, albeit one operating in an internationally competitive tax environment.

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Licensing regime

Financial services are licensed, supervised and regulated by Gibraltar's Financial Services Commission (FSC), which functions independently of the government in operational matters. The Commission is responsible for the authorisation and subsequent supervision of banks and building societies, investment businesses, insurance companies, investment services, company management, professional trusteeship, insurance management, insurance mediation, money transmitters, bureaux de change, occupational pensions schemes, auditors and collective investment schemes.

Gibraltar legislation charges the FSC to regulate the industry in Gibraltar to standards that comply with all EU laws and are, additionally, at least equivalent to UK standards.

The FSC website, www.fsc.gi, provides statistics on all relevant financial businesses including numbers of licensed firms in each sector and statistics such as deposits and total assets of banks as well as assets under management, and so on. The website also includes copies of all financial services legislation.

Gibraltar's regulatory environment thus reflects its status as part of the EU and also the Gibraltar government's policy in relation to the financial services industry, which is a policy of alignment with all international consensual initiatives, standards and international cooperation. In this way, Gibraltar remains at the forefront of reputable international financial services centres.

International cooperation

Gibraltar's successful finance centre is based on the government's conviction that it must remain squarely within the mainstream of international consensus. In line with its commitment to transparency and effective exchange of information (www.oecd.org) Gibraltar has to date negotiated and signed 18 tax information exchange agreements with Organisation for Economic Co-operation and Development (OECD) member countries, is on the G20-instigated OECD 'white list', and is currently negotiating similar agreements with many other countries.

The government of Gibraltar has a long track record of proactive and constructive engagement with international standard-setting initiatives such as, inter alia, the Financial Action Task Force (FATF) and International Monetary Fund (IMF.) Resultant reports published by the IMF noted that Gibraltar was "at the forefront of the development of good practices".

The IMF also concluded that Gibraltar's regulator, the FSC, "carries out its duties diligently and has an intimate knowledge of the institutions under its supervision".

In addition, the IMF stated that "the Gibraltar authorities are concerned with protecting the reputation and integrity of Gibraltar as a financial centre, and are cognisant of the importance of adopting and applying international regulatory standards and best supervisory practices. Gibraltar has a good reputation internationally for co-operation and information sharing." The IMF reports on Gibraltar are available online at www.imf.org, www.gibraltar.gov.gi and www.fsc.gi

Diversified economy

Gibraltar's economy is successful and well diversified, with global or regional leadership positions in port services, tourism, financial services and online gaming, and sustains a high standard of living and of public services. The government's fiscal position is strong. The budget remains in surplus to the tune of more than three per cent of GDP, and net public debt is low at less than 30 per cent of GDP. The economy has tripled in size over the past 15 years, and the number of jobs has increased by 60 per cent over the same period.

As a result of the success of our economy, we have been able to invest extensively while at the same time lowering corporate and personal taxes very significantly. Our corporate tax rate has fallen from 35 per cent to 10 per cent, and the personal tax burden has fallen by up to 65 per cent. The highest effective rate of personal tax is now just 25 per cent.

Although Gibraltar has not escaped some of the effects of the current global economic recession and financial crisis, these have not adversely affected its fiscal position or prevented continuing growth of our economy. Our economy – GDP now stands at £1 billion – grew by 6.5 per cent last year, and will grow by at least five per cent this year.

The success of our economy, and of our finance centre in particular, reflects the government's policy commitment to the highest standards of international cooperation, compliance and regulation. This is the only way in which credible and professional cross-border financial services business can be carried out sustainably. This commitment will remain at the very core of our approach.

In this way we can ensure that Gibraltar is attractive as a place to do business only to leading and reputable entities that share with us an understanding of, and commitment to, the importance of high standards and reputation.

www.gibraltar.gov.gi

Steering a path towards international financial reporting standards

The advantages of increased cooperation in international investment brought about by globalisation have also created a new set of problems for policy-makers, and the need for measures to improve market transparency and comparability

By Hans Hoogervorst, chair, International Accounting Standards Board

The global financial crisis continues to illustrate the integrated nature of international financial markets. Seemingly local events – whether US subprime defaults, European sovereign debt or concerns regarding a slowdown in Asian economic growth – have the potential to affect financial markets and capital flows anywhere in the world.

No one should be surprised. For a long time, investors have sought opportunities and diversification on a global basis. Companies seek to raise capital internationally, while domestic exchanges seek to attract international listings. The time when market participants traded exclusively within their own jurisdictions is long gone. Capital formation has gone global, and capital no longer respects national or political borders.

Challenges of globalisation

Such globalisation in financial markets should be accepted as an essential component of healthy economic cooperation. The international free flow of capital has and will continue to facilitate inward investment that, in turn, has the potential to raise living standards around the world.

However, as a former chair of the Dutch securities and markets regulator, I understand the challenges

presented to policy-makers when global financial markets transcend national or regional regulation. Adopting a global approach to financial regulation is one of the most important elements of the G20's work.

