

Working Together

Improving Regulatory Cooperation and Information Exchange

MONETARY AND FINANCIAL SYSTEMS DEPARTMENT

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and Information Exchange

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Contents

Foreword	ix
Contributors	xi
Preface	xiii
Introduction: Key Issues in Removing the Barriers to Cooperation <i>Richard Pratt</i>	xvii
Part I. Papers from Cross-Border Cooperation and Information Exchange Conference, IMF, July 2004	
Mutual Legal Assistance and Financial Intelligence Units	
1. Use of Information Exchange in Criminal Matters to Combating Money Laundering and Financing of Terrorism <i>Jean-François Thony</i>	5
2. International Cooperation Standards and Practices in Combating Money Laundering and Countering Terrorist Financing <i>William C. Murden</i>	15
3. Egmont Standards and Practices for Defense Against Money Laundering and Countering of Financing of Terrorism <i>Shoba Kammula</i>	22
4. International Cooperation to Combat Money Laundering and the Financing of Terrorism: Legal Position and Practice in the Principality of Liechtenstein <i>Dunja Suessli</i>	26

CONTENTS

5. Cooperation Standards and Practices in Defense Against Money Laundering and in Countering Terrorist Financing <i>Muhammad Baasiri</i>	30
6. Cooperation and Exchange of Information on Supervision of Institutions in Relation to Prevention of Money Laundering and Terrorist Financing <i>Alvaro Pinilla Rodríguez</i>	40
Insurance and Banking Supervision	
7. Cooperation in the Insurance Sector <i>Peter Neville</i>	53
8. Cooperation in the Banking Sector <i>Y. K. Choi</i>	59
9. Supervising International Banks: Swiss Regulatory Practice <i>Eva Hüpkes</i>	64
10. Cooperation Between Banking Supervisors: The Perspective of The Bahamas <i>Rochelle A. Deleveaux</i>	74
11. Negotiating Cooperation Agreements: The Experience of the Australian Prudential Regulation Authority (APRA) <i>Chris Gaskell</i>	84
12. Negotiating Cooperation Agreements: The Experience of the Bank of Italy <i>Giuseppe Godano</i>	94
Securities Regulation	
13. Cooperation in the Securities Sector <i>Ethiopia Tafara</i>	101
14. International Cooperation in the Securities Sector: The Legal Position and Practice in Bermuda <i>Cheryl-Ann Lister</i>	107
IOFC Unified Regulation	
15. International Cooperation: The Legal Position and Practice in the British Virgin Islands <i>Jacqueline Wilson</i>	117

16. Regulatory Cooperation Standards and Practices in the Samoa Offshore Financial Center <i>Erna Va'ai</i>	124
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Part II. International Standards and Practices

17. Cross-Border Cooperation and Information Exchange: Overcoming the Barriers to Regulatory Cooperation <i>Richard Pratt and Henry N. Schiffman</i>	133
18. Results of a Survey on Cross-Border Cooperation and Information Exchange Among Financial Sector Agencies, 2004 <i>Oana M. Nedelescu and Mary G. Zephirin</i>	220

Appendix

Aide-Mémoire of the Conference	279
--------------------------------------	-----

References	281
-------------------------	-----

Box

18.1 Protecting Confidentiality: International Standards	242
--	-----

Text Tables

18.1 Responses Received, by Type of Supervisor and Jurisdiction (Question 1)	224
18.2 Participating Jurisdictions, by Economic Category (Question 1) ...	224
18.3 Volume of Requests for Assistance Made or Received, by Type of Jurisdiction or Agency	235
18.4 Quality of Responses to Requests for Assistance Made and Received (Questions 6 and 13)	238
18.5 Challenges or Impediments in Obtaining Information (Question 10)	249
18.6 Challenges or Impediments in Providing Information (Question 17)	250
18.7 Alternative Sources of Information (Question 9)	253

Appendix Tables

A.18.1 Mechanisms Used for Information Exchange, by Usefulness (Questions 2 and 3)	258
---	-----

CONTENTS

A.18.2a	Information Requested from Foreign Regulators and Agencies, by Purpose (Question 4)	259
A.18.2b	Information Provided to Foreign Regulators and Agencies, by Purpose (Question 11)	260
A.18.3a	Information Requested from Domestic Regulators and Agencies, by Purpose (Question 4)	261
A.18.3b	Information Provided to Domestic Regulators and Agencies, by Purpose (Question 11)	262
A.18.4	Importance of Diagonal Requests	263
A.18.5	Timeliness for Addressing Requests for Information (Questions 7 and 14)	264
A.18.6a	Main Reasons for Refusal Given to Requesting Jurisdictions (Question 8)	266
A.18.6b	Main Reasons for Refusal when Information Requested from Supervisors Is Not Provided (Question 15)	266
A.18.6c	Total Number of Respondents to Questions 8 and 15, by Category: International Exchange	267
A.18.7a	Main Reasons for Refusal Given to Requesting Jurisdictions (Question 8)	267
A.18.7b	Main Reasons for Refusal When Information Requested from Regulators and Agencies Is Not Provided (Question 15)	268
A.18.7c	Total Number of Respondents to Questions 8 and 15, by Category: Domestic Exchange	268
A.18.8a	Main Reasons for Refusal Given to Requesting Jurisdictions (Question 8)	269
A.18.8b	Main Reasons for Refusal When Information Requested from Regulators and Agencies Is Not Provided (Question 15)	270

Figures

4.1	Mutual Legal Assistance Requests to Liechtenstein, 2001–2003 . .	29
18.1	Domestic Mechanisms for Information Exchange, Ranked by Usefulness (Question 2)	228
18.2	International Mechanisms for Information Exchange, Ranked by Usefulness (Question 3)	229

18.3 Information Requested from Foreign Regulatory Authorities, by Purpose (Question 4).....	231
18.4 Information Provided to Foreign Regulatory Authorities, by Purpose (Question 11).....	233
18.5 Main Reasons for Refusal When Information Requested Was Not Provided (Questions 8 and 15).....	244
18.6 Main Reasons for Refusal, by Purpose of Information, When Requests Were Denied (Questions 8 and 15).....	248

The following conventions are used in this publication:

- In tables, a blank cell indicates “not applicable,” ellipsis points (...) indicate “not available,” and 0 or 0.0 indicates “zero” or “negligible.” Minor discrepancies between sums of constituent figures and totals are due to rounding.
- An en dash (–) between years or months (for example, 1998–99 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 1998/99) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY2006).
- “Billion” means a thousand million; “trillion” means a thousand billion.
- “Basis points” refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).

As used in this publication, the term “country” does not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.



Foreword

The financial sector standard setters have issued guidance on the cooperation and information exchange required between supervisors in their various sectors, and this guidance has been updated and broadened. Nevertheless, in its work in assessing financial centers, the IMF has become aware that problems in cooperation and information exchange continue to constrain cross-border supervision.

The IMF has been working indirectly to improve regulatory cooperation through a variety of instruments, including its technical assistance on financial supervision and assessments of compliance with international standards. Its near-universal membership helps it to play a significant role in bringing regulators together for discussion and interaction.

In July 2004, the IMF organized a conference on cross-border cooperation and information exchange bringing together representatives of the standard setters—the Basel Committee on Banking Supervision, the Financial Action Task Force (FATF), the International Association of Insurance Supervisors (IAIS), the International Organization of Securities Commissions (IOSCO)—as well as other organizations—the Egmont Group of financial intelligence units and the Financial Stability Forum (FSF)—and a cross-section of regulators, supervisors, and law-enforcement representatives from a range of jurisdictions. The conference aimed to identify arrangements that could facilitate improved international cooperation and information exchange for both prudential purposes and the prevention of financial abuse.

The conference resulted in an aide-mémoire that underlined the critical importance of effective cooperation and information exchange in view of the

FOREWORD

increasing integration and internationalization of financial markets and services. It noted that while the challenges for cooperation differ among sectors, the differences are narrowing; and it discussed a variety of instruments providing effective channels for information exchange.

The IMF's Monetary and Financial Systems Department has brought together some of the contributions from the conference into this book. Its aim is to promote continuing discussions on ways to overcome the identified constraints on cooperation and information exchange. I hope that this collection of articles will help to document both challenges and successes and to encourage further action to improve cooperation and information exchange.

Stefan Ingves

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Preface

R. BARRY JOHNSTON*

The Conference on Cross-Border Cooperation and Information Exchange was held at IMF Headquarters on July 7–8, 2004 to facilitate developing the close cooperation and information-sharing arrangements required for well-functioning international financial services. The growing integration of world markets has deepened the international operations of financial firms. As a result, there is growing cross-border interdependency of financial institutions; and this requires enhanced information flows to enable financial institutions and national authorities to monitor prudential risk. Financial internationalization also expands the reach of those using the system for criminal purposes. From these perspectives, communications among financial regulators and agencies, both domestically and across borders, have become essential in the maintenance of financial market stability and integrity.

Since the *raison d'être* of international and offshore financial centers is cross-border financial transactions, cross-border information sharing is of particular importance for these jurisdictions. International financial centers have been successful in developing innovative financial instruments that may challenge supervisors' current knowledge and oversight. Effective dissemination of information on these instruments or institutions is an important contribution to the network of financial oversight.

A quick look at the websites of the standard setters would suggest that both supervisors and nonsupervisors know how and about what they need to cooperate and exchange information. When the IMF organized a roundtable

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on issues facing the offshore financial centers in May 2003, however, one of the main conclusions reached was that although each of the standard setters provides extensive guidance, and cooperation and information exchange have considerably improved in recent years, several issues remain to be addressed: (1) finding ways to share information while protecting legitimate rights to privacy and taking account of supervisors' confidentiality obligations; (2) sharing information among supervisors of different sectors (e.g., between banking and securities regulators); (3) sharing information for regulatory, compliance, and law-enforcement purposes; (4) solving the complexity of multiple gateways for information exchange; and (5) addressing possible differences in the treatment of information exchange among the standards.

Furthermore, our assessments under the Financial Sector Assessment Program (FSAP) and Offshore Financial Center (OFC) programs, which utilize the Basel Committee, International Association of Insurance Supervisors (IAIS), International Organization of Securities Commissions (IOSCO), and Financial Action Task Force (FATF) standards as sectoral yardsticks, illustrate the areas that international financial centers need to address with regard to meeting international standards and the practical implementation of the requirements. Capacity constraints among low-income countries, limitations on the powers of some supervisory authorities, and secrecy and confidentiality requirements continue to inhibit effective information exchange in some jurisdictions.

The 2004 conference was organized with the following objectives:

- to exchange information on what standard setters, and national and international agencies are doing to strengthen information exchange and cooperation;
- to identify the impediments to effective information exchange and cooperation, and to learn about the effectiveness of the different approaches to addressing these impediments;
- to hear views about the priorities for action (Given the scarcity of supervisory resources available worldwide, which areas are judged to warrant greater attention than others?);
- to hear views about the additional steps different agencies and the IMF can and should take to strengthen cooperation and information exchange; and
- to develop a road map and work program to strengthen cooperation and improve international information sharing.

In fact, the conference facilitated a rich exchange of views and was sufficiently successful in meeting these objectives to encourage us to bring together several of the contributions in this publication so that we could make them available to a wider audience.

To do so, we asked Richard Pratt to edit the written contributions that we solicited from participants. These are presented in Part I, preceded by an introductory chapter. Richard Pratt and Henry Schiffman, both experienced in the supervisory arena and in cross-border work, expanded their conference presentation on the instruments of information exchange, the approaches used in the different standards, and the barriers and gateways to information exchange to form Part II of this publication. Part II also presents the final results of the survey we conducted of financial regulatory agencies and financial intelligence units.

In the opening session of the conference, I mentioned a few issues that continue to be discussed in the following articles and warrant further consideration.

First, several presentations highlighted the need for memoranda of understanding (MoUs) on sharing information, and IMF assessments have often advised that jurisdictions should prepare MoUs. The conference also heard a number of contrary views on the benefits of MoUs, however. At the same time, it was pointed out that the due-diligence process that accompanies the negotiation of an MoU is often as important as the MoU itself, in that the former allows the negotiators to learn about each other and how they can exchange information effectively. MoUs can be expensive to negotiate; and smaller, developing members have limited capacity to build the necessary relations to negotiate formal agreements.

Second, exchanging information between supervisors covering different sectors (e.g., banking and securities) and between supervisory and financial intelligence units (FIUs) is still cited as a constraint. Working, as we do, on both prudential supervisory areas and anti-money laundering and combating the financing of terrorism (AML/CFT), we are aware of the challenges supervisors have in cooperating and exchanging information outside their areas. The conference provided some useful practical suggestions on how to handle these constraints.

Third, the results of our assessments against the relevant codes and standards show that there are differences between sectors in their degree of compliance with the relevant criteria for cooperation and information exchange. The banking sector is most advanced in information sharing; insurance does well if supervision is in place; but securities and AML/CFT require a lot of work.

The lattermost finding seems to be related in part to the type of information that these sectors most need to share—concerning clients and information needed for court actions—rather than financial supervisory information. Conferees suggested that expanded AML/CFT supervision may be narrowing the differences between the sectors.

Fourth, the workshop identified areas where there is a need for improved, secure gateways for information exchange. Examples included the presence of confidentiality agreements and bank secrecy, or conditions on the use of information passed on to a foreign supervisor. While our assessments show that the number of jurisdictions with strong secrecy laws is decreasing, there remain other constraints on information exchange. For example, many jurisdictions are required to consider individual privacy and the public interest in the sharing of information.

Fifth, surprisingly mundane constraints on information exchange were mentioned during the workshop. For example, supervisors may not know whom to contact to obtain information; and by the time the required individual is identified, that information may be of little use. As a concrete result of the workshop, an increased number of standard setters are posting information on supervisory contacts and looking into cross-sectoral issues to improve information exchange.

In summary, the conference proved to be the venue of a strong cross-fertilization process for the establishment of communication channels among the supervisors and FIUs to improve cross-border and cross-sectoral cooperation and information exchange. The aide-mémoire of the conference provided a road map to take the work forward. We hope that the chapters in this book will stimulate improved communication in a wider group.



Introduction: Key Issues in Removing the Barriers to Cooperation

RICHARD PRATT

1. Introduction

- 1.1. The purpose of this book is to contribute to the enhancement of international cooperation for financial sector regulation and supervision. It seeks to identify the main barriers to effective and timely cooperation and to suggest ways of removing them.
- 1.2. The book has two parts. Part I consists of a series of chapters written by representatives of international standard-setting bodies, regulatory authorities,¹ and financial intelligence units (FIUs). The chapters are based on presentations given to an International Monetary Fund (IMF) conference on cross-border cooperation and information exchange held in Washington in July 2004. Part II consists of two chapters: one reports on research into international standards and practices in respect of international cooperation, and the other reports on a survey of regu-

¹The term “regulator” has tended to be used for securities authorities and those combined authorities responsible for all financial services sectors, whereas the term “supervisor” has been used for banking and insurance authorities. Supervision has traditionally meant a focus on monitoring the overall (usually financial) performance of a financial institution, whereas regulation has involved setting standards governing the conduct of business and relationships with customers. This distinction is becoming less relevant, since all regulators and supervisors both set standards and monitor performance. In this chapter, the term “regulation” is used to denote both regulation and supervision. The term “supervisor” is retained for banking and insurance authorities. “Supervision” is used (for any authority) where this refers to the ongoing monitoring of a financial institution’s compliance with the law and regulation.

latory authorities and FIUs seeking information on their practical experience of cooperation.

- 1.3. The book includes commentary and analysis that is the result of a wealth of different experiences by a wide variety of regulators, law-enforcement experts, and policy advisors. It demonstrates substantial common ground between the various contributors. It also demonstrates some variations in approach and practice that may create barriers to effective and timely cooperation. The analysis of these differences leads to some suggestions for future action to enhance cooperation between regulatory authorities and FIUs.

2. Support for International Cooperation

- 2.1. Each part of the book demonstrates that all regulatory authorities attach importance to effective and timely international regulatory cooperation. The contributors, the survey, and the review of standards and practices make it clear that regulatory authorities understand the need for better international and domestic cooperation.
- 2.2. Contributors also agree on the importance of the right attitude among officials of the regulatory authorities and FIUs. Commitment to the process of cooperation is important (Baasiri). Time spent building relationships pays off (Wilson, Va'ai). Officials who know and trust each other can find ways of cooperating and exchanging information within the law. Informal contacts (within the law) are frequently cited by contributors as more effective and faster than formal requests (Neville, Gaskell).
- 2.3. The survey of regulatory authorities, described in the second half of the book, also shows that the system is working reasonably well. The overall results of the survey suggest that most regulators have a high degree of satisfaction with the assistance received through international cooperation and that, in most cases, assistance is provided within a month of a request being made. The survey also suggests, however, that the differences of approach among jurisdictions discussed later on are an important source of information exchange failure.

3. Barriers to Cooperation

Confidentiality Provisions and Legal Gateways

- 3.1. Notwithstanding the degree of satisfaction with the process at present, there is clearly scope for improving the effectiveness of cooperation and information exchange. Not all regulatory authorities are equally satis-

fied with the assistance they receive from other authorities. Moreover, there are important differences in approach between regulatory authorities, as revealed by the chapters in Part I and further demonstrated in the review of standards and practices (particularly Section 5 and Appendix C of Chapter 17 by Pratt and Schiffman) and the survey report (Chapter 18) in Part II.

- 3.2. On the one hand, the survey results show that 44 percent of requesting authorities² indicated that the main impediments to the satisfactory exchange of information were secrecy laws or confidentiality provisions in the requested authority. On the other hand, for some authorities—the International and Offshore Financial Centers (IOFCs)—the main reason for refusing assistance (cited by 37 percent of such centers) was the incapacity of the requesting authority to provide the necessary confidentiality undertakings. This result is illuminating, in that it demonstrates that what appears to one authority to be an unreasonable secrecy or blocking provision may appear to another to be a necessary confidentiality protection.
- 3.3. In fact, few would question that there are sound reasons for confidentiality of personal or business financial affairs (Va'ai). There will not be a regulatory authority in any jurisdiction that is not bound by secrecy or confidentiality restrictions of some kind (since such restrictions are required by international standards). Equally, there will be hardly any regulatory authorities whose confidentiality restrictions are not subject to some exemptions (or gateways)—again, as required by international standards. The real problem experienced by the 44 percent who referred to excessive secrecy provisions, therefore, is not whether a secrecy law exists but whether the gateways allow cooperation to be given or information to be exchanged.
- 3.4. The limitations placed by many regulatory authorities on the use of gateways tend to be concerned with the following:
 - 3.4.1. the nature of the information that can pass through them (and in particular, whether it includes information on customers and the beneficial owners of accounts, companies, and trusts);³

²Throughout this chapter, the term “requesting authority” is used to denote the authority seeking assistance and receiving information; “requested authority” is the authority whose assistance is sought and which is transmitting information.

³In the case of trusts, the reference should be to the beneficiary rather than the beneficial owner.

- 3.4.2. the protection given by the requesting authority to confidential information, once it has been received (and in particular, whether the requesting authority is expected to seek permission from the requested authority before passing information to a third party);
 - 3.4.3. the purposes for which the information is to be used;
 - 3.4.4. whether or not the requesting authority would be able to provide similar assistance (reciprocity);
 - 3.4.5. where the information relates to a breach of law or regulation, the nature of the offense that has been committed and whether the offense has a close parallel in the requested jurisdiction; and
 - 3.4.6. the nature of the authority requesting the information (and in particular, whether it is an authority exercising functions similar to those of the authority from whom assistance is sought).
- 3.5. Clearly, in the past (and, in some cases, at present), there have been jurisdictions that have seen it as being in their economic interests to frame the law so as to shield their financial businesses and customers from legitimate enquiry. The kinds of factors listed previously may have been used as devices to find respectable reasons for refusing requests. International pressure has substantially reduced the number of such jurisdictions.
- 3.6. Even if there were no such jurisdictions, however, virtually all regulatory authorities and FIUs would continue to impose some limitations of the kind described in paragraph 3.4.

Nature of Information and Purpose for Which It Is Sought

- 3.7. Confidential information is sought primarily about regulated financial services institutions (banks, insurance companies, and securities businesses), on the one hand, and the customers of such institutions, on the other hand. Information is sought to assist in licensing and supervision of financial institutions and for the enforcement of financial services laws, where offenses have been detected—including insider dealing, market manipulation, financial fraud, other frauds, and others. It is a reasonable generalization (although not necessarily true in every case) to note that banking and insurance supervisors tend to seek information for licensing and supervision purposes and are more likely to seek information about regulated institutions. In contrast, securities regulators and FIUs are much more likely to seek information related to enforcement action and are also more likely than banking or insur-

ance supervisors to seek information about the customers of financial institutions.

- 3.8. The survey results show that all banking supervisors request information related to supervision matters, about 80 percent to licensing, and only 47 percent to enforcement. For securities regulators, 83 percent of agencies made requests related to enforcement, 67 percent to licensing, and only 42 percent to supervision. Similar results apply to agencies receiving requests. According to the survey, securities regulators and FIUs (who engage in a higher proportion of enforcement cases) are less satisfied (77 percent) with the process of cooperation than banking and insurance supervisors (90 percent).
- 3.9. It is worth noting that this distinction between the focus (in the context of information exchange) of banking and insurance supervisors, on the one hand, and securities regulators (and FIUs), on the other hand, is becoming less marked. Increasingly, banking and insurance supervisors consider that legal and reputational risks, as well as responsibilities to combat money laundering and terrorist financing, demand that they share information about customers of financial institutions with other regulatory and law-enforcement authorities (Neville).
- 3.10. Nevertheless, there is an important distinction between the issues that arise when information about regulated businesses is exchanged for purposes of supervision and licensing, and where information about customers is exchanged for enforcement purposes (Lister). It is worth noting that information about regulated businesses will frequently already be in the hands of the requested authority, whereas information about customers frequently has to be obtained using investigative powers. As a generalization, it is reasonable to say that information about regulated institutions that is in the hands of the requested authority can be exchanged more readily and with fewer difficulties than information about customers that has to be obtained using investigative (often compulsory) powers (Lister).

Information About Regulated Businesses

- 3.11. The survey confirms that most information relating to supervision and licensing matters concerns regulated businesses rather than their customers. Where information on these matters is passed between regulatory authorities, the following issues arise.
 - 3.11.1. If a supervisor (usually a banking or insurance supervisor) is concerned about the financial stability of a financial institution,

any disclosure of that concern could precipitate the very failure that the supervisor feared (Gaskell). It is therefore essential to ensure that the relevant information is restricted to supervisors with a key interest.

- 3.11.2. There is a danger that a supervisor in one country receiving the news that another supervisor is concerned about the stability of a financial institution may take action that, although protecting the customers in its own jurisdiction, may not be in the interests of the customers in the jurisdiction of the supervisor releasing the information or more generally (Choi).
- 3.11.3. Where a multinational financial services institution has branches or subsidiaries in many different countries, the relative responsibilities of home and host supervisors are asymmetric (Godano). The home supervisor, responsible for consolidated supervision, needs as much information as possible about the worldwide activities of the business. It must be able to conduct wide-ranging on-site visits in every part of the business. In contrast, although the host supervisors have a legitimate interest in the financial soundness of the parent (Deleveaux), it is impractical for all of them to have rights to conduct visits to the parent.
- 3.11.4. Moreover, the asymmetry could also apply to the importance of the information to the supervisor. On the one hand, in some countries, a large proportion of the banking system is effectively controlled by foreign banks, and their activity in the jurisdiction is critical to the jurisdiction's financial and economic well-being. On the other hand, business in that jurisdiction accounts for only a small proportion of those foreign banks' activities. There exists an asymmetry between the high importance of the business in the jurisdiction to the host supervisor and the relatively low importance of the business in that jurisdiction to the foreign banks and their consolidated supervisors.⁴
- 3.12. These are important issues. Nevertheless, there is much evidence that these issues can be resolved by discussion between supervisory authorities, provided that requested authorities develop trust in the requesting authorities. This may explain the high degree of satisfaction with information exchange referred to in paragraph 2.3.

⁴This point was emphasized by participants at the IMF conference in July 2004.

Information About Customers for Licensing and Supervision

- 3.13. The survey shows that information about the customers of financial institutions is required by regulatory authorities for licensing (by 8 percent of agencies), supervision (18 percent), and enforcement (36 percent) purposes. In the case of licensing and supervision, the information about customers is probably required to determine the extent and nature of the exposure of a financial institution to individual major customers. For enforcement, the information may be required to investigate offenses.
- 3.14. The exchange of information about customers to determine the exposure of a financial institution to important customers (for licensing and supervision purposes) raises different issues from those raised when information is required for an investigation into alleged improper action by the customer (unless it becomes clear that the customer has been deliberately concealing his/her/its identity to disguise the fact that what appear to be a series of smaller, unrelated exposures should, in fact, be regarded as a single large one).
- 3.15. Although this book is mostly concerned with information exchanged between regulatory authorities, it is also important that there be proper information flows within a multinational financial institution, so that it can manage its risks. Those risks will include large hidden exposures to a single customer. They will also include reputational risks arising from relationships with certain kinds of customers, such as politically exposed persons. It is essential that a multinational financial institution be allowed to transmit information between branches and subsidiaries in different jurisdictions and its head office so that it can adequately manage these risks (Hüpkes). It is important to ensure that this does not conflict with domestic laws in host countries that restrict the flow of information on customers in order to protect the confidentiality of customer information (Deleveaux).
- 3.16. In either case—information exchanged within a multinational financial institution or information exchanged between regulatory authorities—where the information concerns customers for the purpose of managing a financial institution's risks, there would appear to be no threat arising to the civil rights of the customer. It is difficult to see why there should be any more constraints on the flow of such information than where the information is solely about regulated financial institutions. It is important that constraints on information flows that are designed to protect the rights of those under investigation do not inhibit the flow of information designed to enable proper risk management and its supervision.

Information About Customers for Enforcement

Due Process and Use of Compulsory Powers to Collect Information

- 3.17. The issues that arise where information is exchanged that may lead to judicial action against individuals or customers of financial institutions are described by Thony in Chapter 1. In respect of information that can be used in court as evidence that may result in a criminal conviction, jurisdictions' laws seek to balance the need to provide information quickly, in a form that can be used in evidence, against the need to ensure that it is collected and distributed in a way that respects the demands of due process and does not infringe the legitimate rights or interests of the requested countries or of those who might be the subject of the information that is exchanged (Thony). Given the sensitivity of these issues, most jurisdictions' mutual legal assistance arrangements insist that the courts review individual cases to determine that civil rights are not infringed, and the government (executive branch) reviews the cases to ensure that sovereignty is not affected.
- 3.18. In most countries, the desire to protect the civil rights of a person under investigation has resulted in rules that constrain the investigation of offenses and the use of information acquired in such investigations. These rules sometimes apply differently to regulatory authorities than to law-enforcement authorities. The contributors to the book display a range of different approaches. These differences of approach often appear to cause the most significant barriers to information exchange. The survey shows that 47 percent of respondents identified difficulties in understanding the differences in legal and institutional frameworks across jurisdictions as impediments to information exchange.
- 3.19. In some jurisdictions, all regulatory authorities and law-enforcement agencies abide by the same due-process principles so that information is only ever collected in a way that protects the civil rights of those under investigation (including the bar on compulsory self incrimination, for example). According to this approach, once the information is collected, it can be exchanged between different authorities and used in whatever way is most efficient for civil and criminal enforcement (Tafara).
- 3.20. In other jurisdictions, although these constraints apply to law-enforcement agencies and perhaps to FIUs, certain regulatory authorities are given compulsory powers that allow them to insist on information being provided and that provide no rights to individuals to refuse to cooperate beyond the preservation of legal privilege. Where

this is the case, however, civil rights are protected by insisting that information collected using compulsory powers can be used only in certain ways. (For example, a statement given under compulsion cannot be used in court against the person giving the statement (Pratt and Schiffman).) Jurisdictions taking this latter approach often argue that their legislatures have given them exceptional information-gathering powers because of the wider public interest in ensuring stable and fair financial intermediaries and markets. They argue that it would be defeating the intentions of their legislatures to use compulsory powers to bypass the civil rights protections that apply in the context of the investigation of criminal offenses.

Approach of FIUs⁵

- 3.21. Some FIUs argue that information, however obtained, can be exchanged on any matter, provided that it is used only for intelligence purposes, remains under the control of the transmitting authority, and is never used in a court of law (Kammula). Assuming that such a proviso is accepted, then, according to this approach, there is no jeopardy to the civil rights of the subject of the information exchange.
- 3.22. The Egmont statement of best practice says that the transmitting authority should not unreasonably withhold permission for the use of information, unless giving permission for the use of such information would be clearly disproportionate to the legitimate interests of a natural or legal person or the state of the providing FIU, or would otherwise not be in accordance with fundamental principles of its national law. These are broadly the same considerations that underpin the need for formal mutual legal assistance (MLA) treaties (Thony), but the Egmont statement of best practice suggests that such decisions should be made not by a government or a court (as is normal in MLA cases) but rather by the officials of an FIU.
- 3.23. Other FIUs consider that information exchanged between FIUs can include documents and statements taken under oath. They also consider that the information exchanged should be available for passing to a prosecuting authority and could be the justification for the seizing and freezing of assets (Baasiri).

⁵See also the IMF/World Bank publication *FIUs: An Overview*, available on the Web at <http://www.imf.org/external/pubs/ft/fiu/fiu.pdf>.

Approach of Regulatory Authorities

- 3.24. Some regulatory authorities with compulsory information-gathering powers impose conditions on the use of the information collected. Some insist that information collected using regulatory powers cannot be used for prosecution (Lister). Others insist on written undertakings that information will not be disclosed to a third party without the prior written permission of the originating authority. Some of the regulators provide that such an undertaking should not apply where there is a legal or constitutional obligation to disclose (Gaskell, Hüpkes), but not all regulators have such an exemption. Those that do not argue that, in practice, in such circumstances, they would not unreasonably withhold their permission (Wilson, Deleveaux, Choi).
- 3.25. Even though requested authorities may, in practice, be prepared to give such consent on a case-by-case basis, the retention of a requirement to seek permission, even in the face of a legally enforceable demand, may mean that the requesting authority is unable to accept information that is subject to such a condition. For if the requested authority is unable to give a blanket authority to disclose information in the face of legally enforceable demands, it follows that there may be some circumstances in which it would not do so. The requested authority may not know what these circumstances might be. If permission were refused, the requesting authority would be forced to choose between breaking a domestic obligation and breaking their undertaking to the transmitting authority. Moreover, in some cases, a requirement for an undertaking not to pass information to another authority may frustrate the whole purpose of the request for information—for example, where a regulatory authority is responsible for investigating a market-related offense but would normally pass the case to another authority for prosecution according to the legal and constitutional requirements of that country. On balance, therefore, there is a strong case for discouraging the use of such undertakings, and many argue that their use is contrary to international standards.
- 3.26. Some regulatory authorities argue that there should be a clear distinction between civil and criminal issues. Where a criminal prosecution is in prospect, information should be supplied through the mutual legal assistance route. Even if information leading to the criminal investigation was originally supplied on a regulator-to-regulator basis, criminal prosecutions should not be based on information originally supplied for regulatory purposes. Using the regulatory cooperation route is not transparent and does not give the individual the opportunity to make

representations about whether or not information should be transmitted. There are no international standards as to whether, in these circumstances, the individual should be told, or whether there should be an anti-tipping-off provision (Lister). According to this view, if the mutual legal assistance route causes delays because its procedures are slow, then the answer should be to reform the mutual legal assistance procedures. Attempting to bypass them using regulatory cooperation will simply undermine confidence in regulator-to-regulator information exchange (Lister).

- 3.27. The conditions and restrictions previously described may be perceived by the originating authority to be necessary to protect the rights of their jurisdiction and those of the regulated businesses and customers. They may be perceived by the requesting authority as arbitrary barriers. Where regulatory authorities exchange information regularly and build up trust with each other, the issues can be resolved fairly readily. When information is sought from jurisdictions that have only recently opened gateways or are new to using compulsory information powers on behalf of other authorities, however, there is a higher degree of caution (Lister). This may increase the likelihood of information exchange being frustrated in practice.

Other Barriers to Cooperation

Case-by-Case Examinations of Regulators and Requests

- 3.28. Many regulatory authorities insist that they should judge, for every request, whether or not the requesting authority is genuinely a regulatory authority, whether the request itself falls within acceptable limits, whether the information supplied is relevant, whether there is a real investigation that justifies the request, and so on (Deleveaux, Lister). Despite such procedures, however, it is rare, in practice, for such a request to be refused as a result of these considerations (Lister).

Need for an Independent Interest in Subject Matter of a Request

- 3.29. Some regulatory authorities are content to provide assistance to any authority regardless of whether or not they have an independent interest in the matter under investigation and regardless of whether the facts of the case would constitute an offense in their own jurisdiction (Tafara). Others cannot use compulsory powers to obtain information where the use of such powers is solely in order to assist another authority (Gaskell).

Dual Criminality

3.30. Law-enforcement agencies are more likely to have dual criminality requirements—that is, they are unable to provide assistance for the investigation of an offense if the action under investigation would not constitute an offense if committed in their own country (Thony, Suessli). Dual criminality requirements are less likely, however, when the nature of the crime is broadly similar in the jurisdictions of requested and requesting authorities. The Financial Action Task Force (FATF) recommendations discourage dual criminality requirements from preventing information exchange in cases of suspected money laundering or terrorist financing. Similarly, dual criminality requirements are also discouraged in the case of regulatory offenses, even though many regulatory authorities are required, when considering a request from a foreign authority for assistance, to take account of whether an offense for which assistance is requested has no close parallel in the requested jurisdictions (Lister, Deleveaux, Wilson).

Diagonal Information Sharing

3.31. Whether or not a regulator can share information with an authority carrying out functions rather different from its own is a matter of concern to a number of authorities (Murden). Indeed, the difficulty of “diagonal cooperation” is a matter of concern to the international standard-setting bodies. The survey’s design does not allow any conclusions to be drawn about cooperation between different kinds of regulators, but it does show that, internationally, the extent of cross-border exchange of information between FIUs, on the one hand, and banking, insurance, or securities regulators, on the other hand, is very low at between 10 percent and 15 percent.

3.32. In addition to the problem of information exchange between different kinds of regulatory authorities and between regulatory authorities and FIUs, a further potential barrier can be created when different jurisdictions divide functions in different ways. For example, some jurisdictions give FIUs responsibility for assessing compliance by regulated businesses with anti-money laundering/combating the financing of terrorism (AML/CFT) requirements (customer due diligence, internal controls, staff training, account monitoring, and so forth) (Gaskell, Pinilla Rodríguez). There may be many advantages in this arrangement (Pinilla Rodríguez), but it does create a potential problem for regulated businesses by making them subject to different and conflicting requirements in respect of their priorities, their internal controls, and corporate

governance; and it risks wasting the regulator's superior knowledge of the business of the regulated institutions. Moreover, it is essential that FIUs with this responsibility be able to exchange information with regulatory authorities in other jurisdictions where foreign regulatory authorities have AML/CFT responsibility. As Pinilla Rodríguez emphasizes, it is essential that such potential barriers not be allowed to become real ones.

Reciprocity

- 3.33. The extent to which a regulator should insist that assistance be given only to an authority capable and willing to provide reciprocal assistance is discussed in the book (Tafara). Reciprocity is commonly taken into account by requested authorities. The survey suggests that no banking supervisor finds that reciprocity constitutes a barrier but that 38 percent of securities regulators state that they have to take such matters into account. It is rare, however, to find that this leads to a refusal to cooperate.

Availability of Information-Collecting Powers

- 3.34. Although not raised to any significant extent by contributors to the conference, the survey and the Pratt and Schiffman chapter suggest that the absence of powers to collect information is an important constraint. For example, 43 percent of unified regulators give limited powers to collect information as a reason for refusing requests for information, although the survey results suggested that some unfilled requests in this area may reflect misdirected queries.

Proactive Information Exchange

- 3.35. Another issue not raised by contributors but discussed by Pratt and Schiffman is the ability of a regulatory authority to provide assistance without being asked. This kind of assistance is clearly implicit in the structure of suspicious activity reports. It is also frequently given by regulators when they come across information that would be useful to foreign regulators. Some authorities cannot give assistance, however, unless they have received a written request, and this inhibits proactive information exchange.

4. Common Values

- 4.1. It is clear that regulatory authorities share a strong belief in the importance of international cooperation. It is clear from the contributions to this book that the barriers to cooperation that remain do not arise primarily

because of a lack of good will or intent but rather from genuinely different approaches to the issues that were raised at the July 2004 conference.

- 4.2. It is an irony, therefore, that the vast majority of requests for information are made and received by jurisdictions that share common values. They wish to detect and deter wrongdoing, and they wish to respect due process and the civil and commercial rights of businesses and their customers. Regarding civil rights and the demands of due process, whether the civil rights are expressed in the European Convention on Human Rights, the U.S. Constitution, or in other forms, the vast majority of regulators who seek and give information are in jurisdictions that are subject to broadly similar requirements. Moreover, where the information concerns a regulated business, both the requested authority and the authority receiving the information are committed to, and subject to, the same international standards of supervision—the Basel Committee on Banking Supervision (Basel), the International Organization of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS)—and therefore are likely to be subject to comparable confidentiality restrictions and using the information for broadly similar purposes. Equally, all FIUs that are members of the Egmont Group are committed to the same group principles.
- 4.3. In contrast, the legal, constitutional, and other institutional requirements that give effect to these high-level principles are often very different. The survey results and the individual contributions to the book show that different legal and institutional arrangements are among the most significant barriers to cooperation (Godano). Moreover, many countries frame their legislative requirements and, in particular, the tests that they insist be applied before information is exchanged in a way that requires the requested authority to make assessments of the precise legal arrangements of the requesting authority (either on a case-by-case basis or when concluding a memorandum of understanding (MoU)) and/or to impose conditions on the use of the information.
- 4.4. In some cases, the test that has to be applied is that the requesting authority has equivalent provisions to those of the requested authority (Lister, Gaskell). This can often involve a time-consuming analysis. Where legal and constitutional traditions are very different, such a test may result in the frustration of cooperation.
- 4.5. The contributors also agree on the importance of informal contact and the establishment of trust to facilitate information agreement. Trust can be built up through contact and communication. Conversely, inadequate

communication can undermine trust where direct action by a foreign regulator interferes with the relationship between a regulator and a regulated institution in its own jurisdiction (Wilson).

5. Removing the Barriers

- 5.1. The international standard-setting bodies have actively addressed these issues. First, by organizing conferences and forums for discussion of issues arising from international cooperation, they help to build up the trust that is essential for effective information exchange. For smaller jurisdictions with fewer resources available for travel, it may be helpful to include provision for travel to conferences as part of technical assistance packages.
- 5.2. Second, the standard-setting bodies in this context have clearly defined the legal and regulatory powers that regulatory authorities should have to collect and share information, and have established standards for the use and protection of confidential information.
- 5.3. Third, standard-setting bodies define and describe best practice in information exchange.
- 5.4. In addition, most of the standard-setting bodies recognize the value of MoUs and have drawn up model memoranda of understanding or defined the items that should be included within such agreements. The IAIS has prepared a model MoU, and the Basel Committee has issued a paper on the essential elements of cross-border cooperation. The survey results show that the majority of respondents found MoUs useful as a means of building trust and facilitating information exchange. Although the standard setters clearly indicate that the existence of an MoU should not be a prerequisite for information exchange, 40 percent of regulators in advanced economies responding to the survey cited the absence of an agreement as an important impediment (the second-highest one, below only secrecy laws).
- 5.5. IOSCO has gone one step further in agreeing the Multilateral Memorandum of Understanding (MMoU).⁶ This sets clear standards regarding the powers that should be available to the requested authority, the confidentiality of the information that is exchanged, and the use to which it may be put. All IOSCO members are invited to sign it.

⁶In their April 2005 Annual Conference, IOSCO decided that by January 1, 2010 all member regulators should have applied for and been accepted as signatories under Appendix A of the IOSCO MoU or have expressed (via Appendix B) a commitment to seek legal authority to enable them to become signatories/members.

Moreover, for all signatories, an independent verification team assesses whether potential signatories have the necessary legal powers.

- 5.6. The IOSCO MMoU was drafted on the basis of the existing objectives and principles of IOSCO, together with resolutions that the IOSCO President's Committee has adopted over a number of years. Some consider that the MMoU demands too much of signatories. The MMoU was drafted, however, on the basis of existing IOSCO policies that have already been endorsed by the entire membership. The MMoU is cited by some survey respondents as a useful model for other standard-setting bodies to follow.
- 5.7. The Egmont Group statement of best practice, principles, and model agreement may fulfill the same purpose, given that the group has devised a procedure for independently assessing the legal powers of new entrants (Kammula).
- 5.8. It may be helpful, therefore, to undertake a review of the way in which the IOSCO MMoU and Egmont statement are implemented in order to establish the lessons learned, with a view to considering whether other international standard-setting bodies should develop their detailed requirements in respect of information exchange along similar lines, including a process of independent assessment of adherence to these standards.
- 5.9. Standard-setting bodies might then consider encouraging regulatory authorities to rely upon independent assessments of compliance with international standards rather than making case-by-case assessments of requesting authorities and of the nature of an information request in every case.
- 5.10. Although it is conceivable that a regulatory authority could rely upon the assessment of an independent body to judge whether a counterparty had arrangements that met international standards, it is not reasonable to expect such an assessment to judge whether another regulatory authority had equivalent standards to its own. Given resource constraints, the independent body can assess only whether or not minimum standards are met. Where some jurisdictions exceed minimum standards (and most will do so in some respects), the use of the "equivalence" requirement is likely to result in repeated, time-consuming assessments of each jurisdiction's arrangement by every other counterparty to information exchange. These time-consuming assessments are especially burdensome on smaller jurisdictions that may not have the resources to conduct them.

- 5.11. Many of the barriers to cooperation are well known and have been the focus of developing international standards. The list of possible action points described in Chapter 17 by Pratt and Schiffman are reinforced by the discussions that took place at the conference and by means of the survey. Increasing mutual trust, developing awareness of international standards, encouraging transparency in compliance, and undertaking independent assessments of compliance with those standards continue to be sound and sensible ways of improving cooperation.

PART I

**PAPERS FROM CROSS-BORDER
COOPERATION AND
INFORMATION EXCHANGE
CONFERENCE, IMF,
JULY 2004**

**Mutual Legal Assistance
and Financial
Intelligence Units**

Use of Information Exchange in Criminal Matters to Combat Money Laundering and Financing of Terrorism

JEAN-FRANÇOIS THONY

1. Introduction

- 1.1. Countries recognize that strong regional and international cooperation on cross-border transactions, including the implementation of best practices concerning information sharing in criminal matters, are needed if they are to be successful in combating money laundering (ML) and the financing of terrorism (FT).
- 1.2. All international instruments on international cooperation in criminal matters include legal provisions to facilitate or organize information exchange among authorities in charge of investigations or prosecution. Experience has shown that sharing intelligence and evidence swiftly and smoothly is key to conducting successful investigations and also, and even more importantly, to preventing and detecting criminal schemes before they are carried out. The international norms and standards on information exchange in criminal matters usually address the issue by devising three different frameworks for information exchange: (1) informal communication channels, (2) the financial intelligence unit (FIU) channels, and (3) mutual legal assistance (MLA) mechanisms. The norms and standards are necessary to provide them with a legal basis, and to set up processes to speed up the exchange of information (direct transmissions, acceptable language, etc.).
- 1.3. Each approach has its own advantages, and it is up to each country to decide how to proceed on a case-by-case basis, depending on its own needs and objectives, and on the degree of rapidity and reliability required. The challenge is to get information quickly and, where necessary, to be able to use it in a court of law.

2. Sources of International Norms and Standards on Information Exchange in Criminal Matters

- 2.1. The main sources of international obligations and standards related to the information exchange in criminal matters are the United Nations (UN) Conventions, the UN Resolutions adopted by the Security Council, and the Financial Action Task Force (FATF) 40 Recommendations (combined with the 9 Special Recommendations) that contain provisions on information exchange in criminal matters concerning anti-money laundering and combating the financing of terrorism (AML/CFT). In 2001, the Egmont Group of financial intelligence units also developed its “Principles for Information Exchange Between Financial Intelligence Units for Money Laundering Cases.”¹
- 2.2. The sources of international law on information exchange in AML/CFT criminal matters are contained in a series of international conventions and resolutions. In addition to harmonizing legal frameworks, the substantive provisions of these conventions and resolutions aim at organizing exchange of information, mutual legal assistance procedures, and law-enforcement cooperation among member states. The main international instruments in this respect are
 - 1988 UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances: *Articles 7 and 9.1.*
 - 1990 Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds of Crime: *Articles 7–10, 23, and 24.*
 - 1999 UN Convention for the Suppression of the Financing of Terrorism: *Articles 12, 18.3, and 18.4.*
 - 2000 UN Convention Against Transnational Organized Crime: *Articles 7.1.b., 18, and 27.*
 - 2001 UN Security Council Resolution (UNSCR) 1373.
 - 2003 UN Convention against Corruption: *Articles 14, 46, 47, 48, and 58.*
 - FATF 40 Recommendations + 8 Special Recommendations: *Recommendations 34, 36, 37, 38, and 40. Special Recommendations I and V.*
- 2.3. UN/IMF/World Bank model legislation does not set a standard per se, but translates the existing norms and standards into legal provi-

¹Adopted in The Hague, June 13, 2001. See www.egmontgroup.org.

sions. The Model Legislation on Money Laundering and the Financing of Terrorism, civil law (“continental”) legal system² developed by the United Nations, the International Monetary Fund, and the World Bank is worth mentioning here, since it proposes a comprehensive set of provisions to not only implement but also complement the international instruments and provide a legal basis for organizing international cooperation and information exchange.

3. Information Exchange Channels

Informal Channels of Communication

- 3.1. Information exchange in criminal matters is usually sought, at the initial stage of investigation, by means of police-to-police contact, which is faster, cheaper, and more flexible than the formal route of mutual legal assistance. Such information exchange can be carried out through contacts developed and maintained within the framework of the International Criminal Police Organization (ICPO)/Interpol, the World Customs Organization (WCO), Europol, and other networks that have been established for this purpose, such as bilateral or multilateral task forces.
- 3.2. The term “informal” is used, since information is exchanged on an ad hoc basis, using individual (sometimes personal) contacts or nonbinding agreements, rather than through legal treaties or agreements. As a result, the information has no legal value and could not, for example, be used as evidence against someone. Nevertheless, any information exchange, including informal exchanges, must be conducted within the law. In particular, the information exchange must be consistent with privacy, confidentiality, or secrecy laws, or laws prohibiting the transmission of sensitive information to foreign authorities.
- 3.3. These informal means of information exchange are used to share intelligence and information obtained voluntarily³ (such as statements of witnesses) or public records or other information or data from publicly available sources.
- 3.4. In addition to spontaneous contacts, this informal exchange of information can be organized through memoranda of understanding

²Such model laws will also be developed in the near future for common law and Islamic law systems.

³Informal sharing of information excludes the use of coercive measures.

(MoUs) or bilateral or multilateral treaties. For example, the 1988 United Nations (UN) Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances has established a UN directory of competent national authorities that lists the designated authorities to whom requests for exchange of information can be directed. These channels are also used to establish joint investigation teams comprised of officers of two or more states where cross-border surveillance of operations related to money-laundering or drug-trafficking cases is needed. Whenever law-enforcement authorities want, for example, to set up a controlled delivery in a foreign country, the UN directory of competent authorities allows them to easily identify a direct contact there with whom they can get in touch. This directory is a good example of a simple and concrete measure taken by an international convention to speed up the informal information-sharing process between countries.

