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Western Hemisphere Department

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CONTENTS

TOWARD A SUSTAINABLE INTERNATIONAL BUSINESS AND FINANCIAL SERVICES SECTOR IN BARBADOS[1]

A. Introduction

1. **The International Business and Financial Services (IBFS) sector in Barbados is economically important.** The sector, which ranks second to tourism, is an important source of foreign exchange, tax revenue and employment. It comprises a diversified set of business entities**,** including many non-financial sector companies with activities as varied as import-export, real estate, manufacturing, R&D, among others. Tax revenues combined with operational and non-operational expenditure are around 9 percent of GDP. The sector employs skilled labor accounting for about 3 percent of the labor force.

2. **The contribution of the IBFS sector to the local economy has been relatively stable in recent years but its contribution to fiscal revenues has declined**. The sector has displayed lower profitability since the global financial crisis. More recently, it suffered from two changes in Canadian tax legislation. Consequently, tax revenues have declined while other expenditures have largely offset such decline. The sector also faces some risks from the loss of correspondent banking relationships (CBRs) that has affected most Caribbean countries.

3. **This note summarizes recent development in Barbados's IBFS and assesses the extent to which the loss of correspondent banking relationships (CBRs) pose a risk to its future**. The rest of this note is structured as follows: Section B reviews the literature on offshore centers (OFC) and their contribution to host jurisdictions. Section C looks at the Barbados IBFS in the Caribbean context. Section D describes the IBFS in Barbados, and analyses its contribution to the real economy. Section E discusses the extent to which the IBFS sector has been affected by the loss of correspondent bank relationship. Section E concludes and provides policy recommendations.

B. The Impact of OFCs on Host Jurisdictions – A Literature Survey

4. **OFCs are typically classified according to the sources and uses of funds, with specific focus on financial services**. They can be:

- **Primary centers**. Advanced economies represent the major market area of primary centers and are the predominant suppliers and users of funds. With their dominant financial intermediary role, primary centers serve as the hub of international banking and finance for its market area, offering a whole spectrum of offshore financial services.

[1] This note was prepared by Gregorio Impavido (gimpavido@imf.org) and Joel Okwuokei (jokwuokei@imf.org) with valuable input from Judith Gold and benefitted from comments from the Barbados International Business Association (BIBA) and the Ministry of Industry International Business, Commerce and Small Business Development.

- **Booking centers**. In a booking center, financial intermediation takes place predominantly between non-residents. To attract offshore entities, a booking center needs to meet only minimal requirements in terms of financial infrastructure. Its primary attraction typically lies in its highly favorable tax and/or regulatory regime.

- **Funding centers**. A funding center channels offshore funds from outside its market area into local areas. For instance, the Association of Southeast Asian Nations (ASEAN) as a group are the target net borrower in the Asian Dollar Market.

- **Collection centers**. Collection centers tend to channel funds outside of their market area. They exploit the low absorption capacity of their market areas to accumulate net foreign assets.

5. **OFCs generate direct benefits for host jurisdictions**. For instance, license fees are the most common source of revenue but given their small nature, they have an impact only on very small host economies. Some jurisdictions require offshore entities to hold specific amounts of domestic financial assets through capital and reserve requirements. The importance of these source of "levies" is limited given the intense tax competition to attract offshore banks and the need to separate onshore and offshore activities to limit contagion risk. Similarly, tax revenues, including withholding taxes, profit taxes, income taxes on local employees, and stamp duties, have also limited impact on host economies as tax competition limits overall revenues. Operational and non-operational expenditure are by far the largest contribution to host economies, unless OFCs are mainly mailboxes in the host economies. They tend to be proportional to the costs of inputs and with fixed costs being an important share of overall costs. They are also proportional to the number of licensed entities. They consist mainly of salaries and wages associated with local employment, rent of offices, administrative expenditures, telecommunication expenses, and auditing, accounting, and legal fees.

6. **OFCs generate also indirect benefits for host jurisdictions**. These include: (i) higher capital inflows (onshore utilization of offshore funds) as well as higher FDI to the host economy (Desai, Foley and Hines, 2006; Blanco and Rogers, 2011; González and Schipke, 2011); (ii) know how transfers and development of the domestic financial sector, including internationalization of domestic banks, development of local expertise in international finance (Rose and Spiegel, 2007); and (iii) higher economic growth of related industries such as insurance companies, money brokers, merchant banks and investment companies, international legal and accounting firms, hotels, printing plants, and telecommunication companies.

7. **At the same time, OFCs attract costs for host jurisdictions**. The degree of "leakages" between the onshore and offshore sectors (i.e., the extent that the offshore sector can fund, or be funded by the local economy) can generate costs including the impairment of monetary policy, inflationary effects, adverse impact on domestic economic policy, capital leakage, and the inflow of speculative offshore funds. Reputational costs and contagion risks are high when offshore entities come from jurisdictions with weak supervision and governance standards. They are also high when offshore entities come from traditionally reputable jurisdictions but when the host jurisdiction does not apply strict fit and proper tests at the time of licensing. The importance of these costs, relative to benefits, depends on the degree of monetary policy

autonomy and the overall governance standards associated with the licensing and supervision of OFC entities.