In the area of financial reporting, progress is well advanced. When the International Accounting Standards Board (IASB) began its work in 2001, it inherited a set of international accounting standards (IASs) that few countries or companies used. Each country would account for the same transaction in different ways, depending on where that transaction occurred. This patchwork of financial reporting standards inhibited investors from allocating capital efficiently, requiring an 'accounting premium' to be charged due to the risks involved when investing based on unfamiliar local reporting standards.

Only by countries agreeing to follow the same path can international standards be achieved

Growing acceptance of global standards

Fast-forward through 10 years of substantial reform, and international financial reporting standards (IFRSs) – the successors to IASs – have gained the respect of market participants and regulators as high-quality standards. Even countries that previously had their own sophisticated accounting standards have viewed the adoption of IFRSs as a way to improve market transparency and comparability.

The IASB has continued to work in close cooperation with standard-setting authorities around the world to improve and align financial reporting standards, in pursuit of a single set of high-quality accounting standards. The work of the IASB and the US-based Financial Accounting Standards Board (FASB) has been instrumental in this process. As a result of almost a decade of joint work by the two boards, IFRSs and US Generally Accepted Accounting Principles (GAAP) have seen substantial improvements and are now converged in many important areas.

Thanks to ongoing improvements to standards by the IASB, investors and other users of financial statements have greater visibility of the financing of pension schemes and the cost of granting stock options. They also have a better understanding of off-balance sheet activities and the assumptions made when calculating fair value measurements.

> "The case for a single set of high-quality financial reporting standards is compelling, and progress towards this goal has been remarkable"

At present, more than 120 countries have chosen to require or permit the use of IFRSs. Repeated G20 communiqués have called for a wholesale move towards a single set of high-quality financial reporting standards. From next year, two-thirds of G20 members will require the use of IFRSs, and the remaining G20 members are well on the way. Chinese accounting standards are already substantially similar to IFRSs, while the United States and Japan, both of which already permit foreign registrants to report using IFRSs, will decide if and how to incorporatethem into their domestic financial reporting regimes in the next year.

Priorities for the future

So what is left to do? First, while the majority of the convergence programme is now complete, the IASB will continue to work with the FASB to complete the remaining joint projects to the highest possible standard. This involves finalising improvements to lease accounting, revenue-recognition requirements and financial instruments accounting – three of the most challenging areas of financial reporting. The IASB and FASB will also work together to develop a common approach to insurance accounting – an area in which there is only a stopgap measure. It is important that this joint work with the FASB is completed on a timely basis; however, quality will remain the overriding priority.

Second, the IASB and FASB will work to encourage the rest of the world to come on board. The momentum towards the global adoption of IFRSs is, in my view, unstoppable. However, different jurisdictions will follow different routes, each with its own challenges, on the path towards global standards. A clear and unequivocal commitment to embrace IFRSs is the most important factor for those economies yet to adopt. The transitional arrangements are secondary.

Third, the IASB has begun to consult on its future agenda once the convergence programme with the FASB is complete. Some jurisdictions would certainly appreciate a period of calm after such an intense period of standard-setting activity. Other, more recent adopters of IFRSs are waiting for the IASB to provide answers to their own financial reporting challenges. How should the IASB deal with projects that were deferred in order to prioritise the convergence programme and the IASB's comprehensive response to the financial crisis? The IASB must also finish the conceptual framework and come up with a clearer, more consistent definition of other comprehensive income. Input from this consultation will inform the determination of how to proceed.

Building on strong connections

Finally, the IASB must further strengthen its institutional relationships. It must deepen the sense of buy-in and ownership by those already using IFRSs and who have entrusted the IASB to develop financial reporting standards on their behalf. This quid pro quo is an essential and fair part of the bargain when a country adopts the IASB's standards.

The case for a single set of high-quality financial reporting standards is compelling, and progress towards this goal has been remarkable. However, the standards must continue to evolve. We must complete the remaining convergence projects to a high standard, encourage the remaining economies to come on board, consult widely on our future agenda and strengthen institutional relationships.

The G20 leaders' ongoing support for the work of the IASB and the attainment of global accounting standards is most welcome. ◆

WALKING THE TIGHTROPE:

THE TRICKY ISSUE OF TAMING THE BIG BANKS

By Michael McKee, Head of Financial Services Regulatory, DLA Piper UK LLP

THE MAIN REGULATORY AGENDA: G-SIFIS AND SHADOW BANKING

The principal regulatory work of the 2010 Seoul G20 summit was to approve the new Basel 3 Accord and set an agenda focused particularly on globally systemically important financial institutions ("G-SIFIs") and on the shadow banking system. This set the regulatory agenda for the Cannes G20 summit.

In the case of G-SIFIs the overall policy objective is to reduce the moral hazard posed by SIFIs. Work during 2011 has focused on two main areas:

- Discouraging G-SIFIs from growing too big or too risky by developing an additional capital charge for G-SIFIs which is particularly penal for the largest and most risky institutions.
- Making it easier to resolve G-SIFIs in the event of their collapse without taxpayer solvency support.