- 3.5. These informal channels of communication are fast, easy, and cheap. They have proved essential material to support law-enforcement agencies in financing of terrorism cases. Such information has, in many cases, led investigators to target surveillance on specific individuals or networks, and allowed them to trigger investigations that could not have started otherwise. But there are three caveats to this approach:
 - 3.5.1. the information cannot be obtained using coercive measures normally requiring judicial authority and control;
 - 3.5.2. confidential information cannot be shared with foreign counterparts, especially information that is covered by bank secrecy or by bank confidentiality.
 - 3.5.3. the information cannot serve as evidence in court, because it was not gathered with the required due-process guarantees.

Financial Intelligence Unit Channels

- 3.6. In money-laundering and financing of terrorism cases, most of the raw material for investigators is financial information held by banks and other financial institutions. This information is in essence confidential. Until the development of AML/CFT laws, the only way to get access to this information was to get a court order allowing the investigator to receive this confidential information from banks. But the court orders could be granted only when the investigator was already aware of the crime and needed ex post evidence. Money-laundering crimes would have continued to be as confidential as the financial transactions on

which they were based if banks and other financial institutions had not been required to report transactions deemed suspicious and therefore susceptible of hiding a criminal laundering operation. The objective was to make law-enforcement efforts more proactive. But a filter was needed, because suspicion does not mean crime. Financial intelligence units were established, in response to the need for this filtering mechanism, to receive and analyze the large quantity of suspicious reports before identifying those that genuinely add to intelligence information and disseminating that information to law-enforcement agencies when suspicion is substantiated during the analysis process.

- 3.7. A variety of types and models of FIUs⁴ have been set up by various countries, depending on the legal and administrative traditions of the state. In general, however, they all carry out similar core functions:
 - 3.7.1. receiving, analyzing, and disseminating disclosures from the financial sector;
 - 3.7.2. receiving and responding to requests for information from other FIUs;
 - 3.7.3. serving as a clearinghouse to coordinate the AML/CFT activities of other agencies;
 - 3.7.4. serving as a repository, a central location of strategic and operational information useful in the fight against ML/FT, that may be consulted by other law-enforcement agencies (database function);
 - 3.7.5. performing research and strategic analysis in support and/or at the request of other domestic agencies or ministries;
 - 3.7.6. advising the authorities on ML/FT issues and legislation;
 - 3.7.7. in some cases, supervising compliance with the AML/CFT provisions, often with the power to impose sanctions or other coercive measures; and
 - 3.7.8. in a few cases, carrying out regulatory responsibilities, such as issuing rules, regulations, or guidelines covering suspicious currency transactions reporting and other AML/CFT requirements.

⁴See International Monetary Fund and World Bank Group, 2004, *Financial Intelligence Units: An Overview* (Washington: International Monetary Fund).

- 3.8. To carry out their functions, FIUs have access to two kinds of information:
 - 3.8.1. information and/or records that are “spontaneously” provided by the reporting institutions, such as banks and financial institutions, through suspicious transaction reports (STRs) and other types of reports that AML laws require them to file; and
 - 3.8.2. information that FIUs, at their request, can obtain from any public authority or from reporting agencies, either to augment information received through suspicious transaction reports or at the request of a foreign financial intelligence unit responsible for receiving and processing reports of suspicions.
- 3.9. Because money laundering and the financing of terrorism imply the cross-border transmission of confidential financial information, the detection of money laundering and financing of terrorism operations depends on information sharing among FIUs in different countries and on their ability to cooperate, speedily and efficiently, with their foreign counterparts.
- 3.10. To this effect, FIUs must be empowered by law to share information with foreign counterparts. This is not always possible, because, in many cases, laws establishing FIUs prevent the sharing of confidential information except in certain specified cases and, even in those cases, strictly limit the conditions under which information can be shared with, and the uses to which it can be put by, foreign FIUs. These restrictions are designed to avoid any abuse and, in particular, to protect the constitutional or civil rights of the individuals who are the subjects of the information. Indeed, such individuals are, in most cases, innocent of any crime (the number of STRs that end up in criminal investigations is very limited across the board). It is therefore critical to ensure that STRs and other financial information handled and processed by the FIU remains confidential all along the way.
- 3.11. The problem is that, depending on the type of foreign FIU, the confidentiality requirements and standards governing the use of the information may not be the same as those of the providing FIU. To overcome this difficulty, FIUs, within the Egmont Group, are negotiating and signing MoUs to harmonize the conditions under which financial information can be shared, with a view to maximizing the extent to which information can be shared, while ensuring that confidentiality will not be breached and limiting the use that the foreign FIU can make of such information.

- 3.12. Sometimes, the sharing of information between FIUs is not made spontaneously but at the request of a foreign FIU. In this case, the FIU must be specifically empowered by law to act on the basis of foreign requests. In other words, when the FIU receives a request by a foreign counterpart to look for information, there must be a legal power given to the FIU to search for that information in financial institutions, even if the financial institution has not filed an STR.
- 3.13. To summarize, the exchange of information among FIUs is premised on a threefold legal requirement:
- 3.13.1. the general power given by law to the FIU to use the information received within the purview of the law for other purposes than its transmission to law-enforcement or judicial authorities;
 - 3.13.2. the power to exchange information with foreign counterparts; and
 - 3.13.3. the power to request banks to provide financial information at the request of a foreign counterpart.
- 3.14. Within these limits, the FIU channel provides a means for quick and efficient exchange of information. It is flexible, while allowing the use of coercive measures. The legal value of the information obtained is stronger, but, even so, the information has to remain confidential and, in particular, cannot be used in open court and therefore cannot be used in a prosecution.

The Mutual Legal Assistance Process

- 3.15. In most countries, cooperation between justice systems for the investigation and prosecution of offenses requires very complex procedures called mutual legal assistance. MLA arrangements are governed by treaties or bilateral agreements that usually contain a number of restrictive conditions. Such conditions, which may inhibit the comprehensive and rapid exchange of information, are necessary to protect the sovereignty of states and ensure that evidence gathering undertaken in the MLA process abides by due-process principles.
- 3.16. The protection of sovereignty is fundamental because MLA requests imply the use of coercive powers in a country for the benefit of a foreign country, and states usually want to ensure that the mutual legal assistance request would not infringe on or violate its sovereign powers. For example, a warrant of arrest sent by foreign authorities may be used in a way that effectively interferes in the political process in another country, or may be used by a country to exercise constraint over another country.

- 3.17. This is the reason why, before a request for mutual legal assistance is forwarded to the appropriate authority (namely the court), this request will be reviewed by the executive branch (despite the principle of separation of powers) to examine whether there is an impediment of a political or diplomatic nature that would prevent the execution of the foreign request. It is worth noting that such impediments arise only rarely and are especially unusual where two countries have a bilateral MLAT. Some argue that the damage done by the delays in the investigation and prosecution process caused by the administrative procedures designed to prevent such rare occurrences are disproportionate to the benefits gained in the tiny number of instances where political or diplomatic issues are detected. There would be advantage in seeking ways to minimize the number of instances where such case-by-case review was necessary.
- 3.18. Due-process requirements, which are enforced by the courts themselves, aim at ensuring that prosecutions and coercive powers are used in a way that protects the rights of accused persons and, more generally, of citizens. For example, in most countries, before granting the MLA request, courts will check whether the facts for which a person is being prosecuted and the request is being made are considered a criminal offense by law in both the requesting and the requested states. Such requirement, called the “dual criminality” requirement, is based on a basic principle of criminal law (“*nullem crimen, nullen poena, sine lege*” or “there is no crime, there is no punishment, without law”). When MLA is sought in money laundering offense cases, things are much more complicated, since the offense itself is very complex, and very often defined in different terms from one country to another. In addition, the predicate offenses do not necessarily have the same definition, and the scope of predicate offenses varies from one country to another. The dual criminality test in AML cases therefore becomes very tricky: both the money-laundering offense and the predicate offense must be defined in the same terms in each law, and, in addition, the predicate offense must be one in the laws of both the requested and the requesting states. For this reason, FATF Recommendation 37 encourages a flexible interpretation of the dual criminality principle by requesting members to grant MLA when the underlying conduct is the same, even if the terms used to define the offense are different or the offense is not listed in the same category of offenses.
- 3.19. The MLA approach, which is based on respecting due-process requirements, is the only way to ensure that the information gathered during the investigation will be admissible in court as evidence. The informa-

tion gathered from informal or FIU channels could not be used for evidentiary purposes. Therefore, since the final objective of AML/CFT enforcement is precisely to get people convicted—and their assets confiscated—by a court, there will be a need at some point to use formal means of circulation of information. But because of the political review (sovereignty) and the legal review (due process) of MLA requests, the process is very long and complex.

- 3.20. Mutual legal assistance requests can be granted on the legal basis of (1) a multilateral treaty, such as the UN Convention on Drug Trafficking or the UN Convention on Transnational Organized Crime, or (2) a bilateral mutual legal assistance treaty (MLAT). It can also be settled on the principle of reciprocity, however, when there is no preexisting agreement between the countries: mutual legal assistance is then granted if the requesting state commits to grant the same assistance if it is requested to do so in similar circumstances.

4. Speed or Power

- 4.1. When an authority wants to determine how best to proceed in requesting information, it will have to strike a balance between speed and power. Basically, what is the information to be used for? If it is for intelligence purposes, but will not be used as evidence in court, then informal communication channels or the medium of financial intelligence units would suffice. When this information is covered by a confidentiality requirement or entails the need to compel a bank or other financial institution to provide the information, the FIU channel would be preferred if the FIU has such powers. As the gathering of intelligence becomes a part of a criminal investigation for money laundering or the financing of terrorism leading to a prosecution, or when information cannot be obtained otherwise than through enforcement measures, then the collection of information requires the channel of a mutual legal assistance request.

5. Conclusion

- 5.1. In an environment where financial transactions and electronic transfers allow money to be laundered or funds to be channeled to terrorists at the click of a mouse, the need for rapid transmission and exchange of information between law-enforcement agencies is critical. International instruments have strived, over the years, to make this flow of intelligence smoother and more efficient. The traditional channels of communication between states, a complex mixture of diplomacy and

justice, have failed to enable a rapid response to money-laundering techniques. Criminal organizations have long since taken advantage of the shortcomings of the MLA procedures. Originally designed to protect the interests of states and their citizens, they have wound up protecting criminal networks. In response, law-enforcement agencies have developed parallel channels of communication, notably through Interpol, and have used computer technology to speed up the exchange of information.

- 5.2. When the first FIUs were created, one of their first endeavors within the Egmont Group was to set up an information exchange system, in parallel to the law-enforcement and judicial ones. Some experiments such as FIUNET, a computer network of FIUs among some European countries, are designed to further increase the speed and efficiency of information exchange by allowing a 24/7 sharing of information among multiple partners. The information shared through these more informal channels is not legally reliable enough, however, to allow for its use as evidentiary material. These channels must therefore be complemented by the use of more formal communication channels when information is to be used in court. This allows the ultimate conviction, and the confiscation of the assets, of criminals who engage in money laundering and the financing of terrorism. The need for parallel information channels will fade when mutual legal assistance procedures are reviewed with a fresh perspective, to limit the procedural requirements to those strictly needed for the protection of individuals, and when justice systems set up direct communication channels for mutual legal assistance like the newly created Eurojust¹ within the European Union.

¹Eurojust is a European Union body established in 2002 to enhance the effectiveness of investigations into serious cross-border and organized crime.

2

International Cooperation Standards and Practices in Combating Money Laundering and Countering Terrorist Financing

WILLIAM C. MURDEN¹

1. Introduction

- 1.1. This chapter discusses the recommendations of the Financial Action Task Force (FATF) that relate to international cooperation and information exchange and their implementation.
- 1.2. Since its creation, the FATF has spearheaded the effort to adopt and encourage implementation of measures designed to counter the use of the financial system by money launderers, terrorist financiers, and other criminals. It first adopted its 40 Recommendations on Money Laundering in 1990, setting out a basic framework for anti-money-laundering (AML) efforts intended to be of universal application. Since then, the FATF has revised its Forty Recommendations twice—first in 1996 and then more recently in 2003—to ensure that they remain up to date and relevant to the evolving threats. The FATF 40 Recommendations are now the recognized international standard for anti-money laundering.
- 1.3. Following the terrorist attacks in the United States on September 11, 2001, the FATF expanded its mission beyond anti-money laundering to also focus its energy and expertise on a worldwide effort to combat

¹These comments reflect the personal views of their author and do not necessarily reflect the official positions of the U.S. Department of the Treasury, the Financial Action Task Force, or the International Monetary Fund. The author appreciates the valuable contributions to this article by Nan Donnell, Juhan Jaakson, Paul Ashin, and Richard Pratt, but any remaining errors are entirely his own.

the financing of terrorism (CFT). The FATF issued Eight Special Recommendations on Terrorist Financing in October 2001 and added a Ninth Special Recommendation (on cash couriers) in October 2004—and it calls on all countries to adopt and implement these special measures along with the FATF 40 Recommendations. The objective is to deny terrorists and their supporters access to the international financial system.

- 1.4. The Working Group on International Financial Institutions Issues (WGIFI) was established by the FATF Plenary in Paris in February 2003. The Working Group was successful in helping the international community reach consensus on several technical and policy issues. Its mandate was to serve as a point of contact on matters arising with the international financial institutions (IFIs) on the collaborative effort on AML/CFT issues, and to oversee and coordinate the FATF's participation in the pilot program implementing use of the AML/CFT methodology. The WGIFI expired in October 2004, and it was replaced by the Working Group on Evaluations and Assessments, which has a broader mandate addressing all AML/CFT assessments by the IFIs and the FATF.

2. Information Exchange and the FATF Recommendations

- 2.1. The ability of various authorities in different countries to freely exchange information about money laundering and terrorist financing targets and investigations is key to combating money laundering and terrorist financing effectively on a global scale. The FATF has recognized this need in a number of recommendations, including Recommendation 40, which covers general administrative and regulatory international cooperation, and Special Recommendation 5, which concerns cooperation in the context of terrorist financing. Special Recommendation 3, on freezing and confiscating terrorist assets, is also relevant to the question of information exchange. These recommendations are discussed, in turn, later in this paper.
- 2.2. Recommendations 36 through 39, which deal with the specific issues surrounding judicial cooperation, including mutual legal assistance, extradition, confiscation, and compulsory measures, are not discussed further here.
- 2.3. To understand the implications of these recommendations for regulators and other practitioners—including those in offshore centers (OFCs)—it is appropriate to go beyond the recommendations themselves and look at the Interpretative Notes and Best Practices papers

that the FATF has issued on these subjects. It is also important to examine the assessment criteria associated with each recommendation in the AML/CFT Methodology, adopted in February 2004 by the FATF Plenary and by the IMF and World Bank Executive Boards in late March 2004. The methodology is being used by FATF, the FATF-style regional bodies (FSRBs), and the IFIs to assess jurisdictions' compliance with the FATF AML/CFT Recommendations.²

- 2.4. The FATF has been engaged in an active dialogue with the Basel Committee, the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), and the Egmont Group on how to enhance cooperation and information exchange—especially in the complex circumstances where bank regulators and financial intelligence units (FIUs) need to share information. For example, the FATF president held a conference call with the Basel Committee and the IAIS in May 2004 and another with IOSCO in June 2004. All participants agreed to identify experts to collaborate on this issue.

3. Recommendation 40: “Other Forms of Cooperation”

- 3.1. Recommendation 40 sets forth a comprehensive framework for the widest possible range of international information exchange. It does the following:
 - 3.1.1. calls for countries to establish and maintain gateways to facilitate prompt and effective information exchange between counterparts;
 - 3.1.2. states that jurisdictions should not invoke bank secrecy laws or fiscal matters alone as reasons not to exchange information; and
 - 3.1.3. calls for the protection of the information under privacy and data-protection standards.
- 3.2. Based on this broad-ranging recommendation, the criteria for Recommendation 40 in the AML/CFT Methodology specify the following points:

²The AML/CFT Methodology was amended in February 2005 to add criteria for assessing compliance with Special Recommendation IX (SR-IX) and is available on the FATF website at <http://www.fatf-gafi.org>.

- 3.2.1. Countries should ensure that their competent authorities provide the widest possible range of international cooperation to their foreign counterparts—and provide such assistance in a rapid, constructive, and effective manner.
 - 3.2.2. Such exchanges should not be subject to disproportionate or unduly restrictive conditions.
 - 3.2.3. There should be clear and effective gateways, mechanisms, or channels that facilitate prompt and constructive information exchange directly between counterparts.
 - 3.2.4. Examples of such gateways (other than mutual legal assistance or extradition treaties, which are addressed in Recommendations 36–39 and do not adequately provide for certain types of exchanges) include laws allowing exchange of information on a reciprocal basis, bilateral or multilateral agreements, or arrangements such as memoranda of understanding (MoUs) and exchanges through appropriate international or regional organizations such as Interpol or the Egmont Group. Such information exchanges should be possible both spontaneously and upon request and in relation to both money laundering and the underlying predicate offenses.
 - 3.2.5. Countries should ensure that all their competent authorities are authorized to conduct inquiries on behalf of foreign counterparts and, in particular, should ensure that their FIU is authorized to make specified types of inquiries on behalf of foreign counterparts.
 - 3.2.6. Requests for cooperation should not be refused on the grounds of laws that impose secrecy or confidentiality requirements on financial institutions or designated nonfinancial businesses and professions (DNFBPs) (except where legal profession privilege or legal profession secrecy applies).
 - 3.2.7. Countries should establish controls and safeguards to ensure that the information received by their competent authorities is used only in the manner authorized, consistent with their obligations concerning privacy and data protection.
- 3.3. One key issue of particular interest in the implementation of Recommendation 40 has been the matter of “diagonal” information exchange. This refers to exchanges with noncounterparts, such as between an FIU

and a non-FIU in another country. This issue generated a great deal of discussion during the revision of the 40 Recommendations. As a result, Recommendation 40 is quite forward leaning in the realm of international information exchange. Countries should seek to enable diagonal information exchange to the extent possible.

4. Special Recommendation V

- 4.1. Special Recommendation V calls for countries to provide the greatest possible assistance to another country in connection with criminal, civil enforcement, and administrative investigations inquiries and proceedings relating to the financing of terrorism. This could be implemented on the basis of treaties, formal and informal arrangements, and other mechanisms for mutual legal assistance (MLA) or information exchange, in connection with criminal, civil enforcement, and administrative investigations.
- 4.2. The assessment criteria are essentially the same as those for Recommendations 36 to 40 applied to the financing of terrorism.
- 4.3. In going forward, diagonal information exchange remains an issue, and there will be further discussion between FATF, the Basel Committee, IOSCO, the Egmont Group, and others to discuss sharing of information with supervisory authorities within the context of implementing Special Recommendation V.

5. Special Recommendation III

- 5.1. Timely communication between authorities is especially crucial for the freezing of terrorist assets. This is covered by FATF Special Recommendation III. The FATF “Best Practices” paper on SR III fleshes out this issue in some detail.³
- 5.2. Special Recommendation III states that each country should implement measures to freeze without delay funds or other assets of terrorists, those who finance terrorism, and terrorist organizations in accordance with the United Nations resolutions relating to the prevention and suppression of the financing of terrorist acts.
- 5.3. Each country should also adopt and implement measures, including legislative ones, which would enable the competent authorities to seize and confiscate property that is the proceeds of, or used in, or intended or

³“Freezing of Terrorist Assets: International Best Practices” published by the FATF in October 2003.

allocated for use in, the financing of terrorism, terrorist acts, or terrorist organizations.

- 5.4. The global nature of terrorist financing networks and the urgency of responding to terrorist threats require unprecedented levels of communication, information exchange, cooperation, and collaboration among authorities in different jurisdictions.
- 5.5. In the immediate aftermath of the tragic events of September 11, 2001, the U.S. government took immediate and decisive action to improve its arsenal of financial weapons in the war on terror. It issued an executive order that, among other provisions, authorized the Secretary of the Treasury to freeze the financial assets of terrorist groups and their supporters in the United States. Since terrorism is a global phenomenon, however, the United States needed to work closely with its allies to ensure that freezing actions were simultaneous and multilateral to prevent terrorists and their supporters from moving funds elsewhere. The Group of Seven finance ministers and, later, the Group of Eight (G-8) foreign and justice ministers reached agreement to institute a “prenotification” program whereby countries would provide enough advance notice and information to their partners to take coordinated freezing action against designated terrorists and supporters. The program has expanded beyond the initial small group of countries and demonstrates the importance of strong communications, information sharing, and cooperation.
- 5.6. Among the key elements of this communication are
 - 5.6.1. timely and secure prenotification of pending designations, to enable the greatest possible simultaneity of action;
 - 5.6.2. facilitating consultation between jurisdictions to gather, verify, and correct identifier information for designated persons;
 - 5.6.3. rapidly and globally communicating new designations and the supporting information; and
 - 5.6.4. maximizing the sharing and publicizing of information about the amount of funds and other assets that each jurisdiction has frozen.
- 5.7. There is one interesting issue to note in connection with information sharing on freezing designations that is perhaps unique or at least more prevalent in connection with terrorism. Much information on terrorist targets is obtained from clandestine or intelligence sources. This infor-

mation can be highly classified to protect its sources and methods and can be difficult for foreign governments to share with one another. This has presented some particular challenges not found in supervisory and regulatory information sharing, especially in protecting the disclosure of information when it is passed onward to other governments.

6. Implementation Implications

- 6.1. Sharing of information and full and effective international cooperation has been a basic FATF principle from its inception. The revision of the FATF Recommendations in 2003 and the new AML/CFT Methodology continue and expand on that tradition.
- 6.2. FATF considers full compliance with the information sharing and cooperation measures of the FATF Recommendations to be a vital component of an effective AML/CFT regime. Assessments in the past have indicated that countries have focused on this vital aspect but that there has remained room for improvement. We are learning more as we gain experience with the new methodology.

3

Egmont Standards and Practices for Defenses Against Money Laundering and for Countering the Financing of Terrorism

SHOBA KAMMULA

1. Background on Egmont Group of Financial Intelligence Units

- 1.1. The Egmont Group is an informal network currently comprised of 94 financial intelligence units (FIUs). FIUs play an important role in cross-border information sharing.
- 1.2. Egmont defines an FIU as follows:

“A central, national agency responsible for receiving, (and as permitted, requesting), analysing and disseminating to the competent authorities, disclosures of financial information:

 - (i) concerning suspected proceeds of crime and potential financing of terrorism, or*
 - (ii) required by national legislation or regulation, in order to combat money laundering and terrorism financing.”*
- 1.3. Recently, the Egmont Group added the combating of terrorism financing to the scope of the FIU’s functions.
- 1.4. Membership in the Egmont Group is restricted to FIUs that satisfy the requirements of membership. The Egmont Group has formed an Outreach Working Group that approaches and works with potential candidates to prepare them for membership. Once the Outreach Working Group is satisfied that the candidate is performing the functions of an FIU, it recommends the FIU’s candidacy to the Legal Working Group. The role of the Legal Working Group is to ensure that there is an adequate legal basis for the FIU and its core functions.

Once the Legal Working Group is satisfied that the candidate FIU has a proper legal basis, the candidate is referred to the heads of the Egmont FIUs, which vote on membership.

- 1.5. Egmont members must agree to abide by Egmont's Principles of Information Exchange. In sum, these principles provide that information requested from an Egmont member is to be used only for the purpose for which it was requested. At all times, the FIU providing the information maintains control over how the information will be used, because it must consent to how the information will be used and with whom it will be shared.
- 1.6. Information exchange through the Egmont FIU network fosters two important concepts: trust and confidentiality. As explained later in this chapter, these are critical in encouraging speedy cross-border information exchange.

2. Benefits of Information Exchange Through the FIU Network

- 2.1. As an informal network, Egmont FIUs are able to exchange information expeditiously, because the exchange is not subject to the more burdensome requirements of other forms of information exchange, such as mutual legal assistance treaties (MLATs). The FIU process, however, cannot replace the MLAT process, because these two processes serve very different and distinct purposes.
- 2.2. While the MLAT is a vehicle for exchanging evidentiary material that can be used in formal court proceedings, the FIU network allows for the exchange of *financial intelligence*. Intelligence is used to *develop* an investigation but generally has no evidentiary weight. Thus, the FIU network is typically employed at the outset of an investigation, during the information-gathering process. The intelligence exchanged by FIUs consists primarily of suspicious transaction reports (STRs). In most countries, STRs have no evidentiary weight, because they are filed by financial institutions regarding possible or suspected money laundering. STRs are often referred to as "lead" information, because they may lead or direct law enforcement toward a potential financial trail that can be used to develop an investigation. Once the case is in the formal court-proceeding stage, law enforcement generally must use more formal channels, such as a court order or mutual legal assistance treaty, to obtain information that can be used in court. Because the STR generally cannot be used in court, law enforcement must obtain the underlying financial institution records about

the particular customer or transactions that could be admitted in court.

- 2.3. Although the FIU exchange is less burdensome and quicker than the more formal MLAT mechanism, it is still subject to important restrictions and controls on the dissemination of the intelligence. STRs constitute highly sensitive material not only because they involve financial information but also because they are based only on suspicions. For this reason, STRs are not made public, and the FIU providing the information always retains control over how it is used, consistent with the Principles of Information Exchange. At the same time, the Principles of Information Exchange also encourage the free exchange of information and, accordingly, limit the extent to which such control will, in practice, be exercised in, for example, cases where dissemination would fall beyond the scope of application of the FIU's anti-money laundering/combating the financing of terrorism (AML/CFT) provisions or could lead to impairment of a criminal investigation.
- 2.4. Information exchange is also relatively quick within the Egmont Group, because FIUs are dealing with counterparts that they trust. All Egmont members have been vetted by the Egmont process and have agreed to abide by the Egmont Principles of Information Exchange. This allows information to be exchanged without fear that it will be disclosed inappropriately.

3. Obstacles to Information Exchange Between FIUs

- 3.1. FIUs are each subject to a different set of legal, political, and historical factors. These differences can create obstacles to information exchange. Broadly speaking, there are two types of obstacles to information exchange between FIUs: legal and structural.
- 3.2. Legal barriers to information exchange include differences in the laws governing each FIU. For example, the issue of what constitutes a crime, and therefore a predicate offense for money laundering, may differ depending on the law of each country. An FIU in one country may be seeking information related to an activity which the other FIU does not recognize as a criminal offense. Again, because the goal of the Egmont Group is to encourage the exchange of information, Egmont's Statement of Best Practices notes that differences in the definition of offenses should not be an obstacle to the exchange of information among FIUs. This position is also consistent with FATF Recommendation 37, which encourages countries to avoid dual criminality requirements. Nevertheless, some FIUs are constrained

by domestic law and cannot exchange information relating to offenses committed elsewhere that are not recognized in their own jurisdictions.

- 3.3. Structural barriers to information exchange also occur because FIUs may perform their core functions differently as a result of how they are organized. For example, an FIU that is structured as a police unit may play more of an investigatory role than one that is structured as an administrative unit that serves to support law enforcement. As a result, when a police unit is seeking information from an administrative FIU, the police unit may be just as interested in receiving law-enforcement information as financial intelligence from its counterpart.

4. How Have FIUs Overcome These Barriers?

- 4.1. Within Egmont, the experience has been that FIUs have demonstrated great flexibility in how they have interpreted and viewed requests for information so as to maximize information sharing. For example, in the aftermath of the terrorist attacks on the United States on September 11, 2001, the Financial Crimes Enforcement Network (FinCEN) received a strong response to its requests for information relating to the 9/11 suspects. Arguably, FinCEN's requests could have been viewed narrowly and rejected by Egmont partners as requests that did not involve money laundering or the proceeds of criminal activity. Nonetheless, Egmont FIUs were willing to provide information to FinCEN. The informal nature of Egmont and the spirit of trust and confidentiality, combined with the knowledge that the information provided to FinCEN was intelligence that might ultimately develop into a traditional money-laundering case, provided Egmont partners with sufficient flexibility to respond to the requests for information.
- 4.2. FIUs have been able to bridge the gaps created by their unique structural differences by becoming well integrated into the AML framework of their jurisdiction, establishing good relationships with law-enforcement and supervisory authorities. Thus, even if an FIU does not have direct access to specific types of information, it can nonetheless intermediate the request on behalf of the foreign FIU.

4

International Cooperation to Combat Money Laundering and the Financing of Terrorism: Legal Position and Practice in the Principality of Liechtenstein

DUNJA SUESSLI

1. Description

- 1.1. This chapter gives an overview of the legal position and practice in the Principality of Liechtenstein with respect to international cooperation in the context of anti-money laundering/combating the financing of terrorism (AML/CFT).

2. Liechtenstein: Facts and Figures

- 2.1. Bordering on Switzerland to the west and on Austria to the east, Liechtenstein, with an area of 160 square kilometers, is the sixth smallest state in the world. It has a population of approximately 34,000.
- 2.2. Financial services are an important economic sector but not the largest. About 40 percent of the country's GDP is the result of value added in industrial production and manufacturing. The financial services sector contributes 30 percent of GDP.

3. Liechtenstein's Commitment to Fight Money Laundering and Financing of Terrorism

- 3.1. Liechtenstein has joined in, and fully supports, the intense cooperation of the international community in the fight against money laundering and financing of terrorism. The relevant standards in Liechtenstein have been acknowledged by international bodies such as the IMF on the occasion of the offshore financial center (OFC) assessment in 2002. The mission team observed "a high level of compliance" with international standards for AML and CFT.

4. General Framework

- 4.1. The crime of money laundering encompasses a comprehensive list of predicate offenses including corruption and financing of terrorism and also covers own-funds laundering. Participating in organized crime, forming and participating in terrorist groups, committing terrorist offenses, and financing of terrorism constitute criminal and extraditable offenses as well.

5. Mutual Legal Assistance

- 5.1. Liechtenstein grants mutual legal assistance with respect to the aforementioned crimes. The main legal basis for granting mutual legal assistance is the Law on International Mutual Legal Assistance in Criminal Matters (MLA Law). The MLA Law allows the granting of mutual legal assistance to every jurisdiction in the world. But if and insofar as there are special agreements, namely bilateral or multilateral treaties, the MLA Law is overridden by these treaties.
- 5.2. One of the most important bilateral agreements for Liechtenstein is the mutual legal assistance treaty (MLAT) between the United States and Liechtenstein. Liechtenstein is also a signatory of the multilateral European Convention on Mutual Legal Assistance in Criminal Matters.

6. Law on International Mutual Legal Assistance in Criminal Matters (MLA Law)

- 6.1. Pursuant to the provisions of the MLA Law,¹ Liechtenstein can grant extradition, transit, and what is called genuine legal assistance. This term means every kind of support for foreign proceedings in criminal matters, including sending of objects and documents, serving summonses on witnesses to appear, and transferring arrested persons for the purpose of providing evidence. Liechtenstein can also, itself, assume prosecution of offenses committed in other jurisdictions and can enforce decisions taken by foreign criminal courts. For example, it can enforce foreign forfeiture orders. In this respect, Liechtenstein can enter into agreements for the sharing of proceeds.

¹The following is equally valid for mutual legal assistance granted by Liechtenstein pursuant to the provisions of the European Convention on Mutual Legal Assistance in Criminal Matters. There are only slight differences with regard to the procedure.

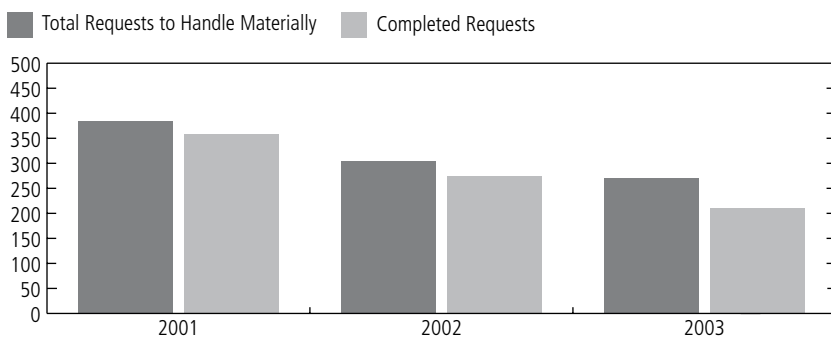
- 6.2. There are some prerequisites for mutual legal assistance. One such prerequisite is dual criminality. Furthermore, mutual legal assistance for fiscal offenses is precluded. This means that mutual legal assistance is not granted with regard to a request referring exclusively to a fiscal offense. But in criminal cases where fiscal matters are involved, mutual legal assistance is granted subject to a proviso that the information given may not be used to prosecute a fiscal matter.
- 6.3. Banking secrecy forms no obstacle in this context. It may be lifted whenever knowledge of a person's private data is essential to the conduct of domestic or foreign criminal proceedings. Banking secrecy cannot justify a refusal to testify or produce documents. If the financial intermediary fails to produce relevant documents, the examining magistrate has the power to order a search.
- 6.4. Also, the use of other compulsory powers is permitted in an investigation in the context of mutual legal assistance. A wide range of investigative techniques is allowed, such as the confiscation and opening of letters and the monitoring of telephone conversations. What is prohibited is the use of agents provocateurs and sting operations.

7. MLAT for United States and Liechtenstein

- 7.1. The MLAT between the United States and Liechtenstein, which entered into force on August 1, 2003, has some special features. Perhaps the most important aspect of the treaty is that a lack of dual criminality cannot justify a refusal unless the execution of the request would require a court order for search and seizure or other coercive measures.
- 7.2. Moreover, mutual legal assistance is granted with respect to tax fraud as defined by the contracting parties.

8. Statistics

- 8.1. Figure 4.1 shows the number of foreign mutual legal assistance requests to Liechtenstein during the years 2001–2003. It also shows the percentage of requests already completed. The figures were last updated in April 2004.
- 8.2. In more than 75 percent of the cases, it takes less than four months to complete a request. To achieve such a benchmark, Liechtenstein has had to expend a lot of effort and make many improvements with respect to personnel, legal framework, and processes.

Figure 4.1. Mutual Legal Assistance Requests to Lichtenstein, 2001-2003

- 8.3. The bulk of requests come from neighboring countries such as Switzerland, Germany, and Austria. Only a few requests come from farther afield.
- 8.4. In most cases, the underlying offense is fraud; embezzlement and money laundering are the next most frequent offenses.

9. Information Exchange by FIU

- 9.1. In addition to the exchange of information by way of mutual legal assistance, the Liechtenstein financial intelligence unit (FIU) is widely empowered to exchange information (including account- and transaction-specific information) with foreign counterpart FIUs.
- 9.2. For this information exchange, the Liechtenstein FIU does not need a memorandum of understanding but will enter into one if this is required by the counterpart FIU.
- 9.3. With respect to national authorities, the FIU is provided, upon request, with the information required for the discharge of its responsibilities.

10. Administrative Assistance

- 10.1. Furthermore, the financial market supervisory authorities and also the future Financial Market Authority (FMA)² may grant international administrative assistance under the condition that specific requirements are complied with.
- 10.2. It is notable, in this context, that banking secrecy does not limit the ability to forward client account information.

²Liechtenstein created the Integrated Financial Market Authority on January 1, 2005.

5

Cooperation Standards and Practices in Defenses Against Money Laundering and in Countering Terrorist Financing

MUHAMMAD BAASIRI

1. Introduction

- 1.1. This chapter discusses the key elements that have to be in place to allow effective cooperation and mutual assistance between law-enforcement agencies in different countries in the fight against money laundering and the financing of terrorism.
- 1.2. In order to be able to cooperate with foreign authorities and to provide assistance, it is first essential that all authorities be empowered by having the necessary domestic legislation in place. Legislative measures are necessary at the national level to enable judicial authorities to criminalize offenses related to money laundering (ML) and terrorist financing (TF). Local laws should permit law-enforcement authorities to freeze, seize, and confiscate assets derived from ML offenses (such as drug sales, manufacturing, processing, and trade) or intended to finance terrorist acts or provide support for terrorist operations, which are considered a threat to international peace and security.
- 1.3. Domestic legislative measures, while necessary, are not sufficient. The current state of technology offers money launderers the appropriate tools to transfer money, in the layering¹ process, into a series of accounts at various banks across the globe. For example, money launderers are using shell and front companies to hide their operations behind seemingly legitimate businesses while also creating a tedious and confusing

¹Layering is the use of several financial transactions to distance laundered money from its origins.

path for investigators to follow. Sometimes the offense committed takes place in one jurisdiction and the funds resulting from the commission of the offense are rapidly transferred or couriered to another financial center. Since investigators are restricted to their own jurisdictions, and because funds move like water, which follows the path of least resistance, it is necessary for law-enforcement and investigative authorities to cooperate not only at the local level with concerned agencies but also with foreign counterparts. As a result, laws should be in place to allow law-enforcement agencies to communicate and assist their foreign counterparts in fighting offenses related to ML/TF. The chapter discusses the details of the required assistance.

- 1.4. Countries should cooperate with one another and provide—on the basis of treaty, agreement, arrangement, or other mechanisms (including assistance provided on an ad hoc basis with no prior agreement in place)—the greatest measure of assistance in connection with criminal and civil investigations, inquiries, and extradition proceedings, in respect of the offenses set out in their laws. Cross-border cooperation and information sharing permits law-enforcement authorities to exchange and obtain information from foreign counterparts to deter, detect, and prosecute money laundering and terrorist financing. It also enables them to take practical actions, such as seizing and freezing assets at the request of foreign authorities, taking statements from witnesses, and acquiring documents and other evidence.

2. Essential Elements for Information Exchange

- 2.1. Effective cross-border cooperation and information exchange among law-enforcement agencies depends heavily on five essential elements. First, all parties involved, both domestically and internationally, should be committed to fighting ML/TF. Second, laws and regulations should allow authorities to enter into agreements among themselves for the purpose of sharing financial information related to ML/TF offenses. Such agreements will often be in the form of memoranda of understanding (MoUs). Third, there should be a central unit that meets the Egmont definition of a financial intelligence unit (FIU) and is charged with facilitating the rapid exchange of information between the local authorities and their foreign counterparts. Fourth, national authorities should coordinate among themselves to gather, in a timely and convenient manner, the necessary information specified in the request for assistance. Fifth, and finally, the requested FIU should be able to gather the information requested as rapidly as possible. This process must

include the ability to acquire documents and other materials from persons within the jurisdiction of the requested FIU and the ability to take statements from witnesses. The FIU must be able to process such information safely and securely, and supply it to the requesting FIU to allow it to take the necessary steps, which might include freezing suspects' accounts (after identifying all the main players) and forwarding the case to the prosecuting authorities. If necessary, the requested FIU should also be in a position rapidly to freeze or seize assets within its own jurisdiction, at the request of the foreign FIU. In those countries where it is considered necessary to follow a judicial process before the assets of citizens who have not been convicted of offenses can be frozen or seized by the state (whether or not at the request of a foreign jurisdiction), it is essential that the judicial process can be made effective equally rapidly.

3. International Standards

- 3.1. International organizations such as the Financial Action Task Force (FATF), the World Bank, the International Monetary Fund (IMF), the United Nations, the Egmont Group, and the regulatory standard-setting bodies² are taking a leading role in promoting the international exchange of information among relevant authorities. FATF Recommendation 40 calls upon countries to ensure that their competent authorities provide the widest possible range of international cooperation to their foreign counterparts. In the course of its initiative concerning noncooperating countries and territories, the FATF has defined criteria for identifying such countries. One of these criteria is the existence of secrecy provisions applying to financial institutions and professions that can be invoked against, but not lifted by, either administrative authorities in the context of inquiries into ML or judicial authorities in criminal investigations. The IMF and the World Bank, when conducting reviews of standards and codes in particular jurisdictions (usually conducted as part of Financial Sector Assessment Programs (FSAPs)) review adherence to the FATF recommendations according to a methodology drawn up in agreement with the FATF. This methodology requires an assessment of whether an FIU is authorized to share financial information with its foreign counterparts, either on its own initiative or upon receipt of a request for assistance. Simultaneously, the methodology requires an assessment of whether

²The Basel Committee on Banking Supervision, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors.

the FIU keeps and provides statistics on the number of requests for assistance received from foreign authorities, as well as the number of responses forwarded to the requesting authorities.

- 3.2. By the same token, the Egmont Group has developed a model MoU for FIU-to-FIU information sharing, created a secure website to facilitate information exchange, and set specific conditions for the exchange of information. MoUs set out the terms and conditions under which FIUs share financial intelligence and financial information with each other. A typical MoU identifies the parties, type, limits on the use, and restrictions on the dissemination of the shared information. In addition, the Egmont Group recognizes that it is necessary to identify and take steps to resolve issues with uncooperative FIUs. A draft paper on internal procedures concerning compliance with Egmont Group standards, including redress procedures with respect to noncompliant FIUs, has been circulated among Egmont members for a decision. The paper covers, among other things, four criteria: (a) noncompliance with the Egmont Admission; (b) breach of confidentiality; (c) detrimental practices in operational exchanges; and (d) misuse of the Egmont documents or the Egmont Secure Web. Noncompliant FIUs will be subject to redress procedures, which may, in extreme cases, result in their suspension or removal from Egmont membership.

4. FIU Network

- 4.1. Even where legislation provides for cooperation in accordance with the standards and recommendations of the international organizations, bureaucracy and complex legal systems can create serious additional impediments to the process of sharing information. Illicit proceeds from serious offenses—as was described earlier—travel at a relatively high speed from one country to another in the layering process. Therefore, to overcome these difficulties and obstacles, it is very important to pursue effective and reliable routes of communication, such as the FIU-to-FIU network, in order to be able to track the flow of money and to identify all the players involved. This network facilitates the rapid exchange of financial intelligence across borders, a process that usually occurs faster through FIUs than through other government information-sharing channels, for the following reasons:
 - 4.1.1. Most FIUs share information on the basis of a bilateral agreement in the form of an MoU.

- 4.1.2. FIUs are usually separate units, not placed under the supervision of a ministry or administrative unit within the government and, hence, are autonomous in taking any decision (and not subject to delays that may occur between government agencies as the necessary approvals are sought) as long as the FIU does not contravene local laws and regulations as well as secrecy provisions and policies on data protection.
 - 4.1.3. Exchange of ML/FT information among FIUs is one of the primary purposes of FIUs.
 - 4.1.4. As Egmont members, FIUs have access to a secure web through which information is forwarded very rapidly to the recipient.
 - 4.1.5. Because FIUs are not authorized to utilize the information which they receive from their foreign counterparts before any judicial or administrative authority unless they receive the written consent of the sending FIU, specifying the terms and conditions under which they may use and disseminate the information contained in the report, this obviates the need to carry out the normal judicial proceedings designed, in most countries, to protect citizens' civil rights before allowing confidential information to be obtained, transmitted to another country, and used against that citizen.
- 4.2. Requesting financial intelligence from an FIU involves four steps. First, the foreign FIU makes a request for assistance to another FIU for financial information to support a case involving ML/TF or other related crimes. Second, the requested FIU searches its database and seeks information from other government agencies and, if necessary, from financial institutions and others to respond to the request. Third, the FIU analyzes the gathered information and prepares a report to share the information with the requesting FIU. Finally, the requested FIU forwards an investigation report to the requesting FIU.
 - 4.3. For FIUs to work effectively, it is important that their staffs have unquestioned integrity and sufficient competence to carry out their tasks. A shortage of such staff may hinder the investigation and jeopardize the information exchange. It is important that FIUs take measures and set criteria for employment, which might include:
 - 4.3.1. skills and experience commensurate with the intended operations;

- 4.3.2. the presence of a well-defined continuing professional education program (CPE) at the FIU, through which staff are continuously updated on the issues;
 - 4.3.3. background checks or police reports taking into account their financial status and integrity, as well as precise evaluations of their net worth.
- 4.4. Hence, the FIU-to-FIU network is another channel through which information relating to ML/FT offenses is exchanged between two counterparts, whose ultimate objective is to bring gathered intelligence before the administrative and judicial authorities. Such intelligence will, in some cases, enable the administrative and judicial authorities to take action or to issue an order that allows them to take control of specified funds or assets or issue an order specifying that ownership be transferred to the state. This is usually the case when there is a criminal conviction and a court decision whereby the property is believed to have been derived from proceeds relating to ML/FT offenses. Therefore, the FIU-to-FIU network assists other government channels in the fight against ML/FT, contributing to achievement of successful results.

5. Other Communication Channels

- 5.1. The preceding should not be construed, however, as a belief that the FIU-to-FIU network is the only channel available to bring offenders to court and deprive them of their illicit gains. It is noteworthy to mention here that there exist, alongside this channel, other reliable and active channels, such as Interpol, that play an important role in cross-border investigations. This network facilitates the exchange of information among various investigatory bodies and law authorities, which, in connection with criminal investigations across borders, can result in an effective cross-border investigation. In addition, Interpol has broad authority to access remote geographical areas to obtain records, thereby obtaining evidence not easily accessed by other authorities or through other channels of communication. Highly secured and fast methods of communication at the disposal of Interpol enable it to obtain evidence and execute search warrants or arrest warrants.

6. Lebanon SIC

- 6.1. A case in point concerning cross-border cooperation and information exchange is the experience of Lebanon and my own experience at the

Special Investigation Commission (SIC)—Lebanon’s FIU—which is considered the centerpiece of the country’s anti-money laundering/combating the financing of terrorism (AML/CFT) regime. The SIC is renowned for its active and proactive international cooperation.

- 6.2. Throughout our work, the SIC’s staff use the “4Cs” motto—which constitutes a good recipe for a successful cross-border cooperation and information exchange—as follows:
 - 6.2.1. *Commitment to combat money laundering and terrorist financing.* Such commitment is covered by the governing AML Law 318, which was promulgated in April 2001. Equally, our commitment is demonstrated through several venues of international cooperation, both bilateral (that is, FIU-to-FIU) and multilateral (through the Egmont Group of FIUs).
 - 6.2.2. *Coordination among components of the AML/CFT regime.* We consider such coordination essential in achieving the desired objectives.
 - 6.2.3. *Cooperation with foreign FIUs and other competent authorities.* This helps develop and resolve cases through information sharing.
 - 6.2.4. *Combining FIUs’ know-how and expertise through workshops, seminars, exchange programs, and in other ways.* With this collaborative effort of the concerned international community, the fight against money laundering and the financing of terrorism will advance.
- 6.3. The Lebanese law clearly provides for information exchange with the concerned agencies, both locally and internationally. Since its inception in April 2001, the SIC has been proactively engaged in working closely with many FIUs on investigation cases. Cases coming from foreign sources were dealt with by the SIC, and information was exchanged, where applicable, in line with the prevailing law and the standards set by the Egmont Group.
- 6.4. Realizing the importance of fostering interagency cooperation, the SIC has been instrumental in furthering the AML/CFT regime in Lebanon. The government, acting at the initiative of the SIC, has set up a national committee in charge of coordinating policies among concerned agencies involved in AML/CFT. The government has also authorized the creation of two special AML units in the police and customs authorities, respectively. Simultaneously, the SIC has built an

effective system that connects the concerned agencies through a software application system that facilitates the exchange of information among them in a secure and swift fashion. In this respect, the Lebanese authorities are required to immediately respond to any information request by the SIC, because Law 318 empowers its chairman to communicate with any Lebanese or foreign judicial, administrative, financial, or security authority in order to request information or obtain the details of previous investigations that are linked or related to ongoing investigations by the commission. As such, there are no legal restrictions on the ability of the Lebanese authorities to pass confidential personal information to the SIC.