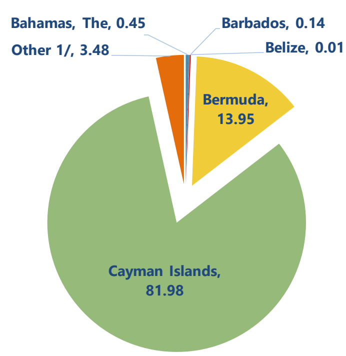
C. The Size and Contribution of OFCs in the Caribbean

8. **OFC in the Caribbean are mainly booking centers for intra-group funding**. They transact/intermediate mainly with non-residents.[2] Financial service companies traditionally operate a central treasury model where the parent in one jurisdiction grants its branches and subsidiaries in other jurisdictions access to the group global pool of liquidity via the region. Some offshore banks offer overnight sweep accounts for a diversified customer pool outside the region while other undertake investment banking activity, assisting foreign affiliates of the parent company's customers to raise working capital. OFCs in the region also include non-financial companies (mining, manufacturing, real estate, and other services) that find it advantageous for tax reasons to elect the Caribbean as their fiscal domicile.

9. **They are small by international standards**. OFCs in Caribbean countries attract around US$3 trillion, or 7 percent of global portfolio inflows. The majority of inflows ends up in the Cayman Islands, accounting for 82 percent of total inflows into the region. As of 2016Q2, Barbados attracted only about US$4 billion, or 0.1 percent of regional inflows (text charts).

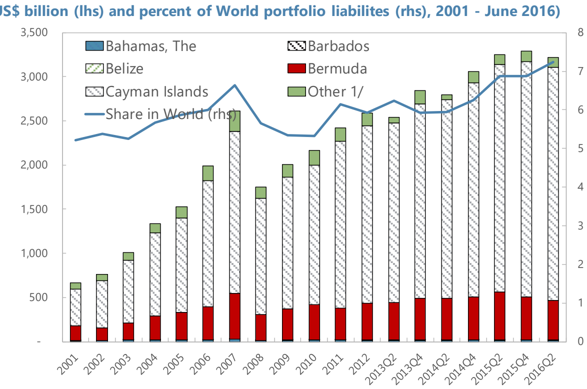
10. **However, they are relatively large with respect to the size of host economies** (text chart). Over the last 10 years, the size of the OFC, measured in terms of BOP portfolio liabilities, in The Bahamas, has averaged 200 of 2015 GDP. For Bermuda and Cayman Islands, comparable figures are 7,800 and 58,000 percent of respective GDP.[3] Over the same period, the OFC in Barbados has increase threefold, from 30 to 100 percent of 2015 GDP (text carts).[4]

Caribbean OFCs portfolio liabilities
(Percent of Caribbean portfolio liabilites, June 2016)



Sources: IMF, Coordinated Porfolio Investment Survey.
1/ Anguilla, Antigua, Aruba, Curacao, Dominica, Grenada, Guyana, Jamaica, Martinique, Netherlands Antilles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

Caribbean OFCs portfolio liabilities
(US$ billion (lhs) and percent of World portfolio liabilites (rhs), 2001 - June 2016)



Sources: IMF, Coordinated Porfolio Investment Survey.
1/ Anguilla, Antigua, Aruba, Curacao, Dominica, Grenada, Guyana, Jamaica, Martinique, Netherlands Antilles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

[2] But not exclusively, as foreign companies need to establish bank accounts domestically to pay for working capital, utilities, taxes, and other operational expenses.

[3] Latest available GDP data is 2013 for Bermuda and 2014 for the Cayman Islands.

[4] This is smaller than the onshore banking sector with assets amounting to 146 percent of 2016 GDP.

11. Because of their size, OFCs have contributed considerably to economic activity in the Caribbean. For the region as a whole, using data for 15 Caribbean island economies, Butkiewicz and Gordon (2013) find that the presence of an OFC had a sizable and positive effect on national income growth. Using estimates based on revenue flows, employment, and services, González-Miranda *et al*. (2013) find that the OFCs contributed about 1 percent of GDP in Antigua and Barbuda, 7.8 percent in Barbados, and 7.4-9.2 percent of GDP in The Bahamas. Britton and Sacks (2007) report that offshore banking in The Bahamas directly accounts for about 3.5 percent of GDP (almost 40 percent of banking sector's total value added) and over a quarter of total banking sector employment.[5] Moreover, they find that value added per employee in the OFC has been nearly twice as large as those of onshore banks. IMF (2017a) finds that Bahamas offshore banks & trusts provide around 1,000 jobs with an average wage that is about twice the average wage at domestic banks, and that in 2016 the total wage bill and registration and license fees of offshore banks amounted to about 1.7 and 0.2 percent of GDP, respectively. Similarly, Suss, Williams, and Mendis (2002), estimate that the OFC in The Bahamas contributed 2.5 percent of GDP in local expenditure, and directly employed almost 1,000 workers at the end of 2000 (or 0.7 percent of the labor force).