G-SIFIs are mostly large banking groups. The G20's regulatory agenda since the financial crisis began has been dominated by concerns about banks and investment banks – and most of the G20 regulatory changes have been directed towards these institutions. However, as the regulatory requirements on banks increase so it becomes more attractive to transfer business to non-banks if they can achieve some of the same business outcomes. So it is also very important for the G20 to look at shadow banking. Otherwise, by increasing regulation in one area the G20 might simply be creating the possibility of a new crisis arising in a different set of institutions which are less tightly regulated.

The 2011 work has taken place against a steadily worsening economic backdrop. Instead of the sub-prime mortgage focus of 2008, attention is now on sovereign debt. Sovereign debt problems bring into focus the intimate connections between governmental decisions relating to budgeting, taxation and the allocation of national resources and the global financial markets. They also show the extent to which financial groups headquartered in particular countries are, in part, dependent on the status and rating of their home country's debt.

Too heavy handed an approach to G-SIFIs risks a reduction in capital flows globally – which could put increased pressure on the sovereign debt of particular countries and, in turn, on the banks headquartered in, or heavily exposed to, those countries. However, too light an approach could lead to the growth of even larger G-SIFIs – increasing the risk that a collapse of one or more of them would lead to huge costs for national governments and the global economy and to ever greater regulatory intervention thereafter. The G20 leaders must walk the tightrope in between.

EXTRA CAPITAL CHARGES FOR G-SIBS

As mentioned most G-SIFIs are banks. The Basel Committee published a paper in July 2011 on its proposed assessment methodology for extra capital charges for these globally systemically important banks (G-SIBs). Initially 28 financial institutions have been identified as G-SIBs. The IIAS is carrying out parallel work with regard to global insurance groups. The main objective is to require G-SIBs to hold more capital to increase their capacity to bear losses in times of significant stress for global financial markets – reducing the risk of their collapse.

Key elements of the Basel Committee proposals are:

- To identify and use a series of key indicators to measure the systemic importance of a G-SIB based on the impact its collapse would have on the global financial system and wider economy. The indicators will reflect: a G-SIBs global activity, its overall size, interconnectedness with other institutions, the extent to which another entity could be substituted for it and complexity. Each of these 5 categories will be given a weighting of 20%.
- G-SIBs would be grouped into 4 different "buckets" based on their scores using the indicators. The size of any additional capital charge will be determined by the bucket they are put in.
- G-SIBs should be incentivised to try and lower their charge by reducing the aspects of their business which produce high indicator results.
- Supervisory judgement can override the indicators – but should only do so in exceptional cases.
- The additional capital charge should be met using Common Equity Tier 1 only.

RESOLUTION PLANS

If a G-SIFI collapses it is clear, from the collapse of Lehman Brothers, that better tools are needed to resolve it together with better cross-border arrangements. The FSB published a report on this in July 2011 and highlighted four main areas for improvement:

- The need for national resolution schemes, with a menu of specialist resolution tools, for financial institutions. Ordinary corporate insolvency regimes were inappropriate and special regimes are required.
- Stronger bilateral and multilateral cooperation regimes that are institution specific so that cross-border firms can be resolved in a more orderly and less expensive way.
- Better resolution planning by firms and authorities including each G-SIFI developing Recovery and Resolution Plans (RRPs).
- Measures to remove obstacles to resolutions such as e.g. fragmented data and information systems and complex web of intra-group transactions.

The paper also proposes a possible statutory bail-in mechanism which would allow a resolution authority to write-down or convert into equity unsecured and uninsured claims. This could either recapitalise the existing entity or a new bridge entity. Countries would write powers to create such a mechanism into their resolution regimes.

SHADOW BANKING

In developing the scope for its work on shadow banking the FSB has decided to adopt a wide definition in the first instance. It has concluded that it should focus on "a system of credit intermediation that involves entities and activities outside the regular banking system and raises i) systemic risk concerns, in particular by maturity/liquidity transformation, leverage and flawed credit risk transfer, and/or ii) regulatory arbitrage concerns".

The definition is not entity specific but money market funds, hedge funds and non-bank credit providers could fall within it. Some insurers could also be caught – but ordinary life insurance activity would not.

Different options it is focusing on are:

- Banks' interactions with shadow bank entities – to reduce the spillover of risks into the regular banking system.
- Potential direct regulation of shadow banking entities.
- Regulated activities – possible regulated intervention focused on certain activities e.g. credit intermediation rather than on entities.
- Macro-prudential measures – which might address systemic risk in the shadow banking system more broadly.

DLA PIPER'S VIEWS

DLA Piper considers that it is vital to the world economy to have a sound global banking system.

Consequently it supports the concerted action being taken by G20 countries to enhance international cooperation between countries and regulators.

DLA Piper considers, however, that it is also vital at present to stimulate growth in a global economy where recovery is still very fragile in many places. Experience has shown that the 2008 crisis has damaged economic growth more significantly than at first was expected. Banks are a vital transmission mechanism for economic activity and increased capital, liquidity and regulatory obligations exercise a brake on the role they play – impacting growth.

It will be important, therefore, that capital requirements for G-SIFIs are carefully calibrated. So DLA Piper supports the general framework for SIFIs but proposes more work on calibration and fine-tuning prior to implementation. This should include consideration of the size of the additional capital charges. It is arguable that smaller charges may be sufficient.