- 6.5. The SIC is also keen to upgrade the professional level at concerned agencies, and, as such, has been extremely active in conducting and arranging conferences and seminars on AML/CFT.
- 6.6. Moreover, in addition to its proactive stance in terms of international cooperation and information exchange, the SIC enjoys broad powers: it is the sole authority able to lift banking secrecy in cases relating to money laundering and terrorist financing. Based on the evidence or circumstantial evidence surrounding the suspicious transaction report, the SIC may decide to lift banking secrecy and, in many instances, to freeze related bank accounts. Over the past years, the SIC has lifted banking secrecy and/or frozen related bank accounts in connection with cases coming from internal and external sources.
- 6.7. The low-level, complex legal structure adds value in this regard. The SIC's commitment to international cooperation is illustrated in the key role it has played in creating the Middle East North Africa FATF (MENAFATF), which is the seventh FATF-style regional body. This body was launched on November 30, 2004 in Manama, Bahrain, which is the seat of the secretariat. It was established by 14 Arab countries from the Middle East and North Africa region, following four informal discussions that started in October 2003. The SIC secretary, Mr. Muhammad Baasiri, was unanimously elected as president for the first year.

7. Overcoming Barriers to Cooperation

- 7.1. In this writer's opinion, there are several barriers and impediments to effective cross-border cooperation and exchange of information among countries and their respective agencies, including FIUs. Some of those reasons are the following:

- 7.1.1. a lack of clear political commitment to cooperate internationally;
 - 7.1.2. the absence of adequate AML/CFT legislation and regulations covering domestic powers and their use on behalf of foreign authorities;
 - 7.1.3. inadequate staffing and lack of professional standing of FIUs;
 - 7.1.4. complex legal systems; and
 - 7.1.5. bureaucracy.
- 7.2. What can the international community do to alleviate and address the issues and concerns that hinder meaningful cooperation and help achieve a better system of information dissemination among countries and concerned authorities, particularly their FIUs? I would like to offer the following suggestions as examples of what international organizations (such as the IMF, the World Bank, the FATF, the United Nations, the Egmont Group, and the regulatory standard-setting bodies) could provide that may help improve the exchange of information:
- 7.2.1. create an awareness of the need for cross-border cooperation and information exchange;
 - 7.2.2. encourage countries to promote and enact flexible regulations, especially with respect to information sharing, both locally and internationally;
 - 7.2.3. promote the Egmont-MoU model for information exchange;
 - 7.2.4. support the setup of FATF-style regional bodies;
 - 7.2.5. support the creation of staff exchange programs among FIUs and other concerned agencies;
 - 7.2.6. sponsor and actively participate in regional and international training and seminars;
 - 7.2.7. take a lead role in promoting international cooperation and providing technical assistance; and
 - 7.2.8. consider setting up an international central database to be accessible to contributing FIUs, where possible.
- 7.3. In conclusion, I would like to underscore the importance of forging a partnership among the world's countries and, in particular, between the international organizations, on the one hand, and the concerned professional agencies of the respective countries, on the other hand.

This effort should aim at building a proper mechanism whereby all concerned find mutual benefit by recognizing and acting to meet the need for information sharing, thereby enhancing the financial and social stability of individual countries and the international community as a whole. In the process of forming such a partnership, however, they should always bear in mind the need to avoid red tape and unnecessary political complexities.

6

Cooperation and Exchange of Information on Supervision of Institutions in Relation to Prevention of Money Laundering and Terrorist Financing

ALVARO PINILLA RODRÍGUEZ

1. Description

- 1.1. This chapter focuses on the relationship between financial intelligence units (FIUs) and the bodies responsible for the supervision of those institutions that have special responsibilities in the fight against money laundering at the national and international levels.

2. Definition of Financial Intelligence Unit

- 2.1. A financial intelligence unit is defined by the Egmont Group¹ as:
“a central national agency responsible for receiving (and, as permitted, requesting), analysing and disseminating to the competent authorities, disclosures of financial information:
(i) concerning suspected proceeds of crime and potential terrorist financing, or
(ii) required by national legislation or regulation, in order to combat money laundering and terrorism financing.”
- 2.2. In order to meet the FIU’s objectives, it is essential that either there be a fluid relationship and exchange of information at the national level between the FIU and the authorities responsible for supervising the obligated institutions, or that the FIU has the power of supervision in

¹Interpretative Note concerning the definition of a Financial Intelligence Unit,” published by the Egmont Group on November 15, 2004.

relation to the prevention of money laundering and terrorist financing. In either case, it is important that there be a good relationship between the FIU and the supervisory body.

- 2.3. There needs to be a mechanism for international cooperation and information exchange that includes not only information about suspicious transactions, which may be of interest to an FIU in another country, but also information concerning the obligated institutions being supervised. Where the information concerns a supervised institution, and the body responsible for supervision of anti-money laundering/combating the financing of terrorism (AML/CFT) controls is the FIU, it is important that the FIU be able to share this information with the foreign supervisory body, as its counterpart, without informing the domestic supervisory authority.

3. Institutions with AML/CFT Obligations

- 3.1. The most significant institutions obliged to comply with the regulations on the prevention of money laundering and terrorist financing are in the banking sector, the securities sector, and the insurance sector. These sectors, especially banking, are normally responsible in most countries for a large share of the disclosures of suspicious transactions that are passed on to FIUs for further analysis. These sectors bring together institutions that, given their size and volume of business, are more liable to be used for money laundering and terrorist financing. For this reason, the Financial Action Task Force (FATF) Recommendations (and the Basel Committee on Banking Supervision's guidelines) include special requirements necessary for the effective prevention of these phenomena. The FATF Recommendations also require jurisdictions to ensure that compliance with these obligations by obligated institutions is monitored by an external authority—usually the supervisory authority but sometimes the FIU.

4. Measures to Be Adopted by Obligated Institutions

- 4.1. The FATF Recommendations and specific guidelines issued by the regulatory standard setters² require that obligated institutions adopt procedures and controls, which, in view of their importance, are listed here:

²See, for example, the Basel Committee's papers, "Customer Due Diligence for Banks" and "General Guide to Account Opening and Customer Identification" on the Web at <http://www.bis.org>.

- 4.1.1. internal controls and compliance departments appropriate for their size and structure;
 - 4.1.2. clearly defined internal regulations and corporate policies for the prevention and control of money laundering and terrorist financing;
 - 4.1.3. procedures to identify customers, to know their business, and to build a profile of the expected account activity (with the level of detail to be determined on a risk-weighted basis);
 - 4.1.4. procedures for monitoring the activity on the account so as to compare it with the expected profile and thereby detect unusual transactions (using automatic means wherever possible);
 - 4.1.5. established internal rules for the disclosure of suspicious transactions;
 - 4.1.6. appointment of a person or a department in the institution able to provide advice and to receive reports;
 - 4.1.7. training for all staff of the institution;
 - 4.1.8. controls applicable to subsidiaries and branches in foreign countries; and
 - 4.1.9. specific procedures for high-risk areas and businesses.
- 4.2. These are mentioned only as a brief guide to those aspects that should be considered in order to ensure effective supervision of obligated institutions by national authorities.

5. How Should Supervision Be Carried Out and by Whom?

- 5.1. The task of supervising institutions to prevent money laundering and the financing of terrorism should be carried out only by the FIU where this supervisory role has been assigned to the FIU. Otherwise, it should be carried out by the relevant sector supervisor.
- 5.2. If the task of supervision lies with the sector supervisor, this assignment of responsibility will have the following advantages:
 - 5.2.1. it will take advantage of the human resources and experience of the supervisory teams in inspection tasks—in that the supervisors will be familiar with the business, organization, personnel, and culture in the financial institution, all of which are relevant to the effective analysis of compliance with the special

requirements relating to money laundering and terrorist financing; and

- 5.2.2. preventing money laundering and terrorist financing would be one of the areas to cover within broader inspection, and the supervisor can examine and apply controls that are valid for both financial aspects and for checking compliance with the obligations on prevention of money laundering and terrorist financing.
- 5.3. When the FIU plays the role of supervisor, the advantages are as follows:
 - 5.3.1. it will be able to take advantage of the specific experience it has accumulated regarding money laundering and terrorist financing of the FIU; and
 - 5.3.2. it will be easier for the FIU, which will receive all suspicious transaction reports, to monitor the performance of institutions in submitting reports and to take remedial action where appropriate.
- 5.4. Whatever course is chosen, it is essential to ensure proper coordination between the supervisory authorities and the FIU. Moreover, it will be essential to have adequate human resources to ensure proper coverage of obligated institutions.

6. The Case of Spain

The Supervisory Function

- 6.1. Responsibility for supervision tasks on money laundering issues lies with the Spanish financial intelligence unit, the Servicio Ejecutivo de la Comisión de Prevención de Blanqueo de Capitales e Infracciones Monetarias (SEPBLAC). This role gives SEPBLAC direct permanent knowledge of the systems for prevention of money laundering and terrorist financing of the obligated institutions in Spain.
- 6.2. This knowledge is complemented by a specific procedure for the evaluation of disclosures of suspicious transactions from obligated institutions, which this chapter does not aim to describe.

Types of Supervision and Selection of Institutions for Inspection

- 6.3. Supervision visits to obligated institutions may be initiated on either the initiative of the institution itself or the requirement of the authorities. In turn, visits may be general or specific.

- 6.4. An annual supervision plan is drawn up for a set of institutions that are to be inspected. These are selected according to a number of parameters, including:
 - 6.4.1. the level of risk of the sector to which they belong;
 - 6.4.2. the number and quality of the disclosures of suspicious transactions received; and
 - 6.4.3. compliance with the requirements of the organization and procedures for the prevention of money laundering and terrorist financing.

Scope of Supervision Visits

- 6.5. Supervision visits to obligated institutions focus primarily on the following two areas:
 - 6.5.1. review of the regulatory compliance department (on the prevention of money laundering and terrorist financing): its organization, structure, and functions; and
 - 6.5.2. compliance with the internal procedures and controls established for the prevention of money laundering and terrorist financing.
- 6.6. On a more detailed level, they should include a review of the following points:
 - 6.6.1. organization of the institution;
 - 6.6.2. corporate policies;
 - 6.6.3. policies and procedures on knowing their customers;
 - 6.6.4. high-risk transactions;
 - 6.6.5. disclosures of suspicious transactions;
 - 6.6.6. controls applied to subsidiaries and branches; and
 - 6.6.7. specific procedures for high-risk areas and businesses.

Conclusion of Supervision Visit

- 6.7. At the end of the visit, a report is prepared stating the inspected institution's level of compliance with the requirements for prevention of money laundering and terrorist financing.
- 6.8. The risk of exposure to transactions relating to money laundering to which the institution is exposed is also evaluated, for the internal use by the office.

- 6.9. The most important point is the *preparation of a series of written recommendations on those measures that the institution should adopt and implement*. This report is sent to the regulatory compliance officer and the senior management of the institution.
- 6.10. The institution must reply to this report within the period established, explaining how the process of adoption and implementation of these measures will be undertaken.
- 6.11. SEPBLAC's supervisory department will verify this process through the following phase, which is referred to as *recommendation follow-up*.

Recommendation Follow-Up

- 6.12. In this phase, SEPBLAC's supervisory department has to verify that the measures have been adopted and implemented. To do so, it requires that the institution provide the relevant documentary evidence. Where necessary, it will carry out a fresh inspection visit to make the necessary checks in situ.
- 6.13. Lack of compliance with the recommendations drawn up by SEPBLAC constitutes an infringement of Spanish regulations on the prevention of money laundering and may result in penalties being imposed in accordance with these regulations, such as civil fines, public or private statements of censure, and the temporary removal of certain officers.

Supervision Undertaken in Framework of Agreements with Sector Supervisors

- 6.14. As noted previously, it is important to ensure close coordination between the FIU and the corresponding sector supervisors in respect of supervision of the procedures and bodies that the obligated institutions have to establish to enable them to prevent money laundering and terrorist financing. To do so, it is necessary to define the terms of the collaboration between the FIU and the supervisory body in a document, which should also specify the procedure to carry out these tasks in a coordinated way.
- 6.15. To implement an effective collaboration mechanism, the agreements between the FIU and the supervisor should describe and specify at least the following relevant aspects:
 - 6.15.1. Money laundering prevention may be the object of an inspection visit or one of the areas covered by the inspection team within the context of a general inspection. Where the FIU,

rather than the supervisor, has responsibility for monitoring compliance with money laundering and terrorist financing obligations, there is a danger of inconsistent approaches; and it is essential that any recommendations for changes made by the supervisor are agreed to by the FIU, so that they will be in conformity with its criteria and needs, and be subject to periodic review and update.

- 6.15.2. Again, where the FIU is responsible for supervision of compliance with defenses against money laundering and terrorist financing, there may be a further problem if the priorities of the FIU and the supervisor are different. The FIU should therefore indicate the institutions, in accordance with their appropriateness, that it wishes to have included in the supervision plan for the prevention of money laundering.
- 6.15.3. The supervisor makes the inspection visit and prepares the final report, sending either his report or the chapter on the prevention of money laundering, as applicable, to the FIU.
- 6.15.4. On the basis of the report by the supervisor's inspectors, the FIU formulates its written recommendations.
- 6.15.5. The supervisor follows up these recommendations and reports back to the FIU on the adoption and implementation of the measures adopted by the supervised institution.
- 6.16. The agreement may also encompass cooperation between the two institutions on the detection and identification of practices or transactions by institutions, which may constitute infringements of the regulations on the prevention of money laundering or, in general, other regulations of the sector in which they operate.
- 6.17. The agreement may envisage, and contribute effectively to, the maintenance of a permanently updated census of all institutions in the sector. This is a particularly useful tool for the FIU when it is controlling and maintaining an up-to-date census of obligated institutions.

Requirements to Be Met by Newly Created Institutions

- 6.18. The new regulations implementing Spanish legislation, which have recently come into force, establish that financial institutions (including bureaux de change and money transfer companies), firms operating in the stock market, and insurance companies must have a prior favorable report on their systems of compliance with rules on money laundering

and terrorist financing issued by SEPBLAC before receiving authorization to start business.

Cooperation and Information Exchange at National Level

- 6.19. At the national level, we can distinguish two types of cooperation:
- 6.19.1. between supervisors and the FIU, as was alluded to previously; and
 - 6.19.2. between obligated institutions and the FIU, other than that relating to the process of supervision and emanating from the former's obligations to notify the latter of suspicious transactions.
- 6.20. This second case refers to other forms of cooperation, such as
- 6.20.1. profiles of suspicious transactions and irregularities specifically affecting the sector in question; and
 - 6.20.2. sessions, training activities, and forums for exchange of experience between obligated institutions and the FIU.
- 6.21. It is worth noting that in no circumstances will the information obtained be subject to restrictions upon the FIU's ability to pass it on to the law-enforcement authorities when there are signs that it is related to money laundering or terrorist financing.

Cooperation and Information Exchange at International Level

- 6.22. In the Spanish experience, apart from the exchange of information arising from suspicious transaction reports, the most common case where international cooperation arises or becomes necessary is where the head office of a financial institution, as a result of its own internal procedures, has doubts about whether a foreign subsidiary is complying with the regulations on prevention of money laundering and terrorist financing applicable in its host country.
- 6.23. Cooperation in this sphere should take place between the FIUs of the two countries, or between the FIU and the supervisory authority. In any event, international cooperation will seek to prevent obligated institutions from taking advantage of the territorial scope of the regulations and will encourage the involvement of the head office, which in any case should know and oversee adequately the subsidiary's compliance with the rules on the prevention of money laundering and terrorist financing.

International cooperation on Revised Forty Recommendations of the Financial Action Task Force/Grupo de Acción Financiera sobre el Blanqueo de Capitales (FATF/GAFI)

- 6.24. It is, again, worth highlighting that this discussion is referring to forms of cooperation and information exchange other than those relating to the disclosures in suspicious transaction reports.
- 6.25. The new Forty Recommendations of the FATF also cover this type of cooperation in Recommendation 40 (supplemented by its Interpretative Note).
- 6.26. It is worth highlighting the following points regarding Recommendation 40's content:
- 6.26.1. it states that the *competent authorities* must provide the widest possible range of international cooperation to their foreign *counterparts*;
 - 6.26.2. it defines these terms, for the purposes of the FATF Recommendation, as follows:
 - *competent authorities* are those administrative and law-enforcement authorities, including FIUs and supervisory bodies, concerned with combating money laundering and terrorist financing; and
 - *counterparts* are those authorities that exercise similar responsibilities and functions;
 - 6.26.3. it specifies that exchanges of information must also be encouraged with institutions that are not considered counterparts for these purposes, when the capacity to obtain this information is not within the competence of the counterpart;
 - 6.26.4. exchanges of information may take place on the basis of signed agreements or be based on the principle of reciprocity, but such preconditions are not required and, indeed, it is best to have as few preconditions as possible; and
 - 6.26.5. the scope of cooperation, as it is observed, is covered by the new text of the Forty Recommendations such that there is no scope for alleging conflicts of competencies between the parties when either is seeking to provide the other country with relevant information on issues concerning money laundering and terrorist financing.

- 6.27. Additionally, the new concept of exchange of information, present throughout the international regulatory sphere, contemplates the possibilities that information is passed on either at the request of one of the parties or spontaneously. This latter case will include within its scope the spontaneous sending of information on a subsidiary under the supervision of the authority of the country in which it operates, to the corresponding authority in the country in which its head office is based, when irregularities have been detected in the host country as regards the compliance with the regulations on the prevention of money laundering and terrorist financing. Equally, it is important that the supervisor or FIU in the country where the head office of a multinational institution is situated inform the FIU or supervisor of the country where a subsidiary is located when they have information about money laundering or terrorist financing that takes place in the country of the head office but has implications for accounts in the subsidiary. This is consistent with the requirements that already exist in respect of supervision of financial institutions.

Insurance and Banking Supervision

7

Cooperation in the Insurance Sector

PETER NEVILLE

1. Background

- 1.1. The International Association of Insurance Supervisors (IAIS) is pleased to be invited to contribute to this book on cross-border cooperation and information exchange. I am writing this chapter as a member of the Executive Committee of the IAIS on behalf of the IAIS as a whole.

2. Insurance Core Principles

- 2.1. The standards established by the IAIS apply to all insurers and insurance intermediaries, whether they are onshore or offshore. What is important from the perspective of the IAIS is whether or not a jurisdiction is well regulated and cooperative—not whether it is onshore or offshore. Any jurisdiction that is unable to meet the required standards of supervision and cooperation is expected to change its regime. A jurisdiction's small size and arguments that it lacks sufficient staff resources do not justify a failure to meet international standards. One of the IAIS's important roles is to provide technical assistance and training to jurisdictions that have the willingness to meet our standards but lack the technical knowledge to do so.
- 2.2. The standards set by the IAIS are embodied in 28 Insurance Core Principles (ICPs). The ICPs cover the supervision of insurers, reinsurers, and insurance intermediaries. They establish detailed provisions for the overall structure of a supervisory system and the standards that should be in place for supervised entities, ongoing supervision, prudential requirements, and protection of consumers and the market.

- 2.3. ICP 5 deals specifically with supervisory cooperation and information sharing. It states that efficient and timely exchange of information among supervisory bodies, both within the insurance sector and across all the financial services sectors, is critical to effective supervision, particularly in the case of internationally active insurers, including financial conglomerates. It also states that the information to be exchanged should include
- 2.3.1. relevant supervisory information, including specific information requested by another supervisor and gathered from a supervised entity;
 - 2.3.2. relevant financial information; and
 - 2.3.3. information on individuals holding positions of responsibility.
- 2.4. Not just ICP 5, however, but all of the IAIS Core Principles are relevant to international cooperation. All the ICPs work together. For example, they identify who should be supervised, and they require that supervised entities have appropriate information to manage their risks. The ICPs also clearly state that supervisors should have the power to undertake on-site inspections.

3. Memoranda of Understanding (MoUs)

- 3.1. ICP 5 states that a formal agreement with another supervisor is not a prerequisite for information sharing and that supervisors should provide information to their counterparts even where they consider that the other supervisor cannot reciprocate. The problem is that, currently, some supervisors require MoUs to have been signed before they will disclose information. Obviously, this inhibits information flows—especially if an MoU is not sought until a request for information is made between the two supervisory bodies in question—which is far from being ideal.
- 3.2. From the IAIS's perspective, it is paramount that a supervisor have the legal ability to disclose information to other supervisors and be able to obtain and disclose information at the request of other supervisors. Such requests can cover a wide range of matters, including basic due diligence where supervisors need to ascertain the standing of applicants for licenses (and their controllers, associated companies, and directors) where they have a track record in other jurisdictions; the spontaneous disclosure of information to other supervisors where one part of a global group develops a problem; or the proactive investigation of problems by

supervisors with their counterparts in other jurisdictions. As long as the legal framework is sufficiently robust, it should not matter whether an MoU is in place.

4. Regional Cooperation

- 4.1. The distinction that is sometimes drawn between regional and international cooperation is artificial. As humans, we are probably, naturally, more helpful and open to people we know well or who share the same culture. These people are often likely to be in neighboring jurisdictions. Although groups such as the IAIS enable supervisors from around the world to meet each other and develop contacts (and I very much welcome the establishment and deepening of relationships in this way), this is no substitute for a positive attitude toward assisting fellow professionals—wherever they are based—in carrying out their supervisory functions. Insurers and their clients are becoming more global, and we supervisors must follow suit.

5. Confidentiality

- 5.1. ICP 5 emphasizes that cooperation and sharing of information should be subject to confidentiality requirements. The IAIS requires supervisors to take reasonable steps to ensure that any information they release will be treated as confidential by the recipient and that it will be used only for supervisory purposes. This can be achieved either through formal agreements, such as MoUs, or by attaching a condition to the information when it is disclosed.
- 5.2. This issue of confidentiality can be a difficult one, but, as with most other problems in relation to cooperation, if there is a difficulty in respect of ensuring that information provided to another regulator remains confidential, one solution is for supervisors to talk to each other. A telephone call really can help. There is usually a form of words that can be found either to put into a formal agreement or specify as a condition, attached to the information itself, which solves the problem. For example, a condition might allow the receiving supervisor to use the information only for regulatory purposes or for onward transmission only to specific law-enforcement or prosecuting authorities.

6. Links Between Supervisory and Law-Enforcement Authorities

- 6.1. ICP 5 recognizes that supervisory authorities increasingly need to share information relating to anti-money laundering (AML) and the

combating of the financing of terrorism (CFT) and fraud. It is easy to imagine situations where a supervisor finds information during an on-site inspection that provokes suspicion that a crime has been committed and where the intelligence should be discussed with law-enforcement agencies.

- 6.2. ICPs 27 and 28 impose on supervisory authorities the responsibility to require insurers and intermediaries to combat fraud and to comply with the Financial Action Task Force (FATF) Recommendations. They also require supervisory authorities to communicate with law-enforcement authorities and financial intelligence units (FIUs) as well as other supervisors. The need for cooperation is emphasized in the revised AML/CFT Guidance Notes issued by the IAIS after the IAIS Annual Conference held in Amman in October 2004. I want to stress that the Guidance Notes apply to all insurance supervisors and all kinds of insurance business—not just the life and other investment-related business included in the FATF’s recommendations.
- 6.3. We are now living in a world where supervisors should have routine contact with domestic law-enforcement authorities and FIUs. Much of this contact will need to be achieved without formal agreements—if for no other reason than because it is not yet routine for MoUs to be signed between supervisory and law-enforcement agencies. Historically, the disclosure of information by most supervisory agencies to law-enforcement authorities has been difficult, both philosophically and practically. With the increasing involvement of supervisors in AML/CFT and countering fraud, however, there is every reason for regulatory legislation to provide gateways for supervisors to exchange information with those authorities concerned with the prevention, detection, investigation, or prosecution of financial crime. This does not mean bypassing the normal checks and balances that apply to the collection and use of information by law-enforcement authorities. I am not suggesting that supervisory bodies should be used in place of law-enforcement bodies to obtain intelligence or evidence; but in the course of carrying out their regulatory functions, supervisors can and do come across information that can usefully be provided to law-enforcement agencies. Supervisors and law enforcers are working toward common goals in countering economic crime—there is no reason why a partnership approach cannot be adopted, even in the absence of an MoU. My experience, in various jurisdictions—and in relation to all areas of financial services regulation, not just insurance—is that the cooperative approach works.

7. The IAIS's AML/CFT Guidance Notes also stress that, in respect of sharing information between supervisors,

- 7.1. supervisors should not refuse a request for assistance on the ground that the request is considered to involve fiscal matters; and
- 7.2. supervisors should be able to conduct inquiries on behalf of foreign supervisors.

8. Cooperation Between Financial Service Businesses

- 8.1. The IAIS AML/CFT Guidance Notes address the need for the transmission of information between regulated institutions, not just between supervisors—for example, where business is introduced. It is important that the information be adequate, timely, and from a reliable source.

9. Role of International Financial Institutions

- 9.1. I consider that international financial institutions such as the IMF can assist the process of cooperation in two ways.
 - 9.1.1. First, they can help achieve better coordination between—and greater involvement of—all the standard-setting bodies to ensure there is a level playing field for all financial centers and between financial sectors.
 - 9.1.2. Second, in light of their increasing experience in such areas, they could engage with the standard-setting bodies to gather information—case studies perhaps—on the problems that inhibit cooperation, whether these are legislative, administrative, procedural, or simply the result of human reluctance. Information and case studies of this kind would be very useful and could be shared, so that we can learn from them. Safeguarding the international financial system depends not only on good regulation but also on good cooperation.

10. Conclusion

- 10.1. The IAIS has clear standards on cooperation, both in the general context and specifically in relation to AML/CFT. The IAIS guidance paper on AML/CFT has now been published. The IAIS has also published a model MoU that supervisors can draw upon, but our experience in insurance is that cooperation and information exchange work well between supervisors even in the absence of MoUs.

- 10.2. The IAIS welcomes the use of MoUs where they open gateways and ease cooperation, but what is much more important—indeed it is a prerequisite for having an MoU—is that each jurisdiction have the legislation that gives the supervisor the power to collect the information it needs and then creates the gateways required to share that information with other supervisors that need it.

8

Cooperation in the Banking Sector

Y. K. CHOI

1. Description

- 1.1. This chapter discusses the practices in Hong Kong Special Administrative Region (SAR), in terms of cross-border cooperation and information sharing with other banking supervisors. It also covers the arrangements for sharing information with the other financial regulators in Hong Kong SAR.

2. Importance of Supervisory Cooperation and Information Exchange

Globalization of Banks

- 2.1. The banking industry in Hong Kong SAR is now highly internationalized. For instance, 111 out of 135 banks are foreign banks. In addition, several major retail banks are owned by international banking groups. Many local banks have also established overseas branches or subsidiaries. To help ensure the safety and soundness of international banking groups and banks with overseas establishments, banking supervisors need to cooperate effectively with other supervisors on a cross-border basis.
- 2.2. The increasing trend of cross-border fraud cases, such as money laundering, terrorist financing, and e-banking fraud, also calls for cross-border supervisory cooperation and information sharing among financial authorities.
- 2.3. The Basel Committee on Banking Supervision has established a set of international minimum standards for the supervision of international

banking groups and their cross-border establishments. The standards essentially require that the home supervisor of an international bank exercise consolidated supervision of the bank as a whole, whereas the host supervisor is responsible for the supervision of the bank's branch in that jurisdiction.

Financial Conglomerates

- 2.4. There has been an emergence of financial groups that provide a range of financial services, such as banking, securities, and insurance. For example, earlier research suggested that around one-third of European bank deposits belonged to financial conglomerates. Banks in Hong Kong SAR have also been diversifying their income sources into securities brokerage, wealth management, and insurance through their branch networks or subsidiaries. In order to exercise effective consolidated supervision, there is a need for banking supervisors to strengthen their cooperation with regulators of the securities and insurance sectors to help ensure the safety and soundness of the banks concerned.
- 2.5. The Basel Committee on Banking Supervision, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors have jointly issued a number of papers on the principles regarding the supervision of financial conglomerates. These principles highlight, among other things, the importance of information sharing among financial supervisors of different industries and the need for identifying a primary supervisor of a financial conglomerate, having regard to its structure and principal activities.
- 2.6. Although each supervisor needs to perform its statutory responsibility, coordination is necessary to ensure that supervisory information is shared promptly among the authorities and that supervision is coordinated to avoid overlaps or gaps.

3. Experiences with Cross-Border Cooperation and Information Exchange

Mechanism in Place in Hong Kong SAR

- 3.1. In order for the authorities to have the power to share information, there must be explicit provisions in the banking laws. The Banking Ordinance in Hong Kong SAR allows the Hong Kong Monetary Authority (HKMA) to disclose supervisory information to an overseas financial authority to facilitate the performance of the latter's supervisory duties, provided that the authority concerned is subject to adequate

secrecy provisions and the disclosure is not contrary to the interests of depositors or the public interest. The HKMA can also provide individual customers' information to an overseas supervisory authority if it is satisfied that this will help the overseas authority to perform its duties. Such disclosure, however, will be made only on a "need-to-know" basis. In disclosing information to another supervisory authority, the HKMA will normally require the recipient authority not to disclose the information to any third party without the prior consent of the HKMA. Where the recipient authority is compelled by laws to disclose the information received from the HKMA to a third party, the HKMA's usual practice is to not unreasonably withhold consent for the recipient authority to reveal the information.

- 3.2. The HKMA has signed memoranda of understanding (MoUs), or exchanged letters of cooperation, with the financial authorities of 10 jurisdictions.¹ In determining whether to enter into an MoU with an overseas financial authority, the HKMA would generally consider the extent of the relationship between the Hong Kong SAR banking sector and the banking sector of the jurisdiction concerned, and the adequacy of the counterpart's secrecy provisions. Even without entering into an MoU, the HKMA may also share supervisory information with overseas financial authorities, provided that there is a need to do so and the recipient authorities are subject to adequate secrecy provisions in their own jurisdictions. The existence of an MoU helps to clearly specify the type of information to be shared and the need to maintain secrecy.
- 3.3. The HKMA may exchange supervisory information with overseas financial authorities in writing or through regular bilateral meetings. In many cases, we found other channels, such as telephone discussions, e-mails, or ad hoc meetings with overseas authorities, useful, since such channels allow the parties involved to promptly clarify and exchange information on issues of common interest.

An Example of Bilateral Cross-Border Cooperation

- 3.4. The HKMA was notified by an overseas financial authority of a potential fraud case involving staff of the Hong Kong SAR branch of a foreign bank. As a result of the information, the HKMA carried out an assessment on the adequacy of the relevant controls of the Hong Kong branch, and the fitness and propriety of the staff concerned. The

¹Canada, China, Denmark, France, Germany, Indonesia, Macao Special Administrative Region (SAR), the Netherlands, the United Kingdom, and the United States.

HKMA also discussed the case with the home regulator of the foreign bank concerned to facilitate the home regulator's supervision of the bank as a whole. The information sharing helped the HKMA to understand the nature of the case and the weaknesses in the internal controls of the Hong Kong branch concerned.

4. Experiences with Cross-Sectoral Cooperation and Information Exchange

Overview of Cooperation with Local Financial Authorities

- 4.1. The Banking Ordinance in Hong Kong SAR allows the HKMA to share supervisory information with the other three local financial authorities—the Securities and Futures Commission (SFC), the Insurance Authority (IA), and the Mandatory Provident Fund Schemes Authority (MPFA)—and other local agencies, such as the police, under certain conditions. As mentioned before, banks are allowed to offer financial services on securities, insurance, and provident funds through their branch networks or subsidiaries. The HKMA, the SFC, the IA, and the MPFA need to exchange and share information to help ensure the safety and soundness, and proper conduct of the banks concerned. To this end, the HKMA has signed MoUs with the SFC, the IA, and the MPFA to strengthen cooperation on supervision of entities or financial groups in which both parties have a mutual interest. Regular meetings are held with these authorities to exchange information.
- 4.2. These arrangements are important, since the problem of a financial conglomerate that has emerged in one financial sector might have a spillover effect on other sectors of the same group. Any significant problems of a major financial conglomerate would affect not only the conglomerate but also the stability of the financial sector or even that of the entire financial system. Regarding the supervision of complex financial conglomerates, a lead supervisor needs to be appointed to coordinate supervisory efforts so as to ensure information is shared promptly among regulators. Generally speaking, the supervisor responsible for supervising the core business of the financial conglomerate would be selected as the lead supervisor of the group.

Cooperation with SFC

- 4.3. In Hong Kong SAR, the HKMA is the front-line regulator of the securities business of banks. In this connection, the HKMA has been cooperating with the SFC to ensure that the same supervisory standards

applicable to securities firms will be applied by the HKMA to banks' securities business. In particular, the HKMA has sought the SFC's clarification of the relevant regulatory guidelines and standards for securities business, and exchanged information with the SFC whenever there has been a need to do so.

5. Conclusions

- 5.1. With the globalization of banks and emergence of financial conglomerates that operate in different financial sectors, information sharing and cooperation with other domestic and overseas supervisors have become increasingly important to banking supervisors. On the one hand, each supervisory authority should review whether there are any hindrances, in its legislation, to information sharing with overseas supervisors as well as with other local supervisors, and should take appropriate actions to remove such hindrances. On the other hand, supervisory authorities should also review whether adequate secrecy provisions are in place in their legislation to give assurances to authorities providing information that such information would not be passed to another party without the latter authorities' prior consent.



Supervising International Banks: Swiss Regulatory Practice

EVA HÜPKES¹

1. Introduction

- 1.1. A robust framework for cross-border supervision is of key importance to the Swiss Federal Banking Commission (SFBC), which is Switzerland's supervisory authority for banks as well as collective investment funds, securities firms, and securities exchanges.
- 1.2. The reasons are quite obvious. First, Switzerland has, and has always had, a large presence of foreign banks. There are about 350 banks incorporated in Switzerland, 124 of which are foreign owned, and 28 branches of foreign banks. Second, Switzerland is the home of two large, internationally active financial groups that have branches and subsidiaries in more than 30 countries and have the majority of their assets booked abroad. The SFBC thus plays a significant role as both home regulator and host regulator and, as such, needs to cooperate closely with foreign home and host regulators.
- 1.3. The Basel Committee on Banking Supervision's (hereinafter referred to as the Basel Committee) Concordat (1983), Minimum Standards (1992), Report on Cross-Border Banking Supervision (1996), and Core Principles (1997) state the principles that no banking establishment should escape supervision and that all foreign establishments are subject to effective consolidated supervision. More recently, consolidated

¹The text benefited from helpful comments by Marco Franchetti. It is intended as a description of the current legal framework and regulatory practice in Switzerland.

supervision has been extended beyond prudential requirements and the management of banking risk to the management of legal and reputational risk on a consolidated basis and the group-wide application of due diligence standards to avert money laundering/ financing of terrorism (ML/FT) risk. As such, and as set forth in the Basel Committee's Papers on Customer Due Diligence (2001) and Consolidated KYC Risk Management (2004), banking groups are expected to apply accepted know-your-customer (KYC) policies and procedures to both their local and overseas operations. To exercise consolidated supervision and to verify compliance with all relevant rules and procedures in a cross-border context, the regulator relies on intragroup information flows and supervisory cooperation and information sharing. The following sections review the underlying regulatory framework for those two components of cross-border supervision in Switzerland.

2. Intragroup Information Flows

- 2.1. A prerequisite for effective consolidated supervision is that the information necessary can flow from the branch or subsidiary to the head office or parent. If the group does not have the necessary data or cannot verify compliance with its internal policies, rules, and procedures within the entire group, it cannot adequately manage and control its group-wide risks, nor can the supervisory authority accomplish its mission of consolidated supervision. Intragroup information flows are by far the most important channel for cross-border supervisory information. It is therefore important that there be no impediments to the flow of information from a foreign establishment to its parent institution. The SFBC therefore regards the free flow of information necessary for consolidated supervision from the foreign establishments to the Swiss parent as a prerequisite for allowing Swiss banks to set up establishments in other jurisdictions.
- 2.2. For branches and subsidiaries of foreign banks in Switzerland, Swiss law allows the flow of information from a Swiss banking subsidiary or branch to its foreign parent for the purpose of group internal control and consolidated supervision. Banking secrecy is waived vis-à-vis the group for the purpose of consolidated supervision.²

²See Daniel Zuberbühler, Director, Swiss Federal Banking Commission, "Regulatory Challenges for Swiss Banking Secrecy," 30 Years Association of Foreign Banks in Switzerland, Conference on "Foreign Banks in Switzerland: On Course in Choppy Waters" held in Zurich, June 21, 2002, available on the Web at <http://www.ebk.ch/e/archiv/2002/pdf/neu05e-02.pdf>.

2.3. In application of Article 4 quinquies³ of the Swiss Banking Act, information necessary for consolidated supervision purposes can be directly transmitted from a Swiss banking subsidiary or branch of a foreign bank or financial group to its foreign head office or parent company, subject to the following conditions:

2.3.1. *Speciality.* The information transmitted must serve exclusively internal control and supervisory purposes, which include the verification of compliance with all prudential and other regulatory requirements, including anti-money laundering/combating the financing of terrorism (AML/CFT) obligations of the bank.

2.3.2. *Confidentiality.* The foreign parent company and its supervisory authority must be subject to professional or official secrecy and be prohibited from disclosing information to third parties without a specific legal basis. It is acknowledged that the principle of confidentiality is limited by legal constraints, such as the obligation to report suspicious transactions under AML/CFT provisions or legally enforceable demands for information.

2.3.3. *“Long-arm principle.”* The information must not be retransmitted to third parties without the Swiss banking institution’s prior consent. Best efforts suffice, in that it is acknowledged that in all jurisdictions there may be legal constraints that require a retransmission of information by law, by court order, or as a result of parliamentary investigation.

3. Information Sharing in AML/CFT Context

3.1. The scope for intragroup information sharing is no longer limited to credit risks on the asset side, but encompasses the entire universe of risks, including legal and reputational risk associated with ML/FT. To a limited extent, the shared information may relate to individual customers; otherwise, banks would not be able to monitor concentration and funding risk, verify the proper application of KYC standards, and evaluate the risk associated with certain higher-risk customers on a group-wide basis. The customers’ consent is not required. The foreign supervisor may gain access to this information in the course of its supervisory activities. Yet, if the supervisor seeks specific information from foreign establishments, it must circumvent formal admin-

³Article 4 quinquies came into effect in 1995.

istrative assistance procedures by taking advantage of intragroup information flows.

- 3.2. The SFBC Anti-Money Laundering Ordinance⁴ extends the scope of group-wide information sharing more explicitly to customer-related information. This is in line with the international recommendations contained in the Basel Committee's customer due diligence paper,⁵ which more recently was further supplemented by a paper on consolidated KYC risk management.⁶ The SFBC's ordinance requires that the group compliance unit at the head office can gain access, if necessary, to the business relationships of all affiliated companies located in Switzerland and abroad, in order to verify compliance with KYC standards. A centrally held client base is not required. The Basel Committee has stressed this principle in connection with the fight against terrorist financing:⁷ “. . . information would be kept at branches and subsidiaries and made available to the parent bank on request, or at the initiative of the branches and subsidiaries when the reputation or liability of the group could be threatened by the relationship [italics added].” Should banks face impediments to direct access to customer data in foreign branches or subsidiaries, or where foreign laws disallow the communication of relevant customer information to the Swiss parent, they are required to inform the SFBC. If the SFBC is informed of such barriers, the SFBC will contact the foreign regulator in order to confirm whether there are genuine legal impediments and explore alternative arrangements satisfactory to the SFBC. If the impediments prove insurmountable, the SFBC may require banks to close down their

⁴Ordinance of the Swiss Federal Banking Commission concerning the Prevention of Money Laundering (SFBC Money Laundering Ordinance, MLO SFBC), December 18, 2002, available on the Web at <http://www.ebk.ch/d/regulier/pdf/gvv-181202-e.pdf>. See Article 9.

⁵The “Customer Due Diligence for Banks” paper of the Basel Committee of 2001 (available on the Web at <http://www.bis.org/publ/bcb85.pdf>) requires supervision on a global basis of all important customer relationships; see, in particular, Section 16: “Customers frequently have multiple accounts with the same bank, but in offices located in different countries. To effectively manage the reputational, compliance and legal risk arising from such accounts, banks should be able to aggregate and monitor significant balances and activity in these accounts on a fully consolidated worldwide basis, regardless of whether the accounts are held on balance sheet, off balance sheet, as assets under management, or on a fiduciary basis.”

⁶Basel Committee on Banking Supervision, “Consolidated KYC Risk Management,” October 2004, available on the Web at <http://www.bis.org/publ/bcb110.pdf>.

⁷Basel Committee on Banking Supervision, “Sharing of Financial Records Between Jurisdictions in Connection with the Fight Against Terrorist Financing,” April 2002, which is the summary of a meeting of representatives of supervisors and legal experts of the Group of Ten central banks and supervisory authorities on December 14, 2001 in Basel.

operations, or prohibit them from setting up establishments, in the jurisdiction.

- 3.3. Branches and subsidiaries of foreign financial intermediaries in Switzerland must likewise grant group auditors or compliance staff of the foreign head office or parent access to data on individual clients and beneficial owners that are kept in their Swiss offices.⁸ They may also proactively provide information concerning higher-risk customers and activities to the head office or parent bank. For instance, if they are requested by their head office to search their files against a list of individuals or organizations suspected of aiding and abetting terrorist financing or money laundering, they may report back matches that they find. Such information does not constitute a violation of the “tipping-off” prohibition stipulated by the Anti-Money Laundering Law if, at the same time, they have the obligation to file a suspicious transaction report to the Swiss financial intelligence unit, the Money Laundering Reporting Office of Switzerland (MROS).⁹

4. Cooperation on Domestic Level

- 4.1. The SFBC has access to all information from the banks and their external auditors necessary to fulfill its supervisory mandate and may also order special audits to obtain necessary information. Swiss banks are subject to extensive record-keeping requirements. The SFBC Anti-Money Laundering Ordinance requires banks to be organized in such a way as to be able to respond to information requests from authorities within a reasonable time and to establish, by means of documented proof, whether or not a particular individual is a customer of the bank or has the power to represent a customer, or is a beneficial owner of an account held with the bank, or has carried out a cash transaction, which required identification. The account opening documentation, as well as the transaction records, must be retained for at least 10 years.

⁸Article 9 of the Anti-Money Laundering Ordinance states that “financial intermediaries forming part of a financial group, either from Switzerland or abroad, shall allow the group’s internal control bodies and external auditors to access any information which may be required concerning specific business relationships, provided that such information is essential for the management of legal and reputational risk on a global basis.”

⁹Article 10 of the Swiss Anti-Money Laundering Law provides that a financial intermediary must freeze the assets that are linked to the reported suspicious transaction until a formal order is received from the prosecuting office, but only for a maximum of five days, during which the concerned client or a third party must not be informed.

- 4.2. The SFBC may share information with other Swiss regulatory authorities. As such, the SFBC, on a regular basis, shares information with the Swiss National Bank. It also cooperates with the Federal Office of Private Insurance, in particular, with respect to the supervision of financial conglomerates. On AML/CFT, the SFBC works closely with the MROS and the Money Laundering Control Authority,¹⁰ which oversees the application of the Money Laundering Act by all financial intermediaries and other professions that are not subject to a special supervisory regime.¹¹
- 4.3. The SFBC is required to provide information, upon request, to federal and cantonal law-enforcement authorities. The information sharing operates in both directions, in that the SFBC may also request information from law-enforcement authorities, for instance where impending cases are relevant to judge compliance with licensing and operating requirements. The SFBC has, however, shared information, to a more limited extent, on several occasions with Swiss tax authorities on supervised institutions and their shareholders.

5. Supervisory Cooperation on International Level

- 5.1. Besides intragroup information flows, the SFBC relies, for effective cross-border supervision, on supervisory cooperation information exchange, which takes various forms:
 - 5.1.1. *Regular contacts.* Regular personal contacts with foreign home or host country supervisors to discuss supervisory matters and other issues of mutual interest are key to keeping abreast of regulatory developments. They enhance efficient cooperation and serve to build trust. The SFBC holds trilateral meetings two or three times a year with the Federal Reserve Bank of New York and the Financial Services Authority in the United Kingdom. Similar arrangements are in the process of being set up with other supervisory authorities. There is no formal legal underpinning or agreement to hold such meetings. This does not, however, hinder candid discussions on specific supervisory issues.

¹⁰Articles 17–22 of the Money Laundering Act; see also the website of the Money Laundering Control Authority at <http://www.gwg.admin.ch>.

¹¹All those financial intermediaries not subject to special supervision by the SFBC, the Federal Office of Private Insurance (FOPI), or the Gaming Commission are directly subject to the Money Laundering Control Authority's oversight unless they join a self-regulatory organization (SRO) that is licensed and supervised by the Money Laundering Control Authority.

- 5.1.2. *Provision of unsolicited information.* The SFBC may provide information or arrange for information to be provided on a voluntary basis, even though no request has been made. The SFBC proactively provides information to its foreign counterparts if it believes that information will enable or assist the foreign authority to perform its regulatory functions, including supervisory and enforcement functions.
- 5.1.3. *Information sharing for supervisory matters.* The SFBC may be requested by a foreign regulator to share information in its possession or to confirm or verify information provided by the requesting authority. Nonconfidential information may be exchanged informally, via the phone or e-mail. Requests for the provision of confidential information are generally made in writing or, if made orally, confirmed in writing. The SFBC always requires that the requesting authority specify the purpose for which the information is sought.
- 5.1.4. *Joint supervisory actions.* Another practice developed over time by the SFBC and its foreign counterparts is joint supervisory visits and joint meetings held with the bank's management, both in Switzerland as well as in the host country.
- 5.1.5. *On-site inspections.* Under its system of indirect supervision, the SFBC relies on external audit firms to conduct on-site inspections in foreign establishments of Swiss banks.¹² To this end, the audit firm of the Swiss parent needs to have full access to the foreign establishment's files and records, including customer-related data. Whereas the SFBC may carry out supervisory visits at foreign institutions, it does not itself seek direct access to individual customer files in foreign branches or subsidiaries of Swiss banks. This approach is also reflected in the provisions governing on-site inspection by foreign supervisors in Switzerland. Foreign supervisors cannot have direct access to customer information at Swiss offices of foreign banks if that information is related to private banking transactions ("private banking carve-out"). Although direct access by a foreign supervisor is excluded, the information may be requested from the SFBC or be inspected by an audit firm—a special audit mandated by a

¹²With the exception of the large banks, where the SFBC itself also carries out on-site examinations.

foreign regulator and carried out by an audit firm is considered admissible under Swiss law. With the sole exception of private banking-related customer data, foreign regulators can gain full access to all records at offices of foreign banks in Switzerland, including client information in other than private-banking transactions, e.g., commercial loans. To date, supervisors from seven jurisdictions have conducted on-site inspections in Switzerland.

- 5.1.6. *Information sharing for enforcement matters.* If a request for assistance relates to actual or possible enforcement action, the requesting authority has to provide a description of the conduct or suspected conduct that gives rise to the request, and the applicable law or regulation and relevance of the requested assistance. Assistance provided by the SFBC on enforcement matters may also consist of questioning or taking testimony from persons designated by the requesting authority, or the conduct of inspections or examinations of financial institutions.
- 5.1.7. *Joint/coordinated enforcement.* When circumstances arise that lead to an investigation, in which both the SFBC and its foreign counterpart have a joint interest, the SFBC will consult with the foreign authority as to the allocation of responsibilities and the appropriateness of conducting a joint investigation and coordinated enforcement action. In a recent enforcement case against UBS regarding banknote dealings, the SFBC coordinated its actions with the Federal Reserve Bank of New York.¹³ UBS had operated an extended custodian inventory (ECI) facility for the New York Fed in Zurich and committed breaches of its contractual agreement with the New York Fed. The SFBC and the Federal Reserve Bank of New York cooperated closely in this matter and shared the results of their respective investigations.