D. The Barbados IBFS and its Contribution to the Local Economy

12. The Barbados IBFS is unique as it comprises a diversified set of business entities (Box 1). These are:

- **International Business Companies (IBCs) and International Societies with Restricted Liability (ISRLs).** These are non-banks and insurance companies operating mainly in the services and manufacturing sectors. Many are asset managers, financial consultancy firms, and import/export companies. Several of them are large employers of labor, providing research and development services in highly capital intensive industries, like high precision optics.

- **Exempt and Qualifying Insurance Companies (EICs and QICs).** These are mainly captive companies[6] established under the Exempt Insurance Act of 1983 and the Insurance (Miscellaneous Provisions) Act of 1998. More than 80 percent of captive insurance companies domiciled in Barbados are from the United States and Canada.

- **International Banks (IBs).** The activities of IBs is typical of banks in OFCs (Box 2). Wholesale banking accounts for some 85 percent of assets of IBs. The largest entities act as a booking center for intra-group funding operations and do not raise funds from external third-parties. They essentially operate a central treasury model, where the parent in one jurisdiction grants its branches and subsidiaries in other jurisdictions access to the group global pool of liquidity via Barbados. Foreign currency lending and its associated funding account for only 5 percent of total assets. Private banking (wealth management) accounts for the remainder 10 percent. This industry caters to sophisticated high net worth individuals

[5] The authors note that "because The Bahamas does not presently produce Input-Output tables, [they] adapted the published Input-Output tables for Hawaii (in many respects a similar island economy, with strong tourism and commercial sectors) to be consistent with the national and industry accounts of The Bahamas using Bahamas Department of Statistics data. The result of these adjustments is effectively a Bahamian I-O table, using inter-industry coefficients from a similar island economy".

[6] Captive insurance companies are established for the sole purpose of insuring the business of their owner.

globally, and its revenues stem from fee-based income, with the risks of asset deterioration borne by clients rather than by the financial institutions.

Box 1. The Legal Framework for Companies Operating in Barbados's IBFS

Companies operating in the IBFS sector are incorporated under different legislative Acts and supervised by different agencies, depending on their activity. Their business relationship is with non–residents, with limited interactions if any with residents.

International Business Companies (IBCs) are incorporated under the Companies Act of Barbados and must only carry out international business (i.e., generally cannot trade in Barbados). IBCs are licensed, regulated, and supervised by the Ministry of Industry and International Business.

International Societies with Restricted Liability (ISRLs) are incorporated under the Societies with Restricted Liability Act of Barbados. An ISRL may not acquire, or hold land in Barbados, other than land required for its business held by way of lease or a tenancy agreement nor transact business with any Barbados residents. ISRLs are licensed, regulated, and supervised by the Ministry of Industry and International Business.

Exempt Insurance Companies (EICs) are incorporated under the Companies Act of Barbados and must apply for a license under the 1983 Exempt Insurance Act. EICs' activities are restricted to risks and premiums originating outside Barbados. EICs include underwriters, brokers, agents, dealers or salesmen. EICs are licensed, regulated and supervised by the Financial Services Commission (FSC).

Qualifying Insurance Companies (QICs) are generally incorporated under the 1998 Insurance Companies Act of Barbados, registered as insurers under the Insurance Act and must apply for a certificate to qualify as a QIC under the Insurance Act. QICs activities are restricted to risks and premiums originating 90 percent outside CARICOM. QICs are licensed, regulated and supervised by the Financial Services Commission (FSC).

International Banks (IBs) are generally incorporated under the Companies Act and must apply for a license to operate as an international bank under the International Financial Services Act. Such a license is required to carry on any international financial service in or from within Barbados. IBs are licensed, regulated, and supervised by the Central Bank of Barbados.

Box 2. Typical Financial Services Provided by Offshore Banks

Offshore banks typically engage in the following activities:

- **Foreign currency lending and its associated funding** is normally an asset driven business originated elsewhere and booked and funded in the OFC, normally for tax reasons. Sometimes the funding is arranged by the office originating the loan, but sometimes it may be arranged by the entity in the OFC itself. This (wholesale) funding activity gives rise to a substantial volume of inter-bank activity, sometimes, but not always, between branches and affiliates of the same bank.
- **Issuance of securities**. A significant proportion of Eurobonds floated in international capital markets is also issued in OFCs, although the marketing and selling of such instruments would normally be done in major financial markets. Recently, the use of special purpose vehicles registered in some OFCs has led to a growing volume of structured finance deals. Although, IBs in Barbados are licensed to issue securities, in practice the activity is not considered important.
- **OTC trading**. The use of OTC derivative instruments is mainly concentrated in a few primary international financial centers because they entail substantial counterparty, settlement, liquidity and legal risks. Nevertheless, OTC trading may be booked in OFCs if tax, or other reasons make that more profitable. This is not considered an important activity in Barbados' OFC.
- **Wealth management**. OFCs are used for the management of personal funds in a variety of trusts and other forms, some managed by financial institutions but some managed by law firms and other specialists.