It is also vital that the timing of any changes are linked to the timing of changes for shadow banking system entities. This is necessary to prevent arbitrage resulting in activities flowing from banks to non-bank competitors.

It is important to recognise that insurance companies, generally, have very different business models and risk profiles from banks. They should not be exempt from action being taken against them if they are G-SIFIs but it will be important to suitably adapt the approach to take the differences into consideration.

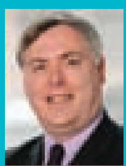
The impact of changes should be kept under regular review – and modified if necessary. The impact on global growth should be considered, in particular.

It is particularly important to develop stronger cross-border mechanisms for national resolution authorities resolving a G-SIFI. Historically states have been stubbornly resistant to international agreement on cross-border insolvency issues – because of sensitivities about assets held within national boundaries. We see this to be one of the key requirements for improving resolution internationally.

We consider that more work needs to be done on the bail-in mechanism but that in principle it is an additional tool in the armoury of resolution authorities.

Overall the main objective for the G20 Summit's consideration of regulatory issues should be to ask itself the question: will these changes enhance global growth prospects at the same time as reducing regulatory risk?

FOR FURTHER INFORMATION PLEASE CONTACT



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Combating corruption

Bribery and corruption, even at apparently minor levels, have a detrimental effect on the economies of countries struggling to generate growth. The G20's plan to tackle corrupt practices is an important step towards eradicating the problem

By Angel Gurría, secretary general, Organisation for Economic Co-operation and Development

Combating corruption is not only about ethics. It is about dealing with the most pervasive crime that erodes the very foundations of fair business, good government and sustainable development. Unfinished roads, crumbling schools and crippled health systems are but a few serious examples that illustrate the impacts of corruption on societies where this phenomenon is critical.

The repercussions of corruption sweep across entire populations. A seemingly trivial bribe can easily and rapidly amount to a major loss of output in a poor country. It is estimated that corruption adds up to 10 per cent to the total cost of doing business. And in sectors especially prone to bribery, such as procurement, it can account for as much as 25 per cent of the cost of procurement contracts. In the current environment of weak global economic activity and poor growth prospects, no one can afford such waste.

These direct economic impacts are only the tip of the iceberg, however. Corruption also bears adversely on the well-being of citizens, businesses and governments. Ordinary people are hurt when bribery means that vital services, such as access to water, health and education, are not provided, which perpetuates poverty and is a source of instability. Local businesses are hurt when they lose contracts because of bribes by others or because they cannot afford or are not willing to pay a bribe. Governments are hurt when, because they accept bribes and abuse their power, they lose their citizens' trust. And the whole world pays the price when bribery and corruption lead to weak governance that undermines national and regional security.

Achievements in anti-bribery strategies

For more than a decade, tackling bribery and corruption and strengthening the integrity of markets have been at the core of the work of the Organisation for Co-operation and Development (OECD). The OECD has become the leading source of anti-corruption tools and expertise in areas such as international business, taxation, governance, export credits and development aid. Paving the way to end bribery in international business transactions, by establishing the Anti-Bribery Convention and rigorous laws against this practice in 38 countries, has been one of its biggest achievements. The OECD has helped countries on every continent to raise the bar in creating and strengthening strategies that would put an end to bribery. It has also developed standards and codes in strategic areas of public and private governance.

But all this is not enough. Genuine political will to eradicate corruption is essential. This is why the G20's

actions on tackling corruption are so significant. The G20 provides a platform for leaders of the world's 20 major economies to share their views on the high-priority issues of the international financial system and to prove their political commitment to implement positive reforms. G20 leaders pledged in the Seoul Anti-Corruption Action Plan to lead by example in the fight against corruption, targeting nine key areas where prompt action must be taken for an efficient and thorough elimination of corrupt practices.

Since the last summit in Seoul in 2010, the G20 Anti-Corruption Working Group has focused on strengthening the implementation of key international standards against corruption, developing tools where gaps existed and encouraging international cooperation in the fight against corruption. Its focus included, in particular, foreign bribery, public-private partnership, public-sector integrity, whistleblower protection, asset recovery and anti-money laundering.

Under the impetus of the G20 focus on anti-corruption, political momentum was gained for all G20 countries to strengthen their legislative frameworks and come into line with key international standards. In addition, many countries, such as China, India, Indonesia and the United Kingdom, adapted their legislative frameworks to bring them closer to these international anti-corruption standards, including the OECD Anti-Bribery Convention and the United Nations Convention against Corruption (UNCAC). Other G20 countries launched reform processes to strengthen their anti-corruption legislation in specific areas, such as India on money laundering and Mexico on whistleblower protection in the private sector.

As reflected in the *Monitoring Report* for the Cannes Summit in November 2011, the Anti-Corruption Working Group has set concrete goals and specific actions for the coming year to carry out the commitments in the action plan, for which the support of international organisations such as the OECD is essential. Among others, G20 members have committed to ensure that legislation is adopted to criminalise foreign bribery and strengthen whistleblower protection by the end of 2012. The OECD Working Group on Bribery provides a forum for the effective review of the implementation of the convention.