6. Cooperation Arrangements

- 6.1. What are the underpinnings for supervisory cooperation and information exchange? There are different ways in which the relationship with a foreign supervisory authority can gain expression. The conclusion of a memorandum of understanding (MoU) is neither a prerequisite nor a

¹³See the press releases of the SFBC at http://www.ebk.ch/e/archiv/2004/20040510/M_10_05_2004_e.pdf and the Federal Reserve Board at <http://www.federalreserve.gov/boarddocs/press/enforcement/2004/200405102/default.htm>.

legal requirement under Swiss law. According to its regulatory practice, the SFBC enters into exchanges of letters, or MoUs, with those supervisory authorities with whom it maintains close regular contacts. In the absence of an MoU, the SFBC can also exchange information on an ad hoc basis provided the foreign authority gives the necessary assurances as required under Swiss banking law.

- 6.2. These assurances relate to the following: (1) the confidential treatment of the information provided, (2) the exclusive use of the information for supervisory purposes, and (3) the affirmation that the information will not be transferred to third parties without the SFBC's prior consent. Confirmation of the requesting authority that it will endeavor to seek consent from the SFBC before disclosing nonpublic information received from the SFBC will suffice. If the requesting authority is subject to a mandatory disclosure requirement, or receives a legally enforceable demand for information under applicable laws and regulations, the requesting authority should notify the SFBC of its obligation to disclose and endeavor to seek consent from the SFBC before making a disclosure. It should make its best efforts to protect the confidentiality of information obtained from the SFBC and, if necessary, use all reasonable legal means to resist disclosure, including by asserting such appropriate legal exemptions or privileges as may be available, for example, by advising the concerned or other requesting party (e.g., a parliamentary commission) of the possible negative consequences of a disclosure on future cooperation between the authorities.
- 6.3. The SFBC may seek cooperation with its foreign counterparts to perform its functions as financial regulator more effectively. At the same time, it is authorized to provide assistance to foreign authorities to the extent that it serves the supervision of financial markets and institutions, and the enforcement of financial laws and regulations. This "specialty principle" excludes information exchange with other authorities, such as foreign law-enforcement authorities or tax authorities. These authorities will have to seek cooperation via their counterparts and mutual legal assistance procedures.

7. Conclusion

Although it is true that cooperation arrangements can be further improved, Swiss law provides for an adequate legal framework for supervisory cooperation and information sharing. This framework consists of two components: (1) the intragroup flow of information necessary for risk management on

a global basis, compiling consolidated reports to the home supervisor, and robust cooperation arrangements; and (2) the cooperation between the SFBC and its foreign counterparts, which includes the sharing of information and the conduct of on-site inspections. Yet, a legal framework is not enough; what makes cooperation and information sharing really work are good working relations based on mutual trust and the willingness to cooperate and share information when the circumstances justify it.

Cooperation Between Banking Supervisors: The Perspective of The Bahamas

ROCHELLE A. DELEVEAUX

1. Country Background

- 1.1. The Commonwealth of The Bahamas is a sovereign nation, with a population of just over 300,000, lying southeast of the United States. There are some 30 inhabited islands out of a total of around 700. The two most populated are New Providence (with the capital, Nassau) and Grand Bahama.
- 1.2. The Bahamas achieved self-governance from the United Kingdom in 1964 and independence in 1973. It is a parliamentary democracy, and the economy is based largely on the tourism (*60 percent of GDP*) and financial services sectors. Per capita income is around \$15,000.
- 1.3. The Bahamas is a significant financial services center offering a wide range of products and services, being particularly strong in private banking and trust business. The authorities are very aware of the ever-present threat to our financial system from money launderers and terrorists. Apart from the important need for information sharing for the cross-border supervision of financial institutions, we also understand the need for countries to share information to assist one another in fighting financial crime.
- 1.4. The Bahamas has long sought to adopt appropriate regulatory and anti-money-laundering statutes and guidance. For example, in 1996, The Bahamas was the first jurisdiction in the Caribbean to enact anti-money-laundering legislation. Also in 1996, The Bahamas, as a member of the Offshore Group of Banking Supervisors, endorsed the

“Report on the Supervision of Cross-Border Banking” and took steps to implement the report’s recommendations.

- 1.5. Financial services in The Bahamas are an integral part of a global activity. Most of the institutions licensed here are branches or subsidiaries of foreign-owned groups and have extensive overseas business. Their home-country supervisors have to be provided with sufficient information about the activities and status of these institutions to enable them to adequately conduct consolidated supervision of the financial groups of which they are part.
- 1.6. Similarly, the Central Bank of The Bahamas, as host regulator, must be assured of the financial viability of the parent institution of its licensee, the control and oversight provided by the parent office, and the quality of supervision by the parent bank’s supervisory authority. This is especially important to control the risks from intragroup exposures. Both the home and the host supervisors have a strong mutual interest in the timely flow of information in both directions.
- 1.7. The Bahamas has adopted several formal avenues for cross-border information sharing with foreign government agencies. These include mutual legal assistance treaties (MLATs), memoranda of understanding (MoUs), and several specific statutes. The Bahamas has signed MLATs with the United States, Canada, and the United Kingdom, and is negotiating one with Brazil.
- 1.8. In December 2000, the government of The Bahamas enacted a compendium of legislation codifying existing supervisory practices. The legislation also enhanced the ability of domestic financial services regulators, including the central bank, to share information with foreign regulatory authorities. The Bahamas also enacted legislation permitting (i) Bahamian courts to provide evidence to foreign courts in relation to civil and criminal investigations and proceedings, and (ii) the domestic regulators to share information more effectively.
- 1.9. Previously, the central bank’s ability to respond to requests from overseas regulatory authorities was limited to cases where a customer gave express or implied consent to the disclosure or where disclosure was ordered by a Supreme Court judge.

2. Central Bank of The Bahamas: Status and Legislative Framework

- 2.1. The Central Bank of The Bahamas was established in 1970 by the Central Bank of The Bahamas Act (CBA), which was amended and

reenacted in December 2000. The central bank has a statutory duty to license, supervise, and regulate banks and trust companies doing business in or from within The Bahamas.

- 2.2. The CBA also provides that the Bank shall, subject to any constraints in the Act, “have power to do anything, whether in The Bahamas or elsewhere, which is calculated to facilitate, or is incidental or conducive to the discharge of its duty.” With respect to cross-border information sharing, the CBA sets out the conditions under which the central bank can cooperate with overseas regulatory authorities.
- 2.3. The central bank’s supervisory powers are provided under the Banks and Trust Companies Regulation Act (BTCRA), 2000. This authorizes the bank to facilitate the consolidated supervision of its licensees by permitting their home-country supervisors to conduct on-site inspections in The Bahamas and to exchange relevant regulatory information with them. The act protects the confidentiality of individual customer information but permits the central bank to share regulatory information for specified purposes.
- 2.4. Taken together, the two acts provide the framework for the central bank to share information with domestic and overseas regulators.

3. Cross-Sector Issues Among Bahamas Financial Services Regulators

- 3.1. The central bank is one of five separate domestic supervisory agencies in The Bahamas, which are collectively referred to hereinafter as “the Group.” These agencies have recognized the need for increased cooperation to minimize instances of supervisory overlap and to foster greater efficiency. In October 2002, they signed an MoU to raise efficiency and harmonize regulatory practices.
- 3.2. The MoU also provides for information sharing among the Group—for example, on disclosure of the names and addresses of applicants for licensing or registration and changes of shareholders, directors, or senior officers of financial institutions. Information is to be shared on a timely basis and confidentiality maintained. Regulatory colleges are to be established where institutions or financial groups are regulated by more than one member of the Group.
- 3.3. One hurdle that the Group has encountered is the inability of the central bank—through an anomaly of the law—to share information (for example, on who are the beneficial owners of a licensee) with two

domestic regulatory authorities, namely, the Inspector of Financial and Corporate Service Providers and the Compliance Commission. The two agencies, however, are empowered to disclose nonpublic information to the central bank about the parties they supervise. It is expected that the anomaly will be corrected by a change in the law.

4. Cross-Border Information Sharing

- 4.1. The Bahamas today recognizes the need for all of its domestic regulators to have similar information-sharing powers. Each member of the Group is empowered by statute to disclose to an overseas regulatory authority “. . . information necessary to enable that authority to exercise regulatory functions including the conduct of civil or administrative investigations and proceedings to enforce laws, regulations and rules administered by that authority.” The central bank, uniquely, is empowered to share regulatory information more widely and can include certain noncounterpart overseas regulatory authorities. The stronger and wider powers of the central bank in this regard partly reflect the wider responsibility the central bank has as the regulator for the banking sector, which enables it to “reach” all financial services entities within the jurisdiction. The bank is also the largest, in terms of resources, and most established regulator.
- 4.2. Although it is not essential for the central bank to sign an MoU with a foreign bank regulator before sharing information with that regulator, the central bank has responded to requests to execute MoUs with foreign bank regulators. Five have been signed, with Barbados, Brazil, Costa Rica, Guatemala, and Panama. Others are being negotiated.
- 4.3. Home-country supervisors that wish to conduct on-site examinations in The Bahamas for the purpose of performing consolidated supervision of the branches or subsidiaries they are responsible for must first submit a written request to the central bank. The latter’s approval is predicated on the following criteria:
 - 4.3.1. the supervisory authority is prohibited by its domestic laws from divulging information obtained in the course of the inspection to any other person; or it has given such written undertaking, as the central bank may require, as to the confidentiality of the information obtained;
 - 4.3.2. the supervisory authority has given to the central bank a written undertaking to comply with the provisions of the BTCRA, 2000

- and any condition imposed under the relevant section of that act;
- 4.3.3. the supervisory authority has given to the central bank a written undertaking to use the information obtained exclusively for the purpose of consolidated supervision;
 - 4.3.4. the supervisory authority has given to the central bank a written undertaking that it shall not transmit information (including information relating to criminal or penal matters) obtained during the course of its inspection to any other authorities or bodies without written consent; and
 - 4.3.5. the supervisory authority agrees to subsequently report to the central bank on the general results of the inspection.
- 4.4. The Bahamas has provided clear gateways for information sharing, whether in relation to civil or criminal matters.
 - 4.5. The central bank's information-sharing powers were intended to enable the bank to share information with other regulators for *supervisory* purposes.
 - 4.6. Where a crime is suspected, or there is evidence that one has occurred, there are a number of other legal avenues home supervisors can use to obtain and transmit information relating to criminal offenses to their domestic law-enforcement agencies. These include the mutual legal assistance treaties that The Bahamas has with a number of countries. These treaties set out the procedure for information sharing in the case of criminal offenses and focus on judicial assistance.
 - 4.7. The Criminal Justice (International Cooperation) Act, 2000 also provides a gateway for sharing information relating to criminal investigations and proceedings. This act requires a foreign authority that has responsibility for criminal investigations or proceedings to apply to the Attorney General of The Bahamas for the evidence or information required to assist the foreign entity in its investigation or proceedings. The Bank would, where a criminal offense is discovered or suspected, seek to facilitate disclosure of information through the appropriate legal channels.
 - 4.8. Normally, approval will not be granted for home-country supervisors to review assets under management or information relating to the deposit operations of any individual customers, as such information is not usually required for the conduct of consolidated supervision. The Banks

and Trust Companies Regulation Act, 2000 does provide, however, that information relating to assets under management or to the deposit operations of any individual customer may be disclosed where disclosure is necessary to enable a home supervisor to assess specific risks or to address specific supervisory concerns. In such cases, the central bank would (and has in the past) disclosed customer information and information relating to assets under management. The central bank will first gather the information that has been requested and review it to determine whether it is actually required. If satisfied, the central bank may pass the information on to the home supervisor.

- 4.9. In practice, home supervisors have had no difficulty with this approach.
- 4.10. The arrangements outlined above would be reflected in any MoUs that the central bank has signed with other foreign bank regulators.
- 4.11. In addition, the central bank has the discretion to allow licensees to disclose such class or classes of information to their head offices, branches, and subsidiaries located outside The Bahamas as it may from time to time approve. Under existing legislation, the central bank may only exercise the discretion to approve transfer of information provided that this information is required for the purposes of carrying out “. . . collation, synthesis or processing . . .” of information on behalf of the licensee. Licensees must seek the central bank’s prior approval.
- 4.12. The central bank is aware of the need for the head offices of its licensees to have access to customer information for risk-management purposes, and the central bank has, in practice, granted approval to Bahamian licensees to disclose such information to their head offices where this is required for risk management, to the extent that the existing statutory provisions may be thought not to accommodate such access. The legislative provisions outlined previously do not prevent head offices from carrying out comprehensive risk-management reviews of their groups that include Bahamian branches and subsidiaries. As a matter of practice, Bahamian licensees do transfer information (excluding customer identity) to their head offices for risk-management purposes.
- 4.13. The Governor of the Central Bank of The Bahamas is also empowered to provide information—on the condition that it is needed for the purposes of consolidated supervision—on the beneficial owners, directors, officers, and operations of any licensee of the bank (including inspection reports on the licensee) to the supervisory authority responsible for regulating the head office of the licensee.

- 4.14. From January 1, 2001 through May 31, 2004, 6 foreign supervisory authorities have carried out a total of 37 on-site inspections in The Bahamas of banks and trust companies that they regulate in their home jurisdictions. The Swiss top the table with 26 inspections.
- 4.15. There are also numerous requests from foreign regulatory authorities for cooperation. In 2002, 18 countries made a total of 41 requests for cooperation (with the most frequent coming from the United States, Barbados, and Costa Rica). In 2003, 19 countries made a total of 30 requests, of which 25 were dealt with during the year. In the first 5 months of 2004, there have been a total of 8 requests from 7 different countries. Further details can be found in the central bank's annual reports.

5. Information-Sharing Regime Under Central Bank of The Bahamas Act, 2000

- 5.1. As noted in Section 3, the Central Bank of The Bahamas can share information with overseas regulatory authorities under the CBA, if specified conditions are met.
- 5.2. The CBA defines "overseas regulatory authority" as
 . . . an authority which in a country or territory outside The Bahamas exercises functions corresponding to—any functions of the Bank; or any additional regulatory functions in relation to companies or financial services as the Bank may specify by order including the conduct of civil and administrative investigations and proceedings to enforce laws, regulations and rules administered by that authority.
- 5.3. The CBA defines "regulatory functions" as "functions of the Bank, or other similar functions relating to companies or financial services as may be specified by the Bank."
- 5.4. In practice, the central bank may share information with foreign bank regulators and designated foreign nonbank regulators. With respect to the former, the central bank is governed by the provisions of the BTCRA, 2000 (discussed previously).
- 5.5. For nonbank regulators, parliament has provided that the central bank must specify, by order, the type of functions that an overseas regulatory authority should be carrying out before the central bank may disclose information to them. The CBA provides that the functions must be similar to those of the central bank (i.e., regulatory in nature).

- 5.6. As a result, the central bank, through the Central Bank of The Bahamas (Overseas Regulatory Authorities) Order 2001 (hereinafter referred to as “the Order”), has specified that “an overseas regulatory authority includes an authority, which in a country or territory outside The Bahamas regulates securities markets, securities exchanges and trading in securities.” Currently, therefore, the central bank may disclose information only to foreign bank or securities regulators.
- 5.7. There has not, in practice, been a need to increase the number of foreign (noncounterpart) supervisors with which the central bank may share information. The Securities Commission of The Bahamas presently has no ability to obtain bank records where, for example, an overseas securities regulator alleges insider trading. This is the reason why the central bank has the ability to share information with overseas securities regulators.
- 5.8. At the time that the Order was made, the other financial services regulators of The Bahamas did not have similar provisions for information sharing in their governing legislation. Amendments to their legislation have now been made to allow them to do this; but, unlike the central bank, they are not empowered to request information from persons or entities that they do not supervise.
- 5.9. Although the central bank is empowered to share information with overseas regulatory authorities, the bank must exercise discretion as to whether or not it will, having regard to the objects of the CBA and its specific provisions on this point. Specifically, the central bank must include the following in its consideration:
 - 5.9.1. whether the foreign authority’s request clearly relates to information necessary for the overseas regulatory authority to exercise regulatory functions;
 - 5.9.2. whether the inquiries relate to the possible breach of a law or other requirement that has no close parallel in The Bahamas; and
 - 5.9.3. the seriousness of the matter to which the information relates and how important the information sought is to the inquiries.
- 5.10. If satisfied on these points, the central bank must also satisfy itself as to the confidentiality of the information to be provided. In this regard, the requesting authority must either be subject to adequate legal restrictions on further disclosures (including the provision of an undertaking

of confidentiality). Alternatively, if there are no legal safeguards in the overseas regulatory authority's law against disclosure of information, the central bank may still pass information to the overseas regulatory authority if

- 5.10.1. the bank has been given an undertaking by the recipient authority not to disclose the information provided without the consent of the bank;
- 5.10.2. and the bank is satisfied that the assistance requested by the overseas regulatory authority is required for the purposes of that authority's regulatory functions, including the conduct of civil or administrative investigations or proceedings to enforce laws it administers; and
- 5.10.3. the bank is satisfied that the information provided will not be used in criminal proceedings against the person providing the information.

6. Challenges

- 6.1. As shown in the preceding, the central bank has responded to numerous regulatory requests in recent years from banking and securities regulators. The bank's primary challenge has been to protect customer information from inappropriate and/or illegal disclosure—such as by the securities regulator, which, as a matter of practice, passes on information provided to it by foreign regulators to its prosecutorial agencies. The central bank has, however, taken the view that the objects of the CBA, 2000 do not include having the bank share information with foreign agencies that have responsibility for criminal prosecutions.
- 6.2. Where a foreign securities regulator desires, on the exercise of its own discretion, to pass regulatory information to a prosecutor for the institution of criminal investigations or proceedings, the securities regulator would, under Bahamas law, need to obtain the prior approval of the central bank. The central bank's consent would not be unreasonably withheld, and, in the case of criminal proceedings, the bank would request the regulator to use the procedure set out in the mutual legal assistance treaty between the regulator's jurisdiction and The Bahamas or, if there is no treaty in place, to use the procedure set out in the Criminal Justice (International Cooperation) Act, 2000. This approach is designed to both assist the foreign regulator and to safeguard the civil rights of the subject of a criminal investigation or proceeding.

- 6.3. It is the view of the central bank that parliament has made provision for The Bahamas to share information relating to criminal investigations and prosecutions either under its mutual legal assistance treaties or under the provisions of the Criminal Justice (International Cooperation) Act, 2000. The information-sharing provisions of the BTCRA, 2000 and the CBA, 2000 relate to disclosure of regulatory information for regulatory purposes.
- 6.4. Where a foreign securities regulator has conducted an investigation and wishes to institute a prosecution, a request for consent to pass on information provided by the central bank pursuant to a regulatory request should be made at the time a decision is made to commence criminal prosecutions. This approach avoids requested jurisdictions being exposed to “fishing expeditions.”
- 6.5. The Bahamas is engaged in continuous review of the information-sharing provisions of its financial sector legislation to ensure that the jurisdiction is able to cooperate appropriately with the legitimate demands of the ever-changing international environment.

7. Conclusion

- 7.1. The Bahamas remains committed to its adherence to international standards on information sharing. We recognize that these standards are beneficial to the global financial community. The challenge for all states remains balancing the rights of individuals against the need for states and financial conglomerates to access information on individual customers for supervisory or business purposes. The Bahamas will strive to ensure that its financial system is not used to facilitate financial crime. We have demonstrated our willingness to cooperate with other jurisdictions to assist in their investigations of contraventions of their regulatory rules and procedures.

Negotiating Cooperation Agreements: The Experience of the Australian Prudential Regulation Authority (APRA)

CHRIS GASKELL

1. Description

- 1.1. This chapter discusses the role of formal cooperation agreements in facilitating international regulatory cooperation. It does so drawing on the experience of the Australian Prudential Regulation Authority (APRA).

2. APRA's Confidentiality Requirements

- 2.1. APRA was established in 1998 from 11 predecessor agencies. The current functions of APRA were previously undertaken by a range of bodies, including the Reserve Bank of Australia (RBA), the Insurance and Superannuation Commission (ISC), and various state regulatory agencies. APRA is an integrated prudential authority to the extent that it covers authorized deposit-taking institutions (banks, credit unions, and building societies), life and general insurance, and certain superannuation (pension) funds. Unlike many other integrated regulators, however, APRA does not cover securities business.
- 2.2. APRA and its staff are subject to secrecy requirements. Taking advantage of the relatively recent provenance of the legislation establishing the regulatory authority, the requirements have been updated to bring them up to current international standards.
- 2.3. APRA "staff, members and other officers" are prohibited from disclosing "protected information" and "protected documents" by Section 56 of the APRA Act 1998. Information or a document will be protected if

- 2.3.1. it was acquired by APRA for the purpose of a “prudential regulation framework law”; and
- 2.3.2. it relates to:
- the affairs of a body regulated by APRA (i.e., a bank or other authorized deposit-taking institution, a life or general insurer, or a superannuation entity); or
 - the affairs of a registered entity (e.g., a finance company or money market corporation); or
 - a body corporate related at any time to a regulated body or registered entity; or
 - a person who is, has been, or proposes to be a customer of a regulated body or registered entity.
- 2.4. In simple terms, information or a document provided by an overseas regulatory agency to APRA about a particular financial institution to assist APRA in regulating it will usually be protected from disclosure. Breach of this secrecy provision is a criminal offense, carrying a penalty of imprisonment for up to two years. There are particular situations, however, where information or documents can be released without infringing Section 56. This includes situations where:
- 2.4.1. the disclosure is “for the purposes of” a prudential regulation framework law. This will depend on the particular instance of disclosure. The precise ambit of this exception has not been tested but includes instances where a prudential regulation framework law:
- specifically provides for the disclosure—for example, Section 131A of the Superannuation Industry (Supervision) Act 1993 (SIS Act) provides that APRA may give information to a relevant professional body about an actuary’s or auditor’s failure to comply with certain duties in relation to a regulated superannuation fund; or
 - necessarily contemplates a disclosure—for example, the Insurance Act 1973 and the Banking Act 1959 provide that certain decisions are reviewable by the Administrative Appeals Tribunal, and it would be necessary for APRA to provide all relevant documents to the tribunal for this purpose;
- 2.4.2. the disclosure occurs with the written consent of the person or financial institution concerned;

- 2.4.3. the disclosure is to, and will assist, a “financial sector supervisory agency,” either Australian or overseas;
 - 2.4.4. the disclosure is to, and will assist, bodies prescribed by regulation under Section 56, for example:
 - the Reserve Bank of Australia;
 - the Australian Bureau of Statistics;
 - the Australian Federal Police or a State or Territory Police Force;
 - the Department of Treasury;
 - a Commission of Inquiry, established under the Royal Commissions Act 1902;
 - the Australian Transaction Report and Analysis Center (AUSTRAC), Australia’s financial intelligence unit;
 - the Council of Financial Regulators; and
 - the Australian Crime Commission.
 - 2.4.5. the disclosure is authorized by an instrument in writing made by APRA or its delegate under the APRA Act;
 - 2.4.6. the disclosure is to an APRA member or staff member for the purposes of the performance of APRA’s functions or the exercise of its powers;
 - 2.4.7. the information is a summary or aggregate such that information relating to any particular person cannot be found out;
 - 2.4.8. the information consists of contact details for persons who perform public functions for the financial institutions concerned; and
 - 2.4.9. the information relates to whether or not a regulated entity complies with a particular section of a prudential regulation framework law.
- 2.5. From the preceding, it can be seen that APRA may provide protected information and documents to certain other domestic agencies to assist them in their powers and functions. Employees of an agency who receive such information or documents will, themselves, be bound by the act, and will not be able to release the information other than under an exception to Section 56 or where the release is for the purpose for which APRA gave the agency the information.

3. APRA's Powers to Assist Foreign Regulators

- 3.1. APRA can exercise its powers under the various acts it administers to obtain information from regulated entities. Apart from limited powers under the Mutual Assistance in Business Regulation Act (MABRA), APRA does not have the power to obtain information from a regulated entity on behalf of an overseas regulator, unless the information was required for its own supervisory purposes under one of these acts. If APRA has already obtained information for its own supervisory purposes, however, then it will be able to share this information with an overseas regulator to assist the latter to perform its functions. Protected information includes customer information, but, again (except under MABRA), APRA would need this for its own purposes before it could seek this from an institution.
- 3.2. APRA has power to take enforcement action, issue directions, etc. but can do so only in accordance with the various acts that it administers. APRA cannot prevent an entity from engaging in particular conduct solely because of concerns raised by an overseas regulator—the conduct must empower APRA, under domestic legislation, to take such action.
- 3.3. The legal provisions (gateways) are written in a way that does not require APRA to enter into a Memorandum of Understanding (MoU) in order to share regulatory information. APRA has, in the past, experienced relatively good cooperation on information sharing with most regulators. There have been a small number of exceptions. One concerned sensitivity by a requested authority about exchanging information, especially documents, from one host supervisor of a specific institution to another, owing perhaps to concerns about responsibilities to the home supervisor. Other examples were with respect to insurance firms. In some of these instances, the desire of the requested authority to protect confidentiality of the information requested was one reason for not meeting a request. This is an issue for many countries, since most jurisdictions have limits to the protections they can offer, as mentioned above for APRA. So although an agency can undertake to do all it can to protect information, there is usually some risk of release and even a chance, in some circumstances, that the information might become public.
- 3.4. In other cases, there is a requirement that an MoU be in place and that equivalency of protections be established for information to be exchanged. It can be a slow process where equivalency is to be established, given that there may be limited resources available in either

jurisdiction for a proper analysis of equivalence. A number of jurisdictions have indicated a willingness to put MoUs in place but also explained that other jurisdictions have priority, either because assessed cross-border risks are higher or simply because discussions with them commenced earlier. In yet other cases, legal constraints have been mentioned.

- 3.5. On the question of how concerns about confidentiality can best be addressed, in APRA's case there has been no practical example of forced disclosure of exchanged information against APRA's wishes. Assurances to this effect are a source of some comfort to peer regulators commencing discussions. Beyond this, counterparts can only undertake to protect the information within the powers they have—for example, seeking to obtain confidentiality orders in court hearings, parliamentary hearings, etc. if documents have to be disclosed and obtaining prior consent before disclosing them voluntarily to third parties (a standard provision of most MoUs).
- 3.6. As mentioned previously, APRA also is subject to the Mutual Assistance in Business Regulation Act 1998. This sets out a process for overseas regulators, for business law purposes, to seek assistance from APRA (and other Australian agencies subject to the act) to obtain documents or take testimony on behalf of (or in the presence of) the overseas financial sector supervisory agency. This is a fairly complicated process, requiring consent by the Attorney General of Australia. A person called to give oral testimony cannot reasonably refuse to do so. Importantly, the information cannot be used as evidence for criminal purposes (on grounds that evidence obtained for one purpose cannot be used for another), and undertakings to this effect from the overseas regulator would be required. Again, APRA has had no experience in handling a request under this legislation. There is similar legislation in Australia covering gathering of information for overseas jurisdictions for criminal purposes, but this is beyond the scope of APRA.
- 3.7. APRA has no responsibility for securities matters—these are the responsibility of the Australian Securities and Investment Commission. Also, APRA has no legislative responsibilities for anti-money laundering/combating the financing of terrorism (AML/CFT). These responsibilities fall to AUSTRAC, which receives reports of both all cash transactions of \$10,000 and over and all other suspicious transactions. APRA has an interest in an authorized entity's policies and procedures for AML purposes, such as know-your-customer (KYC) arrangements and codes of conduct, but this is a high-level interest considered along

with other governance matters from the general operational risk point of view and is relevant only in the same way any other legal or compliance risk is relevant in our assessment of a regulated entity's failure probability. APRA meets with AUSTRAC on an ad hoc basis. One quirk in Australia's legislative arrangements is the fact that APRA can refer matters to AUSTRAC, but not the other way around.

4. Memoranda of Understanding

- 4.1. Without a requirement to have MoUs, it might be assumed that APRA had little reason to pursue them. However, one prime driver pressing APRA to do so was the HIH Royal Commission Report (on the failure of the HIH Insurance Group). The report noted that APRA had minimal formal information-sharing agreements in place and recommended that APRA seek to conclude MoUs with key counterparties in order to improve the exchange of confidential information.
- 4.2. APRA concluded that it could not properly enter into MoUs with other regulators without conducting a due diligence process designed to establish the limits facing a counterparty in meeting undertakings in an MoU—particularly the protection of information. The due-diligence process, by its very nature, involves useful learning about relevant arrangements in the counterpart jurisdictions. So APRA has established an MoU program to
 - 4.2.1. understand the reach of applicable legislation and other legal instruments, and administrative practices applying to professional secrecy and related matters in counterpart jurisdictions, including the limits to confidentiality;
 - 4.2.2. meet conditionality requirements in other jurisdictions to enable them to share confidential information;
 - 4.2.3. inform others of the limits to APRA's ability to resist disclosure (for example, a request from a royal commission or from parliament);
 - 4.2.4. set up contacts and establish the procedures for formal information sharing, if required; and
 - 4.2.5. flag that there are other gateways, in particular circumstances—in particular, for taking testimony.
- 4.3. Most regulators have a general obligation in their legislation prohibiting them from disclosing confidential information to third parties.

However, most, if not all, have exceptions to this rule. The extent of the exceptions varies from jurisdiction to jurisdiction. Therefore, a simple assurance that a secrecy obligation exists in a jurisdiction is insufficient to fully understand the circumstances in which a counterpart may be compelled or obliged to share information. Further, MoUs are not legally binding and generally do not contain a strict obligation prohibiting disclosure—rather it is on a “best endeavors” basis, meaning that each party will use their best endeavors to preserve confidentiality. As such, it is important to understand the circumstances in which other jurisdictions are compelled to disclose. The equivalency process enables APRA to be fully aware of these circumstances and may influence what types of conditions we impose on information being released.

- 4.4. It is important to note that APRA has not yet processed any inward international requests under these formal arrangements, and we have no reason to expect this to change. APRA routinely receives and responds to informal requests, however. In fact, APRA would prefer to keep information exchanges informal, since this is easier, quicker, more flexible (tends to be confined to existing information), and less process driven, but regards it as useful to have MoUs in place in case of need.
- 4.5. APRA also has MoUs with seven domestic agencies, including the Reserve Bank of Australia, the Australian Securities and Investments Commission (ASIC), the Australian Competition and Consumer Commission, and a number of state bodies. It is common, especially with ASIC, to share information under the MoU as well as informally.
- 4.6. APRA is at a relatively early stage in its process of putting MoUs in place, having adopted its current policy toward MoUs in 2003. Prior to this, there was only one MoU—with the Bank of England (which transferred to the U.K. Financial Services Authority (FSA)). This MoU covered only banking. Now APRA has two MoUs in place: one with the U.K. FSA (covering all corresponding remits) and one with the Reserve Bank of New Zealand (covering banking). Several more are at various stages of development.

5. Concluding an MoU

- 5.1. The process of concluding an MoU involves several steps.
- 5.2. APRA first determined which jurisdictions and regulators were the highest priorities for an MoU. For the business case to set such priorities, APRA looked at the extent and risk profiles of business under-

taken by entities from Australia in the overseas jurisdiction and of the business undertaken in Australia by the entities from the overseas jurisdiction.

- 5.3. Following an approach to the counterparty authority, there has been a range of responses in addition to those we are working with to conclude MoUs. Some were not interested. Others have said they would do so if it were essential to information sharing (e.g., required by law) but preferred not to. Others agreed in principle but invited APRA to wait for them to conclude MoUs with others already in their queues. Given that APRA has limited resources for this work, the consequential delays have not been a problem. In addition to the jurisdictions at the top of its own list, APRA itself has been approached by a number of other jurisdictions. For some of these, it is not clear to APRA that there is a solid business case for us to go through the process of concluding an MoU. For others, we have had to signal that we would be happy to work toward establishing one in due course, but that there are other jurisdictions ahead of them in the queue for the present.
- 5.4. The second step, once a jurisdiction indicates it is ready to commence discussions, is to conduct a due diligence process on professional secrecy and related arrangements, including the purposes for which information may be used.
- 5.5. Our Office of General Counsel took the view that it would be inefficient for his staff to attempt to assess the law and practice in target overseas jurisdictions. Consequently, we decided we would seek the relevant information from our counterparts via questionnaire. APRA also completed a similar questionnaire for Australia to use in assisting counterparts with their due-diligence processes. We also produced a general description of arrangements in Australia. Thereafter, there is an interactive process to clarify the situation.
- 5.6. The third step was to determine in which negotiations APRA would seek to build on preexisting MoUs, amended as appropriate, to try to get some early runs on the board. Such preexisting models included the following:
 - 5.6.1. MoUs based on Basel Core Principles to cover banking only;
 - 5.6.2. the IAIS (International Association of Insurance Supervisors) model for insurance regulators; and
 - 5.6.3. a case-by-case approach otherwise for integrated regulators based, where possible, on drafts they might have.

- 5.7. The fourth step was to ensure that the MoUs contained the necessary provisions. APRA seeks the usual provisions on such aspects as
 - 5.7.1. constraints on onward transfer;
 - 5.7.2. clearance where there may be a third-party request;
 - 5.7.3. circumstances where information disclosed could be passed to another authority without APRA's permission (for example, where the information revealed a suspicion that had to be reported under AML/CFT obligations, the information revealed unlawful activity in the recipient's jurisdiction, the disclosure was required by law, or disclosure was necessary to fulfill the purpose for which the information was requested in the first place);
 - 5.7.4. consultation about on-site inspections in the counterpart jurisdiction;
 - 5.7.5. whether assistance is limited to information exchange or other possible forms of assistance; and
 - 5.7.6. allowance for cost sharing.
- 5.8. Australia has also been keen to ensure the widest possible coverage of types of information, including types of institutions. Consequently, we have expanded coverage expressly to cover conglomerate operations, corporates/noncorporates, reinsurance entities, and sister affiliates (i.e., host-to-host exchanges to allow discussions on related entities operating elsewhere than in the home jurisdiction).
- 5.9. Protected information includes information on customers of institutions if relevant, for example, to a prudential concern, so this, too, would be covered by an MoU. Institutions, however, tend to be very cautious about supplying customer information owing to privacy concerns.
- 5.10. APRA is careful not to promise what it cannot deliver. The MoU cannot override domestic legislation. APRA must be able to refuse to assist on public policy grounds if they apply—so every MoU obligation is on a best endeavors basis.

6. Streamlining the Approach

- 6.1. More recently, APRA has started to think that there might be value in generalizing this type of approach—particularly for integrated regula-

tors, such as APRA, that have limited resources to put into the process of negotiating MoUs or that have just recently been formed. This would need to be a modular approach to cover the breadth of different remits in the growing population of integrated regulators.

- 6.2. It would also be of particular interest for a compendium of respective law and practice on professional secrecy and other questions related to information exchange to be prepared by survey to assist regulators in their due diligence work on other jurisdictions.
- 6.3. One of the key issues involved in information sharing in the context of the safety and soundness of financial institutions (an important concern of banking and insurance supervisors) is that it is unlikely regulators will feel confident sharing information about stability problems with all others who have a legitimate interest. We have to be realistic about that. There is, however, much that can be done short of exchanging doubts about stability. For example, regulators can look at internal procedures to ensure appropriate flags are raised where there are policies under development or where other events occur that affect other jurisdictions, and pass along information about those developments.
- 6.4. Beyond this, there is much serious work to be done on cross-border cooperation and coordination, especially developing information exchange protocols where there is a business case for them. This should include frontline supervision in respect of institution-specific material and crisis-management arrangements. Policy development should also be undertaken where harmonization is needed for competitive equity and to minimize compliance costs. MoUs and their related due diligence can be seen as a first step in developing regulatory relationships that will underpin higher-level cooperation over time.

12

Negotiating Cooperation Agreements: The Experience of the Bank of Italy

GIUSEPPE GODANO

1. Introduction

- 1.1. Market integration increases the need for information exchange among supervisory authorities. Even if many supervisory issues are discussed in multilateral forums, information is generally exchanged between two authorities and it is therefore important to establish bilateral contacts.
- 1.2. A common form of bilateral agreement is a Memorandum of Understanding (MoU). Generally speaking, an MoU (or any other formal written agreement) should not be a prerequisite for information exchange. Information exchange should be possible between any two authorities anyway: MoUs should be seen just as an instrument to facilitate the flow of information. Where there are legal, regulatory, or other practices representing obstacles to such an exchange, MoU negotiations should aim at removing the obstacles or creating appropriate gateways so that the obstacles can be overcome in appropriate circumstances. MoUs can therefore be seen as instrumental to the development of increasingly common regulatory and supervisory frameworks across countries.

2. Bank of Italy's Experience: A Flexible Approach

- 2.1. Within the member states of the European Union (EU), negotiations concerning bilateral MoUs between any two of them have been based on a common regulatory framework (banking and financial services directives). However, each MoU has been drafted taking into account the specific national supervisory approach. The bilateral format, chosen

by the banking supervisory authorities in Europe, facilitates the development of a face-to-face relationship between supervisors, a relationship that is most important for the effective application of any cooperation agreement.

- 2.2. Between 1993 and 1999, the Bank of Italy signed 10 MoUs with 10 other EU counterparts¹ following a common format that was updated according to upcoming European financial legislation. In this respect, the flexibility of MoUs' schemes has been tested practically. Over the years, the scope of the MoUs has been progressively extended in order to take into account both European Union and national regulatory developments.
- 2.3. These schemes formed the basis for the drafting of other MoUs with some EU accession countries (such as Hungary, Slovenia, and the Slovak Republic) and other Eastern European countries (such as Bulgaria and Romania) that were selected as MoU counterparts because of the size and significance of Italian banks' presence, with both branches and subsidiaries, in their territories. MoUs with these countries were signed between 2001 and 2003.
- 2.4. The content of these agreements is uniform, based on the general framework arranged by the Groupe de Contact² in the early 1990s, and they generally provide for a detailed exchange of information on the organization, operations, and balance-sheet situation of the supervised entities intending to operate abroad, either establishing a branch or a subsidiary or without physical presence (the EU term for that is "free provision of services"). They provide for periodic bilateral meetings aimed, among other things, at keeping the parties informed about important statutory and regulatory innovations regarding supervision in the respective countries; they ensure a regular exchange of information on the business concerned and the prompt information of the authorities involved when problems arise. The agreements also specify the ways in which home-country authorities can carry out inspections at the establishment in the other party's territory.

¹Austria, Belgium, France, Germany, Greece, Ireland, Luxembourg, the Netherlands, Spain, and the United Kingdom.

²The Groupe de Contact was initially established in 1972 as a working group of banking supervisors in the European Community to discuss exchange of information matters. It is now a working group of the Committee of European Banking Supervisors set up under the Lamfalussy procedure for developing financial services legislation in the EU.

- 2.5. With other non-EU countries,³ supervisory cooperation agreements entered into by the Bank of Italy took several forms besides formal MoUs, such as letters of intent, limited-scope agreements, and informal arrangements. In each case, their common principal objective has always been timely information exchange between authorities.
- 2.6. In general terms, both inside and outside the European area, the exchange of information between the Bank of Italy and its foreign counterparts is limited to supervisory matters. Other areas of criminal relevance, like financial fraud or money laundering, fall within the responsibility of law-enforcement agencies and are often the subject of existing separate bilateral mutual assistance treaties or agreements.

3. Outstanding Issues

- 3.1. In our experience, one factor influencing negotiations for cooperation agreements concerning banking and financial supervision is the scope of information exchange. In this respect, mutual trust and understanding may not be sufficient to overcome the differences between the legal frameworks governing professional and banking secrecy in force within the negotiating parties. These differences may, sometimes, jeopardize the effectiveness of cooperation, especially as concerns the protection of individual data that are at the core of the strategy of many jurisdictions. It comes to my mind, as a way out of this problem, that the matter of access of information on individual customers is covered in the Basel Committee on Banking Supervision's 2003 paper on customer due diligence for banks. This indicates that there are occasions when information regarding individual customers needs to be exchanged, but it also makes clear that safeguards are needed to ensure that information regarding individual accounts is used exclusively for supervisory purposes and can be protected by the recipient in a satisfactory manner.
- 3.2. Another factor that, in our experience, makes negotiations for formal agreements difficult is related to on-site inspections, which are the most commonly used instrument for verifying and collecting information on banks' operations. Problems may emerge when two supervisory authorities are in an asymmetric position—for example, when Country A has no foreign subsidiaries, whereas the majority or totality of its banks, which are very often systemically important in terms of market shares, are owned by foreign capital. The authorities of such jurisdic-

³Brazil, Hong Kong SAR, Japan, Singapore, and the United States.

tions, while recognizing the right of the parent bank's supervisor to perform on-site visits at the bank's subsidiaries in their country, sometimes argue that this should be conditional upon recognition of their right as host supervisors to perform on-site visits at the parent bank.

- 3.3. In fact, it is not within the present cross-border banking framework⁴ for host-country supervisors to perform on-site examination of parent banks. The reason for this is that the host supervisor has no jurisdiction over the parent bank. Responsibility for the parent bank rests with the home supervisor, which is also responsible for the consolidated supervision of the whole banking group. Host supervisors also cannot be given on-site access to parent banks for evident practical reasons: how would a large international banking group with subsidiaries in several countries operate, if the supervisors of each of these countries felt entitled to perform on-site inspections at the parent bank of the group? I think that, as a possible solution to this problem, a distinction could be drawn between the process of on-site inspections and information exchange. It would be possible—and I believe should be possible—for home supervisors to be more open with host supervisors in terms of information exchange without accepting that a host supervisor should be allowed to engage in on-site inspections of parent banks.

4. Next Steps

- 4.1. Cooperation and exchange of information are bound to evolve in view of the blurring distinctions among financial sectors, the increasing cross-border dimension of financial intermediaries, and the enhanced technical capabilities of financial intermediaries in financial risks management and measurement. In this last regard, one has to take into account the increased necessity of cooperation between home and host authorities in relation to the validation of credit and operational risk models stemming from the Basel II framework.
- 4.2. New procedures are to be envisaged to smooth information flows among supervisors of different financial sectors and different countries. They should progressively work together in order to ensure that supervision correctly considers all the aspects of supervised entities' financial activities. Efficient processes for facilitating collegial work should

⁴Reference is made to the following Basel Committee documents: "The Supervision of Cross-border Banking," 1996; "Core Principles for Effective Banking Supervision," 1997; "Core Principles Methodology," 1999; and "Essential Elements of Statement of Cooperation Between Banking Supervisors," 2001.

be designed and coordination of supervisory activities over different groups' components should avoid duplication of effort for both supervisors and supervised entities.

- 4.3. Most probably, cross-border cooperation and information exchange will keep on being managed through flexible arrangements that will be shaped in order to accommodate evolving financial markets and intermediaries.
- 4.4. The increased degree of integration among markets requires an enlarged information exchange not only on countries' economic conditions but also on single operators. In financial sectors, this flow of information is even more important, since financial intermediaries are supervised and supervisory responsibilities are clearly defined.
- 4.5. In the end, cooperation among authorities, in whatever form arranged, is essential in order to avoid circumstances in which single operators' failures jeopardize the growth of economies in which they act.

Securities Regulation

ETHIOPIS TAFARA¹

1. Protecting Securities Markets in the Face of Globalization

- 1.1. The ability to protect domestic securities markets turns on the ability to obtain and provide international cooperation. Capital markets today are increasingly global because transactions transcend national boundaries with greater frequency and speed; public companies raise capital beyond their geographic boundaries; and investors trade outside their countries. Fraudsters are equally unconstrained by borders; they engage in illegal conduct in a multitude of jurisdictions, often simultaneously, and they transfer illegal proceeds to numerous jurisdictions in an effort to evade detection and prosecution. This globalization of fraud is a critical issue for every securities regulator, because illegal conduct that goes without detection or prosecution affects each and every one of our markets. It affects the confidence of our investors and their willingness to invest, and it affects capital formation. And, if aspects of the illegal activity can occur within any of our borders, without fear of detection, we can be assured that those who are inclined to engage in fraud will migrate to these vulnerable markets.
- 1.2. Combating illegal cross-border securities activities requires that securities regulators have strong enforcement tools for their own investiga-

¹Director of International Affairs, United States Securities and Exchange Commission (SEC), representing the International Organization of Securities Commissions (IOSCO). The views expressed are those of the author alone and are not necessarily those of the International Monetary Fund or its member countries; IOSCO; or the U.S. SEC, its staff, or Commissioners.

tions, recognize that a threat to the integrity of a foreign market is a threat to their own, and are in a position to assist foreign authorities in investigating conduct that crosses borders.

2. Effective Domestic Powers to Combat Illegal Securities Activity: The U.S. Model

SEC's Authority to Conduct Investigations and Prosecute Violations

- 2.1. The Securities and Exchange Commission (SEC) has broad powers to investigate possible violations of U.S. federal securities laws. Facts are developed in many instances through informal inquiry, interviewing witnesses, examining brokerage records, reviewing trading data, and other methods. Once the commission issues a formal order of investigation, SEC staff also may compel regulated and nonregulated entities and individuals, by subpoena, to testify and produce books, records, and other relevant documents. SEC staff seek a range of documents in investigations, including bank and brokerage records, telephone records, corporate records, Internet service provider records, audit work papers, and client identification records.
- 2.2. In bringing an action against an entity or individual for violations of the U.S. federal securities laws, the commission can choose to initiate a proceeding either in federal district court or before an administrative law judge. The remedies that the SEC may ask the court or the administrative law judge to impose include disgorgement, cease and desist orders, officer and director bars, and civil monetary penalties. The SEC also may request interim relief from federal district courts to enjoin further fraud or destruction of records, and to impose asset freezes.
- 2.3. In the United States, the U.S. Department of Justice (DOJ) investigates and prosecutes criminal violations of the federal securities laws. SEC staff may refer a matter to the DOJ for investigation, and the DOJ may conduct its criminal investigations parallel to the SEC's civil investigations. Information shared between the DOJ and the SEC makes investigations and prosecution of these parallel matters more efficient and effective. This relationship does not, however, allow either the SEC or the DOJ to circumvent the protections afforded defendants. Each side must collect information in conformity with existing protections, such as a defendant's privilege against self-incrimination in connection with testimonial evidence. Cooperative relationships between securities regulators and criminal authorities are a feature common to virtually all jurisdictions.

SEC's Powers to Assist Foreign Counterparts

- 2.4. The U.S. Congress adopted two specific pieces of legislation to give the SEC the essential legal tools to cooperate internationally. First, the SEC is expressly authorized to assist a foreign counterpart (including use of the SEC's compulsory investigative powers) under Section 21(a)(2) of the Securities Exchange Act of 1934 (Exchange Act). This provision permits the SEC, at its discretion, to provide assistance "without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States." It reflects the fact that domestic securities enforcement should not be impeded because securities authorities, in varying stages of development, are subject to different legal frameworks. In deciding when to exercise its discretion, the SEC must consider whether (1) the foreign authority has agreed to provide reciprocal assistance, and (2) compliance with the request would prejudice the public interest of the United States.
- 2.5. In this regard, it is worth noting that foreign assistance requests to the SEC generally have been made by regulators with which the commission has a history of reciprocity. The SEC has recently encountered, and expects to continue encountering, however, information requests from regulators with which the SEC has little history of information sharing and which have varying degrees of ability to reciprocate. Sound policy reasons exist for providing assistance in these instances, provided, at a minimum, that the foreign regulator has the ability to protect the confidentiality of the information. Providing assistance in these circumstances furthers the long-term interests of the SEC by encouraging international information sharing. Affording assistance in these circumstances also gives the SEC the opportunity to take action to prevent U.S. markets from being used to further fraud, thereby protecting U.S. investors. Less fraud around the world means less fraud that could affect U.S. investors and markets. Additionally, to the extent that proceeds or evidence of fraud is located in the United States, the SEC has a strong interest in ensuring that the United States is not viewed as a safe haven for illegal conduct.
- 2.6. The SEC recognized that foreign counterparts would be reluctant to share nonpublic information with the SEC without assurances that the information would remain confidential. They were concerned, in particular, about possible disclosures to third parties pursuant to a third-party subpoena or under the U.S. Freedom of Information Act (FOIA). As a result, a second legislative provision, Section 24(d) of the Exchange

Act, allows the SEC to keep confidential information it obtains from a foreign counterpart, even in the face of a third-party subpoena or an FOIA request. This confidentiality protection does not, however, prevent the SEC or criminal authorities from using the information necessary to take enforcement action.