13. Barbados attracts international companies for a variety of reasons. The Barbados domicile offers excellent infrastructure, skilled labor, a responsive regulatory environment, tax treaties with the US and Canada (among other countries), and lower operating costs for captives than in many other major domiciles. Additionally, Barbados offers various other incentives such as ease of incorporation, income tax and exchange control concessions for resident expatriate employees, limited investment restrictions as well as confidentiality of financial statements and statutory records including registers of shareholders.

14. However, tax considerations are critical in the choice of domicile and maintaining tax advantages under bilateral tax treaties is an important strategy for the country to attract foreign reserves (Box 3). Three examples illustrate this point:

- Barbados has traditionally been the domicile of choice from which Canadian captive insurance companies and banks could generate tax exempt surplus from non-Canadian business.[7] The status of Canadian EICs domiciled in Barbados changed in March 1996 when the Canada Revenue Agency (CRA) deemed their profits not taxable in Barbados but taxable under Canadian Law. The Barbados government responded by amending the Insurance (Miscellaneous Provisions) Act of 1998 and creating the figure of qualifying insurance company (QIC). A QIC is simply an EIC with up to 10 percent of premiums originating within the CARICOM area. QICs are entitled to many of the benefits of an EIC, including exemption from exchange control, and is also entitled to a foreign currency tax credit which it

[7] Any revenue earned from coverage of Canadian risks does not qualify for exempt surplus treatment in Canada.

can apply against its tax on net income, otherwise taxable at 40 percent. Minimum capitalization, annual licensing, management company access and most other important features of the EIC legislation were also available to the QIC. This new legal entity allowed many Canadian EICs to re-register as QICs and maintain the tax advantage of being domiciled in Barbados.

- In 2008, the signing and ratification of a tax treaty with Mexico created the opportunity for Barbados to attract captives from that country too.
- Changes in Canadian legislation has led the Government of Barbados to reduce applicable tax rates in 2012 to keep the Barbados domicile favorable for Canadian insurers (see further paragraph 16).

Box 3. Tax and Regulatory Benefits Enjoyed by IBs in Barbados

To establish an offshore bank in Barbados, details of the proposed bank must first be submitted to the Central Bank of Barbados for approval. Offshore banking licenses are issued to qualified foreign banks by the Central Bank upon the approval of the Minister of Finance.

There is a minimum capital requirement of US$2 million for banks which accept 3rd party deposits and US$0.5 million for those which do not. It is required that at least one of the directors be a Barbadian resident and that an annual shareholder meeting be held. The bank's accounting records, minutes and resolutions must be maintained at the local office. Offshore banks are subject to annual audits and license fees. Income tax is applied on a sliding scale of 0.25-2.5 percent.

The Offshore Banking Act provides that dividends, royalties, interest, foreign securities funds, gains and assets generated or managed by a licensee are automatically exempt from the provisions of the Exchange Control Act.

Summary of Benefits for IBs in Barbados:

- Tax at the rate of 0.25 percent (on profits over US$15 million) and up to 2.5 percent (on profits up to US$5 million)
- No direct tax or capital gains
- No withholding tax on interest, dividends, royalties or fees
- No exchange control on foreign currencies
- Income tax concessions for qualified foreign employees
- Privacy protection via provisions for strong confidentiality

15. While the number of companies active in the IBFS has fallen, the contribution appears to have remained stable. However, data availability restricts a full assessment of contribution, measured in terms of active companies, employment, tax revenues and expenditures.[8] [9]

- **The stock of active companies** has decreased to around 4,000 from a peak of around 5,000 companies between 2012 and 2015. As of March 2017, the stock of active companies included 25 IBs, 219 exempt EICs (including management companies), 52 QICs, and about 3,700 IBCs.

- **Around 400 new companies are licensed every year**. IBCs and ISRLs (including international trusts, foreign sales corporations, and holding companies) account for about 97 percent of new licenses with the rest representing insurance and insurance management companies.

- **The employment generation capacity of the IBFS sector has stabilized since 2008.** In the period 2001-07, employment was highly correlated with the number of active OFC companies. During that period, 1,531 new firms were licensed annually generating 675 additional jobs. During the period 2008-16, 495 new firms were licensed annually with a net employment loss of 35 jobs. During this period, the average employment in the IBFS decreased from 1.25 to 1 employee per firm (or 3 percent of the labor force).

- **Other expenditures have stabilized to around 8 percent of GDP**.[10] Other expenditures increased from less than B$200 million (or 2 percent of GDP) in 2001 to around B$700 million (or 8 percent of GDP), mainly on account of large increase in professional fees. But this trend has stalled in the last 5-8 years. The composition of expenditure also shifted from fees to wages: the salary component of total expenditure increased despite the loss in employment in recent years while legal, management, and other professional fees decreased (text chart).

- **Tax expenditure has declined since 2007 led by a fall in the contribution of CIT revenue to the government**. Corporate income tax revenue from the IBFS sector, a significant source of tax revenue for the government, have decreased since their peak in 2007 from 4 to around 1 percent of GDP, the same level registered in 2001. As noted below, this would appear to be primarily related to the change is tax rates following the changes in the Canadian tax regimes as it relates to Tax Information Exchange Agreement (TIEA). More recently, tax revenues are reportedly picking up, as a result of new companies that started registering late 2016 and early 2017, in response to changes in UK tax legislation.