An international consensus must be maintained to ensure that corruption is wiped out, creating a fairer and more transparent world in which to do business

“The OECD has helped countries on every continent to raise the bar in creating and strengthening strategies that would put an end to bribery”

In fact, G20 members, in particular those not yet party to UNCAC, have agreed to engage actively with the Working Group on Bribery with a view to ratification.

Also, the Anti-Corruption Working Group expands its scope continuously to areas where enhanced action is needed, including the different branches of the public sector particularly prone to corrupt practices. To reinforce the impact of the recommended standards in this field, G20 members have committed to adopt fair and transparent procurement systems in line with article nine of UNCAC and taking account the OECD Recommendation on Enhancing Integrity in Public Procurement. Furthermore, as for foreign bribery, the OECD will provide a framework for evaluating implementation with its integrity review mechanism, among other tools.

Involving the private sector

In addition to supporting countries in reaching these identified benchmarks on foreign bribery or public-sector integrity, the OECD has assisted countries in developing additional tools, such as a compendium of best practices and guiding principles for legislation. Moreover, because the involvement of the private sector in the fight against corruption is indispensable to ensure its effectiveness, the Anti-Corruption Working Group proceeded to engage further with business and exchange views and experiences. The OECD helped by providing a platform for discussions. Working with the French G20 presidency with the support of the UN Office on Drugs and Crime, the OECD co-organised the conference on 'Joining Forces against Corruption: G20 Business and Government', which offered the first opportunity for high-level representatives of both the public and private sectors to share their efforts to formulate best practices in the fight against corruption.

These turbulent economic times are not the moment for complacency: every day of inaction is a missed opportunity to create a more prosperous, fairer and more transparent world. The G20 Cannes Summit is the opportunity to give impetus to those international commitments made on paper to become concrete action to combat corruption. The OECD is ready to play its part and to continue to support the G20 move closer to a world without corruption. ◆

Impact of the Central Bank of Nigeria banking reforms in Nigeria

Mallam Sanusi Lamido Sanusi, Governor of the Central Bank of Nigeria

The Central Bank of Nigeria (CBN) banking sector reforms were a response to the devastating impact of the global financial crisis, in addition to poor corporate governance practices, overt and undue exposure to the capital market, oil and gas sector, poor risk-management practices and inadequate disclosure and transparency about the banks' financial position.

The CBN commenced a special joint examination in conjunction with the Nigeria Deposit Insurance Corporation (NDIC) to ascertain the true state of the banking industry. The outcome of the examination revealed that a total of eight banks exhibited imminent signs of collapse, which could drag the entire banking sector down, thereby endangering the Nigerian economy.

On August 14, 2009, in order to stem further deterioration in the condition of the affected banks and protect the interest of depositors and creditors, the CBN intervened through a series of measures. It replaced the executive management and, in some cases, the boards of banks with new ones and referred the cases of some of the principal officers to the law-enforcement and prosecution authorities. One former CEO was recently convicted and other cases are being tried.

The CBN injected a total of N620 billion into the banks in the form of tier-two capital to be repaid from the proceeds of recapitalisation in the near future. This has helped to stabilise the banks and restore confidence in the banking system. As a further confidence-building measure, the CBN reaffirmed the guarantee of the local inter-bank market to ensure continued liquidity for all banks and guaranteed foreign creditors credit lines to build confidence in correspondent banking relationships. This led to enhanced liquidity and helped to restore confidence with the international correspondent banks.

Objectives of the reform were predicated on a four-pillar policy framework laid out by Governor Sanusi Lamido Sanusi, namely: a) enhancing the quality of the banks, b) establishing financial stability, c) enabling a healthy financial sector and d) ensuring that the financial sector contributes to the real sector.

Enhancing the quality of banks

In order to enhance the quality of the banks, the CBN put into practice a number of initiatives to promote the safety, soundness and stability of the banking system. The CBN embarked on scrupulous enforcement of good corporate governance and risk management culture in banks with emphasis on enhanced transparency and disclosures, in addition to the implementation of risked-based and cross-border supervision designed to better focus examination efforts on management's processes for identifying, measuring and controlling risks.

Macro-prudential guidelines were strengthened and preparation is being made to move towards implementation of the New Capital Accord (Basel II) by the year 2012. Other complementary measures to enhance the quality of the banks include a policy of limiting the tenure of Chief Executive Officers of banks up to a maximum of 10 years, aimed at forestalling corporate governance abuses.

The Know-Your-Customer directive had to be enforced in order to curb money laundering and other financial crimes in the banking system. There was a comprehensive review of the 'Fit and Proper Persons' rule aimed at ensuring that only credible persons of impeccable financial, personal and professional character are allowed as major shareholders, directors and managers of banks.

In order to safeguard the independence of external auditors, as well as enhance the integrity and credibility of the financial statements audited by them, the bank introduced tenure limit of 10 years for external auditors. Also, the CBN in conjunction with the Securities and Exchange Commission, issued guidelines for margin lending, which placed a limit on the banks' capital market exposure based on a percentage of the bank's balance sheet.