3. Information-Sharing Arrangements

- 3.1. Following the adoption of information-sharing legislation in the United States, many jurisdictions adopted laws with similar aims. With these regulatory tools in place in other jurisdictions, the SEC began to formalize cooperative relationships with various foreign counterparts through international agreements generally known as memoranda of understanding (MoUs). The SEC has entered into approximately twenty bilateral enforcement MoUs with foreign counterparts. Although the existence of an MoU is not a predicate to the SEC's ability to engage in information sharing, the MoUs enhance the SEC's ability to gather the foreign-based information necessary to investigate and prosecute enforcement matters by setting forth a formal mechanism for the sharing of information. Each MoU is designed to fit the particular circumstances of the foreign market and the powers of the SEC's foreign counterpart.
- 3.2. Bilateral MoUs are largely used to share bank, brokerage, and beneficial ownership records. The MoUs generally do not circumscribe the type of information available, however, and do provide for the broadest possible assistance—as a result, the MoUs may also be used to share other information, such as testimony, audit work papers, and Internet service provider information. The MoUs set forth the permissible uses of information, including use for SEC investigations and proceedings and for assisting the DOJ. Apart from permissible uses, the SEC and foreign authorities commit to maintaining the confidentiality of nonpublic information shared pursuant to the MoU.
- 3.3. The SEC is also a signatory to the International Organization of Securities Commissions' (IOSCO) Multilateral MoU. This MoU specifies the particular types of information a signatory may be asked to provide (i.e., bank, brokerage, and beneficial ownership records); the permitted uses of the information (e.g., for civil and administrative investigations and proceedings, and onward sharing with criminal authorities); and the confidentiality of nonpublic information. The Multilateral MoU is open to IOSCO members who demonstrate their

legal authority to comply with the Multilateral MoU's key provisions. Currently (as of 2004), there are 26 signatories to the Multilateral MoU, including the SEC.

4. Necessary Legal Tools for International Cooperation

- 4.1. Over the past two decades, securities regulators have learned that there are certain legal tools essential to combating wrongdoing internationally. These are codified in the IOSCO Multilateral MoU, but these tools are critical, whether or not a securities regulator is an IOSCO member or a signatory to the IOSCO Multilateral MoU. Specifically, each securities regulator must be able to:
 - 4.1.1. collect, under compulsion if necessary, key types of information essential to conducting an investigation, including bank and brokerage records and beneficial ownership information;
 - 4.1.2. share nonpublic information in its files with a foreign counterpart relevant to the investigation the foreign counterpart is conducting;
 - 4.1.3. conduct an investigation in its territory on behalf of a foreign counterpart, irrespective of whether the conduct in question violates, or would violate, the securities regulator's law;
 - 4.1.4. allow information shared with a foreign counterpart to be used to facilitate the foreign counterpart's investigation and resulting proceedings, including assisting in a criminal prosecution; and
 - 4.1.5. outside of the permissible uses, maintain the confidentiality of nonpublic information received from a foreign counterpart.
- 4.2. What this means in real terms is that a securities regulator should have the ability to use its enforcement powers on behalf of a foreign authority to the same extent it uses them to enforce compliance with domestic securities laws.

5. Ultimate Objective

- 5.1. Securities regulators agree that capital markets are essential to the well-being of the global economy and that investor confidence is critical to the success of capital markets. In order to promote investor confidence, we need to show that we are ready, willing, and able to take action against wrongdoers who commit illegal securities activity. This includes taking seriously the fraud and other illegal conduct that occur on mar-

kets outside our own, and giving priority to developing our ability to provide international assistance.

- 5.2. The international regulatory community is only as strong as its weakest link. The strength of the chain depends on each of us having the necessary legal tools to cooperate with foreign counterparts. Cooperation may be further enhanced by information-sharing arrangements, such as MoUs. Only with these pieces in place will we be able assure our investors that the securities markets are safer because securities regulators can act promptly and effectively to protect their interests and the integrity of the markets.

14

International Cooperation in the Securities Sector: The Legal Position and Practice in Bermuda

CHERYL-ANN LISTER

1. Bermuda's Approach

- 1.1. This chapter makes some general comments on Bermuda's framework for regulatory cooperation, with specific regard to international cooperation in the context of Bermuda's investment regulation.
- 1.2. Bermuda is the home for a very substantial financial services industry operating internationally, notably in banking, insurance, and investment business. It is, in particular, a major jurisdiction for insurance and reinsurance business and a principal center for the captive industry, and also has a very large regulated mutual fund sector. The Bermuda Monetary Authority (BMA) acts as the independent licensing and regulatory body for virtually the whole of Bermuda's financial business sector.
- 1.3. In Bermuda, we have aggressively worked to ensure that our regulatory legislation meets both the letter and the underlying objectives of the policy framework that the international standard setters for financial regulation have put forward, including with regard to the requirements to be met for international regulatory cooperation.
- 1.4. In this chapter, I describe our experiences in regulator-to-regulator assistance and also address a number of particular difficulties or conflicts we have identified.

2. Obstacles to Cooperation

- 2.1. Although most authorities (and all reputable authorities) are committed to proper cooperation and information exchange and now have the nec-

essary powers and gateways, we are very conscious of the fact that there may be practical obstacles and delays involved, reflecting a wide range of legal and administrative issues.

- 2.2. The experience of the BMA in both making and receiving requests for information is that it is now rare for a request for supervisory assistance to be directly refused. The problems that remain in international cooperation are mainly manifested in the form of delays in making an adequate response to a request for assistance.
- 2.3. While delays can, of course, be used as a “soft” alternative to outright refusal, the BMA’s observations tend to indicate that delays are much more typically the result of genuine legal issues or practical matters, such as a lack of relevant or adequate resources in the supervisory authority concerned, than of any lack of willingness, in principle, to cooperate.
- 2.4. In considering the type of problems that arise, we find it helpful to distinguish between (1) requests for information that is already in the hands of the requested authority, and (2) those for which the requested authority itself needs to take steps to acquire information from other bodies or persons in its jurisdiction.
- 2.5. The former are by far the more straightforward, since, where the information is already held by the supervisors, it is likely to have been obtained because of a genuine regulatory or supervisory need for the information in question. As a result, it is easier for the requested authority to make a judgment as to whether the material in question is genuinely relevant for the regulatory or supervisory purposes of the requesting authority.

3. Developing Relationships

- 3.1. In all cooperation requests, the existence of a previous cooperative relationship with the requesting authority is extremely helpful in ensuring an appropriate and timely response. For this reason, most authorities spend considerable time and resources cultivating links, both bilaterally and through attendance at relevant international meetings, with their opposite numbers in other jurisdictions.
- 3.2. For many years, Bermuda has devoted significant resources to ongoing discussions and cooperation with other regulators internationally. The BMA is a member of a number of key standard-setting bodies, notably the Offshore Group of Banking Supervisors (operating in close collaboration with the Basel Committee), the International Association

of Insurance Supervisors (IAIS), the International Organization of Securities Commissions, the Council of Securities Regulators of the Americas, and the Offshore Group of Collective Investment Scheme Supervisors.

- 3.3. At the same time, the BMA continues to be closely involved with a number of important international working groups operating under the aegis of the various standard-setting bodies, such as the IAIS Reinsurance Technical Committee, the IAIS Task Force on Transparency and Disclosure in the Reinsurance Sector, and the Basel Committee's Cross Border Banking Group.

4. Value of Memoranda of Understanding

- 4.1. Generally, the BMA sees no need for our relationships with individual regulators to be reflected formally in the development of memorandums of understanding (MoUs) or other exchanges of letters. Putting in place appropriate MoUs almost always involves extensive time and efforts on the part of both parties, something we find is generally not a particularly good use of scarce resources. Moreover, with a wide variety of MoUs in place, it can then become an added burden for an authority to constantly seek to ensure that it is compliant with the varying commitments entered into in the different texts. In our case, therefore, we would rarely see an overriding need for an MoU to be put in place to document mutual commitments. We are, however, perfectly willing to enter into MoUs where others prefer this approach and we can see a practical need. (And, indeed, we do have a small number of MoUs in place where needs have been identified.)
- 4.2. Time and practice have proven that the existence of previous links between the institutions, and ideally personal acquaintance between supervisors, is the best guarantee of timely and appropriate cooperation, regardless of whether or not an MoU is in place.
- 4.3. Where there is no previous history, matters are likely to take longer, often for perfectly valid reasons. Time is required
 - 4.3.1. to identify the appropriate person to contact;
 - 4.3.2. for the BMA, as the requested authority, to conduct necessary checks to ensure that we can properly cooperate with the requesting authority; and
 - 4.3.3. to ensure that the specific request is a valid one.

5. Equivalence

- 5.1. I am sure that many authorities (as we must do under Bermudian legislation) have to satisfy themselves that the requesting authority is an equivalent regulatory body and that confidential information that is put into the hands of that body will be at least as well protected from onward disclosure as it would be in their own hands. Where there is no previous history, these matters can take time and require further correspondence to establish.
- 5.2. The question of the need for such “equivalence” requirements in legislation is a difficult one. National parliaments have put in place strict requirements domestically to constrain the disclosure of confidential regulatory information. It is therefore natural for them to wish to ensure that very different standards could not apply to the information in the hands of another regulator to which it is legitimately passed. It is equally important, however, that legal restrictions not be so inflexible that necessary disclosures are inhibited and that legal challenges to the exercise of an authority’s powers do not proliferate.
- 5.3. Requested authorities, very properly, always retain discretion over whether or not to cooperate in a particular case. A key consideration in that regard is normally the need for the requested authority to be satisfied that the requesting authority has a genuine supervisory purpose in seeking the information in question. Such decisions are much easier to make when the requested authority has previous knowledge of the requesting authority and its regulatory approach, and is able to readily comprehend the supervisory rationale for the request.
- 5.4. In particular, examining in detail the legislation in the other jurisdiction to ensure that the relevant confidentiality provisions are satisfactory and that suitably narrow gateways are specified for onward disclosure of any information passed on to the other authority is normally an important prior condition for information exchange. Inevitably, this involves a need to obtain and review the legal provisions in the legislation governing the functions of the requesting authority, a process which frequently necessitates discussions between the two authorities to deal with any queries.

6. Obtaining Information for Foreign Authorities

- 6.1. By contrast, the greatest difficulties in conducting practical international cooperation arise in relation to requests for information not

already held by the requested authority. This is also the cause of the typically quite different experience of international cooperation from the point of view of securities regulators as compared with those of banking or insurance supervisors.

- 6.2. In sharp contrast to its experience in banking and insurance supervision, the BMA's experience of cooperation requests in the securities sector is that the relevant information is virtually never already in the hands of the regulators. This reflects the fact that the bulk of securities-related requests arise not out of institutional supervision of intermediaries but out of market surveillance—in other words, investigation of market price movements appearing to reflect insider dealing or improper price manipulation. So, almost inevitably, the requested authority has to serve notice on an institution in order to obtain the relevant information. Moreover, the information requested will generally relate not to the prudential supervision of a licensed institution but to the affairs of individual customers of that institution.
- 6.3. As a result, for securities regulatory purposes, international cooperation necessarily tends to involve a much more complex and time-consuming process whereby regulators need to exercise statutory powers to obtain information; and such cases require extensive review and considerable care, since, in all our jurisdictions, the legal powers to collect information, under compulsion, relating to legal or natural persons that are not themselves regulated are constrained and conditioned in certain ways.
- 6.4. In Bermuda's case, for example, the BMA needs to be satisfied as to certain matters before we can give assistance. Requests must come from a regulatory body carrying out corresponding functions; we must also be satisfied they are for a genuinely regulatory purpose, and that the information in the hands of the requesting authority will remain tightly restricted in terms of the use that can be made of it and the persons to whom it may be communicated.
- 6.5. Consequently, such cases are often time-consuming for the requested authority, which needs to obtain sufficient information to satisfy itself that the relevant conditions for use of its powers to compel information are met and can be demonstrated to be met in the event of a subsequent challenge. Resources are then needed to draft the requisite legal notices, to serve them on institutions, to deal with any court challenges, and to review material received in response to notices in order to determine what information should be passed to the requesting authority. Understandably, against that background, delays are almost inevitable.

But, again, our observation suggests that most authorities seek to deal expeditiously with requests, and we have seen extremely little evidence of delays masking a general unwillingness to cooperate.

- 6.6. For many of us, the powers to compel disclosure of information are relatively new tools, and we are still feeling our way through some of these practical aspects. It is important to recognize the sensitivity of the issues raised in this area and, in particular, to ensure that we handle properly the conflict that can emerge between the need for relevant information to flow through regulator-to-regulator gateways and the rights of a client to have proper privacy respected with regard to his or her personal affairs. Bermuda has never had any specific secrecy legislation, but, as with other countries with a legal framework based on English law, there is a strong presumption of privacy under common law for clients' affairs. As supervisors, we have to ensure that this presumption of privacy is overridden by our regulatory powers to compel disclosure of information only in appropriate circumstances and within an acceptable framework of checks and balances governing the exercise of our powers.
- 6.7. As a result, we take extremely seriously the obligations on us with regard to exercising our powers to compel disclosure of information. In each case, we need to ensure that we are able to assess the appropriateness of a particular request and, in particular, that it is targeted on potential breaches of regulatory provisions. Each request is considered directly at the highest levels to ensure that, as an authority, our process of internal review of requests is subject to proper scrutiny. Once the information is received, we review the material in question and pass on whatever appears relevant to the specific request.
- 6.8. It is easy to become irritated at the delays and procedural complexities that can be involved in processing such requests, but I believe we all need to recognize the real sensitivities in this area and seek to strike a fair balance. We need to ensure proper enforcement of market standards, and effective information exchange is an important element in ensuring proper investigation of suspected offenses. But, ultimately, we will undermine effective regulation if we are not seen to act reasonably and fairly. Standards of cooperation have developed very rapidly in recent years. In many countries, the new regulatory gateways are not yet well known or fully understood, and we still need to overcome suspicion and to earn trust. As part of this, it will be important for regulators to be as transparent as possible in explaining the nature of the gateways

and the rationale for them. Once the objectives and the requirements are understood and recognized, greater confidence can be built. It may then become easier for regulatory authorities to seek greater flexibility and discretion in the application of the gateways for cooperation.

7. Transparency

- 7.1. One issue, of course, is that regulators seek to act through such regulatory gateways without transparency at the level of the specific case. If I need to pass on information about a client of a financial institution for a regulatory purpose, it is likely that the individual concerned will have no knowledge of that. Where the purpose of passing that information can be seen as necessary for the prudential supervision of the institution, there is arguably an overriding regulatory imperative. Where information is sought in relation to inquiries into possible market abuse by the customer of the institution, however, the absence of transparency becomes more troubling. Of course, the information on the innocent client is sought essentially to enable him or her to be eliminated from inquiries. And for the guilty, it may arguably handicap an investigation if the individual has to be put on notice.
- 7.2. Information requests of this kind are normally made on a confidential basis and are passed on to institutions on that basis. In most jurisdictions, there are no anti-tipping-off provisions, so, legally, an institution may alert its customer to a request, for example, if it concludes that it may have some obligation to put its customer on notice. I am aware that customers have been alerted in a few cases. So, the reality is that we do not have a level playing field. Neither am I sure that the right answer would simply be to enforce an anti-tipping-off provision. It may be that we, as supervisors, need to think harder about how far and in what circumstances it is legitimate to remove the rights of customers to be aware of the fact that their private affairs are to be subject to scrutiny in this way as a result of the exercise of powers to compel disclosure of information by financial intermediaries.
- 7.3. In addition, there are difficult questions on the distinction between the regulatory and the criminal gateways. In many jurisdictions, Bermuda included, the legal provisions continue to enforce a sharp distinction. Hence, a requested authority needs to satisfy itself that the request is for a proper regulatory purpose—something that can be even more difficult to do where the requesting authority may have powers and responsibilities that also span the criminal law. Moreover, not infre-

quently, inquiries that begin as regulatory subsequently become criminal as a result of a decision of the foreign authorities as to the proper sanctions in a particular case. Understandably, requesting authorities can find it frustrating, in such circumstances, to be told that the regulatory gateways no longer apply and that further cooperation must be sought through recourse to the preexisting mutual legal assistance provisions. It is, nonetheless, most important that they make use of the proper route. I believe it is important to avoid any perception that regulatory gateways are a quicker and easier option than mutual legal assistance provisions, where relevant, since such a development is likely to increase skepticism about regulator-to-regulator gateways and complicate the process of gaining full trust. If there are problems and concerns over the reliability or timeliness of mutual legal assistance and other established cooperation gateways, the proper course is to tackle these issues directly. The alternative, in which regulatory gateways are increasingly used to circumvent these proper avenues, would, I believe, likely be a counterproductive approach.

IOFC Unified Regulation

15

International Cooperation: The Legal Position and Practice in the British Virgin Islands

JACQUELINE WILSON

1. Introduction

- 1.1. The British Virgin Islands (BVI) Financial Services Commission (FSC) is the authority that is responsible for regulating financial services business that is carried on in or from within the BVI. This includes banking and trust company business, company management business, mutual fund business, and insurance business.
- 1.2. The financial services system comprises 10 banks, 389 insurance companies, 3,409 mutual funds, 544,000 registered international business companies (of which fewer than 200,000 are active), and 79 registered agents. Three of the 10 banks are permitted to do business only outside the BVI, and all of them (apart from the government-owned bank) are foreign owned. The insurance sector includes local and captive insurance services being offered by 389 companies. The 346 captive insurers constitute the bulk of insurance business carried on from within the territory. Captive insurers are managed by 14 insurance managers with an established physical presence in the BVI.
- 1.3. The BVI's international business companies (IBCs) market represents a substantial portion of its financial sector. The BVI has thus far registered 544,000 IBCs, all of which must have registered agents, who are licensed under the Company Management Act or the Banks and Trust Companies Act (BTCA) and who are also required to maintain a physical presence in the BVI. Some agents may also have licenses to manage trusts. Other agents are allowed only to manage a limited number of trusts.

- 1.4. The FSC's powers to obtain and disclose confidential information are exercisable against a wide range of persons and in comprehensive circumstances, otherwise known as the gateway provisions. These powers are set out in two pieces of legislation, namely, the Financial Services Commission Act, 2001 (FSC Act) and the Financial Services (International Cooperation) Act, 2000 (FS(IC) Act). The latter deals exclusively with the legal framework for the FSC to provide assistance to, and receive assistance from, a foreign regulatory authority. A foreign regulatory authority is defined as including an authority in a country outside the British Virgin Islands that exercises regulatory functions that, in the opinion of the FSC, relate to companies or financial services.

2. Financial Services Commission Act

- 2.1. Under the FSC Act, the FSC's compulsory powers are exercisable against a regulated person, a person connected with a regulated person, a person carrying on financial services business, and a person reasonably believed to have the required information. The powers are exercisable by the FSC for the purpose of discharging its functions or ensuring compliance with any financial services legislation. The procedure that is followed is for the FSC to issue a notice requiring the recipient of the notice to produce such information as may be specified in the notice.
- 2.2. In addition, under the FSC Act, the FSC's Board of Commissioners has power to request (as opposed to require) any person engaged in or related to any financial services business to furnish the FSC with such information as the board may specify. The board cannot compel a person to produce documents that have been requested, whereas the FSC can compel a person to produce documents that have been required by applying to a magistrate for a search warrant.
- 2.3. The FSC does not have the power to require, nor does the board have the power to request, the disclosure of information that a person would be entitled to refuse to disclose or produce on the grounds of legal professional privilege. This provision of the FSC Act is a codification of the common law doctrine. Documents are subject to legal professional privilege where they are given to a legal practitioner by a client or his representative for the purposes of seeking legal advice or by any person in contemplation of or in connection with legal proceedings. Information is not subject to legal professional privilege if it is communicated or given with a view to furthering a criminal purpose. The FSC Act spe-

cifically provides that it does not prevent a legal practitioner from giving the name and address of his client.

- 2.4. The gateway provisions under the FSC Act allow for disclosures as follows:
 - 2.4.1. for the purpose of legal assistance in the investigation of a criminal activity on a request by an international organization recognized by the board or a law-enforcement authority in a country approved by the board;
 - 2.4.2. for the purpose of assisting a foreign regulatory authority, including a trading or a security or exchange authority in a country or jurisdiction approved by the board, in discharging duties or exercising powers corresponding to those of the FSC;
 - 2.4.3. to the governor, the Executive Council, the board, the FSC's Licensing and Supervisory Committee, or an officer of the FSC;
 - 2.4.4. to any person for the purpose of discharging any duty under any financial services legislation in the BVI;
 - 2.4.5. on the order of a court of competent jurisdiction for the purposes of any criminal or civil proceedings in the BVI;
 - 2.4.6. to any person for the purpose of
 - criminal proceedings in the BVI;
 - disciplinary proceedings, whether within or outside the BVI, relating to the discharge by a legal practitioner, auditor, accountant, valuer, or actuary of his professional duties; and
 - disciplinary proceedings relating to the discharge by a public officer, a member or employee of a BVI statutory board, or a commissioner or employee of the FSC of his or her duties; and
 - 2.4.7. legal proceedings in connection with the winding up of a regulated person in the BVI or the appointment of a receiver.
- 2.5. Where disclosure is made to an international organization, foreign law-enforcement authority, or foreign regulatory authority, those authorities are prohibited from making further disclosures without the prior written consent of the board. To facilitate compliance with this provision in the law, the FSC requires a written undertaking to this effect before granting assistance. The rationale for this provision is to preserve/protect the confidentiality of information that is disclosed by

the FSC to foreign authorities. Although some foreign regulators have objected that such an undertaking may effectively require them to act in breach of obligations under their respective laws, it is suggested that the reasonable exercise of the board's discretion would allow those authorities to make disclosures in keeping with their legal and constitutional obligations.¹

3. Financial Services (International Cooperation) Act, 2000

- 3.1. The FS(IC) Act contains detailed provisions on how the FSC should execute requests for assistance by foreign regulatory authorities and stringent provisions to enforce compliance with the FSC's compulsory powers.
- 3.2. The four main factors for consideration upon receiving a request are the following:
 - 3.2.1. reciprocity by the requesting authority—whether corresponding assistance would be given to the FSC;
 - 3.2.2. whether the inquiries relate to the possible breach of a law or other requirement that has no parallel in the British Virgin Islands (there is no express requirement to establish dual criminality);
 - 3.2.3. the nature and seriousness of the matter to which the inquiries relate and whether the assistance could be obtained by other means; and
 - 3.2.4. whether it is appropriate in the public interest to grant the assistance sought.
- 3.3. It should be noted that the FSC has not refused assistance on any of the above grounds.
- 3.4. Where the FSC is satisfied that assistance should be granted to a foreign regulatory authority, it may exercise its compulsory powers against any person by issuing a direction requiring that person to furnish information, produce documents, or otherwise provide assistance. It is suggested that "assistance" may be interpreted to mean informal interviews. Where a person fails to comply with a direction within three days from the date of the direction or such longer period as the FSC may permit, the FSC may apply to a magistrate for an order requiring the person to

¹An example of this issue is given later in this chapter.

comply with the direction. An application to a magistrate must be processed by the magistrate within seven days of the application, and the failure to comply with an order of a magistrate is an offense punishable, on summary conviction, by a fine not exceeding ten thousand dollars.

- 3.5. As with the FSC Act, under the FS(IC) Act, a person shall not be required to disclose information or produce documents which he or she would be entitled to refuse to disclose or produce on the grounds of legal professional privilege, except that a barrister or solicitor may be required to furnish the name and address of his or her client.

4. Difficulties Encountered in Obtaining/Sharing Information

Objection to Undertaking

- 4.1. The requirement to undertake not to make further disclosure without the prior written consent of the board has met some resistance from two overseas regulators. In both cases, the objection to giving such an undertaking was based on the premise that the overseas regulator was required, or may have been required by law, to pass confidential information to other authorities—investigative, prosecutorial, or legislative.
- 4.2. The reluctance to give the undertaking was therefore sparked by a conflict between the laws of the requesting authority and of the requested authority, that is, the FSC. A lack of understanding of the relevant provisions of BVI law and skepticism that approval for further disclosure would not have been granted may also have played a part. Once a relationship of mutual trust and cooperation was developed, however, the misgivings abated and the process worked smoothly. In one instance, the terms of what would otherwise have been a standard undertaking were reworked to meet the needs of the overseas regulator while satisfying the requirements of the FSC Act.
- 4.3. Save in those exceptional cases, foreign regulatory authorities seeking assistance from the FSC have readily undertaken to be bound by the requirement to seek the prior written consent of the board prior to making further disclosure of confidential information.

Lack of Forthrightness by Requesting Authority

- 4.4. The lack of candor by a requesting authority has a serious impact on the effective execution of a request. Full and frank disclosure of all relevant matters (including any negotiations with the parties who have been requested to produce documents) is essential.

- 4.5. In one instance, the FSC received a request for assistance from a foreign regulatory authority, and the FSC issued a notice to a regulated entity to produce documents pursuant to the request. In the interim, attorneys for the requesting authority entered into negotiations for the production of the same documents with attorneys who were representing the BVI-regulated entity. The negotiations were not disclosed to the FSC. In fact, the FSC first became aware of the negotiations when it wrote to the regulated entity imposing a final deadline for the production of the documents. The regulated entity informed the FSC that its attorneys were negotiating the production of documents with attorneys for the foreign regulator and that it would be advisable to await the outcome of the negotiations. This was obviously the cause of considerable embarrassment to the FSC.
- 4.6. Fortunately the matter was resolved favorably and the requested documents were produced.

Overstepping Boundaries

- 4.7. In one instance, in what could perhaps be best described as an overexuberant effort to achieve the desired result, a foreign regulatory authority made direct contact with a local bank, informing bank officials that an order had been obtained in the jurisdiction where the foreign regulator was located restraining accounts that were held in the BVI and warning the bank that it would incur liability if any sums were withdrawn from those BVI accounts. The foreign regulator ignored the advice of the FSC to restrain the accounts using available procedures under other BVI legislation and threatened the bank that, as a constructive trustee of the accounts, it would incur liability if any sums were withdrawn from those accounts. The bank had earlier provided documents to the FSC pursuant to a request for assistance in the same matter, and the FSC was concerned that the approach of the foreign regulator may have undermined the bank's previously cooperative approach.
- 4.8. Needless to say, the foreign regulator's approach was a source of concern to the FSC and contrary to sound international cooperation procedures.

5. Conclusion

- 5.1. Notwithstanding the difficulties that are sometimes experienced in the international cooperation process, the statutory scheme set out in the FSC Act and the FS(IC) Act has been effective in allowing the FSC to

obtain and disclose confidential information subject to such safeguards as are necessary to both facilitate sound regulatory practices and protect legitimate interests.

- 5.2. The FSC's ability to provide assistance is demonstrated by the following statistics on informal and formal requests:

	2001	2002	2003
Informal	12	32	37
Formal	1	13	10

- 5.3. When an informal request for information is received, the FSC provides information that is publicly available and advises the person making the request on the procedure for obtaining requested information that is not publicly available. When a formal request for assistance is received, the FSC may grant assistance under either the FSC Act or the FS(IC) Act, provided that the requirements of the relevant legislation have been satisfied.

Regulatory Cooperation Standards and Practices in the Samoa Offshore Financial Center

ERNA VA'AI

1. Introduction

- 1.1. This chapter describes the experience of the Samoa offshore financial center (OFC) with cross-border cooperation and exchange of information.
- 1.2. The financial center was established in October 1988 following the enactment of various laws—namely,
the International Companies Act, 1987;
the Offshore Banking Act, 1987;
the International Trusts Act, 1987;
the Trustee Companies Act, 1987; and
the International Insurance Act, 1988.
- 1.3. Since then, the types of products offered by the Samoa jurisdiction have been expanded with a series of changes to these laws. For example, in response to the increased popularity of Samoan international companies, the International Companies Act was amended, over the years, to introduce limited liability companies (LLCs), companies limited by guarantee, and hybrids of these company types. With offshore banks and insurance companies, the enabling licensing legislation was amended in the light of international standards of best practice on supervision.
- 1.4. A particularly important development in 1998 was the introduction of gateway provisions to facilitate information exchange between the

Samoan authorities and their foreign counterparts for supervisory purposes only.

- 1.5. The current experience of the Samoan jurisdiction with cross-border cooperation and exchange of information cannot be seen in isolation. This is because it is part of an emerging global process stemming from concerns about significant gaps in the global system in relation to financial supervision and money laundering. We are experiencing, therefore, the unfolding of various global initiatives from international bodies like the Financial Stability Forum (FSF) and the IMF, and from the Financial Action Task Force (FATF) on anti-money laundering (AML) and combating the financing of terrorism (CFT). These initiatives promote standards of best practice in financial supervision and AML/CFT measures.

2. Striking the Balance Between Confidentiality and Measures to Deter Abuse

- 2.1. A common thread running through these international initiatives is the demand for cross-border cooperation and information exchange. As an offshore financial center, Samoa has taken the demand for cross-border cooperation and information exchange very seriously.
- 2.2. Like many other OFCs, Samoa views secrecy or confidentiality in financial matters as an essential ingredient in the offshore industry that deserves to be protected. Unlike other jurisdictions that rely on common law to protect confidentiality, there are explicit strict secrecy provisions enshrined in all the Samoan offshore legislation.
- 2.3. The strictness of the confidentiality provisions is reflected in the severe penalties for unauthorized disclosures enconced in each of the acts that underlie the Samoan offshore financial center. Although offshore secrecy or confidentiality has justifiably come under vigilant attack, there are still legitimate reasons behind the concept. Such reasons include, for example, trade secrets and the genuine need for privacy of investors residing in countries where kidnapping and security issues are highly relevant. In addition to the need for privacy under the alarming circumstances of the latter, there is also a need for family privacy in relation to probate or succession issues.
- 2.4. In Samoa, secrecy or confidentiality is not absolute, however, and confidential information can be disclosed under compulsion by law. There are clear exceptions to the secrecy provisions, especially where there is

an element of public interest in preventing abuse of the financial system, when fighting crime, or when providing for proper supervision of financial institutions. For example, the Money Laundering Prevention Act, 2000 overrides secrecy provisions in any of Samoa's laws including the offshore regime.

- 2.5. This involves a delicate balancing act between individuals' rights to privacy in the conduct of their business and commercial affairs, and the public interest in crime prevention and proper financial regulation. Maintaining the correct balance is a major challenge that OFCs such as Samoa will continue to face in the future.

3. Experience of Samoa

- 3.1. Let me now describe Samoa's experience with cross-border cooperation and exchange of information.
- 3.2. In general, a combination of local laws and prudent practice allows exchange of information in Samoa between client and professional service providers, between professionals and industry regulators, and between regulators and foreign counterparts. The focus of this chapter is on regulatory exchanges of information.
- 3.3. Samoa has not, to date, entered into exchange of information agreements or treaties with any jurisdiction.
- 3.4. Exchange of information has, to date, occurred on three levels:
 - 3.4.1. informal;
 - 3.4.2. formal requests for legal assistance; and
 - 3.4.3. statutory regulator-to-regulator provisions for exchange of information.

Informal Exchanges of Information

- 3.5. Most of the exchange of information experienced in Samoa before the introduction of legislative gateway provisions was via informal means—for example, by telephone or discussion at supervisory meetings. For informal exchanges of information to occur, it is essential that the regulator establishes trust and understanding with not only his peers but also the financial services industry.
- 3.6. Trust can be cultivated and fostered only where supervisors know each other, and forums and peer groups such as the Offshore Group

of Insurance Supervisors (OGIS) and the Offshore Group of Banking Supervisors (OGBS) can play a pivotal role in its establishment. As a member of the OGIS and an observer of the OGBS, Samoa shares in cooperative efforts to comply with and keep abreast of international standards on supervision, which involve a high level of exchange of information. Other informal exchanges between regulators occur when conducting due diligence on prospective licensees, especially if the applicants are licensed in another jurisdiction. The networking in regulatory peer groups greatly assists inquiries in the licensing and ongoing monitoring of regulated entities. The information exchanged between regulators may include both supervisory and nonpublic information and depends largely on the law and, to some extent, the relationships between regulators.

- 3.7. In relation to the industry, the regulated entities (e.g., trustee companies, offshore banks, and insurance companies) must keep all their records in Samoa. They are also obligated by law to provide audited accounts and annual reports to the regulator and additional information as it may direct from time to time. A high level of information exchange informally occurs at this level (not only between the regulator and the industry but also among the service providers themselves), which is enhanced by the existence of the Trustee Company Association.

Formal Requests for Assistance

- 3.8. In practice, information was exchanged between the Samoan authorities and foreign regulators pursuant to formal requests for legal assistance even before passage of the gateway provisions or the Money Laundering Prevention Act, 2000. For example, in 1994, a request was received by the Samoan Government from the Treasury of the Netherlands for information on a defunct Samoan international company being investigated for laundering proceeds of drug activities. The request for information was granted by the minister of finance (who is the ultimate authority in the offshore sector), given that the company had been deregistered and was deemed not to be entitled to privileges of tax exemption and confidentiality. Moreover, an exemption to the secrecy provisions allowed the initial disclosure by the trustee company to the minister, in what was believed to be in the interests of upholding the integrity of Samoa.
- 3.9. Subsequent to the passage of new legislation, there have been provisions for statutory regulator-to-regulator exchanges of information.

- 3.10. The gateway provisions in the legislation dictate what information can be disclosed and under what conditions. These provisions were introduced under the Offshore Banking Amendment Act, 1998 and the International Insurance Amendment Act, 1998 to allow exchanges of information between regulators, provided three (3) conditions are met:
- 3.11. The regulator is satisfied that the intended recipient authority is subject to adequate legal restrictions on further disclosures, including provision of an undertaking. The phrase “adequate legal restrictions” primarily means that the requesting regulator in receipt of information must have a duty to protect the information provided, which is confirmed by an undertaking given by the requesting regulator that information provided will not be disclosed to a third party without the express consent of the Samoan authorities;
- 3.12. Information provided by the regulator does not contain any names of clients; and
- 3.13. Information is required for supervisory purposes only and is not related (either directly or indirectly) to tax matters or enforcement of exchange controls.
- 3.14. The restrictions on information that can be provided (i.e., relative to names of clients and tax or exchange controls enforcement) are in line with the overall scheme of the legislation as it was formulated back in 1998. Additionally, the new proposed International Banking Bill, 2004 ([which was] envisaged to be enacted in the first quarter of 2005) will expand the scope of information exchange to include information required for purposes of prevention and suppression of terrorism or enforcement of the Money Laundering Prevention Act, 2000.
- 3.15. Samoa also has draft legislation—namely, the International Financial Services Cooperation Bill, 2004. This bill provides for international cooperation between the Samoan authorities and foreign regulatory, law-enforcement, and tax authorities.
- 3.16. As a regulator, I have made several exchanges, pursuant to the statutory gateways, with other regulatory authorities, particularly when conducting due diligence for licensing purposes with, for example, the British Virgin Islands, Vanuatu, Guernsey, Labuan, and the Cayman Islands.
- 3.17. Throughout my limited experience in the exchange of information, there have been some underlying problems.

- 3.17.1. There is a need to understand other jurisdictions' systems (particularly by developing personal contacts), since different countries do things differently—for example, in respect of the structure of supervision and the division of responsibilities between federal and state authorities.
- 3.17.2. Some jurisdictions may not have legal gateway provisions in their legislation to allow the exchange of information and may therefore find that information obtained informally may be held inadmissible in court proceedings.
- 3.17.3. There is a need for a model memorandum of understanding (MoU) to facilitate information exchange. Samoa does not, at present, have an MoU with any other jurisdiction.
- 3.17.4. There is a need to understand the scope and reasons for the request. The regulator making the request should make a full and open disclosure.

4. Future Developments on Exchange of Information in Samoa

- 4.1. In light of the present global climate, it seems highly likely that mechanisms facilitating the exchange of information in Samoa will continue to expand. There is now a trend among offshore financial centers that is being promoted by supranational organizations like the Financial Action Task Force (FATF) to extend existing gateways to law-enforcement agencies.
- 4.2. To this end, Samoa has prepared new draft legislation called the International Financial Services Cooperation Bill, 2004. This bill will provide for international cooperation with foreign regulatory and law-enforcement agencies and designated competent authorities under exchange of information (EOI) treaties and agreements. The draft law is based on similar legislation in the British Virgin Islands (BVI) called the Financial Services Act, 2000 and Part IV of their Financial Services Commission Act, 2001.

PART II

INTERNATIONAL STANDARDS AND PRACTICES

Cross-Border Cooperation and Information Exchange: Overcoming the Barriers to Regulatory Cooperation

RICHARD PRATT AND HENRY N. SCHIFFMAN

1. Introduction

- 1.1. What are the main barriers to international cooperation between regulators, and how can they best be overcome? This was the focus for discussion at the IMF Cross-Border Cooperation Conference held in Washington, D.C. on July 7 and 8, 2004.
- 1.2. In this paper, we discuss the purposes of cooperation between financial service regulators, focusing on banking, securities business, insurance, and anti-money laundering (including combating the financing of terrorism (AML/CFT)). We then examine the multilateral instruments designed to encourage cooperation and the approaches to international cooperation of the international standard-setting bodies (SSBs) or recommendations in the four regulatory areas.¹ We describe the most frequently experienced continuing barriers to cooperation and consider the reasons for them. We conclude by identifying some themes from this analysis and suggesting priority actions for the future.
- 1.3. The paper is based on published reports and discussions with regulators. A survey of regulatory authorities was also conducted. An analysis of the findings was presented to the conference. This paper draws on those findings and on the discussions at the conference.

¹The Basel Committee on Banking Supervision (Basel Committee); the International Organization of Securities Commissions (IOSCO); the International Association of Insurance Supervisors (IAIS), and the Financial Action Task Force (FATF).

- 1.4. Before discussing the specific issues covered by the paper, it is worth making one point at the outset that is clear from research and from the experience of regulators. Although there is no doubt that the existence of institutional or legal impediments to cooperation remain, the willingness of regulatory agencies to engage in cooperation can make a vital difference. On the one hand, in some financial centers, policymakers believe, rightly or wrongly, that their center's comparative advantage lies in providing a safe location for those wishing to escape the attentions of law-enforcement and tax agencies elsewhere. In such a context, however extensive the cooperation powers and however widely drawn the gateways for information exchange, it is improbable that cooperation will be timely and effective. On the other hand, even where there are inadequacies in the cooperation legislation, which leave legal and other barriers to information exchange, a regulator who sees it as a duty and in the interests of the jurisdiction to be cooperative can frequently find ways of assisting foreign agencies within the constraints of that jurisdiction's legislation.
- 1.5. Therefore, although we focus, in this paper, on formal and informal barriers to cooperation and offer ways of overcoming them, we judge that there is nothing quite as effective as the continuing campaign by international standard-setting bodies, multilateral agencies, and individual countries to persuade regulatory agencies, through direct and indirect pressure, to adopt cooperative stances. Trust is enhanced by personal contact, but personal contact requires events and travel. Part of the assistance recommended in this paper is designed to assist in the promotion of events to develop personal contact and to provide support for the costs of travel.
- 1.6. With respect to the organization of this paper, the main themes are discussed in Sections 1–5, and our conclusions and recommendations are set out in Section 6. Appendixes A–E amplify the main themes (including some descriptions of cases). Appendix F analyzes the approaches of the different standard-setting bodies (and the Egmont Group) in their pronouncements regarding cooperation.

2. Purposes of Cooperation

- 2.1. International cooperation assists financial services regulation in many ways. Specifically, it assists regulators when considering licensing applications, conducting ongoing regulation, and carrying out enforcement action.
- 2.2. Regulators are inclined to focus on the way in which international cooperation affects their own performance as regulators and that of fel-

low regulators. International cooperation has a further and wider effect, however, in improving the understanding of the operation of the world's financial system and thereby enhancing efforts to improve stability.

- 2.3. Appendix A provides more detail about the kinds of information that is exchanged for licensing, for ongoing regulation, and for enforcement. This section identifies the key issues.

Licensing

- 2.4. Cooperation is frequently of value when regulators are dealing with new applications for licenses to conduct financial services business (FSBs). It will frequently be the case that a regulator, faced with an application from an FSB for a license, will be aware that the applicant itself, or a member of the same group, has a license to conduct financial services in another jurisdiction. In these circumstances, information about the regulatory track record, the financial soundness of the business, and the competence and integrity of the owners and controllers is of great value. (For a fuller description, see Appendix A.)
- 2.5. For the most part, this form of cooperation presents few difficulties in practice. One major and increasing difficulty that inhibits cooperation in respect of licensing, however, is the extent to which a regulator can share confidential concerns about an FSB with another regulator.
- 2.6. To be effective, cooperation in respect of license applications has to be open and comprehensive. Public information about the regulatory history of an FSB can readily be exchanged. Confidential information about formal actions by the regulator can also be exchanged where the legal powers exist. Regulators have considerable knowledge about an FSB, however, that is not necessarily a matter of public record and may not have been communicated to the FSB. Indeed, there will almost always be some information that is available to a regulator about an FSB that has not been communicated formally, either publicly or confidentially, to the FSB itself. If, in these circumstances, a regulator in Jurisdiction A passes on, confidentially, serious concerns about an FSB to a regulator in Jurisdiction B that are relevant to an application by that FSB (or a closely associated FSB) in Jurisdiction B, it may not be possible for the regulator in Jurisdiction B to reveal that the information was a reason for rejecting an application. On the one hand, it is unfair to the FSB, as a license applicant in Jurisdiction B, to have no opportunity to challenge information that may affect its livelihood. On the other hand, if the regulator in Jurisdiction A withholds information

about those concerns, it is unfair to the regulator in Jurisdiction B to be left unaware of relevant information. The same issue applies to individuals about whom inquiries may be made.

- 2.7. Precisely the same dilemma arises when a regulator receives confidential information from another agency in the same jurisdiction.
- 2.8. As regulators have, quite properly, been required to be more transparent in their decision making, this dilemma has become more acute. In practice, regulators exercise their judgment about the kind of information that should be exchanged. That judgment clearly takes into account the strength of the concerns felt about an FSB and the relevance of the concerns to a new license application in another jurisdiction. The judgment will also be influenced by the trust and confidence that one regulator may have that another regulator will use information wisely and with discretion.
- 2.9. In some cases, the only possible approach is for regulators to decline to transmit to another regulator concerns that do not have an objective basis and that have not been disclosed to the FSB itself, because of the difficulty that that could entail. Such an approach could, however, result in an FSB receiving a license when it would be in the interests of the jurisdiction and the public, and perhaps of the wider financial system, for it to be refused.
- 2.10. One approach to resolving this dilemma is set out in the following (which applies equally, *mutatis mutandis*, to information passed to a regulator from another agency in the same jurisdiction and to information concerning key individuals):
 - 2.10.1. A regulator in Jurisdiction A should pass on concerns about an FSB to a regulator in Jurisdiction B where the FSB (or a closely related entity) is making a license application and where the concerns are relevant to the license application in Jurisdiction B;
 - 2.10.2. Wherever possible, those concerns should be expressed in a way that could be revealed to the FSB (for example, where they are matters of public record or where they have been passed on to the FSB already in Jurisdiction A);
 - 2.10.3. Where the concerns cannot be passed on to the FSB, the regulator in Jurisdiction A should so inform the regulator in Jurisdiction B;

- 2.10.4. The regulator in Jurisdiction B should not turn down the application in Jurisdiction B purely on the basis of confidential information that cannot be revealed to the applicant;
- 2.10.5. The regulator in Jurisdiction B can, however, either:
 - 2.10.5.1. use the confidential information to make further inquiries of the applicant and perhaps to challenge information that the FSB has given in support of its application, or
 - 2.10.5.2. (if the conditions attached to the disclosure of the information allow it) convey the information available to an applicant in order to allow the applicant the opportunity to contest it or to withdraw the application if the information conveyed has some merit.
- 2.10.6. This approach may result in the identification of further information that could be used as a basis for a decision—either in favor of or against the applicant. It may be that even when adopting this approach, no objective information emerges, and the regulator in Jurisdiction B may have no choice but to approve such an application. Nevertheless, the regulator can at least ensure that the applicant is subject to enhanced surveillance until the regulator is satisfied by the FSB's regulatory performance.

Ongoing Regulation

- 2.11. Cooperation enhances ongoing regulation of multinational FSBs. It is, first, essential to establish the respective roles of home and host supervisors of multinational FSBs (usually, but not exclusively banks) and to provide for joint on-site inspections and better mutual understanding of their business (including, perhaps, coordinated requests for information from the FSB). Cooperation can cover particular concerns, such as the growth of exposure of an FSB as a whole to particular borrowers, countries, or markets; its capital adequacy; and any enforcement action and its impact on the assessment of the FSB's integrity. Appendix A covers these points in more detail.
- 2.12. In practice, host supervisors tend to provide much more information to home country supervisors than vice versa. A reason for this is the responsibility of the home-country supervisor for consolidated supervision. In countries where foreign FSBs account for a significant share

of the market, and especially where a foreign institution is systemically significant, host-country supervisors should, however, be able to obtain information from the home-country supervisor on the condition of the parent institution.

- 2.13. There is often a further asymmetry between home and host supervisors that arises primarily in banking and insurance supervision rather than in securities regulation. A home-country supervisor of a major multinational FSB will have information relevant to dozens of other supervisors and may feel it impractical to tell them all. Failure to share such information routinely with relevant host supervisors, however, may result in a lack of understanding by those host supervisors of the issues faced by the home supervisor in respect of that FSB. Such failure may also result in a lack of trust between the supervisors. This, in turn, may mean that a host supervisor fails to share information that would be critical to a home supervisor—perhaps because the host supervisor was unaware of the significance of that information to the home supervisor.
- 2.14. In banking, this need has been explicitly recognized. A report by a working group comprised of members of the Basel Committee and the Offshore Group of Banking Supervisors in 1996² discussed the need for ensuring adequate provision of information from the home-country to the host-country supervisor. It recommended that home supervisors inform host supervisors at an early stage when the home supervisor learns of problems specific to the host country affiliate of an institution. With respect to material adverse changes in the global condition of a banking group with operations in a host jurisdiction, the report acknowledged the sensitive nature of disclosing such information, both as to substance and timing, and indicated that, in such instances, decisions on information sharing with host-country supervisors would have to be made on a case-by-case basis.
- 2.15. An example of home/host-country supervisor cooperation that is perhaps unique is with respect to Nordic countries' supervisors' information sharing regarding the Nordea Group. The group has FSBs in three or four Nordic countries that account for a significant share of the local market, and Nordic country supervisors have an established mechanism for sharing information about the group.

²Basel Committee, 1996, "The Supervision of Cross Border Banking" (Basel).