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[8] This may reflect a break in IBFS employment and expenditure data, that could be the result of a change in sample and/or methodology, as there was no explanation for the large increase between 2007 and 2008. The focus of the discussion on these indicators is on developments since 2008.

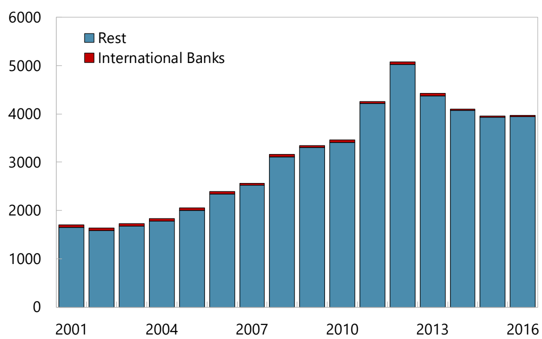
[9] Limited information is available on the Barbadian IBFS sector. There is no systematic approach to data collection and reporting, hampering an accurate assessment of the sector's activities. No information is available on knowledge spillovers or other backward linkages to the rest of the economy. Some of this information is available on the CBB website, or on the website of the IBFS sector association. However, available information is highly descriptive and void of analytical content or policy considerations.

[10] I.e., non-corporate income tax outlays. These include mainly wages and consulting fees.

- **The IBFS is an important source of FX to the economy**. All operating cost and payments for local taxes come from abroad.

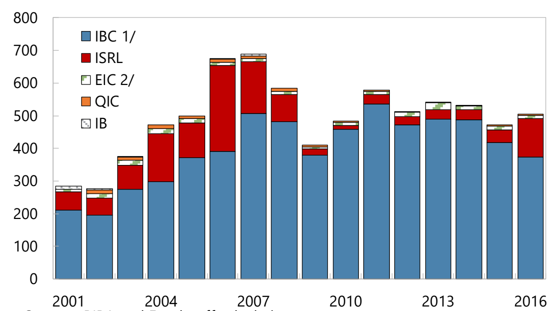
The Direct Contribution of the IBFS Sector

Number of active IBFS companies
(Number)



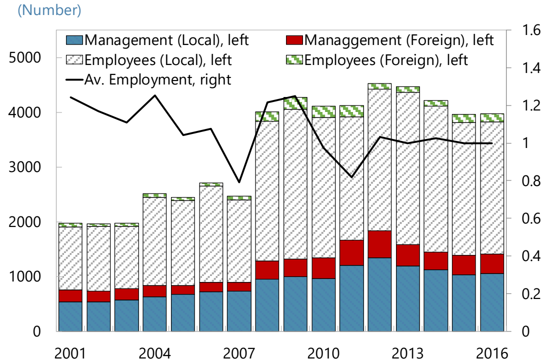
Sources: BIBA and Fund staff calculations.

New IBFS licences
(Number)



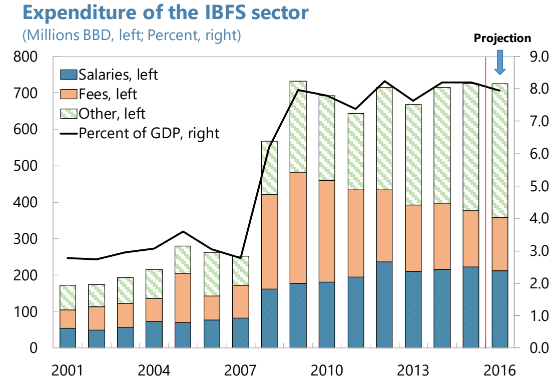
Sources: BIBA and Fund staff calculations.
Notes: 1/ including int. trusts, foreign sales corporations, and holding companies.
2/ including exempt insurance management companies.

Number of employed in the OFC sector
(Number)



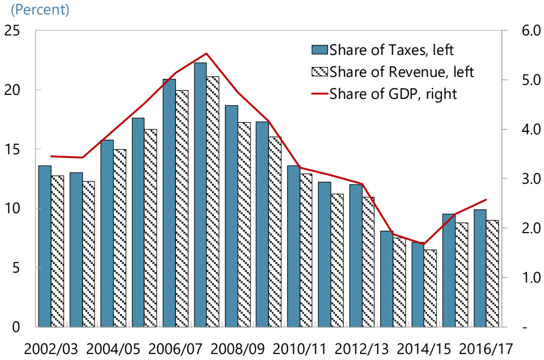
Sources: Barbados authorities and Fund staff calculations.

Expenditure of the IBFS sector
(Millions BBD, left; Percent, right)



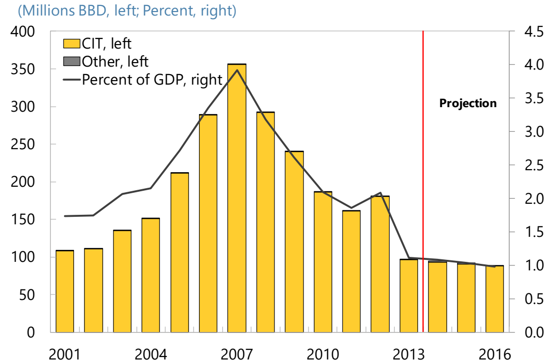
Sources: Barbados authorities and Fund staff calculations.