The Asset Management Corporation (AMCON) was established following the promulgation of an enabling act by the Nigerian parliament in 2011 as a broad resolution strategy aimed at addressing the problem of non-performing loans (NPLs) in the Nigerian banking industry. In line with its mandate, AMCON acquired risk assets of some banks worth over N1 trillion and recently an additional N1.6 trillion was injected into these rescued banks, aimed at boosting their liquidity as well as enhancing their safety and soundness.

Still in pursuit of enhancing the quality of banks, the Universal Banking policy was reversed and a new banking model aimed at making banks focus on core banking was introduced. Also a process of mergers, acquisitions and recapitalisation of the eight intervened banks was initiated.

Having concluded Transaction Implementation Agreements, the rescued banks (Equitorial, Finbank, Intercontinental, Oceanic and Union Bank) successfully secured the approval of their respective shareholders at the various Extraordinary General Meetings. Consequent to the shareholders' approval, the Nigeria Stock Exchange (NSE) has placed Intercontinental, Oceanic and Finbank in full suspension (meaning that their shares will not be traded on the floor of the Exchange, preparatory to being delisted from the daily official list of the NSE).

Thus, Intercontinental will in the next year combine its business with Access Bank; Oceanic Bank has been acquired by Eco-Transnational Bank for a subsequent merger with Ecobank Nigeria; while Finbank will be merged with First City Monument Bank. Union Bank remains the only stand-alone institution, following the proposed injection of $500 million fresh capital and the consequent issue of 11.008 billion shares to Union Global Partners in consideration, as well as 3.3 billion shares to AMCON in lieu of its capital injection to raise the bank's net assets value to zero. This brings to completion the recapitalisation process of the rescued banks and full resolution of the banking crisis.

Establishing financial stability

Another pillar of the reform programme is the imperative to establish financial stability, which is centred on strengthening the Financial Stability Committee (FSC) within the CBN, establishment of a hybrid monetary policy and macro-prudential rules. This also involves the development of a directional economic policy and counter-cyclical fiscal policies by the government and further development of the capital market as an alternative to bank funding.

The FSC will focus on maintaining a systemic stability by way of moderating excessive credit and financial assets growth as a check against an asset price bubble. The Financial Services Regulation Coordinating Committee has been strengthened to address issues of common concern to regulatory and supervisory bodies more effectively.

The CBN has also introduced new macro-prudential rules to address several of the specific causes of the crisis, which include the following:

i. Limiting capital market lending to a set proportion of a bank's balance sheet;
ii. Prohibiting banks from using depositors' funds for proprietary trading, private equity or venture capital investments (the "Volcker rule" or some version of Glass-Steagall);
iii. Adjusting capital adequacy ratios depending on the perceived riskiness of the bank or financial institution
iv. Adjusting capital adequacy depending on the perceived point in the cycle;
v. Forward-looking capital requirement driven by stress tests conducted by CBN.

Enabling a healthy financial sector

Another pillar of the reform is the effort of the CBN to implement a more competitive banking industry structure by way of maintaining a stable interest rate structure. The bank has maintained a very stable Monetary Policy Rate over the last year. This has in no small measure helped to guarantee a business climate amenable for business planning and forecasting.

The CBN established necessary infrastructure such as credit bureaux and credit registrars to function as credit-referencing institutions to write independent credit and status reports on prospective credit customers to provide another level of checks.

To facilitate an improved cost structure for banks through cost control and business process outsourcing, the CBN canvassed for a strategy for sharing of infrastructure facilities such as power and ICT among the banks as a way towards achieving a reduced cost profile in the industry. The CBN, in collaboration with the Bankers' Committee, recently placed cash withdrawal/lodgement limits of N150,000 for individual account holders and N1 million for corporate account holders, with the aim of reducing the high dominance of cash in the Nigerian economy with effect from June 2012.

Working with the banks, the CBN will start the implementation of the policy in phases. There will be pilot schemes in Lagos, Port Harcourt, Abuja, Kano and Aba, which will eventually cover the entire country in a few years. The payment system is constantly being improved.

Microfinance banks have been reinvigorated to take care of the unbanked, economically active segment of the population to foster greater financial inclusiveness, thereby reducing the informal sector. This is a deliberate effort by the CBN towards evolving a new microfinance bank policy with a view to repositioning the institutions for greater efficiency.

Ensuring the financial sector contributes to the real sector

The CBN Governor, acting in his role as adviser to the President on economic matters, ensures that there exists a measurable relationship between the real economy and the financial sector. As a result, the bank adopted a hybrid monetary policy (a combination of market-based monetary policy measures and direct intervention fiscal measures) in some critical sectors of the economy.

To demonstrate this, the CBN recently approved the sum of a N500 billion facility for investment in power projects, which was later extended to the aviation industry. The funds, which are to be channelled through the Bank of Industry, is to be accessed through commercial banks with a tenor of 10 to 15 years at a concessionary rate of not more than seven per cent.

The bank also established a N200 billion Small and Medium Enterprises Credit Guarantee Scheme to promote fast-track access to credit by manufacturers and SMEs in Nigeria. The scheme is funded and managed 100 per cent by the CBN. Prospective loan applicants will be made directly to the participating banks, with a maximum tenor of seven years, inclusive of a two-year moratorium.