- 2.16. Host jurisdictions that have systemically significant institutions may request the inspection reports from the local institution or the home-country supervisor and ask the home-country supervisor to permit a host country supervisor to participate in inspections of the parent institution. At least one jurisdiction that has systemically significant affiliates of its banks abroad routinely sends inspection reports of the parent bank to foreign supervisors.
- 2.17. Ongoing supervision frequently demands proactive disclosure by a regulator. In the case of licensing and enforcement cooperation, where information is requested, the failure of a regulator to respond is highly visible and, if repeated, can prompt complaints and corrective action. Because cooperation for ongoing supervision frequently relies upon a regulator proactively sharing information, however, it is not always immediately obvious where a regulator is failing to provide proper assistance. Moreover, in order to ensure that it has the ability to obtain information for proactive transmission, a regulator must have the infrastructure in terms of skill, resources, information technology (IT), and investigative skills.
- 2.18. For any one regulator, it will frequently be the case that information relevant to a foreign regulator will become evident in circumstances where the foreign regulator is unaware of the existence of that information or of its significance.
- 2.19. More generally, regulators will always face a dilemma about when to share growing concerns about an FSB—particularly where premature disclosure of such concerns could be very damaging to that FSB.
- 2.20. A regulator wishing to cooperate effectively with another will need to have information on the counterparty's regulatory system, personnel and style of regulation, legal structure, and scope of regulatory responsibilities, as well as information on specific firms. When carried out effectively, cooperation in respect of ongoing regulation can have a significant effect in raising standards. Regulators can gain a better understanding of the practices and methods of other regulators. Such information can be valuable in overcoming domestic resistance to raising standards.
- 2.21. If regulators fail to pass on information relevant to ongoing regulation, whether because of inadequate legal gateways, inadequate ongoing regulation practices, caution, lack of trust that another regulator will properly safeguard sensitive information about a failing FSB, or simply

a failure to realize the significance of information for other regulators, their inaction tends not to raise issues. This is because other regulators will often not be aware of the opportunities that have been missed. Similarly, where regulators fail to exchange information about their regulatory standards, the significance of this may be missed. Regulators may simply not be aware that they are failing to receive information about standards and practices developing elsewhere.

- 2.22. The need for spontaneous information sharing about FSBs and regulatory standards more generally creates a greater need for memoranda of understanding (MoUs). An MoU can set out an agreed understanding of what information should be shared, with whom, and when. An MoU can also establish the respective duties of home and host supervisors when there is doubt (as is discussed in Appendix A). It then becomes critical for a regulator to ensure that it has a means of ensuring that it can meet the commitments for routine and spontaneous information sharing that it has entered into. As discussed in Section 3, multilateral MoUs (such as that introduced by IOSCO) can have a useful effect in raising standards.
- 2.23. Ongoing regulation covers a wide range of topics, and it is important that the regulator have the powers to share information on these topics and to do so without waiting for a written request.
- 2.24. It is especially important to find ways both of encouraging greater cooperation and of measuring the performance of individual regulators. There are a number of ways in which this can be achieved. Possibilities include
 - 2.24.1. continued assessments by international financial institutions (IFIs);
 - 2.24.2. greater use of MoUs, especially multilateral MoUs, with regular reviews of their effectiveness by signatories;
 - 2.24.3. increased guidance by regulators acting as home supervisors of multinational FSBs;
 - 2.24.4. technical assistance to assist in building up the infrastructure required for cooperation; and
 - 2.24.5. discussions by groups of regulators from smaller regulatory bodies (tending to be host regulators) on their common experiences and their needs for information and feedback from the major financial centers.

Enforcement Action

- 2.25. The highest-profile and often most controversial aspect of cooperation is the provision of assistance for enforcement action.
- 2.26. Increasingly, criminals are aware that their most effective modus operandi is to conduct their fraudulent activities in one jurisdiction, to keep the criminal funds in another, and to live in a third. Aware of the care taken by regulatory bodies before exchanging confidential information, they exploit the delays the normal due processes inevitably create. They are very well aware that most law-enforcement and regulatory agencies are primarily concerned with offenses that occur in their own jurisdictions and are not always inclined to give high priority to catching wrongdoers who have done no harm in their own jurisdictions. Although assistance in respect of terrorism, drugs, and violent crime is usually forthcoming, assistance in respect of financial crime of the kind investigated by regulatory agencies is often less easily forthcoming.
- 2.27. The particular aspect of enforcement cooperation, in particular for securities and AML/CFT, is that it frequently involves information about the customers of FSBs as well as the FSBs themselves. Information may be exchanged in the context of investigations concerning criminal offenses such as insider dealing or other market offenses. Such cooperation, in turn, means that concerns of confidentiality and civil rights become much more significant. There are also likely to be greater demands on a regulator receiving a request for assistance to take positive action—whether to obtain information, to freeze assets, to deal with an FSB in default of obligations elsewhere, or to assist in other ways. In other cases, cooperation may take the form of guiding a foreign regulator through the legal and other processes necessary to achieve the desired result. Appendix A describes this in more detail.
- 2.28. It follows that, in order to be able to assist in enforcement cases, regulators must have investigative powers, capability, and resources. In this sense, more extensive powers and more positive action are required in order for regulators to cooperate effectively in enforcement cases than in licensing and ongoing regulation. The key issue is achieving the correct balance between the need to assist in the detection and punishment of offenses in a timely way and the need to avoid damaging legitimate civil rights. This dilemma, which is discussed in Section 5, is what lies behind many of the barriers to cooperation.

Domestic Cooperation

2.29. Many of the factors described above apply equally to domestic cooperation. Examples of the significance of domestic cooperation are also included in Appendix A. The significant point is that there is a need for appropriate powers and legal gateways between domestic regulators and other agencies, just as there is to facilitate international cooperation.

Effect of Cooperation on World Financial System

2.30. Regulators will judge the effectiveness of cooperation on the basis of how it helps them do their jobs. However, cooperation has a number of wider benefits, given the global nature of financial services. Such benefits are a matter for discussion but would include the following:

- 2.30.1. the sharing of information about regulatory methods can help increase expectations of regulators and regulatory standards worldwide;
- 2.30.2. the ability of regulators to cooperate in order to exclude from the financial system those who may abuse it (whether deliberately or through incompetence) can improve the stability and effectiveness of financial service businesses to serve investors and the world economy; and
- 2.30.3. similarly, effective cooperation between regulators in carrying out their ongoing regulation could prevent otherwise disruptive failures.
- 2.30.4. Regulators have rightly been called upon to play their part in preventing the abuse of the financial system by money launderers, terrorists, and, indeed, other criminals, such as corrupt public officials.
- 2.30.5. For developing and transition economies, financial scandals and money laundering can have devastating economic and social consequences, and therefore international cooperation is especially important in such contexts. Effective financial sector regulation can reinforce good state and corporate governance, which help foster economic development. Cooperation can spread understanding of good regulatory principles and deter the malpractice that leads to the types of effects described earlier and helps mitigate them when they do occur.

- 2.31. These benefits arise naturally out of the cooperation that should, in any event, take place. More of the wider benefits arise from cooperation over ongoing regulation than licensing and enforcement. This needs to be taken into account when considering the need for assistance to smaller jurisdictions to help them cooperate effectively and is discussed further in the following subsections.

Setting Priorities

- 2.32. All cooperation is important. Cooperation imposes a burden on jurisdictions, however, and this may sometimes demand the establishment of priorities. It may not be possible to set priorities in absolute terms, but it would be sensible for regulatory bodies to establish criteria for setting priorities. These might include
- 2.32.1. the effect of delay (for example, there is little purpose in sending information on a license applicant after the application has been decided);
 - 2.32.2. the significance of the case (For example, the information may be the critical element in a major investigation or affect the national interest.);
 - 2.32.3. the materiality of the assistance that can be given to the case in question; and
 - 2.32.4. the willingness of the requesting jurisdiction to meet some of the cost.
- 2.33. These criteria are likely to result in priority being given to enforcement and licensing. Ongoing regulation is likely to be afforded a lower priority. It is a matter for discussion as to whether this is the appropriate outcome. Such an outcome may, however, underplay the wider benefits to the world's financial system that arise from cooperation and, in particular, from cooperation concerning ongoing regulation. This is a matter that the IFIs need to consider when providing technical assistance and determining the focus of their assessments.

Summary of Themes

- 2.34. The discussion here and the further material in Appendix A raise a number of themes:
- 2.34.1. cooperation in respect of licensing requires a regulator to be open and frank with fellow regulators but demands a proper

- mechanism for dealing with confidential information when assessing an FSB's application;
- 2.34.2. cooperation in respect of ongoing regulation demands a proactive stance from a regulator (with particular care being taken where home supervisors have responsibility for FSBs with operations in a large number of other jurisdictions) and a means of assessing the effectiveness of a regulator in providing spontaneous information about FSBs and regulatory standards;
 - 2.34.3. cooperation in respect of licensing also requires a clear division of responsibilities between host and home supervisors and information flows that are appropriate, taking account of the size and systemic significance of FSBs;
 - 2.34.4. cooperation in respect of enforcement often involves individuals and businesses that are not regulated FSBs, and this raises the issue of the protection of civil rights;
 - 2.34.5. cooperation requires the development of trust between regulators, which is enhanced by regular contact bilaterally and at multilateral conferences;
 - 2.34.6. the wider benefits of cooperation to the world financial system need to be taken into account when considering technical assistance and setting priorities;
 - 2.34.7. although most of the difficult issues raised concern the exchange of confidential information, the value of public information should not be ignored; and
 - 2.34.8. all forms of cooperation can be assisted by ensuring that powers, resources, and capabilities are adequate; that regulators adopt a proactive and creative stance; that priorities are set for the use of resources; and that MoUs set out a full understanding of what is expected.

3. Multilateral and Bilateral Instruments for Regulatory Cooperation

- 3.1. In the past twenty years, and especially in the last ten, there have been numerous initiatives by international organizations that establish principles to promote financial sector soundness and the combating of money laundering and the financing of terrorism. These conventions, principles, and recommendations include provisions that advocate or require broad cooperation among financial sector regulators, financial

intelligence units (FIUs), and law-enforcement authorities in all countries. Some of these instruments will be discussed in more detail below, but the voluntary versus obligatory nature of these instruments deserves consideration.

- 3.2. Under the auspices of the United Nations, three international conventions have been concluded: the Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988) (Vienna Convention); the International Convention against Transnational Organized Crime (2000) (Palermo Convention); and the International Convention for the Suppression of the Financing of Terrorism (1999) (CSFT). The Vienna Convention is concerned essentially with crimes connected with narcotics and money laundering and the CSFT with combating terrorism and money laundering. The Palermo Convention has the broadest potential for promoting international cooperation in combating crimes affecting the financial sector. It covers conspiracy broadly defined, money laundering, corruption, and obstruction of justice. Conventions create obligatory rules. Yet an impediment to their effectiveness for some countries, including in fostering international cooperation, may be their obscure nature, lack of specific implementation modalities or designation of responsible national authorities, or ambiguity as to their sufficiency or validity.
- 3.3. For example, there is ambiguity in the Vienna and Palermo conventions concerning whether the provisions in those conventions on mutual legal assistance are consistent with treaties on mutual legal assistance that are in effect between particular parties. Instead, those conventions could have adopted the solution in the CSFT: its Article 11(5) provides that provisions of all extradition treaties and arrangements between state parties with respect to the offenses covered by the convention “shall be deemed to be modified as between states parties to the extent that they are incompatible with this Convention.” Thus, the rules that prevail are those of the CSFT regardless of other treaties or arrangements on the same subject matter. The rules are clear.
- 3.4. Regarding sufficiency of the conventions, the Palermo Convention, in Article 13(9), provides that “States Parties shall consider concluding bilateral or multilateral treaties, agreements or arrangements to enhance the effectiveness of international cooperation undertaken [for confiscation of instruments or proceeds of crime].” Yet the article contains comprehensive procedures for cooperation in confiscation, and the convention is replete with commitments for cooperation that are

relevant to confiscation. Article 5(4) (g) of the Vienna Convention is to the same effect. Article 13(6) of the Palermo Convention states that a state party may elect to make the actions of identifying and seizing proceeds of crime and requesting competent authorities to issue an order of confiscation conditional on the existence of a relevant treaty, but in such a case that convention shall constitute the treaty. Why the clear commitments under the convention could or should be made conditional on the very convention is not obvious.

- 3.5. Although international conventions should be enforceable against parties that have ratified the agreements, as a practical matter, if a state does not fulfill its obligations under a convention, there is little that can be done. If a somewhat informal complaint does not result in satisfactory action, an aggrieved state would send a diplomatic note complaining of the violation. If that does not produce compliance, a country could attempt to submit its dispute to the International Court of Justice (ICJ), which has jurisdiction, under Article 36 of its statute, over any breach of an international obligation. The only remedy, however, is damages, which are not apparent or substantial in the case of a failure to cooperate within the terms of one of the cited conventions. The ICJ does not issue injunctions to compel compliance with obligations. The ICJ issues advisory opinions that could perhaps embarrass a country that fails to fulfill an obligation to cooperate under a convention; but in financial sector regulation and AML/CFT, there are more practical instruments.
- 3.6. The Vienna Convention, Palermo Convention, and CSFT all include articles on the settlement of disputes whereby a dispute concerning the application of the convention shall be settled by negotiation or arbitration. If the parties are unable to agree on organizing arbitration, one party may submit the dispute to the ICJ. Many countries have reservations about this provision, however, as they believe that one state should not be able to subject another state to adjudication. As indicated above, however, the outcome of an ICJ submission is problematic in the case of cross-border cooperation and information sharing in the financial sector regulatory and AML/CFT contexts.
- 3.7. Instruments of standard-setting bodies, described more fully in Section 4 and Appendix B, are, by their nature, voluntary, yet there is strong encouragement by the international community to make such instruments “soft” law. The pressure exerted by such standard-setting bodies is reinforced by the Financial Sector Assessment Program (FSAP) of the World Bank and the IMF and related Reports on

Observance of Standards and Codes (ROSCs). Under this program, countries are evaluated with regard to their compliance with the principles and recommendations of the standard-setting bodies, including those related to international cooperation. Moral suasion, national pride, peer pressure, and, in the case of Financial Action Task Force (FATF) recommendations, the risk of countermeasures combine to induce countries to improve laws, policies, and practices that are not in conformity with the SSBs' dictates. Furthermore, shortcomings noted in the ROSCs often become elements for reform of IFI-supported financial programs. IFIs also provide technical assistance to enable countries to attain SSB standards.

Legal Nature of MoUs

- 3.8. Some MoUs are binding instruments, where regulatory authorities agree to provide information and undertake other actions that are described in the agreement. They provide that on the request of one regulator, the other will provide the information or take the agreed action. If one party were in breach of its obligations, it is questionable whether the other party could compel production of the information or other action provided for in the agreement, but nevertheless clear commitments between responsible institutions are established.
- 3.9. The IOSCO Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information of May 2002, whose stated purpose is to provide securities regulatory authorities with "the fullest mutual assistance possible to facilitate the performance of the functions with which they are entrusted," provides, in paragraph 6(a), that "the provisions of this Memorandum of Understanding are not intended to create legally binding obligations or supersede domestic laws." This approach is very common in bilateral MoUs between regulatory bodies. In the case of the IOSCO multilateral MoU, however, the agreement establishing the MoU also creates a mechanism for monitoring and enforcing compliance. Under this agreement, as set out in Section III of Appendix B of the MoU, the signatories to the MoU form themselves into a monitoring group that is able to discuss a range of issues, including noncompliance by a signatory. In that event, the monitoring group can propose sanctions including providing a period of time for the signatory to comply; full peer review of a signatory that may not be in compliance; public notice of noncompliance; suspension of a signatory from MoU participation; or termination from MoU participation as provided in the MoU.

- 3.10. In many countries, it is not possible for a body other than the government to negotiate binding legal instruments; and, in such countries, the parliament must approve what would, in effect, once agreed to, be law. Regulatory bodies, while capable of implementing binding regulations themselves, can do so only within the context of underlying legislation and could not impose financial services rules that overrode other rights enshrined in law. In such countries, the process of getting the necessary approvals to a legally binding agreement on cooperation would be too high an obstacle. Pragmatically, it makes sense to adopt a non-legally binding instrument and rely on informal pressure to ensure compliance. This is especially so, since, as the preceding analysis demonstrates, the actual enforceability of legally binding instruments may be more apparent than real.
- 3.11. Cross-border financial regulatory activities and efforts to combat money laundering and the financing of terrorism that have cross-border attributes have been developing rapidly over only the past several years. Thus, whether or not particular bilateral or multilateral agreements for mutual assistance in financial sector regulatory and criminal matters are considered to be legally binding, their wide use and effectiveness is what matters.
- 3.12. Bilateral MoUs have the advantage that they can be tailored to the precise needs of the signatories. This may be the case, for example, where there are a large number of common institutions, or where two jurisdictions share similar characteristics and problems. They can be drafted in a way that speeds up the processing of requests for information and to ensure that spontaneous transmitting of information occurs appropriately. They can overcome the difficulty that arises when a regulator does not know who to contact in a jurisdiction and how to make a request. When two jurisdictions prepare to sign an MoU, they will generally conduct due diligence on each other's laws and regulatory systems. This can be helpful in increasing understanding of each other's standards.
- 3.13. Some jurisdictions prefer not to enter into MoUs because of the amount of time and resources involved in negotiation of an MoU. It is not clear why this is or should be so. The nature and basic subject matter of MoUs are well known. For example, the recommendations for the content of MoUs by the Basel Committee and the model MoU of the IAIS provide for this. Sometimes jurisdictions do not have the requisite legal authority to commit to share confidential information or take evidence

on behalf of a foreign authority, so an MoU that would provide for this cannot be entered into before enabling legislative changes are made. Sometimes the counterparty's analysis of the legislation of the other party reveals this. Such situations should not, however, be considered as necessitating arduous negotiation to reach agreement on an MoU.

- 3.14. Instead, the parties should understand that certain basic conditions must exist for conclusion of an MoU between regulatory agencies or FIUs for cross-border cooperation and information sharing. A jurisdiction that takes the initiative for conclusion of an MoU should have a "term sheet," an outline of its basic requirements for an MoU. If the counterparty realizes that it does not have the legal authority or that it would be contrary to policy to establish an MoU with such elements, negotiations would not begin and further time would not be unnecessarily expended.
- 3.15. Due diligence by one party concerning the legislation of the other party is problematic. Regulators or lawyers of one country often are not capable of adequately analyzing foreign legislation, regulations, and practices. Instead, a regulatory agency should engage local counsel in the other jurisdiction for this purpose. A less adequate alternative, because it may be self-serving, is for a regulatory authority to obtain a legal opinion concerning its capacity for cooperation and information sharing in the financial regulatory and AML/CFT context that can be provided to foreign authorities "off the shelf."
- 3.16. Thus, the process of negotiating an MoU can be made more efficient if the procedure is rationalized. Model MoUs can also contribute considerably to this endeavor.
- 3.17. Some model MoUs (and this is true, for example, of the IAIS model MoU discussed in Appendix B) provide for specific information to be passed by the requesting authority to the requested authority to justify the request. This is usually included because of the provisions in the legislation of many countries to the effect that a regulatory authority must satisfy itself that a request is for a proper purpose, and that information will be used and protected appropriately, before that regulatory authority can pass information. The authority must therefore have enough information to make this judgment.
- 3.18. An alternative approach—which is taken, to a large degree, in the IOSCO multilateral MoU—is to provide that the MoU itself contain provisions that commit the requesting authority to the proper use of the

information, to appropriate confidentiality, the avoidance of “fishing,” and so on. Given the degree of trust that must exist between regulators to allow for the signing of an MoU in the first place, it would be preferable, and would streamline the process, if MoUs took this form and allowed requested authorities to take on trust that a request from a fellow MoU signatory was for a proper purpose and that the information received would be used appropriately, without having to satisfy itself on these scores on each occasion.

Summary of Themes

- 3.19. The themes that arise from this analysis are the following:
- 3.19.1. multilateral instruments are an essential part of the infrastructure of international cooperation;
 - 3.19.2. bilateral MoUs are valuable in establishing a proper understanding of the roles and expectations of the signatories, as well as speeding up the process of cooperation in specific cases;
 - 3.19.3. multilateral MoUs are useful in establishing standards and applying peer pressure on all regulators to meet those standards;
 - 3.19.4. MoUs can be burdensome to negotiate, but this need not be so if models are used;
 - 3.19.5. MoUs can sometimes include burdensome requirements on the authority requesting information, but, with appropriate drafting, this can be avoided; and
 - 3.19.6. treaties are valuable in achieving international credibility for standards and providing a formal legal basis for cooperation (even if, in practice, enforcement of such treaty obligations is problematic).

4. Approaches Taken by Different Sector Regulators

- 4.1. A detailed description of the standards set by each of the standard-setting bodies is in Appendix B. This section discusses the main differences and similarities.
- 4.2. The differences in approaches reflect the nature of regulation and regulatory priorities of the different sectors. Traditionally, the focus of banking and insurance supervision has been on the safety and soundness of the sectors as a whole and specific FSBs. Commercial banking

laws are designed primarily to promote the solvency of institutions and are not concerned explicitly with relations of banks with customers. In the case of banking and insurance, however, the first priority for the protection of the customer may be the continuing financial stability of the FSB. By contrast, the focus of securities regulators has been on the conduct of business by an FSB, the obligations of an issuer of securities (such as the timeliness, adequacy, and accuracy of information disclosed to investors and the market), and the fairness and stability of securities markets. The customer's interests depend less on the continued solvency of the supplier of investment products and more on the way products are sold, managed, and traded. Moreover, securities regulators are often responsible for the investigation of criminal offenses by people who are not involved in regulated businesses when they are engaged in offenses involving market abuse and securities fraud. For this reason, they need to exchange information on customers' records as well as information about FSBs. The FATF is, of course, essentially focused on the activities of customers who may be money launderers or terrorists.

- 4.3. The differences in approach to cooperation reflect the disparities of regulators from each sector:
 - 4.3.1. IOSCO and the FATF place more emphasis on enforcement and cooperation than the other bodies, and cooperation requirements are more extensive and feature more prominently in the objectives and principles;
 - 4.3.2. IOSCO, the IAIS, and the FATF refer explicitly to the need for regulatory authorities to be able to carry out investigations to collect information for foreign regulators;
 - 4.3.3. the Basel Committee focuses on the use of information for supervisory purposes, whereas IOSCO, the IAIS, and the FATF discuss the need to use information sharing as a means of preventing and detecting wrongdoing of various kinds by the users of FSBs;
 - 4.3.4. the Basel Committee and the IAIS focus primarily on the need to share information about FSBs themselves, whereas the FATF and IOSCO insist that there should be information sharing about customers of financial institutions;
 - 4.3.5. the Basel Committee and the IAIS discuss the importance of home and host supervisory roles, whereas this matter does not figure explicitly in IOSCO and FATF standards; and

- 4.3.6. standard setters focus, for obvious reasons, on the kind of information most relevant to their own specific financial services sector, and therefore their descriptions of the kind of information that should be shared differ.
- 4.4. These variations should not be regarded as reflecting contrasting attitudes, but simply differences in the nature of regulation or in the priorities of regulators from each sector. Any differences in practice have become less evident in recent years. The growing number of regulators with responsibility for all aspects of financial sector regulation has meant that there are more regulators who will seek to apply common standards across different financial services sectors. In addition, the recommendations of the FATF have had the effect of increasing the role of the financial regulator in the fight against crime—particularly money laundering and the financing of terrorism but also, through the extension of predicate offenses, other forms of crime. All regulators of all sectors have therefore increasingly been under pressure to cooperate in matters affecting the customers of FSBs as well as those affecting the FSBs themselves.
- 4.5. As a result of these trends, there are a substantial number of common themes among the standard-setting bodies.
- 4.5.1. As a matter of principle, they all require that domestic secrecy or confidentiality laws not prevent sufficient information exchange to allow for the proper performance of the regulatory function. Where there is a danger of this occurring, the standard setters urge regulatory authorities to seek changes in the legislation.
- 4.5.2. All the standard setters emphasize the need for proactive sharing of information as well as the need to provide information on request.
- 4.5.3. All the standard setters require that information passed from one regulator to another should be subject to adequate confidentiality protection and accept that the authority providing information is entitled to impose conditions in this respect.
- 4.5.4. All the standard setters also provide, however, that confidentiality conditions should not defeat the purpose for which the information is requested. Thus, information requested for the purpose of civil or criminal proceedings is bound to be disclosed at some point as part of those proceedings. Moreover, all the standard setters provide that confidentiality conditions will have

to be overridden by court order or legislative requirement in some cases and that they cannot prevent a regulator from disclosing information to the appropriate law-enforcement authority when the information reveals criminal activity.

- 4.6. Appendix F contains a table comparing the pronouncements of the standard-setting bodies for the four sectors in regard to their approach to cross-border cooperation and information sharing.
 - 4.6.1. With respect to pronouncements on information sharing, standard-setting bodies for all four sectors agree that information should be shared with like regulators; the regulatory system should provide for sharing information with foreign regulators; a request for information should be justified; information received should be used only for the stated purposes; confidential information should be shared, but the law may require disclosure of confidential information that has been obtained; and shared information should be protected. Three of the four sectors have stated that information concerning customers should be provided (except the IAIS); a parent authority should inform a host authority on major matters affecting a related host-based FSB, and information regarding material developments in an FSB should be provided in either direction (except the FATF); investigations should be undertaken for counterpart authorities (except the Basel Committee); and information should be exchanged with noncounterparts (except the Basel Committee). The FATF exceptions are understandable, given the focus of AML/CFT efforts on customers of FSBs rather than FSBs themselves, but information regarding a major institutional concern, like the Riggs National Bank case, could be useful to foreign banking supervisors, enabling them to investigate transactions of entities in their jurisdiction with the institution in question. Only the FATF has stated that transactions relating to fiscal matters should not be an obstacle to cross-border cooperation.
 - 4.6.2. With respect to pronouncements of the standard-setting bodies on cooperation in cross-border regulation, all except the FATF (for obvious reasons) have stated that FSBs abroad must be permitted to provide information to their home-country regulator. The Basel Committee and the IAIS have emphasized the need for cooperation in consolidated supervision, and the Basel

Committee alone has advocated the authority of a parent FSB supervisor to inspect a related host country entity at the discretion of the home-country supervisor.

- 4.6.3. With respect to pronouncements on mutual legal assistance (MLA), only the FATF has stated that regulators should facilitate MLA; MLA should not be refused on the basis of bank secrecy or the need for dual criminality; there should be cooperation in the freezing and seizing of assets; and foreign authorities should ratify international conventions for cooperation. Since numerous countries have ratified international conventions, described in Subsection 3.2, that include provisions for MLA, this perhaps explains why other standard-setting bodies have not felt the need to articulate elements of MLA cooperation. For the FATEF, MLA is often crucial for identifying targets and assets for AML/CFT investigations.
- 4.6.4. With respect to pronouncements on MoUs, all are clear that MoUs should not be a precondition for exchange of information. On the one hand, IOSCO has emphasized the advantages of MoUs (and this is consistent with its initiative to develop a multilateral MoU and the importance placed upon its use). The IAIS has also published a model MoU. On the other hand, the FATF has not promoted MoUs, though they are used in practice by many AML/CFT authorities. This is perhaps because the Egmont Group has not encouraged the use of MoUs. As to the provisions to be included in MoUs, both IOSCO and the IAIS have indicated that a requester should provide a detailed justification for a request for information or other cooperation; documents from third parties should be included in the scope of information provided; confidential treatment should be accorded for information provided; and requests may be denied in the public interest of the requested authority. IOSCO has made explicit that provision of specific transaction and account information should be included in requests. Both the Basel Committee and IOSCO have indicated that information regarding beneficial ownership of accounts should be within the purview of information provided.
- 4.7. One factor that is evident from the experience of regulators and was emphasized at the Washington conference, was the difficulties that can arise with respect to “diagonal” information exchange—namely

information that needs to be passed from a banking supervisor to a securities regulator or from a regulatory authority to an FIU. In some cases, this can be overcome by using a two-stage information exchange (passing information from, say, a banking supervisor in one jurisdiction to a banking supervisor in another, and then from a banking supervisor in one jurisdiction to a securities regulator in the same jurisdiction). The problem is becoming less evident with the integration of regulatory authorities and as gateways are reviewed. Nevertheless, it is a matter that deserves attention. It is referred to in the IOSCO Objectives and Principles³ but not explicitly in other standards.

Summary of Themes

- 4.8. The themes that arise from this discussion are the following:
 - 4.8.1. there are some differences in the emphasis placed by the sector-based standard setters on particular aspects of cooperation;
 - 4.8.2. these differences arise from the traditional focus of different sector regulators, with banking and insurance supervisors having a greater focus on FSBs themselves, and IOSCO and FATF focusing more on the relationship between FSBs and customers;
 - 4.8.3. these differences are becoming less evident in practice, however, as a result of the increasing incidence of regulators with responsibility across the entire financial sector and the influence of the FATF in raising awareness of the role of the regulator in fighting financial crime and terrorism;
 - 4.8.4. difficulties with diagonal information exchange remain; and
 - 4.8.5. it follows that all regulators in all sectors need to ensure that their information-gathering powers and the legal gateways for cooperation are sufficient to allow all forms of cooperation and that confidentiality restrictions neither defeat the purpose of the information exchange nor prevent the receiving authority from responding to lawful requirements or disclosing information about criminal activity.

5. Barriers to Cooperation

- 5.1. Appendix C discusses barriers to cooperation that may arise because of inadequate domestic cooperation; inadequate legal powers; bank

³Section 9.5 of the IOSCO Objectives and Principles.

secrecy; legal, constitutional, cultural, and political factors; and inadequate resources. This section discusses the key issues.

Reasons for Barriers

- 5.2. Certain barriers to cooperation have arisen in the past because some jurisdictions have found it helpful to promote their financial services partly by emphasizing that they provide confidentiality. More recently, persons providing company incorporation services have promoted jurisdictions on the basis that the true identities of the owners of such companies can be concealed. Certain financial centers have also been characterized by promotion of their secrecy legislation. Although such jurisdictions have not intended to attract those who wish to escape from proper law-enforcement and other official agencies, the fact is that the offer of confidentiality is an attraction to people with intentions of evading the law. Over time, some FSBs in such countries have come to believe that, for whatever reason, their customers value privacy. Accordingly, these FSBs have lobbied for the reinforcement of that privacy through bank secrecy laws and explicit barriers to information exchange. In jurisdictions like these, there has been resistance to the removal of barriers to the exchange of information.
- 5.3. Barriers to cooperation also arise for other reasons. On the one hand, it is an uncomfortable fact of life for regulators that there is increasing public frustration at the existence of legal and other barriers that hinder the work of law-enforcement authorities when investigating crime, punishing criminals, and returning stolen property to its rightful owners. On the other hand, there is increasing public demand for protection of personal data and increasing attention paid to the rights of individuals, so that investigations into their private affairs have to be conducted according to set procedures with appropriate safeguards provided for civil rights. Laudable though these objectives are, the fact remains that the measures designed for data protection and civil rights can be barriers to cooperation.
- 5.4. The concerns that lead to such barriers are by no means unreasonable. A more detailed discussion of the legitimate reasons for protecting confidentiality is set out in Appendix D. In summary, these include
 - 5.4.1. the protection of commercially confidential information of FSBs, for competitive reasons;
 - 5.4.2. the protection of individuals from improper harassment by the state (or by a foreign state);

- 5.4.3. the protection of the right of the individual to due process and civil rights; and
 - 5.4.4. the protection of the source of information.
- 5.5. It would be wrong to assume that these legitimate concerns could simply be ignored. The key to improving cooperation is to apply the necessary pressure to overcome the demand for secrecy, which arises for the reasons set out in subsection 5.2 above, while maintaining respect for the more legitimate reasons for protecting the confidentiality of personal data. Decisions on whether to cooperate in particular cases will not always be easy. Nevertheless, in practice, most requests for information come from jurisdictions that understand the need for proper confidentiality and have proper regard for the civil rights of those under investigation. Most such requests can therefore properly be accepted.

Nonlegal Barriers

- 5.6. As Appendix C describes, there can be substantial cultural and political barriers to cooperation. These barriers often arise because FSBs in a jurisdiction believe that the maintenance of strict secrecy provisions is necessary to their continuing commercial success. They argue that the efforts by the IFIs and certain countries to remove barriers to cooperation are simply attempts to gain an unfair competitive advantage. Such an argument has, from time to time, been taken up by governments of some (often smaller) jurisdictions.
- 5.7. This view, held by certain jurisdictions, is given credibility by the obvious fact that most money laundering, financial crime, and tax evasion occurs in the larger jurisdictions with mature financial centers and by the fact that such countries also have some barriers to cooperation and some weaknesses in their own legal capacity to exchange information or freeze and seize assets. Larger jurisdictions that focus exclusively on the role of smaller countries in assisting financial crime play into the hands of those who resist the breaking down of barriers, by ignoring the weaknesses in their own jurisdictions. This gives smaller jurisdictions scope to argue that the larger countries should reform their own procedures before applying pressure on others.
- 5.8. In addition to the political and cultural barriers described above, smaller jurisdictions may lack the financial resources or the skilled staff to carry out investigations and information collection for other jurisdictions. Although it is fair to say that a jurisdiction that does not have the resources to regulate its financial sector properly should not be in the

business of providing financial services (at least not for export to other jurisdictions), it is another matter to claim that a smaller jurisdiction should pay the cost of investigations conducted primarily for other, larger, and richer jurisdictions.

- 5.9. Inadequate domestic cooperation also limits the ability of regulators and FIUs to cooperate internationally. In many jurisdictions, governmental agencies do not liaise well with one another. For example, a bank supervisor may not be able to obtain information from a securities regulator that is sought by a foreign bank supervisor, or an FIU may not be able to obtain information from local law-enforcement authorities that is requested by a foreign FIU. Some FIUs have found that the secondment of customs or police officials to an FIU facilitates liaison domestically.
- 5.10. Even where the law does not create an obstacle by requiring, as it does in some jurisdictions, that assistance be provided by a regulatory authority or FIU only to counterpart authorities, in practice cooperation is easier in many cases between counterparts.
- 5.11. Requests from abroad for information that is in the possession of the requested authority is easier to obtain than information that the requested authority must obtain by use of compulsory powers. Information to be used for administrative or civil matters is often easier to obtain than information to be used for criminal proceedings.

Overcoming Nonlegal Barriers

- 5.12. Ultimately, only the governments and regulators in each jurisdiction can overcome domestic cultural and political barriers. They are being encouraged to do so. There is no doubt that the program of evaluation of regulatory standards has had continuing success in reducing barriers to cooperation. The imminence of an assessment and the prospect of an adverse published report are effective spurs to reform. Their effectiveness rests on the perception that the adverse effect on a jurisdiction of a critical report by an IFI is more important than any advantage its FSBs may get from excessive secrecy. To ensure that this remains so, and to avoid the risks of making room for arguments such as those described in subsection 5.6, it is important that IFIs continue to
 - 5.12.1. recognize that weaknesses in cooperation exist in all countries and not simply smaller ones and to apply standards equally to all jurisdictions;

- 5.12.2. recognize the legitimate reasons for confidentiality (in ways discussed further later on); and
 - 5.12.3. encourage all jurisdictions to understand that their continued prosperity relies on access to the world's financial markets and that such access can only be enhanced if they are seen to meet international standards of regulation, including cooperation.
- 5.13. In the past, special actions taken against selected jurisdictions (such as the first FATF NCCT (non-cooperative countries and territories) evaluation, which concentrated purely on offshore centers) have not always operated on this basis. More recently, however, the application of the NCCT exercise to a wider group and the use of the same evaluation methodology by the IFIs for all jurisdictions have resulted in the principles set out previously being applied.
- 5.14. There is clearly scope for providing financial and other technical assistance to assist with the resource constraints that may constitute barriers. Asset sharing can be of considerable significance—but not all investigations result in the confiscation of assets that can be shared. Assistance in dealing with a request can be provided on a case-by-case, bilateral basis.
- 5.15. There may be a case for mentoring or twinning arrangements between larger and smaller jurisdictions. This could take the form of financial assistance, staff secondments, and training. In this way, the interests of the smaller jurisdictions in achieving good regulation, and of the larger jurisdictions in securing maximum cooperation, can be served.

Inadequate Knowledge of Capacity and Mechanisms for Cooperation

- 5.16. An important barrier, in practice, to efficient provision of cross-border assistance is the difficulty frequently encountered by regulatory authorities and FIUs in knowing to whom to send requests for assistance. For example, for large, unitary regulatory agencies, knowing to whom one should address a specific type of request could make the difference between receiving a timely and useful or an untimely and useless response.
- 5.17. Therefore, each regulatory authority and FIU should publish on its website the name and contact details for sending requests of different types; for example, for different sectors for unitary regulators, or for requests for taking evidence as distinguished from requests for information contained in a database.

- 5.18. Equally important is the failure to recognize the capability of foreign financial centers to cooperate. It is evident that there remains a view that certain “offshore centers,” however defined, are unwilling, as a group, to cooperate. Moreover, a number of countries will have had experiences where one or more such jurisdictions have failed to cooperate in advance. They may, perhaps understandably, extrapolate that experience to all such centers. As a result, they may then cease to ask for information, remaining of the view that all such centers should be written off as partners. By ceasing to seek information, however, countries that take this view may not notice the changes that are taking place there or may fail to notice the different practices of different centers. It follows that all financial centers should continue to press all fellow regulators to exchange information whenever they have reason to seek information. It would also be helpful if all regulatory authorities could publish (preferably on a website) the precise details of their ability to cooperate, the conditions that have to be fulfilled, and the information they need from others to support a request.
- 5.19. A further helpful step is for financial centers, or groups of centers, to hold seminars to explain their procedures for information exchange, so that they can be questioned on their practice by those who hold the view that cooperation is inadequate. Where weaknesses are identified, they can be addressed.
- 5.20. Monitoring groups (such as that set up by IOSCO under the multi-lateral MoU) could also be useful in identifying specific weaknesses in specific jurisdictions and in providing a forum for them to be discussed and pressure for improvement to be applied. Similar arrangements could be established, by IOSCO in respect of nonsignatories and by other standard-setting bodies or the IFIs. As a starting point, the IFIs could establish a database of practices based on the experience with FSAP and offshore financial center (OFC) assessments.

Legal and Constitutional Barriers to Cooperation

- 5.21. Appendix C describes a range of legal and constitutional barriers to cooperation. Although they include many examples of barriers, both domestic and international, there are two key factors:
- 5.21.1. inadequate legal gateways for sharing information; and
 - 5.21.2. inability of regulators to collect information or to carry out investigations within their jurisdictions.

- 5.22. Because of the legitimate reasons for protecting the confidentiality of information held by regulators about FSBs and their customers, all jurisdictions have a general provision that such information should be held confidential by both FSBs and the regulators. Such provisions are normal and wholly right and proper. They are required by the international standard-setting bodies. To counterbalance them, jurisdictions need to establish legal gateways through, or exceptions to, the basic confidentiality restriction. Such gateways are also required by standard-setting bodies.
- 5.23. When criticisms are made that specific jurisdictions have bank secrecy legislation that prevents cooperation, such criticisms are too general to be of any constructive value. As noted previously, all jurisdictions have some general confidentiality or secrecy provisions. The criticism, where it is valid, is that, in some instances, the legal gateways through those secrecy or confidentiality provisions are inadequate—either in a particular case or more generally. The key is to make sure that gateways are expressed in terms that allow proper information sharing and that are interpreted flexibly.
- 5.24. As Appendix C demonstrates, gateways can be inadequate in many ways. The most important inadequacies are the following:
- 5.24.1. The gateways set conditions for information exchange that require an analysis of the legal and constitutional arrangements of the counterparties, often requiring that they should be comparable or equivalent to those of the requested authority. This analysis can take time, and when legal and constitutional arrangements are very different, it may frustrate information exchange.
 - 5.24.2. The gateways may restrict information exchange to a regulatory body with similar functions. In practice, different jurisdictions vary in their distribution of powers, and this may prevent cooperation. This could be a particular problem where an area of business is not subject to regulation in one jurisdiction but is regulated in another.
 - 5.24.3. Gateways may restrict information exchange to offenses that are equivalent to those in their own jurisdiction (dual criminality) or even to offenses that have involved an illegal act in the requested jurisdiction (dual illegality). Where these conditions are not satisfied, perhaps because offenses are described in different ways, then information cannot be exchanged.

- 5.24.4. Gateways may restrict information exchange to countries with which there are MoUs or more formal bilateral treaties.
- 5.24.5. Gateways may require guarantees of confidentiality that cannot easily or reasonably be satisfied. For example, a requirement that confidentiality protection should be to an extent equivalent to that in the requested jurisdiction, while not unreasonable in principle, does impose an obligation for research and due diligence that may not be worthwhile in a particular case. Alternatively, a requirement for an absolute guarantee that a receiving authority will never pass information to another person without the permission of the requested authority could not be signed by a regulator that could be under an obligation to disclose it if there were a court order, or who could be under a legal obligation to disclose any suspicion of criminal activity.
- 5.25. Appendix E describes the most common forms of confidentiality requirements with appropriate gateways. These provisions are designed to strike the proper balance between the legitimate demands for data protection and the protection of civil rights, on the one hand, and the need to cooperate for regulatory and law-enforcement purposes, on the other hand. The gateways are designed to protect against the kinds of concerns described previously in subsection 5.2 and also in Appendix D.

Overcoming Legal and Constitutional Barriers

- 5.26. Jurisdictions with different legal traditions and constitutions will wish to express their gateways in different ways. It would be helpful for them, however, to have a model against which to test their effectiveness. The nature of such a model would have to be consistent with the requirements of the standard-setting bodies. The following model is consistent, and could be helpful in assisting jurisdictions to comply, with international standards.
- 5.26.1. There should be a general confidentiality provision that applies to FSBs and to regulators and FIUs.
- 5.26.2. There should be gateways that allow exceptions to a general confidentiality provision where confidential information is passed to another regulator or law-enforcement body for the purposes of regulation of FSBs or the investigations of civil or criminal offenses. This gateway should give the regulator the discretion, but not the obligation, to refuse assistance if,

having taken account of the following specified factors, and using a preponderance of the evidence test, there was reason to believe that it would be wrong to pass on the confidential information:

- 5.26.2.1. whether the information was being used for a regulatory purpose or a specific investigation (not for fishing expeditions);
 - 5.26.2.2. whether the information would be afforded reasonable confidentiality (accepting that, in all jurisdictions, there will be legal disclosure requirements that are seldom used but cannot be completely ruled out; that a receiving authority must be able to pass on, to a proper law-enforcement authority, any evidence of criminal activity in its jurisdiction that may be received as a result of information exchange and that, in some cases, where the information is required for administrative enforcement action, a restriction on further disclosure would negate the point of transferring the information in the first place);
 - 5.26.2.3. whether the provision of information for proceedings in another jurisdiction would unreasonably interfere with proceedings in respect of the same offense by the same person or might create a danger of double jeopardy;
 - 5.26.2.4. whether the assistance would impose an unreasonable cost on the requested jurisdiction and the requesting jurisdiction was not prepared to assist;
 - 5.26.2.5. whether there would be reciprocal assistance in corresponding instances; and
 - 5.26.2.6. whether it was generally in the public interest to provide the information.
- 5.27. None of these factors should be matters that automatically lead to a refusal to provide information. They should simply be factors to be taken into account. Each jurisdiction would need to decide who would have the authority to exercise such discretion. To enhance the prospects for effective cooperation, it would be better if the regulator took the decision—subject to administrative review, if challenged, and, ultimately, to judicial review. Some jurisdictions might consider it pref-

erable to give such discretion to the courts. That is likely, however, to result in unacceptable delays.

- 5.28. Giving such discretion to the regulator would allow an uncooperative regulator much scope for interpreting them strictly. The fact is, however, that the experience of most regulators is that the majority of requests for information from most regulatory authorities can be met, having taken account of the factors described in paragraph 5.26. This is because, in practice, most requests come from regulatory authorities in jurisdictions that respect confidentiality, offer appropriate civil rights, and follow a proper process. If a regulatory body interpreted them in such a way as to refuse such requests on more than a trivial number of occasions, it would soon become apparent. There may be advantage in pressing regulatory bodies to publish data on the extent to which they had received and accepted or rejected requests for information. This would allow comparisons to be made between different jurisdictions.
- 5.29. Regulatory bodies would be wise to adopt internal procedures demonstrating that they had taken account of the specified factors.
- 5.30. The use of bilateral and multilateral MoUs could assist the process of taking account of the specified factors. As discussed in subsection 3.18, if the factors were built into an MoU (either explicitly or implicitly), then it would only be necessary for a signatory to state that a request was within the terms of the MoU and the requested authority could regard itself as satisfied that the relevant factors had been properly considered, unless there was manifest evidence to the contrary. If it became apparent that a signatory was abusing the provisions of an MoU (and it would become clear very quickly if this were so), then that regulatory body should no longer be allowed to continue as a signatory to the MoU.

Inadequate Information-Gathering Powers

- 5.31. As Appendix D demonstrates, the absence of effective information-gathering powers and the determination to use them can be a serious barrier to cooperation. The need for proper information-gathering powers is established by the standard-setting bodies in greater or lesser detail and certainly includes the need for the regulator to
- 5.31.1. have the power to insist on certain records being maintained by FSBs, including customer due diligence information and proper records of transactions, for at least five years;

- 5.31.2. insist, in particular, that records on customers should include details of beneficial ownership where the account holder is a nominee or a company whose shares are held by nominees or are in bearer form, and of beneficiaries and other interested persons where the account holder is a trustee;
 - 5.31.3. have powers to obtain that information from any person (and not just regulated FSBs) for the purposes of information exchange—when the regulator decides it is appropriate;
 - 5.31.4. have general powers to obtain information from FSBs; and
 - 5.31.5. have powers to prohibit FSBs that do not have their mind and management in the jurisdiction and are unwilling or unable to provide information or that are shell banks. Both the Basel Committee and the FATF recommend that shell banks be prohibited.
- 5.32. A regulator clearly cannot exchange information if there are inadequate powers to obtain it in the first place.

Technical Barriers to Information Exchange

- 5.33. Technical barriers to information exchange arise when information technology is not compatible. For example, if the word-processing software through which an inquiry regarding targets of investigation is transmitted cannot be readily used in the requested regulator's information databases, valuable time may be lost in pursuing misfeasance.

Summary of Themes

- 5.34. The themes that arise from this discussion are the following:
- 5.34.1. Barriers to cooperation arise both from a perception that secrecy is a valuable asset for commercial reasons and from inadequate resources, as well as to protect legitimate commercial and civil rights concerns. Education and international pressure can minimize the effect of the commercial barriers, and technical assistance can alleviate financial resource constraints. It would be wrong to ignore the legitimate reasons for legal barriers, even though there are useful steps that can be taken to lower these barriers.
 - 5.34.2. International pressure from specific countries, IFIs, and standard-setting bodies is more effective in reducing

commercial or cultural opposition to information exchange if it is seen to be evenhanded between larger and smaller jurisdictions.