CIT Revenue (2003-2017)
(Percent)



Sources: Barbados authorities and Fund staff calculations.

Tax revenues from the IBFS sector
(Millions BBD, left; Percent, right)



Sources: Barbados authorities and Fund staff calculations.

16. The declining trend in tax revenues previously reported is attributable to the aftermath of the global financial crisis and changes in Canadian legislation.

- **The global financial crisis reduced inflows (or investment), earnings and generally increased uncertainty.** Also, global efforts to strengthen the financial system, implied pressures on OFC's to adhere to stricter standards and share more information. This introduced considerable uncertainty for both supervisors and commercial entities as new standards, codes, and enforcement norms were being developed.

- **Changes in Canadian tax legislation prompted changes in applicable tax rates**. Canadian companies account for about 80 per cent of all the business conducted in the IBFS. In 2007, Canada announced that signing a TIEA with Canada would allow companies registered in that jurisdiction to generate exempt surplus under Canadian Law. This eliminated the preferential treatment enjoyed by companies domiciled in Barbados under the Canada-Barbados Tax treaty (see Box 3 of IMF 2016). In response, the Government of Barbados reduced tax rates applicable to IBCs and ISRLs in 2012 to keep the Barbados domicile favorable for Canadian insurers relative to other low tax jurisdictions.[11] Because of this change, corporate income tax (CIT) revenues in 2013 were 54 percent lower than in 2012. As of January 1, 2015, the Canadian government strengthened the integrity of exemption under its foreign accrual property income regime to limit the erosion of its tax base, thereby reducing the benefit of holding companies in Barbados and other favorable tax jurisdictions. This also impacted the trust sector, which had been one of the island's growth areas. Consequently, several entities that were licensed as banks have either closed, or changed their designation to IBCs.

17. There are other indirect contributions attributed to the IBFS. These include the personal income taxes paid by employees, the VAT and duties paid by the sector's employees on their spending in the economy and similarly from the fees and other expenditures that the sector delivers to other players in the domestic economy. However, in the absence of data, these cannot be measured. Further, there is also a number of domestic companies that apply for exemptions applicable to IBFS sector companies on the basis of intermediating exclusively with non-resident and providing high–value added businesses. According to the Ministry of Industry, expenditure of this segment could amount to an additional 3 percent of GDP.

E. Withdrawal of Correspondent Banking Relationships

18. Withdrawal of correspondent banking relationships continues to be of great concern to Caribbean authorities. However, while the impact on Barbados has been small, concerns about this has dampened new activity and increased operational cost as banks increase verification and compliance efforts. Over the 2013-16 period, 8 IBFS institution were reported to have lost corresponding bank relationships mainly with US and Canadian banks (Worrell 2016; CCMF, 2016). Some correspondent banks from the Netherlands, UK and Germany have also terminated CBRs with financial institutions in Barbados.

19. The ownership structure of the domestic banking in Barbados mitigates CBR pressures. All domestic banks are foreign–owned, with sound home country supervision. The parent companies of all the

[11] The change was to lower the marginal tax rate on earning over US$15 million from 1 to 0.25 percent.

banks enjoy strong reviews from domestic regulators and international rating agencies. Each bank has several CBRs with full banking services, and in multiple currencies. They also have the benefit of accessing their parent's resources to conduct international transactions.

20. Faced with CBR pressures, Barbadian commercial banks have terminated relationships with certain clients. The increased scrutiny from correspondent banks, greater resources required to conduct due diligence, and low profitability have led some banks to cut off domestic clients that poses high ML/TF risks. However, profitability considerations may have also played a role. Banks were reported to have closed 60 clients' accounts since 2013, mainly in the money transfers services and the IBFS (CBB, 2017). De–risking of the money transfer services operators, the main source of remittances, reflects the high transactions volume and cash intensive nature of this sector.

21. Global banks withdrawal decisions have other implication for the IBFS sector. In addition to loss of accounts with the domestic banks, establishing new business relationships with banks have been challenging. Sometimes domestic banks require the approval of their corporate head offices to open accounts for clients in the OFC sector (Wright and Kellman, 2017). Canadian–owned banks are mandated by their home supervisor to obtain IBC's customers' information when opening accounts for IBCs requiring, in cases, potential clients in the IBFS sector to establish a relationship directly with the parent bank. Where the decision for a new account opening for IBCs is to be made by a Canadian parent, the wait time could be prolonged. In some cases, IBCs have had to wait for several weeks, beyond the normal verification period before an account is opened. Furthermore, U.S. correspondent banks' appetite to process transactions from the IBFS sector has waned. Some offshore banks have reported a sudden increase in anti-money-laundering and know– your–customer requests, and in many cases with short response deadlines. In some cases, correspondent banks have suspended, or closed the accounts of IBs when the responses to requests were slow, or inadequate. Besides termination of CBR relationships, IBFS entities have also experienced restriction on existing relationships in some cases. Wire transfers, sometimes, take several days because of need to verify the customers' information.