In summary, the CBN banking reform has recorded notable achievements when compared with experience from many other jurisdictions. The Nigerian banking sector reform was the only banking sector intervention or bailout where depositors did not lose their deposits with banks. There has been a considerable improvement in the macroeconomic environment, with a stable Naira exchange rate sustained for over 18 months and an inflation rate in low double digits.

There is also the emergence of AMCON, which acquired the NPLs from banks valued at over N1.2trillion and subsequently injected a further N1.6 trillion. The AMCON operation not only stabilised the banks' balance sheet, but also helped to inject liquidity into the banking sector. It is equally significant to note that AMCON was able to raise the bailout fund without any recourse to the national treasury.

Moreover, there has been increased financing of the agriculture value chain, from less than one per cent to two per cent of the loan portfolio of banks. Nine Nigerian Banks are currently among the top 1,000 banks in the world. Remarkable improvement is being recorded in corporate governance and better risk management profile.

The intervention in the aviation sector has helped to stabilise operations and has saved thousands of jobs as well as enhanced safety in that industry. Credit to the private sector has also increased, with the non-oil sector acting as the growth driver, so much so that the Nigerian economy remains one of the fastest growing in the world, with an overall GDP growth projected at 7.8 per cent for 2011.

SPONSORED FEATURE

Ending tax-haven secrecy: a framework for G20 action

As markets become increasingly globalised, so the opportunities for cross-border crime and other misconduct proliferate. Developing countries need swift G20 action to ensure banking and financial secrecy no longer undermine their ability to benefit from global trade

By Loretta Minghella, Director of Christian Aid and formerly Head of Enforcement Law, Policy and International Co-operation at the UK Financial Services Authority

Let me be a little blunt, in the hope of catching your attention. Back in 2009, the G20 declared that "the era of banking secrecy is over". But two years later, from developing countries' perspective, nothing much has changed.

Indeed, it seems that the significant progress that has been made in getting tax havens to share information with other countries has largely focused on protecting the tax bases of the wealthiest nations.

Of course one can see why this has happened – the financial tumult of recent years has sent governments racing to secure their faltering sources of revenue. It has also made foreign aid more controversial among electorates.

Fortunately, there is a link between international financial secrecy and developing countries' need for aid – tackle the secrecy and over time, the need for aid will diminish. That would please electorates in many rich countries, but becoming less dependent on aid is very much in poor countries' interests, too.

It is laudable that some G20 countries are maintaining the commitment to give 0.7% of GNI to poor countries. But poor countries' need to finance public services and infrastructure is vast and often goes beyond what aid budgets can cover.

So in the longer term, governments must raise revenue from their own citizens and companies operating within their jurisdictions. As well as bringing in funds, this is likely to make them more accountable to their citizens and less able to indulge in corruption.

Right now, however, offshore financial secrecy is allowing corrupt leaders, unscrupulous businesses and tax dodgers to undermine the fragile tax bases of developing countries. Of course, not all transactions with tax havens are nefarious, but the secrecy that surrounds them sends a strong signal that the risks of getting caught are low. Even if developing countries had enough well-trained, properly-paid tax officials, that same secrecy would prevent them collecting the monies due to them.

As a former financial regulator and Chair of the Standing Committee on Enforcement and Exchange of Information at the International Organisation of Securities Commissions, I have seen how legislation is effective only when you also have timely access to information about potential abuse.

Now, as Director of Christian Aid, I see the harm that a lack of international cooperation is doing to people living in poverty across the world.

Christian Aid estimates that about US$160 billion is lost to developing countries through tax dodging each year. By contrast, aid to developing countries totalled $120 billion in 2009. So for every one dollar we give in aid to developing countries, more than a dollar is removed, illicitly.

This is why it was so welcome when in 2009 the G20 proclaimed that the "era of banking secrecy is over". Cannes provides the perfect opportunity to take this one step further. To raise the bar on financial secrecy, G20 countries must sign and ratify the OECD/Council of Europe convention on Mutual Administrative Assistance in Tax Matters and provide the opportunity for non-G20 developing countries to engage. And, crucially, offshore jurisdictions need to feel pressure to sign the convention. This will maintain momentum on the tax and transparency agenda for future summits.

Offshore financial secrecy is allowing corrupt leaders, unscrupulous businesses and tax dodgers to undermine the fragile tax bases of developing countries

By promoting such high-level coordination on financial transparency, both G20 and developing countries can capture resources and use them to foster the sustainable and balanced growth that is in all our interests.

Christian Aid is part of a global movement calling for G20 action on tax havens, to protect the interests of poorer countries as well as rich ones.

christian aid

www.endtaxhavensecrecy.org

Keeping the consensus on tax havens

The drive to end bank secrecy and to implement sanctions on tax havens has been undermined by political deals between countries. Only regulation and coordination on a global scale can bring about proper international standards

By Amandine Scherrer, associate researcher, Canada Research Chair in Security, Identity and Technology, Université de Montréal, and OPIAS Consulting

In April 2009, the gathering of G20 leaders in London announced a crackdown on tax havens. Their communiqué advocated sanctions against non-cooperative jurisdictions and declared that the "era of banking secrecy" was now over. This commitment led to the publication by the Organisation for Economic Co-operation and Development (OECD) of a renewed list of non-cooperative jurisdictions around the world, the improvement of regulatory mechanisms through the newly established Financial Stability Board (FSB) and its expert group on non-cooperative jurisdictions, and the enhancement of peer-review mechanisms through the Global Forum of Transparency and Exchange of Information for Tax Purposes.