- 5.34.3. Asset sharing, bilateral assistance, and twinning or mentoring arrangements can be used to overcome a scarcity of resources.
- 5.34.4. Although all countries have some confidentiality requirements, coupled with a set of legal gateways, in some cases those gateways are hedged with too many and too burdensome prior restrictions.
- 5.34.5. A useful model to follow, consistent with the standards issued by the standard-setting bodies, would be to establish gateways that could be used after certain factors had been taken into account but with no one factor acting as an absolute precondition.
- 5.34.6. Preferably, the judgment on the factors to be taken into account should be made by the regulator, subject to administrative or judicial review if challenged.
- 5.34.7. There are technical barriers and inadequate transparency that can also inhibit cooperation.
- 5.34.8. Cooperation can be unnecessarily inhibited if the perception that information cannot and will not be shared by a particular jurisdiction is not consistent with that jurisdiction's current stance.
- 5.34.9. MoUs can help regulators by explicitly covering the factors to be taken into account so that the judgment is easier to make in respect of any request from an MoU signatory. There would be a general presumption that a request was for a proper purpose and that the requested authority should honor it.
- 5.34.10. Regulators must have adequate information-gathering and investigative powers.

6. Findings and Recommendations

- 6.1. The analysis in this paper and the factual material in the appendixes lead to a number of findings:
 - 6.1.1. A regulator with enthusiasm for cooperation can achieve a significant degree of cooperation even when legal powers and gate-

ways are not fully developed. There is therefore a strong case for continuing education and encouragement to achieve cooperation.

- 6.1.2. Cooperation is also enhanced by the development of personal trust between regulators, achieved through personal contact at conferences and other meetings.
- 6.1.3. Cooperation is necessary for judging licensing applications from FSBs with a presence in more than one jurisdiction, for ongoing regulation, and for enforcement. Especially in the case of ongoing regulation, but to some degree in the other areas, it is necessary to ensure that regulators exchange information spontaneously as well as on request.
- 6.1.4. It is particularly important to define the roles of home and host supervisors and to take account of the difficulties that arise when a home supervisor has responsibility for multinational FSBs with operations in many jurisdictions, all of which are host supervisors to the same home supervisor that has responsibility for consolidated supervision.
- 6.1.5. There is a need for criteria to establish which forms of cooperation should be given priority. These criteria should take account of the wider benefits of cooperation to the world's financial system as well as the benefits to specific regulators.
- 6.1.6. It is necessary to have adequate information-gathering and investigative powers in order to achieve all forms of cooperation. These powers should, in general terms, cover the elements detailed in subsection 5.31.
- 6.1.7. Cooperation should cover public as well as confidential information and should encompass other matters such as freezing, seizing, and confiscating assets.
- 6.1.8. MoUs, both bilateral and multilateral, can be effective in assisting cooperation, although their existence should not be a prerequisite for that cooperation. The drafting process for MoUs need not be as cumbersome as is sometimes feared. MoUs can be drafted in a way that streamlines information flows and obviates the need for requested authorities to satisfy themselves, in each case, that requests are for a proper purpose and that information will be appropriately protected and used.
- 6.1.9. In addition, multilateral MoUs are an effective form of peer pressure to raise standards.

- 6.1.10. Treaties are valuable in establishing basic legal commitments for cooperation but raise issues as to their sufficiency.
- 6.1.11. Differences between the approach of various regulators for different sectors, whether banking, securities, insurance, or AML/CFT, are less significant than they might once have been and no longer need prevent proper cooperation.
- 6.1.12. Similarities between regulators from different sectors are more important and emphasize the need for proper information sharing to allow regulators to function effectively and to provide that confidentiality requirements, while important, must leave room for the proper use of the information where this involves public proceedings as well as for regulators to pass information as a result of legal requirements or a general public duty to disclose criminal activity.
- 6.1.13. There are barriers to “diagonal” cooperation between regulators of different sectors.
- 6.1.14. Political and cultural barriers to cooperation can be overcome by a process of international encouragement, provided it is seen to be fair and evenhanded.
- 6.1.15. The protection of civil rights can be achieved in a manner consistent with effective cooperation, provided that legal gateways through confidentiality provisions are properly and flexibly drafted and the appropriate body is given the discretion to identify the rare occasions when cooperation is infringing these rights. One model is that described in subsection 5.26.
- 6.1.16. The proper exercise of that discretion can be encouraged by publishing data on the number of requests for assistance that have been received and accepted or rejected.
- 6.1.17. Cooperation has a wider benefit to the world’s financial system as well as a benefit in terms of improved regulation of FSBs.
- 6.2. These findings suggest for discussion the following as recommendations for governments, regulators, standard-setting bodies, and IFIs:
 - 6.2.1. the IFIs and standard-setting bodies should facilitate further conferences for both education and networking, so as to enhance the degree of personal trust necessary for information exchange;

- 6.2.2. all jurisdictions should assess their confidentiality provisions and legal gateways against the provisions set by international standards, supplemented by the model set out in subsection 5.26;
- 6.2.3. all jurisdictions should review their information-gathering powers against the provisions established by the standard-setting bodies summarized in subsection 5.31;
- 6.2.4. all jurisdictions should publish information on whom to contact within regulatory agencies and FIUs for specific types of requests for assistance;
- 6.2.5. all jurisdictions should publish their record in accepting or rejecting information requests;
- 6.2.6. all jurisdictions should publish details of the powers and ability to share information, the conditions that apply, and the information that a requesting authority should supply in order successfully to gain assistance;
- 6.2.7. all jurisdictions should review their practices in dealing with information requests in respect of licensing, ongoing regulation, and enforcement against the approaches described in this paper;
- 6.2.8. all jurisdictions should set criteria for determining their cooperation priorities;
- 6.2.9. consideration should be given, by all standard-setting bodies, to drafting multilateral MoUs on the lines agreed by IOSCO;
- 6.2.10. the standard-setting bodies that have not done so should consider drawing up multilateral or model MoUs and should keep them up to date;
- 6.2.11. MoUs should, where possible, contain within themselves commitments by the parties to making proper requests in the terms of the standard-setting bodies, with appropriate confidentiality protections, so that a requested authority can take on trust that information is being properly requested and will be properly used by an MoU partner, without having to satisfy itself on that score in each case;
- 6.2.12. consideration should be given to increased asset sharing and bilateral assistance, and to twinning or mentoring arrangements that could help smaller jurisdictions to cooperate to the fullest extent;

- 6.2.13. the standard-setting bodies should encourage members to harmonize their information technology software to facilitate rapid communications;
- 6.2.14. the program of evaluation and education by the IFIs and the standard-setting bodies should continue, with the results published to the fullest extent;
- 6.2.15. the standard-setting bodies or the IFIs should step up the process of monitoring information exchange in practice and establish forums at which the jurisdictions can be identified and the problems discussed;
- 6.2.16. the IFIs should facilitate the development of twinning and mentoring between jurisdictions, and those involved in such twinning arrangements should consider whether financial assistance to cover the costs of cooperation (where these create a burden on smaller jurisdictions) could be covered; and
- 6.2.17. the IFIs should provide technical assistance to member countries that specifically focuses on the removal of barriers to cooperation that are inappropriate.

Appendix A

Benefits of Domestic and International Cooperation

A.1. Section 2 of the paper describes the purposes of domestic and international cooperation in terms of license applications, ongoing regulation, and enforcement. This appendix gives examples of the kinds of information that should be exchanged in order to gain those benefits.

Licensing

A.2. A regulator faced with an application from a financial services business (FSB) that is a branch or subsidiary of an FSB that is regulated elsewhere is likely to want information about

- i. the regulatory track record of the applicant's parent company—its compliance culture, its openness with the regulator, and its adherence to the rules;
- ii. its capital status (particularly for banks), its solvency (for insurance), and its financial resources (for all sectors);
- iii. its record with respect to carrying out due diligence on its customers, which is particularly important in anti-money laundering (AML) efforts and measures to combat the financing of terrorism (CFT);
- iv. any material enforcement action that might have been taken;
- v. the risks posed by the FSB's business to the objectives of its home regulator—such information is helpful for the regulator faced with a new application by enabling it to build a risk profile of the business for the purposes of risk-based regulation;
- vi. the owners and controllers of the group as a whole—in order to determine whether they are fit and proper and in order to meet the specification of Financial Action Task Force (FATF) Recommendation 23 that there be “legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in a financial institution”; and
- vii. the ability of the applicant to manage the new investment that is involved in the new license application—whether they have the financial capacity, the management competence, and the technical skills to cope with a new venture.

- A.3. Information on these matters will assist a regulator to make appropriate decisions on new license applications.

Ongoing Regulation

A.4. A key requirement for effective ongoing regulation of multinational FSBs is the appropriate division of duties between home and host supervisors. In principle, these divisions of duties are well established, with the home-state supervisor responsible for prudential matters across a group as a whole and the host-state supervisors focusing on conduct of business by the entity physically located within its jurisdiction. Nevertheless, divisions of responsibility are never clear cut, and there are frequently unique features of an FSB that make the position less obvious.

- i. Most host-state supervisors will expect to monitor the extent to which an FSB conducts due diligence of its customers for AML/CFT defenses. Host-state regulators will frequently expect to set their own standards and requirements so as to achieve a level playing field among different FSBs in their own jurisdictions. FATF Recommendation 22, however, requires a regulatory body to make sure that its standards are exported to all branches and subsidiaries of their FSBs that exist outside its jurisdiction. Cooperation between home and host supervisors to compare standards and to establish the precise roles of both regulators in respect of AML/CFT standards is essential for effective regulation.

Many large multinational FSBs have *complex structures* that require several layers of home- and host-state responsibility. A banking group based in Country A could have branches and subsidiaries in Countries B and C and branches in Country D. Subsidiaries in Countries B and C could also have branches in Country D. Supervisors in Countries B and C would be host supervisors for branches and subsidiaries in their own countries and home supervisors for the branches in Country D. The supervisor in Country D would look to the supervisors in Countries B and C to be home-state supervisors for some branches and to Country A to be home-state supervisor for others. Clearly, in such circumstances, the potential for gaps is substantial. Formal agreements, to establish respective roles, should be reached wherever possible.

- ii. For all structures, whether complex or not, regulators need to know the general approach of both home and host regulators when considering the application of international standards and

the implications of changes in those standards for regulated institutions, including the risk profile of the business or the application to banks of the new Basel Accord.

- A.5. A further manifestation of cooperation for ongoing regulation is the extent and nature of on-site inspections by a home supervisor of a branch or subsidiary in another jurisdiction. In addition, cooperation can also take the form of joint on-site inspections. Such inspections frequently require formal agreements to ensure that all parties understand their respective roles and have established ground rules for dealing with confidentiality protection. Joint on-site inspections can result in new information being obtained by both home and host regulators, not only about the FSB being examined but also about the respective processes of the regulators. As such, they can be highly effective and valuable forms of cooperation.
- A.6. Routine ongoing regulation of multinational groups requires a flow of information on regulatory developments concerning an FSB. The consolidated supervisor needs to know if there are factors in branches and subsidiaries in other jurisdictions that might pose risks. Such factors might include the following:
- i. the growing exposure of a bank to connected borrowers in different jurisdictions;
 - ii. matters that might prompt prompt enforcement action;
 - iii. concerns about the capital or solvency position of a multinational FSB;

One example of this relates to the Australian insurance company HIH, in 2001. The Royal Commission investigating the collapse observed that the Australian prudential supervisor, the Australian Prudential Regulation Authority (APRA), was aware of a number of warning signs that HIH was heading toward statutory and commercial insolvency, one of which was an approach by representatives of the U.K. Financial Services Agency (FSA) and a subsequent meeting in the margins of an International Association of Insurance Supervisors (IAIS) meeting in Kuala Lumpur. At that meeting, the FSA informed APRA of the FSA's concerns about the U.K. branch;⁴

⁴Report of the HIH Royal Commission, Commonwealth of Australia, 2001, 24.1.11 and 24.1.13.

- iv. information about local conditions in either home or host country that may not be apparent from banks' books of account or financial statements; and
- v. routine findings that provide comfort as well as concern can be exchanged.

In each of these cases, information flows need to be open and spontaneous and should flow in both directions between home and host supervisors.

- A.7. Information on legal and regulatory developments in each jurisdiction and their implications for future cooperation is useful to home and host supervisors.
- A.8. Cooperation between regulators can avoid regulatory arbitrage. Most FSBs in most countries claim, at some time, that they are suffering from unfair treatment, in that regulations are being applied more harshly in their jurisdictions than elsewhere, and will point to one or two examples to prove the point. Some regulatory bodies have been taken in by such claims and have repeated the argument that they, uniquely, are expected to apply international rules to an extent not followed elsewhere. In practice, research into the examples given by FSBs that make such claims tends to show that even where one element of a regulatory regime is biting more harshly on them, there are other countervailing factors. Cooperation between regulators helps them avoid being picked off by individual FSBs or lobbying groups in this way.

Enforcement Cooperation

- A.9. Enforcement cooperation can take many forms:
 - i. the provision of public and nonpublic information about an FSB—including prudential matters concerning its solvency or capital;
 - ii. the provision of public and nonpublic information about customers that is relevant to the responsibilities of a regulator—such as information on brokerage records to assist in a market abuse investigation, or information on customers to assess the willingness of all members of a group to follow appropriate due-diligence information, or information on specified customers' accounts to determine the extent of exposure of a group to connected persons;

- iii. the use of investigative powers to take statements or compel the production of documents;
- iv. freezing, seizing, and confiscating assets where this is within the responsibility of a regulator;
- v. assistance with referrals to prosecutors and with court processes where these are necessary; and
- vi. the use of direct-sanction powers, such as a company windup, a cease and desist order, or a revocation of a license.

Cooperation for Regulatory Policy Development

A.10. Besides cooperation for more routine matters in financial sector supervision and regulation, cooperation over development of regulatory policy for sectors as a whole can be important, especially where there are significant cross-border implications. For example, in June 2004, the U.S. Securities and Exchange Commission (SEC) and the Committee of European Securities Regulators (CESR) announced plans to increase their cooperation. The primary objectives of such joint efforts are to

- i. identify emerging risks in U.S. and European Union (EU) securities markets for the purpose of improving our ability to address potential regulatory problems at an early stage; and
- ii. engage in early discussion of potential regulatory projects in the interest of facilitating converged, or at least compatible, ways of addressing common issues.

The SEC and CESR will also share their experiences regarding enforcement matters in transatlantic and European cross-border cases. Key areas for discussion are market structure issues, future mutual fund regulation, development of an effective infrastructure to support the use of international financial reporting standards, and credit-rating agencies. By discussing emerging problems at an early stage and working to facilitate convergence of regulatory approaches, the SEC and CESR hope to be able to avoid unnecessary administrative barriers to cross-border capital market activities.⁵

Domestic Cooperation

A.11. Regulators need to cooperate with a financial intelligence unit (FIU) and with other regulators and law-enforcement agencies. For

⁵SEC Press Release No. 2004-75, June 4, 2004.

jurisdictions with multiple regulators, cooperation between fellow regulators is especially important. Where regulators are split along financial services sector lines (banks, insurance, and securities), the sector-based regulators have to ensure they are dealing consistently with complex groups. Cross-cutting issues like corporate governance, the approach to fitness and properness, and the implementation of AML/CFT rules must be consistent.

For example, in the United States, the financial services regulators have both formal and informal arrangements to share information. The arrangements are numerous because of the several federal financial sector regulators, including the Federal Reserve System, the Office of Comptroller of the Currency (OCC), the SEC, the Commodities Futures Trading Commission (CFTC), and the Federal Deposit Insurance Corporation (FDIC) and 50 individual state insurance and banking supervisors. The cooperation includes identifying emerging issues in the financial institutions industry; coordinating regulatory activities; and the sharing of financial and enforcement information, including prior notification regarding enforcement action taken against a commonly regulated entity. There are shared databases that include restricted information on suspected illegal conduct as well as a separate database for suspicious activity reports (SARs) in relation to bank fraud, theft, and money laundering. In addition to financial institutions and regulatory agencies, law-enforcement authorities also have access to this SAR database.⁶

Cooperation in regulatory policy development takes place in other multilateral forums in addition to the example given.

- A.12. Some jurisdictions have split responsibilities for conduct of business and prudential supervision between separate regulators. In both Australia and the Netherlands, which have adopted that model, the FSBs have been aware of a striking difference in approach between the two authorities. Prudential supervisors have approached their task in more informal ways, preferring to operate by developing consensus with the regulated entity and through persuasion on a confidential basis, whereas business regulators have been more ready to take enforcement action and to go public with their findings. To a great extent, these differences reflect the different kinds of issues with which the respective authorities are dealing.

⁶Information based on an interview with the U.S. Financial Crimes Enforcement Network (FinCEN).

- A.13. Under AML/CFT regulations, FSBs are expected to make suspicious transaction reports (STRs) and, in some jurisdictions, cash transaction reports (CTRs). Cooperation between the regulator and the FIU can identify trends in compliance. This can establish which FSBs or which categories of FSB are reporting properly and which are not. It can identify whether there are trends that need to be reinforced or checked.

For example, one offshore jurisdiction established that, at one point, a large proportion of STRs were filed by a small group of banks serving the local population (whereas most banks had offshore clients). The banks, when questioned, stated that their policy was to monitor local newspapers for reports of convictions of drug dealers and, where they established that these involved one of their customers, they would report the last 10 cash withdrawals. Clearly, such STRs were useless, and consequently the jurisdiction was able to mount a campaign to improve reporting standards.⁷

- A.14. Cooperation with FIUs can also identify institutions that are themselves most likely to be attracting suspicious customers, and this, in turn, may prompt a review of their due-diligence procedures as well as of the integrity of the owners or controllers of the businesses.
- A.15. More widely, cooperation can ensure that regulators and law-enforcement agencies can cooperate when action needs to be taken against criminal institutions. The regulator has wide powers that can complement those of the prosecutors and police. It can close down or wind up FSBs or remove specific individuals who may be responsible for wrongdoing.

For example, in one jurisdiction, the police suspected that a particular firm, regulated in the business of trust and company administration, was engaged in serial money laundering. In a coordinated action, the police seized the files and computers and sealed the office, while the regulator was able to suspend the license and instruct the banks to refuse to take instructions from the suspect.⁸

Public and Nonpublic Information

- A.16. A great deal of effective cooperation, even in enforcement cases, does not require the controversial use of investigative powers or the exchange of nonpublic information.

⁷Example is based on an interview with a regulator.

⁸Example is based on an interview with a regulator.

There is frequently considerable public information about companies in the form of annual returns and published accounts or of names of directors and owners. Even where these are fraudulent and false, that fact alone is of value. Such forms of assistance can be given without any legal gateways.

Appendix B

International Standards for Cooperation

- B.1. This appendix describes the approach taken by the international standard setters to international cooperation.

Banking: Basel Core Principles and EU Requirements

- B.2. The need for cross-border cooperation and information exchange is well established among bank supervisors, as is the commitment and practice. The Basel Core Principles (BCP) for Effective Banking Supervision issued by the Basel Committee on Banking Supervision, as amended in 1997, provide the bank supervisory framework for all member countries of the IMF. Core Principle 1 provides that a bank supervisor should have

arrangements for sharing information between supervisors and protecting the confidentiality of such information.

- B.3. Part IV on Cross-Border Banking, which includes principles 23–25, establishes policies and practices for cooperation and information sharing between foreign bank supervisory authorities mainly in the context of consolidated supervision of different branches or subsidiaries of the same bank. The provisions are quoted in the following:

23. Banking supervisors must practice global consolidated supervision over their internationally-active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.

24. A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.

25. Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.

- B.4. The Basel Committee also published a paper on *The Supervision of Cross-Border Banking* in October 1996. This paper derived from an examination of impediments to information flows. It emphasized the need for adequate information flows to allow home and host supervi-

sors to carry out their duties in full. Its 29 recommendations covered a wide range of matters. It drew attention to the importance of unfettered access by the home supervisor to all information related to safety and soundness in the host jurisdiction. The paper stated that although this would not always include information on depositors and customers, there would be circumstances where this would be necessary. Its recommendations also made clear that although it was important that information passed from one supervisor to a foreign supervisor for prudential purposes be used only for that purpose and not be passed to a third country without the prior permission of the supervisor providing the information, it would be necessary to allow for the possibility that, in some cases, a supervisor could be subject to court action to disclose information and that it must always be possible for a supervisor who becomes aware of criminal activity within its jurisdiction to be able to pass information about that activity to the appropriate authority.

- B.5. In 2001, the Working Group on Cross-Border Banking of the Basel Committee published a note on *Essential Elements of a Statement of Mutual Cooperation* that provides a reference for memoranda of understanding (MoUs) between bank supervisory authorities or between bank supervisors and other financial sector regulators. MoUs should provide a basis for mutual trust and willingness to share information. MoUs are widely employed by bank and other financial institution supervisors. The note covers three basic elements of MoUs: sharing of information, on-site inspections, and protection of information.
- B.6. With respect to protection of information, the note states that a supervisor receiving information “must provide the assurance that all possible steps will be taken to preserve the confidentiality of the information received.” If the recipient of information wishes to transmit it to a third party, that supervisor should receive agreement from the supervisors that provided the information. The note recognizes that, in some jurisdictions, a bank supervisor may be legally compelled to release information in its possession to prosecutorial authorities or by virtue of a judicial or parliamentary subpoena, for example. Thus, supervisors should inform those supervisors providing confidential information whether there are circumstances under which they cannot guarantee the confidentiality of information they receive.
- B.7. The Basel Committee published a paper in August 2003 entitled *High Level Principles for the Cross-Border Implementation of the New Accord*. This drew attention to the implications of the new Basel Capital

Accord for cross-border cooperation, emphasizing the need for clear definition of responsibility between home and host supervisors and enhanced cooperation. This cooperation is particularly necessary to recognize the needs of the home and host supervisors and to avoid duplication of burdens on businesses resulting from redundant or uncoordinated approval and validation work.

- B.8. Similarly, other papers by the Basel Committee have drawn attention to the implications for cross-border cooperation of other developments such as electronic banking.⁹
- B.9. Although the main focus of cross-border cooperation relates to safety and soundness issues, the Basel Committee has also noted the increasing need for supervisory cooperation between banks in relation to specific assets and liabilities—for example, in the context of the abuse of the financial system by politically exposed persons (PEPs) engaged in corruption and by terrorists.¹⁰ The committee emphasized that cooperation using mutual legal assistance treaties (MLATs) and via financial intelligence units (FIUs) was usually the most appropriate method but also noted that banking supervisors should play a part. In particular, if a host supervisor were to become aware that a branch of a bank was being used by terrorists, it should inform the home supervisor.
- B.10. In the European Union, the use of bilateral arrangements for sharing information between banking supervisors is widespread. This is appropriate in view of the liberal right of banks in one European Union (EU) country to establish branches in other EU countries. The EU directives contain rules for the coordination of laws, regulations, and administrative provisions relating to credit institutions. Prudential supervision of a credit institution, including the activities it carries on in other member states, is the responsibility of the home-country supervisor. There is also a requirement for consultation when a subsidiary of a credit institution in one member state seeks a license in another member state and when there is a proposed change in control of an institution that has a subsidiary in another member state. Thus, supervisors need to coordinate with their counterparts in other member states.

⁹Basel Committee on Banking Supervision, *Management and Supervision of Cross-Border Electronic Banking Activities*, July 2003.

¹⁰“Sharing of financial records between jurisdictions in connection with the fight against terrorist financing”—April 2002.

Securities Business: IOSCO Principles

- B.11. Cross-border cooperation is central to the standards set by IOSCO, the International Organization of Securities Commissions. The preamble to the IOSCO by-laws states the following:

Securities authorities resolve to cooperate together to ensure a better regulation of the markets, on the domestic as well as on the international level, in order to maintain just, efficient and sound markets:

to exchange information on their respective experiences in order to promote the development of domestic markets;

to unite their efforts to establish standards and an effective surveillance of international securities transactions;

to provide mutual assistance to ensure the integrity of the markets by a vigorous application of the standards and by effective enforcement against offences.

- B.12. The IOSCO Objectives and Principles of Securities Regulation (updated in May 2003) contain a section on cooperation. The principles highlight first the importance of domestic cooperation in the discussion of Principle 1: “The responsibilities of the regulator should be clear and objectively stated.” IOSCO emphasizes the need for

strong cooperation among responsible authorities, through appropriate channels,

observing that the responsible authorities are domestic agencies in this context.

- B.13. Principles 11 through 13 deal with international cooperation as follows:

11. The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.

12. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.

13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

- B.14. In the discussion on international cooperation in the Objectives and Principles and in its methodology designed to assess compliance with the principles, IOSCO emphasizes the following points:

- i. International cooperation should not be inhibited by domestic secrecy or blocking law. Violators of securities laws route transactions through foreign jurisdictions to disguise identity of parties, flow of funds, or beneficial ownership. There is therefore a need to be able to make such information available to a foreign regulator.
- ii. The potential scope of assistance should encompass a wide variety of assistance needs.
- iii. MoUs and other arrangements are helpful and should identify circumstances in which assistance can be provided, the types of information to be provided, confidentiality requirements, and permitted uses. An MoU should determine who can give assistance to whom and what procedures should be followed.
- iv. Although it is important that the confidentiality of nonpublic information be maintained, this should only be done to an extent consistent with the purposes of the release of the information. IOSCO emphasizes that a requested authority may impose conditions ensuring appropriate use of the information and ensuring the confidentiality of the *information except pursuant to the uses permitted, such as in a public enforcement action for which use the information was requested*.¹¹
- v. IOSCO urges all jurisdictions to remove any requirements for dual illegality (the need for an illegal act to have taken place in the requested authority's jurisdiction) and for dual criminality (the requirement that an illegal act under investigation in a foreign jurisdiction would also have to have been an offense if it had occurred in the requested authority's jurisdiction).
- vi. IOSCO makes clear that all regulatory authorities should be able to get information about a license holder and its customers, including bank and brokerage records. These should include the name of the account holder, the beneficial owners of bank accounts and of companies, and the beneficiaries of trusts where this information is held in the jurisdiction. They should provide for voluntary cooperation from subjects of an enquiry. They must also be able to get information under compulsory powers and be able to take statements under oath.

¹¹IOSCO Methodology for Assessing Adherence to the Objectives and Principles, October 2003, Explanatory Note to Principle 11.

- B.15. In respect of information about conglomerates, regulators should be able to share information about the structure and capital of, and investments in, connected and linked companies; exposures within and outside the group; and internal controls and systems.
- B.16. IOSCO has taken a further step in developing standards of cooperation by adopting a multilateral MoU.¹² The purpose of the MoU is to offer a vehicle, available to all IOSCO members, for information exchange. It is based on the Objectives and Principles. Any IOSCO member can apply to sign it. Whereas in the case of bilateral MoUs, each party has the opportunity to undertake due diligence on their counterparty, this is not possible for a multilateral MoU, where a signatory has no influence over who the other signatories might be. To substitute for bilateral due diligence, IOSCO has created a screening process whereby groups of IOSCO members review the legislation of an applicant country so as to ensure that it has the legal capacity to undertake its commitments. This screening process is rigorous and involves a decision-making and appeal process within the senior councils of IOSCO.
- B.17. Signatories to the MoU affirm that no domestic secrecy or blocking laws or regulations should prevent the collection or provision of the information requested within the scope of the MoU, by the requesting authority. The MoU also provides that information can be denied under the following circumstances:
- i. *where the request would require the Requested Authority to act in a manner that would violate domestic law;*
 - ii. *where a criminal proceeding has already been initiated in the jurisdiction of the Requested Authority based upon the same facts and against the same Persons, or the same Persons have already been the subject of final punitive sanctions on the same charges by the competent authorities of the jurisdiction of the Requested Authority, unless the Requesting Authority can demonstrate that the relief or sanctions sought in any proceedings initiated by the Requesting Authority would not be of the same nature or duplicative of any relief or sanctions obtained in the jurisdiction of the Requested Authority;*
 - iii. *where the request is not made in accordance with the provisions of this Memorandum of Understanding; or*
 - iv. *on grounds of public interest or essential national interest.*

¹²IOSCO Multilateral Memorandum of Understanding, May 2002.

- B.18. There is no right of refusal on grounds of confidentiality. Within the terms of the MoU, however, the requesting authority undertakes to keep information confidential except where disclosure is necessary to fulfill the purpose for which the information was requested—which includes enforcement proceedings and criminal prosecution—or in response to a legally enforceable demand.
- B.19. The MoU reinforces the IOSCO stance on dual criminality by stating that
- Assistance will not be denied based on the fact that the type of conduct under investigation would not be a violation of the laws and regulations of the Requested Authority.*
- B.20. The IOSCO President's Committee has passed a resolution encouraging all members to sign. Moreover, by publishing a list of the members that can sign, IOSCO is putting pressure on all members to amend their legislation so as to be able to sign. It is therefore an effective means of persuading IOSCO's members to raise their standards.
- B.21. Within the European Union, the regulatory bodies for securities business have become the Committee of European Securities Regulators (CESR). CESR has devised a common MoU, which draws on the cooperation provisions of the Investment Services Directive (ISD). The ISD provides for requirements of professional secrecy, along with gateways where appropriate, but also requires that
- Member States may conclude cooperation agreements providing for the exchange of information with the competent authorities of third countries or with third country authorities or bodies whose responsibilities are analogous to those of the bodies referred to in points (i) and (ii) of Article 54(3)(a) and points (a) and (b) of the first subparagraph of Article 54(4) only if the information disclosed is subject to guarantees of professional secrecy at least equivalent to those required under Article 50.*
- B.22. This provision imposes a severe test in that it could be argued that it requires a cooperation agreement to be in place before information is exchanged and sufficient research to be done to satisfy the test that confidentiality provisions should be equivalent to those in the EU. Such a provision, if interpreted literally, could prevent a positive response to an ad hoc request. Securities regulators have not all interpreted this provision so narrowly, however, and many exchanges of information take place without a formal MoU. A similar clause is included in the updated ISD currently being finalized.

B.23. IOSCO maintains a record of all other MoUs signed between its members, and these show a widespread network of information-sharing agreements. The content varies enormously. The need for such bilateral agreements may begin to fade as more securities regulators sign the multilateral MoU.

Insurance Supervision

B.24. The International Association of Insurance Supervisors (IAIS) core principles require that

5. The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.

B.25. The IAIS specifically refers to the need to share information to counter fraud, money laundering, and terrorist financing. Otherwise, the key points emphasized by IAIS are the following:

- i. the need to protect the confidentiality of the information;*
- ii. although information-sharing agreements are useful, they should not be a prerequisite for information sharing;*
- iii. information should be shared concerning supervised institutions and individuals in key positions; and*
- iv. information should be shared on key characteristics of the supervisor's regime and on any action taken or (preferably) contemplated against a supervised entity.*

B.26. In December 1999, the IAIS issued a paper on principles applicable to the supervision of international insurers.¹³ This spells out the information needs of home and host supervisors. The paper emphasizes the need for a check, where necessary, by the host supervisor on information provided by the insurer—although the paper (unlike the Basel Core Principles) does not require that joint on-site visits be permitted. The importance of proactive disclosure by both home and host supervisors is also emphasized in the paper.

B.27. The paper suggests that those supervisors whose confidentiality requirements prevent or constrain the sharing of information should review their requirements in consideration of the following conditions:

¹³IAIS, Technical Committee, Revised Insurance Concordat, December 1999.

- i. Information received should only be used for purposes related to the supervision of financial institutions.
 - ii. Information-sharing arrangements should allow for a two-way flow of information, but strict reciprocity in respect of the format and detailed characteristics of the information should not be demanded.
 - iii. The confidentiality of information transmitted should be legally protected, except in the event of criminal prosecution. All insurance supervisors should, of course, be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections.
 - iv. The recipient should undertake, where possible, to consult with the supervisor providing the information if the former proposes to take action on the evidence of the information received.
- B.28. The IAIS principles in respect of cooperation are spelled out more fully in the Model Memorandum of Understanding issued as a Guidance Paper by the IAIS in 1997.¹⁴ It is comprehensive, containing provisions on all important matters that are relevant to cross-border cooperation and information sharing in the context of insurance supervision, including: (i) the supervisory purposes for which assistance is to be provided; (ii) the types of assistance that may be provided; (iii) the information to be conveyed by the requesting authority in a request for assistance; (iv) considerations of the requested authority in determining whether to accept a request; (v) procedures for taking testimony and conducting inspections; (vi) permissible uses of information supplied and confidentiality; and (vii) onward transmission of information received.
- B.29. With respect to information to be conveyed by the requesting authority in a request for assistance, paragraph 15 of the IAIS Model MoU provides that the following should be specified by the requesting authority:
- i. *the purpose for which the information or assistance is sought (including in appropriate cases details of the law, regulation or requirement of the requesting authority which is suspected to have been breached);*

¹⁴IAIS Guidance Paper No. 2, September 1997.

- ii. *a description of any particular conduct or suspected conduct which has given rise to the request and its connection with the jurisdiction of the requesting authority;*
- iii. *the link between any suspected breach of law, regulation or requirement and the regulatory functions of the requesting authority;*
- iv. *the relevance of the requested information or assistance to any suspected breach of law, regulation or requirement of the requesting authority.*

B.30. Paragraph 15 also states that “the requested information must be reasonably relevant to securing compliance with the law, regulation or requirement specified in the request.”

B.31. Requested jurisdictions wish to know what use is to be made of the information requested of them, especially to ensure that appropriate confidential treatment is accorded such information. Paragraph 24 of the IAIS model MoU includes the following provisions on permissible uses of information:

The information supplied will be used solely for the purpose of

- i. *securing compliance with or enforcement of the law, regulation or requirement specified in the request by initiating or assisting in criminal prosecution arising out of the breach of such law;*
- ii. *conducting or assisting in civil proceedings arising out of the breach of the law, regulation or requirement specified in the request and brought by the Authorities or other law enforcement or regulatory bodies within the jurisdictions.*

B.32. Paragraphs 25 and 26 of the IAIS Model MoU contain illustrative provisions with respect to confidentiality.

25. Each authority will keep confidential to the extent permitted by law:

any request for information made under the [MoU] and any matters arising in the course of its operation, unless such disclosure is necessary to carry out the request, or the requested Authority specifically waives such confidentiality; any information passed under the [MoU] unless it is disclosed in furtherance of the purpose for which it was requested.

26. Unless the request provides otherwise, the confidentiality provisions of the [MoU] shall not prevent the Authorities from informing other law enforcement or regulatory bodies within [their] jurisdictions . . . of the request or of

passing information received pursuant to a request to such bodies, provided that

a. such agencies or bodies have responsibility for prosecuting, regulating or enforcing laws, regulations and requirements [relating to supervision and regulation of insurance];

b. the purpose of passing such information to such an agency or body [relates to supervision and regulation of insurance]; and

c. the requesting Authority has provided any such undertaking in relation to the information requested which is required by . . . the requested Authority.

- B.33. Paragraph 26 and subparagraphs (a) and (b) appropriately provide that information received by a requesting authority may be transmitted to law-enforcement or supervisory bodies in its jurisdiction if this is done pursuant to supervision and regulation of insurance. Subparagraph 26(c) may, in some cases, place undue restrictions on onward transmittal of information if a requested jurisdiction does not allow onward transmittal, although such a condition would appear to be inconsistent with subparagraphs (a) and (b). As indicated previously, in most jurisdictions, onward transmittal to criminal-law-enforcement authorities cannot be prevented.
- B.34. If a supervisory authority does not wish to provide general authority for the use of information it provides, it can attach general conditions: for example, it may specify that the information be used only for supervisory purposes, including for enforcement of law or regulations by the requesting authority or other authorities in its jurisdiction for civil, administrative, or criminal proceedings.
- B.35. The European Union's Third Life Directive also includes the provision referred to previously in the context of the Investment Services Directive. In the context of insurance, however, it is widely regarded as meaning that there should be no information sharing without a cooperation agreement (thus breaching an IAIS principle). Particularly in the context of the United States, there is rarely sufficient need to justify the expense of assessing the legal position of any one of the U.S. states in order to enter into an information-sharing agreement with it.

Money Laundering and the Financing of Terrorism: FATF

- B.36. International cooperation and information exchange is critical for anti-money laundering/combating the financing of terrorism (AML/CFT)

activities because of the multinational nature of money laundering and terrorism financing. The layering stage of money laundering often involves transfer of assets from a financial institution in one country to a financial institution in another country in order to conceal the assets or their ownership from law-enforcement authorities. Cross-border cooperation and information exchange for AML/CFT purposes is usually between FIUs that have been established by governments especially for this purpose. They may be independent entities or departments of governmental agencies like ministries of finance, ministries of justice, prosecutors' offices, or police departments.

- B.37. The Vienna Convention (1988) provided the basic definition of money laundering that is widely used in other multilateral instruments and laws. It states that

The conversion or transfer of property, knowing that such property is derived from any offence [of production, delivery or sale of narcotics], or from an act of participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions.

- B.38. Since narcotics offenses are one of the principal bases of money laundering, the provisions on international cooperation and information sharing in the convention are important for AML.
- B.39. Article 7(2) provides that parties to the convention shall afford mutual legal assistance to one another for purposes including taking evidence or statements from persons; effecting service of judicial documents; executing searches and seizures; examining objects and sites; providing information and evidentiary items; providing relevant documents and records, including bank, financial, or business records; and identifying or tracing proceeds, property, or instrumentalities for evidentiary purposes. The convention also covers confiscation of assets and extradition of persons. Thus parties to the convention have general authority to cooperate and exchange information on relevant bases for AML. Article 7(15) of the convention provides, however, that mutual legal assistance may be refused for reasons including that the requested party believes the request is likely to prejudice its sovereignty, security, or other essential interests or if the authorities of the requested party would be prohibited by domestic law from carrying out the action requested with regard to any similar local offense.

- B.40. The Convention for the Suppression of the Financing of Terrorism (CSFT) establishes as an offense, inter alia, collecting or providing funds knowing that they will be used to cause serious injury to civilians, to intimidate a population, government, or international organization to act or refrain from acting as they otherwise would. Article 2 provides that parties to the convention shall afford one another “the greatest measure of assistance in connection with criminal investigations or extradition proceedings” in respect of the offenses covered by the convention, “. . .including assistance in obtaining evidence in their possession necessary for the proceedings.” Whether “in their possession” is a significant limitation is not clear. If this means providing to requesting authorities only information in government agency files rather than undertaking conscientious investigative efforts to establish new files, it would be a limitation. This article also provides that parties may not refuse a request for mutual legal assistance on the grounds of bank secrecy, or involvement of fiscal or political offenses.
- B.41. The Financial Action Task Force (FATF) Forty Recommendations (FF) contain comprehensive provisions for AML/CFT. Recommendations 35–40 relate to international cooperation and include the need for countries to ratify and implement the Vienna, Palermo, and CSFT conventions and recommendations for countries rapidly and effectively to provide “the widest possible range of mutual legal assistance,” including in investigations, in the absence of dual criminality, and in seizing and confiscating laundered assets or instrumentalities used in relevant offenses. They also urge that money laundering be an extraditable offense and that there be simplified procedures for direct transmission of extradition requests and extraditions based on warrants for arrest.
- B.42. Recommendation 40 seeks to overcome factors that have been impediments to international cooperation. It says
- Countries should ensure that their competent authorities provide the widest possible range of international cooperation to their foreign counterparts. There should be clear and effective gateways to facilitate the prompt and constructive exchange directly between counterparts, either spontaneously or upon request, of information relating to both money laundering and the underlying predicate offences. Exchanges should be permitted without unduly restrictive conditions. In particular:*
- Competent authorities should not refuse a request for assistance on the sole ground that the request is also considered to involve fiscal matters.*

Countries should not invoke laws that require financial institutions to maintain secrecy or confidentiality as a ground for refusing to provide cooperation.

Competent authorities should be able to conduct inquiries; and where possible, investigations, on behalf of foreign counterparts.

Where the ability to obtain information sought by a foreign competent authority is not within the mandate of its counterpart, countries are also encouraged to permit a prompt and constructive exchange of information with non-counterparts. Cooperation with foreign authorities other than counterparts could occur directly or indirectly. When uncertain about the appropriate avenue to follow, competent authorities should first contact their foreign counterparts for assistance.

Countries should establish controls and safeguards to ensure that information exchanged by competent authorities is used only in an authorized manner, consistent with their obligations concerning privacy and data protection.

- B.43. The FATF Interpretative Note to Recommendation 40 emphasizes the importance of conscientious inquiries by FIUs on behalf of counterparts. It says

FIUs should be able to make inquiries on behalf of foreign counterparts where this could be relevant to an analysis of financial transactions. At a minimum, inquiries should include: searching its own databases, which would include information related to suspicious transaction reports and searching other databases to which it may have direct or indirect access, including law enforcement databases, public databases, administrative databases and commercially available databases. Where permitted to do so, FIUs should also contact other competent authorities and financial institutions in order to obtain relevant information.

- B.44. For CFT, the FATF also has Eight Special Recommendations (SRs) on Terrorist Financing. SR V. on International Cooperation provides that countries, on the basis of a treaty, arrangement, or other mechanism for mutual legal assistance or information exchange, should give one another

. . . the greatest possible measure of assistance in connection with criminal, civil enforcement, and administrative investigations, inquiries and proceedings relating to the financing of terrorism, terrorist acts and terrorist organizations.

- B.45. The FATF Best International Practices paper on Freezing Terrorist Assets emphasizes the importance of international cooperation in

CFT. It notes that “the global nature of terrorist financing networks . . . requires unprecedented levels of communication, cooperation and collaboration. . . .”

- B.46. Best practices to improve international cooperation in CFT by sharing information relating to the freezing of terrorist-related assets includes developing a system for mutual, early, and rapid prenotification of pending designations, so that assets can be frozen simultaneously across jurisdictions. Jurisdictions should also have a system for consultation with other jurisdictions for gathering and verifying identifier information for designated persons and organizations.
- B.47. Most cross-border communications regarding AML/CFT are with respect to particular suspicious transactions of organizations or individuals, often where the AML/CFT activities take place substantially in the requesting jurisdiction. However, jurisdictions should be encouraged to spontaneously inform foreign authorities of significant AML/CFT risks that authorities in one jurisdiction have become aware of regarding certain businesses or individuals that have activities in other jurisdictions. These could be risks involving certain financial products of financial services businesses (FSBs) or other businesses subject to AML/CFT scrutiny or control risks of particular businesses, including in cases where the suspect activities take place mainly in another jurisdiction.
- B.48. The basic activities of FIUs are to receive, analyze, and disseminate information related to transactions that may constitute money laundering. While some FIUs—for example, those that are part of police departments—may undertake investigations, FIUs generally provide pre-investigative analysis of transactions for referral to law-enforcement authorities. FIUs exchange information internationally, often using bilateral MoUs, since many AML laws require that FIUs’ cross-border exchanges of information be on the basis of a formal agreement with a foreign authority.
- B.49. AML laws usually provide that information that is proprietary to FIUs may be exchanged at the discretion of the FIU. This would be mainly information from suspicious transaction reports (STRs) and cash transaction reports (CTRs) in the FIU’s database and information that FIUs can obtain from commercial databases. When information sought by foreign FIUs is not possessed by an FIU but rather by financial institution regulators or by banks, bank secrecy requirements have sometimes been an impediment to exchange of information. As blanket

bank secrecy provisions have become less prevalent, there have remained jurisdictions where gateways have been defined too narrowly or interpreted in too restricted a fashion to allow proper cooperation.

- B.50. The Egmont Group, which has 101 member FIUs [as of June 14, 2006], has issued pronouncements to its members on cross-border cooperation. Although there is a comprehensive procedure for admitting members to the Egmont Group that includes assuring that “they are legally capable and willing to cooperate on the basis of the Egmont Principles of Information Exchange,” those principles are somewhat restrictive in their recommended procedures for information sharing.
- B.51. The Egmont Principles (of June 2001) advocate sharing of information spontaneously, as well as on request, yet in requesting information, an FIU is recommended to disclose “the reason for the request, the purpose for which the information will be used and enough information to enable the receiving FIU to determine whether the request complies with its domestic law.” Given the vetting of Egmont members and the general purpose of all requests to FIUs, it would seem that requiring all such specific information for each request could have been dispensed with.
- B.52. Regarding permitted uses of information conveyed to a requesting FIU, the Egmont Principles state that a “requesting FIU may not transfer information shared by a disclosing FIU to a third party, nor make use of the information in an administrative, investigative, prosecutorial, or judicial purpose without the prior consent of the FIU that disclosed the information.” Since the most important use of information obtained by an FIU is to disseminate it for combating money laundering, which usually involves investigative, prosecutorial, or judicial proceedings, requiring specific consent for such uses of information conveyed is questionable. It appears that mutual trust among at least some Egmont members may have a way to go.

Cooperation Regarding Financial Conglomerates

- B.53. The Joint Forum on Financial Conglomerates issued recommendations in 1999 that are not addressed especially to cross-border cooperation but are quite relevant in view of the multinational presence of financial conglomerates. The forum recognizes the need for regulators to understand how a financial group is managed and risk is controlled—by entity or product line and for coordination among separate regulators to ensure that a conglomerate is adequately regulated.

- B.54. Thus, there is a need for exchange of information among regulators, both within their own sectors and among regulators of different sectors, and of cross-border exchange of information for conglomerates with activities in different jurisdictions. There is also a need to enhance regulatory coordination, including by designating and defining the responsibilities of a coordinating regulator.

Appendix C

Barriers to Effective Cooperation

C.1. Although there is much scope for cooperation that does not involve the exchange of confidential information, for the most part, the barriers to cooperation affect information exchange. Much of what follows in this appendix focuses on the barriers to the exchange between regulators of confidential information.

Inadequate Domestic Information-Gathering Powers

C.2. Information cannot be exchanged if it is not obtainable by the requested regulator in the first place. Regulators need information about the business of regulated entities and of their customers. For example, bank supervisors need access to information about depositors to ensure that they understand whether there is a risk of concentrated lending risk. Securities regulators need access to information about investors (or depositors of banks) when investigating market-related offenses or following the funds derived from such activities. Insurance supervisors need customer information to meet their obligations under the Basel Core Principles to tackle insurance fraud.

C.3. The findings of IMF reports on specific jurisdictions are that, in a number of cases, there are gaps in the requirements placed on financial services businesses (FSBs) in respect of the information they must obtain and hold. Typical examples of this are

- i. the beneficial ownership of FSBs themselves, beneficial ownership of accounts, and beneficial ownership of companies and beneficiaries of trusts where companies and trustees hold accounts with banks;
- ii. inadequate provision for the preparation of financial statements, so that basic financial information is not available to the regulator; and
- iii. bearer shares, which permit the owners to conceal their identities, without requiring imposition of alternative measures, such as immobilization or an overriding disclosure requirement.

C.4. Where jurisdictions allow *shell banks* to receive licenses, it is very difficult to obtain any information about them. Shell banks are defined for this purpose as banks that have no physical presence anywhere. Licenses are offered to entities with a legal presence in one jurisdiction but with the mind and management elsewhere. That management is not, itself, subject to any regulatory supervision. In such cases, it is

highly problematic to obtain any useful information. This is why the Basel Committee and the Financial Action Task Force (FATF) recommend that shell banks not be licensed. This stance by Basel and the FATF has been effective, as indicated by the apparent decline in the incidence of shell banks.

- C.5. Even where a bank is not a shell, the absence of a physical presence in a jurisdiction where a license is held creates problems in obtaining information where the bank is reluctant to transmit information from one jurisdiction to another—either because of alleged legal restrictions (which sometimes exist) or because of other internal policy reasons. In some cases, it is possible to obtain information through a memorandum of understanding (MoU) with the jurisdiction in which the bank does have a presence. However, MoUs are not always a sufficient substitute for direct access to information by a regulator, and there may be circumstances in which such exchange of information is not possible. It is always better for a regulator to insist that records necessary for it to undertake its tasks are held within its jurisdiction.
- C.6. Where information is available within a jurisdiction, it is sometimes the case that the regulator has limited access to it:
- i. in some jurisdictions, the regulator is not allowed access to information about customers or depositors, for example, or can only gain such information with a court order; or
 - ii. in other cases, the regulator does not have explicit powers to monitor the performance of FSBs or to insist on obtaining whatever information is necessary for the fulfillment of its objectives.
- C.7. Where powers are available, some regulators have been found by the international financial institutions (IFIs) to have inadequate resources to monitor the operation of regulated FSBs properly. A frequent comment made in IMF Reports on Standards and Codes (ROSCs) concerns the absence of a program of effective on-site visits and, sometimes, the absence of sufficient resources to conduct desk-based regulation adequately. Where this is so, such regulators cannot give useful information in response to overseas enquiries, and still less spontaneously, on such matters as the risks posed by these kinds of institutions, any developing regulatory concerns, or the compliance culture.
- C.8. The ability of a regulator to obtain information even where powers are available can be constrained by excessive political or commercial interests.