22. Banks that lost CBRs and IBCs that had their accounts terminated have sought alternative arrangements in other jurisdictions. Some domestic financial institutions and IBFS have found replacement CBRs, although with second and third tier correspondent banks in the US and Europe. Some others have yet to established alternative arrangements.

F. Conclusions and Policy Recommendations

23. The IBFS sector in Barbados is economically significant. It is an important source of foreign exchange, employment and tax revenue. For instance, it has an estimated total expenditure of around 8 percent of GDP, direct jobs created by the sector amounts to around 3 percent of the labor force in 2016, and it contributes around 3 percent of total tax revenues.

24. Its contribution to the local economy has been relatively stable in recent years but data is inadequate for a thorough assessment. The sector has slowly recovered from the adverse impact of the global financial crisis and changes in Canadian tax legislation. Available data suggest that recent changes in the UK tax law led to a modest recovery in the number of registered entities in 2016. While overall expenditures by the sector have remained steady, the decline in tax revenues as a result of tax competition in the region and changes in double taxation agreements (DTAs) and bilateral tax treaties (BITs, especially with Canada) has had serious repercussions on the fiscal accounts, which the government is still grappling with.

25. While the impact of the loss of CBR to date appears to have been modest, it could dampen the sector's expansion prospects. The risk of withdrawal of CBRs has been linked to the termination of a number of IBFS clients bank accounts. However, expenditure of the IBFS sector has remained stable suggesting that the risk of withdrawal of CBRs has not been significant such that it has led to a decline in the sector. Notwithstanding, actors in the IBFS are concerned that risks associated with CBR will dampen growth prospects.[12] The few institutions affected managed to switch to other correspondent banks.

26. The sector would benefit from a comprehensive developmental strategy. This would be focused on:

- **Improving the ease of doing business**. This is critical for the sector to grow as it is for the rest of the economy. The authorities should focus efforts to improve the country's ranking in the World Bank's "Ease of Doing Business" index, especially given that the international business sector is losing some of its competitiveness due to new and expanding tax transparency laws and regulations in North America and Europe (IBRD 2017). Barbados could also learn from country experiences and implement international best practice in incorporation of companies, enacting legislations, issuing of licenses, construction and work permits, and tax clearance certificates. Improvement in the efficiency of public service delivery is also important.

- **Competing on costs of skilled labor rather than taxes while reducing risks**. Higher value business process outsourcing is a potential source of growth for Barbados. Companies domiciled in other OFCs with high labor costs (such as Bermuda, for instance) can outsource services to the Barbados taking advantage of its skilled labor force. Services that can be provided include financial accounting and treasury and legal services, for instance. Other OFCs in this region cannot compete on labor costs as most employees with their sectors are relatively higher cost expatriate workers. In Barbados, about 90 percent of the employees in the sector are local. Oversight and local regulations would need to be revamped to strengthen data security/protection, process discipline, and providing sufficient transparency and accountability during audits from home jurisdictions.

- **Expanding the network and scope of DTAs and BITs** and continuously adapting them to new circumstances that are primarily outside the control of the Barbadian authorities.

27. The sector would benefit from enhanced monitoring, transparency, and a structured communication strategy. The objective of this would be to improve data collection and its analysis as a way to strengthen public recognition of the role of the IBFS role, reduce the risk of inconsistencies in policy implementation, and possibly attract new firms. Such a communication strategy would include both enhanced channels and enhanced content:

[12] The risk of withdrawal of CBRs has also not affected remittances (see annex).

- **Enhanced channels**. These would include: (i) an annual report by the CBB on the evolving contribution of the IBFS sector to the local economy (see next bullet on recommended content), (ii) enhanced CBB website for press releases, policy decisions, and as a historical repository of all documents needed to assess the performance of the IBFS sector; and (iii) periodic reporting to relevant stakeholders.

- **Enhanced content**. This would include: (i) enhanced information on the contribution of the IBFS sector to the local economy in terms of employment, knowledge transfer, private and public consumption and investment, net generation of FX reserves, among others; (ii) information on regulatory and supervisory standards followed by the relevant authorities with particular emphasis on progress toward adherence to international standards, including on AML/CFT, and on maintaining strong fit and proper tests for licensing and renewal of license; (iii) articulation of a developmental strategy aimed at increasing net FX generation capacity and backward linkages with the rest of the economy; and (iv) information on the conduct of the relevant supervisory authorities describing their performance in pursuing the objectives of the aforementioned developmental strategy also published in the CBB annual report and summarized as needed on its website.

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Annex I. Recent Global Trends in Correspondent Bank Relationships

1. **Correspondent bank relationships (CBR) supports international trade**. CBR arrangements involve bilateral cross border arrangements between banks, typically through the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network, for the exchange of messages that could be associated with payments, trade finance, FX, and securities transactions. By linking a country's payment system to the rest of the world, CBR enables international trade and BoP flows.

