Regulation hits small centres

Post-crisis reform reduces market efficiency

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Hurriedly designed measures have biased international financial markets in favour of the largest players, according to their smaller rivals. Countries such as Barbados believe they are losing out even though their compliance levels match the best.

Small international business and financial services centres such as Liechtenstein, Guernsey, the Caymans and Barbados have an enduring place in international commerce because they make the international system more efficient. They allow international companies to offer products and services to the global market more cost effectively than they could otherwise. For this reason, the foremost centres have proven resilient in the face of frequent criticism.

International firms that use subsidiaries in IBFS centres for aspects of their global operations are more competitive than those that do not. As a result, the centres play a vital part in the efficiency of international finance. The sources of IBFS competitiveness vary by country but include the expertise available, global interconnectedness, the standard of information technology, the centre's quality of life and the quality of infrastructure. Most centres will offer local expertise that is on par with London, New York and Singapore but at significantly lower cost.

Thanks to 20 years of intense global scrutiny, dating back to the Asian financial crisis, all small IBFS centres of substance offer expertise on a par with that in advanced economies.

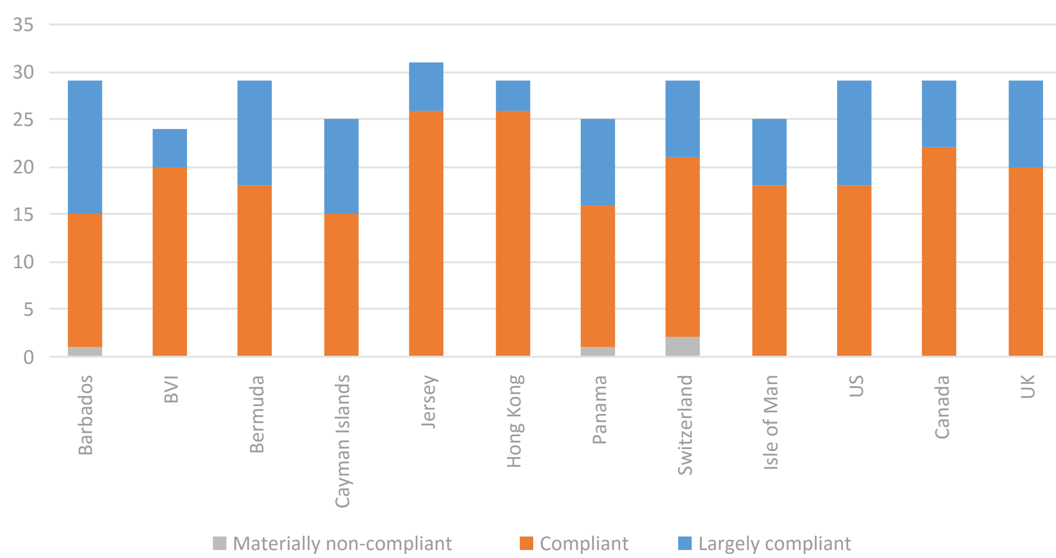
Barbados holding up against advanced economies

The most highly regarded centres, among which Barbados counts itself, have a reputation for probity and high quality regulation that goes back many decades. Thanks to 20 years of intense global scrutiny, dating back to the Asian financial crisis of the mid-1990s, all small IBFS centres of substance have brought their market conduct and supervisory practices up to international standards. They are now on a par with those in advanced economies such as the US and the European Union.

Procedures and guidelines have been put in place for certifying compliance with international standards. They include the comprehensive financial sector assessment programmes conducted by teams of specialists organised by the International Monetary Fund and World Bank, the peer review processes of the Financial Action Task Force on money laundering, and the mutual evaluation processes of the global forum on the exchange of tax information.

Influencial small IBFS centres comparable to US, UK and Canada

Country compliance with Basel core principles, number of items



Source: Financial Action Task Force recommendations report, International Monetary Fund
Note: Excludes Bahamas and Luxembourg

The cost of financial transactions has been increased by a combination of uncoordinated, hurriedly designed measures to combat tax evasion, financial illegalities and market misconduct.

The Chart shows how the most influential small IBFS centres compare with the US, Canada and the UK, with respect to the implementation of the Basel Core Principles for Banking Supervision, globally agreed norms administered by the Bank for International Settlements and reported on by the Financial Sector Assessment Program.

Given this level of compliance, it is frustrating that some international reforms in the wake of the financial crisis have had the unintended consequence of creating barriers to the efficient flow of international finance, especially through small centres. The most wide-ranging example is the implosion of the global market for correspondent banking transactions. This resulted from a crushing burden of misinformation, unilateral actions by national regulators and regulatory over-reach.

'Derisking' hurting smaller players

The cost of financial transactions worldwide has been increased by a combination of uncoordinated, hurriedly designed measures to combat tax evasion, financial illegalities and market misconduct by international companies. These measures have biased international financial markets in favour of the largest players, driven some smaller players out of formal markets altogether, and forced many companies to make choices that are against their best commercial interests. This 'derisking' has been reported across the globe.

The best way to put matters right is through coordinated action by the international bodies which have been established to oversee international financial reform – the Financial Stability Board, the Basel Committee, the Financial Action Task Force and the global forum. In the wake of the financial crisis there was a strong sentiment in favour of urgent action. Evidence is growing that the actions that countries and international institutions rushed into do not, in fact, address the root causes of the crisis.

Global derisking has seen international financial institutions being driven out of activities and markets that were sources of competitive efficiency and profitability. Communities and individuals are being deprived of financial legitimacy simply because of where they are located, how large they happen to be, or what type of activity they are engaged in.

Regulators must recognise that the global regulatory strategy needs to be re-evaluated. An increasing number of commentators see the evidence that international financial reform is heading in the wrong direction. It's time to take stock. ■

DeLisle Worrell is former Governor of the Central Bank of Barbados.