Did this move for greater transparency prove to be a long-lasting one? In today's time of harsh budgetary cuts and restrictions, tax havens are increasingly perceived by the public as financial havens for a privileged few, unscrupulous companies and corrupt developing-world leaders. Governments are concerned about the loss of tax income. In today's international economic and social context, a consensus seems to have been reached on the need to regulate tax havens and offshore jurisdictions.

Exchanging information

Improvements have been achieved in the regulation of tax havens as set out in the G20's action plan. The OECD blacklist has indeed led to a record number of multilateral tax information exchange agreements (TIEAs), with at least 500 signed, according to the G20 under the French presidency. More than 30 countries have shown progress in implementing the OECD standards.

The Global Forum now includes 101 jurisdictions and observers, allowing more jurisdictions to enter into agreements in line with its Model Agreement and both the OECD Model Tax Convention on Income and Capital and the UN Model Double Taxation Convention.

There are now 34 reports of the Global Forum that describe jurisdictions' rules for ensuring that information is available, making it accessible by competent authorities and providing the mechanisms to exchange information with foreign tax authorities.

The reports also recommend how to improve cooperation in international tax matters. Follow-up mechanisms are in place, with a subsequent assessment stage every three years. Close to 60 reviews are now completed. The Global Forum also released an assessment in 2010 that identified a strategy for working with the OECD, other international organisations and regional groupings, to provide technical assistance to all interested jurisdictions so that they can fully implement the standard.

The G20 has, without doubt, taken the lead in these steps towards greater transparency in regulating tax havens. Given the complexity of the task, the past two years have proved very fruitful. However, progress should not be overestimated. The quest for more transparency and regulation is often hampered by political bargains and distinctive domestic agendas.

A striking example is the Rubric Project, which was initiated by Swiss banks in 2009 and supported by Swiss authorities. It aimed to propose a flat-rate tax on the income of foreign-domiciled clients for countries that wish to avail themselves of the service.

This tax was to be deducted by the paying agent – the bank – and credited to the tax authorities of the client's tax domicile. The project led to Switzerland's formal agreements with Germany and the United Kingdom earlier this year. If such bilateral agreements confirm the will to enhance the exchange of information between countries for tax purposes, they also demonstrate a breach in the unanimity of the 2009 London Summit.

> "In today's climate of harsh cuts, tax havens are perceived as financial havens for a privileged few, unscrupulous companies and corrupt developing-world leaders"

Such deals indeed allow banking secrecy to continue and undermine international efforts to crack tax havens. Moreover, they are contrary to the spirit of the European Union Savings Tax Directive, which takes primacy over bilateral agreements. Many reports underline that these deals mark a setback for international efforts led by the OECD and EU to improve transparency in the banking

The increase in the number of multilateral tax information exchange agreements offers a ray of hope in tackling tax havens

system. The current dispute between US authorities and Swiss banking officials, over a revised tax treaty to hand over the details of US citizens using Swiss banks, demonstrates how the issue of bank secrecy remains an object of harsh and sensitive negotiations.

Implementing sanctions

Another concern is the issue of sanctions. Even if the G20 London Summit and the G20 Pittsburgh Summit reached a consensus on proper sanctions against tax havens (such as increased disclosure requirements; withholding taxes and denial of deductions adding extra weight to the principles of tax transparency and information exchange in bilateral aid programmes), the technical difficulties of implementing them remain high.

Also, the OECD lists still face criticism and defiance. The question of the transparency of the international regulatory mechanism that fails to include territories linked to influential powers such as China (Macau, Hong Kong), the US (Delaware) and the UK (the Channel Islands, British Virgin Islands) remains an open one.

Indeed, these jurisdictions share common features with well-recognised non-cooperative offshore jurisdictions and tax havens. Also, the principle by which a country or territory is removed from the blacklist after only mere declarations of intention to comply with international standards is often denounced by civil society.

In May 2009, the OECD's Committee on Fiscal Affairs decided to remove all three remaining jurisdictions (Andorra, Liechtenstein and Monaco) from the list of non-cooperative tax havens. As a result, no jurisdiction is currently listed. Similarly, Switzerland was removed from the grey list only a few weeks after the announcement of the OECD list in 2009.

Requirement for regulation

The G20 Cannes Summit should reaffirm the need for international regulation and coordination on the issue of tax havens and encourage the expansion of the Global Forum, as well as the network of TIEAs. The G20 leaders should also support OECD efforts in updating its non-cooperative jurisdictions list, promoting transparent assessment mechanisms and sound judgement.

The peer-review reports produced by the Global Forum should be endorsed and their follow-up mechanisms firmly promoted. Technical difficulties in implementing international standards, as well as in ensuring effective sanctions, should be clearly identified and targeted as priorities in the coming years. ◆