2. **Since the global financial crisis, global banks have selectively withdrawn from CBR with direct impact on only a limited number of countries**. During 2012-15, CBR withdrawal varied significantly across countries. While no clear trend has been detected (CPMI 2016), the number of active correspondent banks, as well as the value of transactions decreased over the same period while the volume of transactions increased. (IMF 2016a). Between 2015-16, IMF staff reports found this issue macro-critical in the Caribbean, small islands of the Pacific, the MENA region, Central Asia and Africa.

Table 1. The Withdrawal of CBRs

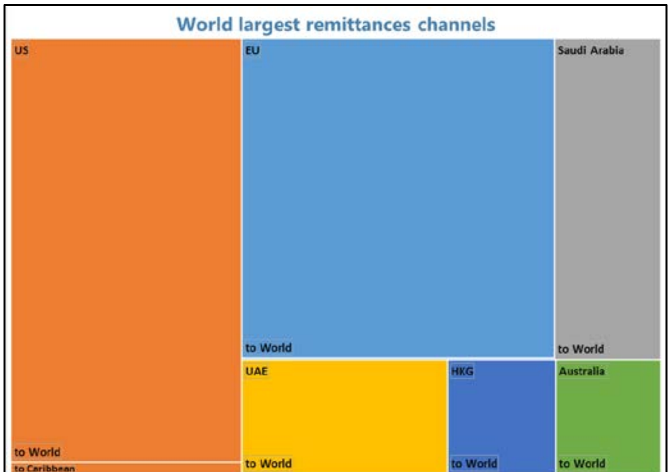
The Impact of the Withdrawal of CBRs	
No significabt impact/moderate impact	The Bahamas, Barbados, Costa Rica, Grenada, Guatemala, St. Lucia, Tonga, E; Savador, Guyana, Jamaica, Panama, Saudi Arabia, Solomon Islands, Sri Lanka, and St. Vincent and the Grenadines
Adverse Impact	Belize, Liberia, and Sudan.
The Quantification of the Loss of Business in Respondent Banks	
The Bahamas	Six institutions, representing about 19 percent of domestic banking system assets, have recently lost CBRs.
Belize	Only 2 of the 10 domestic and international banks have CBRs with full banking services. The Central Bank of Belize lost three CBRs.
Liberia	All commercial banks have lost at least one CBR in the last 3 years, with the most affected losing about 78 percent of their CBR accounts.
Panama	The total number of CBRs remained stable at 463–464 between March 2015 and End-February 2016 (62 relationships were lost, but Panamanian banks managed to establish 63 new relationships).
Sudan	Sudan lost almost half of its CBRs between 2012 and 2015.

Source: IMF (2017).

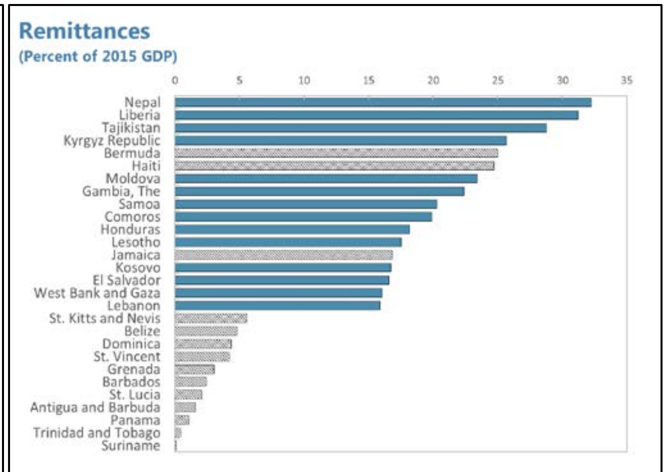
3. **CBR withdrawal could affect domestic economies through multiple macro financial channels**. Pressures on CBRs could disrupt financial services and cross-border flows, including trade finance and remittances, thereby potentially undermining financial stability, inclusion, growth, and development goals. Moreover, loss of CBRs could have an impact on the availability of banks' funding from foreign sources and their ability to provide foreign currency loans for trade finance and/or service their foreign currency denominated debt, compounding existing bank vulnerabilities. In extreme cases, the loss of CBR by a central bank would compromise its capacity to manage foreign reserves.

4. **CBR withdrawal has the potential of disrupting remittances flows**. In 2015, estimated remittances amounted to US$580 billion and concentrated in few important corridors such as US, Euro

Area, Saudi Arabia, UAE, Hong Kong and Australia (text figure). However, only 1 percent of world remittances reach the Caribbean, mainly from the US, Euro Area, and Canada. While, amounts are small they represent a large share of GDP in select countries. Notably, for Jamaica, Haiti and Bermuda remittances are more than 15 percent of respective GDP while for the ECCU countries and other jurisdictions around the Gulf of Mexico, remittances represent between 0 and 5 percent of respective GDP (text figure). In the case of Barbados, the risk of withdrawal of CBRs has not been associated with changes in remittances, which have remained practically constant in recent years at around 2.5 percent of GDP (see text chart).



Sources: WB Remittances database and IMF Staff calculations.



Sources: WB Remittances database and IMF Staff calculations.