In one jurisdiction evaluated by the IMF, the powers of the regulator to obtain confidential information from FSBs were simply ignored in practice.¹⁵

- C.9. Equally important can be the presence of those with an interest in the regulator's decisions on the regulatory supervisory board. It can be of value to obtain the expertise and experience of FSB practitioners on a regulatory supervisory board. Where those practitioners are currently subject to regulation, however, conflicts of interest can arise. Even if individuals withdraw from discussions about institutions in which they are themselves interested, they may have a general approach—for example, on the disclosure of information by an FSB to a regulator—that can inhibit a regulatory agency from performing its proper duties. The IMF identified one jurisdiction in particular where this was the case.
- C.10. Regulatory standards set for all three sectors demand that a regulator should have immunity from actions taken against the body and its staff in respect of their regulatory decisions, provided that the decisions are taken in good faith. The absence of such immunity can inhibit a regulator from acting aggressively to obtain the necessary information.
- C.11. Finally, a regulator may be inhibited from obtaining the information necessary to do its own job or to assist others because of inadequate domestic cooperation with other agencies in the same jurisdiction
- i. between different regulators, where regulatory responsibility is split;
 - ii. between statutory regulators and self-regulating organizations (SROs); or
 - iii. between regulators and law-enforcement agencies, at least in the context of developing trends but especially as a means of alerting different agencies to concerns about specific institutions and individuals.
- C.12. In each of these cases, the limitations on cooperation may be exacerbated by inadequate legal gateways between agencies or even by reluctance on the part of staff within one agency to look beyond that agency's interests to the interests of law enforcement in the jurisdiction as a whole.

¹⁵IMF ROSC.

Overcoming Barriers to Domestic Cooperation

- C.13. Such barriers to domestic information gathering and sharing can be overcome. In practice, some jurisdictions set up formal bodies designed to bring the various authorities together to discuss trends and specific cases:

One jurisdiction, for example, has instituted a domestic information sharing body encompassing all agencies with a law enforcement interest, including the Attorney General, the regulatory authority, the FIU, the tax authorities and others. While such a body cannot remove legal impediments to information sharing, it can be used to build confidence and to discuss matters not constrained by law. It can also create the basis for recommendations for legislative change.¹⁶

- C.14. The domestic barriers to cooperation may be erected because of the understandable concern to protect sensitive information about financial institutions and their customers and the need to avoid taking action that might jeopardize future information flows or even prejudice the rights of a suspect under investigation. It is important that the arrangements described here not be undertaken in a way that jeopardizes those rights.

Political Barriers to Cooperation

- C.15. Determination to be of assistance to a fellow regulator can produce a creative frame of mind when seeking ways to help a fellow regulator within the terms of the existing legislation. Conversely, a reluctance to cooperate can render inoperative legislation that provides for gateways for exchange of information—for example, where the regulator narrowly interprets the powers to cooperate or interprets very broadly the tests that have to be passed before assistance can be given.
- C.16. The ROSCs have observed, with respect to some jurisdictions, an assumption by the local financial services industry that secrecy is the key asset providing a competitive advantage for the jurisdiction. It is also apparent from the refusal of certain European Union (EU) member states to exchange tax information routinely, as part of the EU Savings Tax Directive, unless Switzerland, the Crown Dependencies, and other third countries do the same, that they have this view.
- C.17. Where such a culture dominates the financial services industry in a jurisdiction, it is likely to inhibit an open and cooperative approach by the regulator.

¹⁶Example based on an interview with a regulator.

C.18. Cultural factors are intangible. They are affected by legal and commercial imperatives, but they can also affect the degree of cooperation that can be achieved for any given set of laws and information gateways.

Overcoming Political Barriers

C.19. Information-sharing and confidence-building meetings within and between jurisdictions can help break down these cultural barriers. The work of international institutions, such as the FATF, the World Bank, and the IMF, is already encouraging greater cooperation.

C.20. Although controversial, the extraterritorial pressure placed on other jurisdictions by U.S. legislation can be effective in prompting reform. The USA Patriot Act gives draconian powers to the U.S. Treasury Secretary if, in his opinion, an institution or jurisdiction is of primary money laundering concern. There is no doubt that these powers have been effective in encouraging greater cooperation.

C.21. Peer pressure could also be increased by encouraging all regulatory bodies to publish statistics on the number of requests for information received; the number dealt with and those refused or delayed, with reasons; and the timeliness of responses. Such transparency would be helpful in identifying barriers while also encouraging jurisdictions to maintain a good response rate to information requests.

C.22. Pressure from multilateral institutions and from economically more powerful countries, while effective, can be argued to infringe the sovereignty of those jurisdictions under pressure. It is necessary to consider carefully the balance of advantages and disadvantages in applying external pressure in this way.

Bank Secrecy

C.23. Laws, usually commercial banking laws, often provide that present and past bank officers, employees, and agents are not permitted to use information for personal gain or gain by any person or entity other than the bank that they serve or have served. Such laws also protect a customer's right to privacy by insisting on a ban on disclosure of nonpublic information that the officers, employees, or agents obtained in the course of their service to a bank. Contracts between banks and their officers, employees, and agents often contain similar provisions. Such laws and contractual provisions are sometimes obstacles to effective cross-border cooperation and information exchange among financial sector regula-

tors and financial intelligence units (FIUs), especially when there are no explicit appropriate exceptions to the general rule.

- C.24. Most bank secrecy laws contain exceptions that permit disclosure to, for example, local financial institutions' regulatory authorities and their agents, external auditors of a bank, judicial authorities, foreign bank regulatory authorities, authorities responsible for combating money laundering, and in instances when the protection of the bank's interest in legal proceedings requires disclosure. In many cases (except where such a restriction would defeat the purpose of information exchange), the gateways place confidentiality restrictions on the recipients of such disclosed information. Sometimes disclosure is permitted by virtue of laws other than the commercial banking law, such as international conventions, and when the relationship between the commercial banking law and the other laws is not clear. Some countries do not have well-developed rules for conflicts of law.
- C.25. The pressure from international standard-setting bodies has, to a great extent, removed blanket bank secrecy legislation; there is evidence from evaluations of specific countries that some provisions remain, however. Even where gateways have been introduced, they may not necessarily overcome long-held assumptions about the role of secrecy. In its report on one jurisdiction, the IMF noted
- From discussions with the regulators and the industry, it was apparent that the authority of the regulators to have access to [confidential] information was being ignored or challenged. In some cases, this appeared to be based on a belief that the provisions of the [gateways in banking and other legislation] in this regard did not override the specific secrecy provisions contained in the Companies Act. In other cases, there was a general belief that some unspecified, but universal secrecy laws must, almost by definition, exist to prevent such access.¹⁷*
- C.26. Even where there are no overriding secrecy provisions, the protection of confidential information is frequently one of the key tests that must be passed before a regulatory authority can pass on information.
- i. The most common test is that the requesting authority must protect confidentiality to the same degree as the requested authority. This provision occurs in EU legislation. On the face of it, this is an understandable provision, but it can cause difficulties:

¹⁷IMF ROSC.

For example, an insurance regulator in an EU member state might require assistance from an insurance supervisor in the United States. Insurance in the United States is regulated at the state level, and each state has different provisions in respect of freedom of information and the ability of the legislature to demand information. The EU supervisor may not consider that the case justifies the time and expense necessary to undertake the legal research necessary to satisfy himself as to the equivalence of the confidentiality protection and may find it necessary to drop the case.

- ii. A similar test may require the requesting authority to sign an unqualified undertaking that confidentiality will be protected. In practice, very few jurisdictions could, in fact, sign such an undertaking, since there could be circumstances when a prosecutor, court, parliament, or other regulator could demand disclosure according to other legal provisions. The demand for an unqualified undertaking of confidentiality may thus be a barrier in practice.
- iii. Other jurisdictions require an undertaking that information will not be passed to another authority without their written permission. While a requirement for prior notification is important, a strict requirement for prior permissions can effectively be another barrier to cooperation, since in many jurisdictions a regulatory body would be bound to pass any evidence obtained of illegal activity to the relevant authority. The demand for an unqualified assurance that no information would be passed to another authority may itself be a barrier.

The IMF report on one country noted that information could be shared with foreign regulators only if the information provided were used within the scope of regulatory duties, as described in the request of the foreign authority. Within the foreign authority, access to the information provided had to be granted only to persons who were subject to official secrecy provisions. The information had to be kept strictly confidential and could be used only in accordance with the agreed regulatory purpose. Any further disclosure of the information, whether to other national authorities or to other foreign authorities, was not allowed. In the case where, according to the foreign legislation, the information provided by the [regulatory body] had to be forwarded to other authorities, the regular mutual assistance procedure had to be duly complied with.¹⁸

¹⁸IMF ROSC.

- iv. In some jurisdictions, information can be passed to another jurisdiction only with the consent of the attorney general or of a court. This can be a barrier to cooperation, if the tests imposed by an attorney general or the court have been designed to protect the rights of those charged with criminal offenses rather than to facilitate cross-border cooperation between regulators.

Overcoming Bank Secrecy Barriers

- C.27. Barriers based on the existence of secrecy legislation or a culture of secrecy can be overcome only by the repeal of that legislation and a change in culture. In practice, the most restrictive kinds of bank secrecy legislation have now been removed in most countries. Most jurisdictions have confidentiality provisions with gateways for passing confidential information in specified circumstances. It is now necessary to overcome the remaining secrecy culture and to ensure that gateways are designed in a way that facilitates information sharing.
- C.28. It is essential that FSBs trust a regulator to treat confidential information appropriately. In its evaluation report on one country, the IMF stated¹⁹ that there was a suspicion that the regulator could not be trusted with information. The establishment of a track record creating trust is therefore an essential prerequisite to overcoming the concerns that support bank secrecy.

Legal and Constitutional Barriers to Cooperation

- C.29. In general, cross-border cooperation and information exchange among financial sector regulators and FIUs need not, in principle, be impeded by differences between common-law and civil-law jurisdictions, although, in practice, the different legal traditions and practices can create barriers. In the context of anti-money laundering (AML), for example, the United Nations Office on Drugs and Crime (UNODC) promulgated separate model laws for AML in respect of civil-law and of common-law jurisdictions that contained essentially the same definition of the offense of money laundering, powers for law-enforcement authorities, and provisions for mutual legal assistance.²⁰ In civil-law jurisdictions, however, it is sometimes easier to seize assets in a peremptory manner on the basis of *ex parte* requests by law-enforcement authorities

¹⁹IMF ROSC.

²⁰The model law for civil-law countries is being revised and is intended to become a joint United Nations/IMF/World Bank model law.

to a court. Common law is more concerned with representation of all adversaries and providing an opportunity for a hearing before seizure of property is permitted.

- C.30. Constitutional provisions have not been a significant impediment to internal cooperation. Some constitutions, however, restrict the scope for administrative sanctions that can be important in providing incentives for financial institutions to provide information or for officials of financial regulatory institutions to perform their responsibilities. Some constitutions, including many in transition economies, provide that a person may not be deprived of property without a decision by a court. Administrative fines, for example, can be considered inconsistent with this constitutional requirement. The burden of proof on a defendant in a money-laundering prosecution to establish the legality of monies obtained is sometimes considered inconsistent with the rights of an accused and could impede an extradition.
- C.31. Cooperation is easiest when a request comes from a jurisdiction with a similar legal system to that of the requested authority. The fact is, however, that there are significant differences between jurisdictions and, unless legislation providing for cooperation is drafted flexibly, it can be a barrier to cooperation.
- C.32. Although, as noted previously, there is no need for the difference between civil- and common-law systems to prevent cooperation, in practice it can do so. The concept of an investigating magistrate is common in civil-law systems and unknown in common-law systems. Many regulators in civil-law jurisdictions pass the investigation of regulatory offenses, such as insider dealing or companies law violations, to an investigating magistrate. Many common-law jurisdictions give some of these investigating powers to the regulator. Most legislation providing for gateways on information sharing requires that a regulator pass confidential information only to a body that has functions similar to its own. It is unlikely that an investigating magistrate could be so regarded.

In one case, a regulator in a common-law jurisdiction was investigating a potential insider dealing and market manipulation offense, where much of the activity under investigation took place in another, civil-law jurisdiction. The common-law regulator asked the civil-law regulator for assistance with the investigation. The civil-law regulator agreed to investigate and handed the case to the investigating magistrate. The magistrate operated under a condition of confidentiality and stated that he was unable to tell the civil-law regulator, still less the foreign common-law regulator, what progress was

*made with the investigation. Since no information had been received for several years, the common-law regulator had to abandon the case.*²¹

- C.33. Different common-law countries share regulatory, investigating, and prosecuting functions differently. The same is true of civil-law countries. Where this is the case, the frequently used provision that a regulatory body can only exchange information with a body that has functions similar to its own can create a barrier if interpreted narrowly.

*In one case, a jurisdiction passed all responsibility for investigating insider dealing and other regulator offenses to the attorney general. The regulator received a request for assistance with an insider dealing investigation from a regulatory body. The regulator passed the request to the attorney general, who carried out the investigation and obtained the information. The attorney general was able to pass the information only to another prosecuting authority. Neither the regulator in the requested jurisdiction nor the requesting jurisdiction qualified. The requesting regulator refused to accept that information should be routed through the prosecutor in its jurisdiction and a stalemate ensued. (The requested jurisdiction eventually changed its legislation to allow for information to be passed more easily to a nonprosecuting authority).*²²

- C.34. Barriers can similarly be erected when the scope of the regulatory authority varies from one jurisdiction to another. In its report on one jurisdiction, the IMF reported:

There may be some limitation in those powers, arising from the language used in [the legislation] and the statutory definition of financial services legislation, when the inquiring regulatory body is discharging a regulatory function in an area of financial services regulation that is not presently regulated by the [requested jurisdiction]. For example, if the foreign regulator is looking for information about the activities of a market intermediary, which functions are not yet regulated in the [requested jurisdiction], the provisions of [the legislation] may not extend to allow the FSC [Financial Services Commission] to provide the information.

- C.35. One frequently occurring example of this relates to the regulation of trust and company service providers. This is usually the subject of regulation in offshore centers, but rarely so in onshore centers. The revised FATF Recommendations require that countries ensure that

²¹Interview with the regulator.

²²Interview with the regulator.

there is adequate, accurate, and timely information on express trusts, including information on the settlor, trustee, and beneficiaries, that can be obtained or accessed in a timely fashion by competent authorities. Requests for assistance in respect of such bodies cannot be met by requested authorities in jurisdictions where such activity is not formally regulated.

- C.36. Barriers can be created when jurisdictions insist on dual-criminality or even dual-illegality provisions.

In one case, an investigation was taking place into a “pump and dump” scheme, whereby the publisher of an investment newsletter promoted securities in order to drive the price up and then sold the securities he owned at the artificially inflated price. The money was transferred to a company incorporated offshore. The regulator sought assistance. The requested authority determined that its legislation provided it with the scope to provide assistance but that the drafting in fact only allowed assistance when the act in question took place within its own jurisdiction. The requested authority changed its legislation to remove the impediment.²³

- C.37. Much of the value from cooperation in respect of ongoing regulation arises from the sharing of judgments and tentative concerns about developments in an institution. It is natural that a regulator should not wish to damage the reputation of an institution by sharing a concern that may turn out to be unfounded. Equally, a regulator is unlikely to want to share concerns about an institution if there is a danger of that opinion becoming public in a way that would undermine confidence and precipitate the very crisis it is the regulator’s duty to avoid. These concerns are very sensitive and cannot simply be legislated away. They can constitute a barrier.
- C.38. The need for an MoU or other formal agreement can also be a barrier if a jurisdiction chooses to make it so. If a jurisdiction requires such an agreement and then prolongs the process of negotiation or makes impossible demands, it can effectively prevent cooperation in practice. Even with goodwill, MoUs can frequently take a considerable time to negotiate.
- C.39. Finally, the existence of specific legislative provisions requiring that certain factors be taken into account can provide scope for challenge by those objecting to the exchange of confidential information, to the

²³Interview with the regulator.

effect that the regulator has failed to follow the legislative provisions as to the matters that must be taken into account.

In one case, a regulatory body was the subject of judicial review by an FSB seeking to prevent the transfer of information to a foreign regulator. During the course of the case, the internal papers of the regulator were disclosed to the court. The court noted that in an internal memorandum, the regulator had said that there was no reason why assistance should not be granted. He was therefore taken to have started from the assumption that assistance should be given and had failed to satisfy himself that the transmission of information was necessary in the light of the factors stated in the law to be material. The court ruled that the regulator could not disclose the information without giving proper consideration to the factors set out in the law. However, the court accepted that, if the regulator were to give proper consideration to such factors and were to judge that exchange of information was necessary, the information could be disclosed.²⁴

It is important, therefore, that the regulator does not allow cooperation to be frustrated by failing to follow the proper procedures.

Overcoming Legal and Constitutional Barriers

C.40. Legal and constitutional barriers can be overcome by drafting appropriate legal provisions. Although it is not right simply to ignore the protections and safeguards for civil rights that underlie some of the barriers, there are some points that can usefully be borne in mind when drafting legislative gateways:

- i. Some jurisdictions have legislation that explicitly allows for different regulatory and legislative arrangements in different jurisdictions and therefore allows information to be passed to bodies that have some similar functions to a regulator but which are not identical.
- ii. Such legal gateways do not require specific stages in an investigation to be reached in the requesting jurisdiction, since different jurisdictions may well conduct their investigations in different ways.
- iii. Gateways should not demand dual criminality or dual illegality.

The U.S. SEC, for example, provides a useful model in allowing the SEC, if it thinks fit, to collect information and pass it to a foreign regulator even if it was in respect of an activity that was not an offense in

²⁴Interview with the regulator.

the United States and for which the U.S. SEC would not have investigative powers in the United States.

- C.41. Many jurisdictions allow their regulators to enter into MoUs but do not require them as a prerequisite for information sharing. The Basel and International Association of Insurance Supervisors (IAIS) standards are explicit that MoUs should not be a prerequisite.
- C.42. Many jurisdictions draft their legal gateways for information sharing in a way that recognizes that there may be circumstances where a requesting regulator could not guarantee, as a matter of law, that information received from a foreign regulator would be held confidential, nor could they undertake, as a matter of law, not to use the information for a prosecution. Jurisdictions unable to give cast-iron guarantees, however, can frequently give certain undertakings to resist attempts to obtain the information in question and to consult the requested regulator if an irresistible demand for information is received. This has been achieved in many jurisdictions by drafting legislation that requires a regulator to take account of specific matters before exchanging information but does not necessarily demand that the regulator refuse assistance. Typical of the kind of considerations that a regulator will expect to have to take into account are the following:
- i. that the request is for a regulatory purpose from a body with regulatory functions;
 - ii. that the information provided will be afforded proper (but not absolute) confidentiality;
 - iii. where the information is for an investigation, that there is reasonable cause for believing that an offense has been committed;
 - iv. that the information is for a purpose that would be regarded as legitimate in the requested jurisdiction;
 - v. that there is likely to be reciprocal assistance; and
 - vi. that there is no overriding public policy concern, including the cost of complying with a request, that would justify refusing it.
- C.43. These tests require discretion by the regulatory bodies. In exercising that discretion, jurisdictions need to be in a position to distinguish between cases where civil rights are not at risk and cases where there is likelihood that they would be threatened. It is also possible to build up trust in specific jurisdictions as a result of practice in successive cases,

where the legislation allows the regulator to take account of experience when making a judgment.

- C.44. One approach, adopted by many regulators, is to work on the assumption that where they have an MoU, they should accept that any request made by the signatory to that MoU is for a proper regulatory purpose unless there are obvious grounds for doubting it. Jurisdictions can undertake due diligence on the countries with whom they have an MoU, so as to satisfy themselves of the existence of proper protections. Thus, where there is an MoU, it is reasonable to take the view that the very fact that a regulatory body is investigating and seeking assistance is itself sufficient to satisfy the test that there is reasonable cause for believing that an offense has been committed.
- C.45. For regulatory agencies not subject to an MoU, it may be necessary to be more proactive in ensuring that the requested authority is aware of the reasons for any information request, where it involves commercially sensitive information.
- C.46. Whether or not there is an MoU, cooperation works best when regulators know and trust each other. Regular attendance at international conferences and other meetings of larger and smaller groups can be very effective in establishing that trust.
- C.47. The measures designed to overcome legal and constitutional barriers place much reliance on the discretion of the regulator. It is essential that the regulator puts in place proper procedures to make sure that full account is taken of the relevant factors and that accountability and judicial review arrangements are sufficient to ensure that this discretion is properly exercised in practice.
- C.48. Overall, it is perfectly possible for regulators to have regard to the legitimate concerns raised by the need to protect civil rights but to do so in a way that does not inhibit proper cooperation.

Inadequate Resources

- C.49. Exchanging information already in the possession of a regulator is a relatively cost-free matter. Undertaking investigations on behalf of another regulator, however, can be a major burden on a jurisdiction. For smaller offshore centers, the number of requests for assistance can amount to a substantial burden.
- C.50. Aside from the financial cost, a smaller jurisdiction may simply not have the investigative skills or a sufficient number of staff to mount an

investigation, take statements, demand and analyze documents, and prepare a report on behalf of another regulator. These constraints can amount to a real barrier to cooperation.

Overcoming Resource Constraints

- C.51. Resource constraints cannot easily be removed. Extensive use of asset sharing can be of assistance—especially if such asset sharing can extend beyond those authorities with seizing powers (often the police or public prosecutor) to regulatory bodies that contribute to the same objectives.
- C.52. Priorities can be established for responding to requests. For example, where the purpose of a request clearly indicates its importance or urgency, such a request could also be accorded expeditious treatment. The key is to establish criteria. These might be on the following lines:
- i. the effect of delay—for example, there is little purpose in sending information on a license applicant after the application has been decided;
 - ii. the significance of the case;
 - iii. the materiality of the assistance that can be given to the case in question; and
 - iv. the willingness of the requesting jurisdiction to meet some of the cost.
- C.53. Investigative skills can be bought from forensic specialists. They are costly, and this underlines the need for asset sharing to help meet the cost.
- C.54. Technical assistance can be given by multilateral institutions and bilaterally by other jurisdictions.

Appendix D

Legitimate Reasons for Protecting Confidentiality

- D.1. What follows relates solely to the exchange of nonpublic information. Other forms of assistance and cooperation are not subject to the same constraints.

Protecting Commercial Secrets

- D.2. Financial services businesses (FSBs) are innovative entrepreneurial enterprises. They devise financial products and methods of delivering services to their customers that may well be unique to them. In order properly to regulate such institutions, a regulator must have access to such information. An FSB is not entitled to refuse to provide such information to its regulator but it is entitled to assume that the regulator will not disclose that information in ways that would benefit a competitor.
- D.3. FSBs may also engage in acquisitions from time to time, restructure their businesses (perhaps involving redundancies), move into new markets, or make other key strategic business decisions. They are entitled to expect that they should be in a position to judge the timing of their announcements of such matters to suit their own commercial advantage—provided that they are not thereby misleading the market.
- D.4. Regulators should respect such sensitivities, even though commercial secrets of these kinds tend not to remain secret for very long. Moreover, the need for FSBs to be transparent in their dealings with their customers and the financial services market more generally means that there is a limit to the extent to which they can legitimately hold commercial matters confidential. Within those limits, however, the regulator should respect the need for privacy.

Protecting Individuals from Harassment by the State and Others

- D.5. Bank secrecy traditions have often developed in countries to which businesses and individuals have turned in order to escape arbitrary actions by the state. Switzerland, partly because of its tradition of neutrality and its reputation for adherence to bank secrecy, has long been regarded as an example of a haven for such purposes—even though it currently has an excellent record of responding to requests for confidential information.
- D.6. There remain many parts of the world where kidnapping for the purpose of extortion remains a real threat for wealthy people and businesses. Such people find safety in concealing the nature and location of their assets. These concerns are real and reasonable.

D.7. When governmental officials are not competent or are subject to undue influence, different considerations arise regarding the sharing of information. In some countries, for example, corrupt officials seek information on bank customers for purposes of extortion. When this motive is suspected by a regulator when asked for assistance, it is natural that there should be greater caution. In countries where the rule of law generally prevails, however, legitimate exceptions to bank secrecy that facilitate cross-border cooperation and information exchange among financial sector regulators and financial intelligence units (FIUs) should be explicit so as to ensure that cooperation is not inhibited.

Protecting Operation of Due Process

D.8. Regulators have wide powers. They are able to require FSBs and sometimes others to give them information. Frequently, and in many countries, there is no (or a very limited) right of the individual or business to refuse to comply on the grounds of self-incrimination.

D.9. These powers frequently apply to FSBs and, in some cases, to their customers. In the case of FSBs, it is clear that they have chosen to work in the financial services sector on the understanding that the advantages given to an FSB when it receives a license (i.e., the ability to provide a well-remunerated service in respect of financial services) demand corresponding obligations.

D.10. Customers of an FSB have not made this choice, however. They may reasonably take the view that they have certain civil and human rights, including the right to due process and protection of personal data. There are no reasons why the legal provisions that encapsulate those rights should not apply simply because of special powers held by regulators over FSBs with whom they, as customers, do business.

D.11. The upshot of this is that in most countries that have compulsory information-gathering powers over FSBs, it is not permitted to use a statement so acquired to secure a criminal conviction. The European Court of Justice has concluded that using a statement made by a person under compulsory powers in a criminal prosecution of that person is an infringement of the right not to incriminate oneself under Article 6 of the European Convention on Human Rights.²⁵

²⁵*Saunders v. The United Kingdom* (19187/91) [1996] ECHR 65 (17 December 1996).

- D.12. Because different countries have different arrangements in this respect, there is a natural concern that information might be passed from one country (where there is a ban on the use of compulsorily required information for criminal prosecutions) to another (where there is no such ban). This is less of a problem in the European Union (where all countries are subject to the protections of the European Convention on Human Rights) or the United States (as a result of the protections in the U.S. Constitution). Nevertheless, outside these countries, protections, while they frequently exist, vary in their form. It is clearly right that cooperation between regulators respects the requirements in the country where action is likely to be taken in respect of any business or individual.
- D.13. As is true of state harassment, this is a legitimate concern but one that should not be allowed to hinder proper cooperation between regulatory bodies.

Data Protection

- D.14. Increasingly and very properly, individuals are being afforded greater rights concerning the protection of data held by official and private bodies about their affairs. Rights are given to the individual to have access to, and be able to check, the information held about them by any body that can collect data. Individuals are also given rights to object to the passing of information from one agency to another.
- D.15. In many cases, financial services regulators are exempt from certain provisions of data-protection laws. Nevertheless, some of the provisions do apply, and it is incumbent on regulators to ensure that they use their powers and their ability to cooperate in such a way as to abide by the principles of such data-protection provisions.

Protecting Information Sources

- D.16. The examples already given reflect the proper concerns for the protection of the rights of the citizen. There is a further concern of practical significance to the authorities in many jurisdictions. Many authorities with specific responsibilities need information from the subjects of their responsibilities in order to fulfill those responsibilities. This is particularly true of revenue-collection agencies and regulators. In both cases, the authorities have been willing to undertake to keep information received from businesses and individuals confidential—even from other domestic authorities—in order to encourage the businesses and individuals to be open with them. There is a fear that if a tax authority were

known routinely to pass information to another authority (whether regulatory or law enforcement), then it would receive less information and be less able to perform its duties efficiently.

- D.17. It is easy to be cynical about these kinds of arrangements. If an individual is engaged in conduct that would be of interest to the police, he or she cannot be expected enthusiastically to pass the information to the tax authorities that they need to raise additional taxes. Nevertheless, there is a degree to which authorities can ensure greater openness from FSBs by offering confidentiality protection to information so disclosed, even from other authorities. Individuals and businesses may be acting legally but may not want to have the expense and disruption of a tax investigation to demonstrate that this is so. An assurance of confidentiality can be effective in encouraging a greater degree of openness.

Appendix E

Common Confidentiality Provisions with Associated Gateways

- E.1. Article 18(8) of the Palermo Convention states that “States Parties shall not decline to render mutual legal assistance . . . on the ground of bank secrecy.” Article 7(5) of the Vienna Convention and Article 12(2) of the CSFT contain identical wording. The principle is well established, and it is now rare for a jurisdiction to rely solely on a bank-secrecy provision as a reason for refusing assistance. This does not mean that there are no refusals or that refusals on other grounds may not be a cover for the protection of secrecy. There remains a need for continued vigilance on the part of international standard-setting bodies to promote greater cooperation and limit the effects of secrecy provisions, while recognizing the concerns that have led to some of the confidentiality provisions.
- E.2. As always, it is necessary to strike a balance between these considerations and the need to ensure proper regulations of FSBs and proper cooperation with law enforcement.
- E.3. The balance is reflected in the operation of the law governing confidentiality in different jurisdictions. In the United Kingdom, for example, the confidentiality obligations of FSBs are governed by the Tournier principles (named after a landmark case *Tournier v. National Provincial and Union Bank of England 1924*). This states that a bank (or an FSB) does have a duty of confidentiality but that the duty is overridden
- i. where the customer gives consent;
 - ii. where the bank is required by law to disclose;
 - iii. where it is in the interests of the bank to disclose; or
 - iv. where it is in the interests of the public to disclose.
- E.4. This principle is reflected in most other jurisdictions. In some cases, this common-law precedent applies directly. In others, it is reflected directly in legislation. The report on bank secrecy published by the European Banking Federation in April 2004 lists the legal provisions in European countries. In most cases, they follow this prescription with some variations.
- E.5. Clearly, the principle leaves it open to an individual jurisdiction to determine in which cases the exceptions will override the duty of

confidentiality. It is a requirement of the FATEF, for example, that the obligation to report suspicions should override confidentiality provisions. The obligation to provide information to regulators also frequently overrides the confidentiality provisions. It is essential to ensure that this is clear.

- E.6. Where the law does require disclosure to a regulator, however, it will also impose corresponding duties of confidentiality on a regulator to keep information confidential except where there is a specific gateway in specified circumstances. As noted previously, in the discussion of barriers in Appendix D, it is all too often the case that the gateways are inadequate or the tests to be passed before they can be used are too burdensome.

Appendix F

Cross-Border Cooperation and Information Exchange: Comparison of Pronouncements of Standard-Setting Bodies

	Banking	Insurance	Securities	AML/CFT
Information sharing				
Share information with like supervisors	1	2	3	4
Share confidential information	5	6	7	8
Protect shared information	9	10	11	12
Justify request for information		13	14	15
Use information obtained only for stated purpose	16	17	18	19
Provide customer information	20		21	22
Inform regarding entity material development	23	24	25	
Parent authority informs host authority on major matters	26	27	28	
Establish cooperation mechanisms		29	30	31
Regulatory system provides for sharing with foreign supervisors	32	33	34	35
Investigate for counterparts		36	37	38
Exchange information with noncounterparts		39	40	41
Law may require disclosure of confidential information	42	43	44	45
Fiscal matters no obstacle to cooperation				46
No onward transmittal or use of information for enforcement without prior approval				47
Supervision				
Consolidated supervision	48	49		
Parent authority discretion to inspect host entity	50			
Institutions abroad must inform home supervisor	51	52	53	
Mutual legal assistance (MLA)				
Facilitate MLA				54
Not refuse MLA on bank-secrecy grounds				55
Dual criminality no obstacle to MLA				56
Cooperation in freezing and seizing assets				57
Ratify international conventions for cooperation				58
Memoranda of understanding (MoUs)				
No secrecy laws prevent provision of information	59		60	61
Detailed justification of request		62	63	
Request may be denied in the public interest		64	65	
Confidential treatment for information provided	66	67	68	
Beneficial ownership information provided	69		70	
Transaction, account information provided			71	
Documents from third parties provided		72	73	
Taking testimony provided		74	75	
Information provided for administrative, civil, or criminal matters		76	77	

Notes: I: Included in a standard-setting body (SSB) pronouncement more or less explicitly.

Pronouncements means rules or recommendations contained in documents styled as standards, recommendations, interpretative commentaries, best-practice papers, model memoranda of understanding, assessment methodologies, and other declarations of standard-setting bodies.

The SSBs are the Basel Committee on Banking Supervision (Basel), the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), and the Financial Action Task Force (FATF). Since it is the financial intelligence unit (FIU) grouping to stimulate international cooperation, the Egmont Group's principles are also referenced. AML/CFT denotes anti-money laundering/combating the financing of terrorism.

Appendix F (continued)

- ¹BCP 1(6), 24.
- ²IAIS Principle (2000) 16.
- ³IOSCO Principle 11.
- ⁴FATF Recommendation 40.
- ⁵Basel Committee paper, *Information Flows between Banking Supervisory Authorities* (1990).
- ⁶IAIS Principle 5.
- ⁷IOSCO Principle 11.
- ⁸FATF Recommendation 40(b).
- ⁹BCP 1(6).
- ¹⁰IAIS Principle (2000) 17; ICP 5.
- ¹¹IOSCO Objectives and Principles, Paragraph 9.4.
- ¹²FATF Recommendation 40; Egmont Principle 13.
- ¹³IAIS Model MoU paragraph 15.
- ¹⁴IOSCO Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information (hereinafter referred to as "IOSCO MoU") Article 8b.
- ¹⁵Egmont Principle 10.
- ¹⁶BCP Methodology 1(6) (EC 3).
- ¹⁷IAIS Insurance Concordat 4.3 a.
- ¹⁸IOSCO Multilateral MoU Article 10.
- ¹⁹Egmont Principle 11.
- ²⁰Basel Committee paper, *The Supervision of Cross-Border Banking*, II (1) (vi), III B (9).
- ²¹IOSCO Objectives and Principles 9.4.
- ²²FATF Recommendation 40.
- ²³Basel Committee paper, *Essential Elements of a Statement of Mutual Cooperation* (2001) p. 2; Basel Committee paper, *Information Flows between Banking Supervisory Authorities* (1990) B (ii).
- ²⁴IAIS Insurance Concordat 20 b.
- ²⁵IOSCO Multilateral MoU Article 13.
- ²⁶Basel Committee paper, *Information Flows between Banking Supervisory Authorities* (1990) C; Basel Committee paper, *The Supervision of Cross-Border Banking* (1996), II(2), III(e)28.
- ²⁷IAIS Concordat 22 c.
- ²⁸IOSCO Multilateral MoU Article 13.
- ²⁹IAIS Methodology ICP 5 EC (b).
- ³⁰IOSCO Objectives and Principles 12.
- ³¹FATF Special Recommendation V.
- ³²BCP 1(6).
- ³³ICP 5.
- ³⁴IOSCO Objectives and Principles 13.
- ³⁵Egmont Principle 9.
- ³⁶IAIS Model Memorandum of Understanding (1997) (hereinafter referred to as "IAIS MoU") 21.
- ³⁷IOSCO Objectives and Principles 9.4.
- ³⁸FATF Recommendation 40(c).
- ³⁹IAIS Model MoU 2.7.
- ⁴⁰IOSCO Objectives and Principles 9.5.
- ⁴¹FATF Recommendation 40.
- ⁴²Basel Committee paper, *The Supervision of Cross-Border Banking* (1996), Paragraph 11.
- ⁴³IAIS Principle (2000) 17.
- ⁴⁴IOSCO Multilateral MoU Article 11.
- ⁴⁵Egmont Principle 7.
- ⁴⁶FATF Recommendation 40 (a).
- ⁴⁷Egmont Principle 12.
- ⁴⁸BCP 23.
- ⁴⁹ICP 17.
- ⁵⁰Basel Committee paper, *Essential Elements of a Statement of Mutual Cooperation* (2001) p. 2; Basel Committee paper, *The Supervision of Cross-Border Banking* (1996), II(1)(x), III(c)18.

Appendix F (concluded)

⁵¹BCP 25.

⁵²ICP Methodology – ICP 6 EC (b).

⁵³IOSCO Methodology Principle 21 KQ 5.

⁵⁴FATF Recommendation 36(a).

⁵⁵FATF Recommendation 36(d).

⁵⁶FATF Recommendation 37.

⁵⁷FATF Recommendation 38.

⁵⁸FATF Special Recommendation I.

⁵⁹Basel Committee paper, *Supervision of Cross-Border Banking*, Recommendation iii, paragraph 5.

⁶⁰IOSCO MoU 6(b).

⁶¹FATF Recommendation 40.

⁶²JAIS MoU 15.

⁶³IOSCO MoU 8.

⁶⁴JAIS MoU 10, 19.

⁶⁵IOSCO MoU 6(e) (iv).

⁶⁶Basel Committee paper, *Essential Elements of a Statement of Mutual Cooperation* (2001), p. 3.

⁶⁷JAIS MoU 25.

⁶⁸IOSCO MoU 11.

⁶⁹Basel Committee paper, *Customer Due Diligence for Banks*, October 2001.

⁷⁰IOSCO MoU 7(b) (ii).

⁷¹IOSCO MoU 7(b) (ii).

⁷²JAIS MoU 9(c).

⁷³IOSCO MoU 9(b) and (c).

⁷⁴JAIS MoU 9(b).

⁷⁵IOSCO MoU 7(b) (iii).

⁷⁶JAIS MoU 24.

⁷⁷IOSCO MoU 10(a) (ii).

Results of a Survey on Cross-Border Cooperation and Information Exchange Among Financial Sector Agencies, 2004

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Executive Summary

This paper reviews the key findings of a survey on cross-border cooperation and information exchange among financial sector regulators and agencies, conducted between May and December 2004, of 74 banking, insurance, and securities regulators and financial intelligence units from 52 countries.

The results of the survey suggest that cooperation, including information exchange, in the jurisdictions covered is generally adequate at both the national and international levels. Respondents indicated a high degree of satisfaction with the assistance received and provided and with the timeliness of responses to requests for assistance.

Conditions among the different types of agencies are not, however, uniform. These differences may be useful in informing future discussions on cross-border information sharing. For example, the survey identifies securities regulators and financial intelligence units (FIUs) as experiencing the most difficulty in exchanging information, apparently because the information they require is more often enforcement related and may therefore be more difficult to obtain. Supervisors that do not primarily request enforcement-related information cited fewer concerns with information exchange.

¹At the time this chapter was prepared, the authors worked in the Monetary and Financial Systems Department of the IMF. They wish to express their gratitude to the officials of the 74 agencies that generously responded to the survey. They also thank Tanya Smith, Ana Fiorella Carvajal Carvajal, and Richard Pratt for their useful comments and suggestions. The authors, are, however, responsible for any remaining errors.

Other key findings of the survey include the following:

- Advanced economies place more emphasis on formal arrangements, while emerging markets and developing countries cooperate at a more informal level, possibly reflecting limitations on their capacity to achieve such arrangements.
- Memoranda of understanding (MoUs) were identified by survey participants as the preferred mechanism for cross-border information exchange. Emerging markets identified ad hoc contacts as the primary mechanism, followed by MoUs.
- There is a positive correlation between the volume of cross-border information exchange and the level of income and financial activity in the respondent jurisdictions. On average, advanced economies and international and offshore financial centers (IOFCs) exchange several times more information than the emerging/developing economies and the other jurisdictions (nonIOFCs).
- A major obstacle to information exchange continues to be inadequate gateways through secrecy or other confidentiality requirements, which was the main difficulty cited by requesting organizations. Agencies unable to meet requests primarily identified an inability to collect the information requested.
- When asked to provide their own descriptions of obstacles, respondents noted difficulties in understanding other jurisdictions' legal and institutional arrangements and, hence, in determining the gateways for cooperation. The lack of formal agreements was identified as an issue for securities regulators and FIUs.
- Participants indicated that more could be done to improve international cooperation and information exchange. The most predominant mechanism for improving information exchange, identified by approximately half the respondents, was to enter into formal arrangements. This ties in very closely with concerns raised by respondents regarding obstacles resulting from poor comprehension of the gateways for cooperation. Additional suggestions for improving information exchange included improving domestic legislation to remove impediments to information sharing, strengthening internal mechanisms to address requests for information in a more efficient way, and developing informal relationships between supervisors.

List of Abbreviations

AFA	absence of a treaty or a formal arrangement
AHCs	ad hoc contacts
AML/CFT	anti-money laundering/combating the financing of terrorism
C	client of the regulated financial services business
DCT	The offense in question is not an offense in the requested jurisdiction.
EU	European Union
FIUs	financial intelligence units
IMF	International Monetary Fund
IOFCs	international and offshore financial centers
IOSCO	International Organization of Securities Commissions
LBAs	legally binding agreements
LCs	letters of commitment
LPC	Requested agency lacked the powers to collect the information requested.
MoU	memorandum of understanding
NonIOFCs	jurisdictions other than international and offshore financial centers
NonSC	Requesting authority was unable to give the necessary confidentiality undertakings.
ORR	other reasons for refusal
RFB	regulated financial services business
SC	secrecy laws and other confidentiality restrictions
SIM	non-equivalent functions of the providing/requesting agency

I. Introduction

The growing integration of financial markets and the deepening of the international operations of financial firms underscore the critical importance of international cooperation and information exchange among financial sector supervisors and agencies in ensuring effective supervisory oversight and the stability of financial systems.

To inform discussions at the IMF Conference on Cross-Border Cooperation and Information Exchange, a group of 55 jurisdictions was surveyed during May and June of 2004. With the encouragement of conference participants, a further 42 agencies were invited to participate in the survey in August 2004. In addition, during the first round of the survey, the Egmont Secretariat kindly asked its members to complete the survey. As a result of these three mailings, we obtained responses from 74 financial sector and FIU agencies from 52 countries.

The survey aimed at identifying the practices and obstacles to international cooperation and information sharing in the financial sector and how these vary by sector, type of agency, level of income, and financial activity of the responding jurisdictions. The survey posed questions to identify the most important information-exchange mechanisms; determine the types of information exchanged; assess the volume, timeliness, and quality of the assistance received and provided; identify the most important challenges in, and barriers to, exchanging information; and examine views on ways to improve information exchange.²

The chapter is organized as follows. Section II describes the sample of respondents. Section III discusses the mechanisms used for information exchange domestically and internationally. Section IV describes the purpose and volume of information most frequently exchanged. Section V examines the degree of satisfaction with the assistance received or provided by the financial sector agencies. Section VI addresses the challenges and impediments in sharing information, as well as the alternative sources of information used when the requests for assistance were refused. Section VII describes the views of the participants on ways to improve information exchange.

II. The Respondent Sample

From the total of 97 agencies invited to participate in the survey (see Appendix B for the questionnaire), answers were received from 78 agencies (Table 18.1) in 52 countries, with a roughly similar number in each of 4 economic/jurisdiction categories: developing IOFCs (13), other developing

²The preliminary results of the survey were presented at the Conference on Cross-Border Cooperation and Information Exchange, which was hosted by the IMF in Washington on July 7–8, 2004. An update of the survey, with expanded coverage, was presented at the Second Annual IMF Roundtable for Offshore and Onshore Supervisors and Standard Setters, which was held in Basel on November 2, 2004.

Table 18.1. Responses Received, by Type of Supervisor and Jurisdiction (Question 1)

Type of Supervisor	Total	International and Offshore Financial Centers (IOFCs) ¹	Non-International and Offshore Financial Centers (NonIOFCs) ²	Advanced Economies ³	Emerging Markets and Developing Countries ³
Banking	19	6	13	9	10
Securities	12	3	9	6	6
Insurance	11	3	8	9	2
FIUs ⁴	16	6	10	12	4
Unified ⁵	20	13	7	10	10
Total	78	31	47	46	32

¹This group is composed of regulatory authorities from the following international and offshore financial centers: Aruba, The Bahamas, Bahrain, Barbados, Bermuda, the British Virgin Islands, the Cayman Islands, Costa Rica, Cyprus, Dominica, Gibraltar, Guernsey, Hong Kong SAR, Ireland, the Isle of Man, Jersey, Lebanon, Luxembourg, Macao SAR, Mauritius, Monaco, Samoa, Singapore, and Switzerland.

²This group is composed of regulatory authorities from the following jurisdictions: Argentina, Australia, Belgium, Brazil, Canada, Chile, Colombia, Finland, France, Germany, Indonesia, Italy, Malaysia, the Netherlands, New Zealand, Panama, Poland, Portugal, Serbia, the Slovak Republic, Slovenia, South Africa, Spain, Sweden, Taiwan Province of China, Thailand, the United Arab Emirates, and the United States.

³According to IMF's World Economic Outlook classification.

⁴The group includes one AML/CFT regulator.

⁵Three regulatory authorities provided separate answers for the different sectors. Those responses are included under the relevant sectors. The actual number of unified regulators participating in the survey was 23.

Table 18.2. Participating Jurisdictions, by Economic Category (Question 1)

	Total	International and Offshore Financial Centers (IOFCs)	Non-International and Offshore Financial Centers (NonIOFCs)
Emerging markets and developing countries ¹	28	13	15
Advanced economies ¹	24	11	13
Total	52	24	28

¹According to IMF's World Economic Outlook classification.

jurisdictions (15), advanced IOFCs (11), and other advanced jurisdictions (13) (Table 18.2). In terms of a sector-of-agency categorization, 78 responses were received,³ half from banking and unified supervisors (accounting for 19 and 20 responses, respectively), 12 from securities supervisors, 11 from insurance supervisors, and 16 from FIUs (among which one was an AML/CFT supervisor) (see Table 18.1).

³Three unified regulators provided separate answers for the different sectors supervised, and their responses were included under the relevant sectors. Therefore, although the actual number of supervisors and agencies participating in the survey was 74, 78 responses by sector were received.

Caution should be exercised in generalizing the results, given the limited number of responses received per sector (especially for the securities and insurance sectors), as well as the low response rate to some questions. Given the difficulty of compiling statistics from records, many responses may reflect the observations of the supervisors completing the survey, rather than a strict tabulation of agency records. Nevertheless, results are consistent with both our assumptions and other evidence (see Chapter 17 by Pratt and Schiffman in this volume).

Influence of Respondents' Areas of Responsibility

In analyzing the results of the survey, our expectations or assumptions were that cooperation by and among regulatory authorities depends, *inter alia*, on (a) the different roles played by the authorities, reflecting their industries; and (b) the standards set by the competent standard-setting bodies or industry groups (see Pratt and Schiffman, Chapter 17).

For example, a large part of the traditional work of banking supervisors is to verify the financial condition of institutions in an attempt to secure the funds borrowed from the public through deposits. In addition, banks' systemic importance has given them the longest and most developed supervisory guidance; relatively strong networks for information exchange; and greater exposure to the need for, and understanding of, information sharing between home and host supervisors. The Bank of Credit and Commerce International (BCCI) failure of the 1990s confirmed and underlined the importance of cross-border consolidated supervision in international cooperation. The international standards for banking supervision emphasize the need to practice global consolidated supervision over internationally active banking organizations, as well as providing for a clear delimitation of attributes between home and host country supervisors.

Similarly, insurance supervisors are concerned with monitoring insurance companies' solvency so that insurers can meet insureds' claims. Cross-border cooperation has been less of an issue in insurance because the business, apart from reinsurance, has tended to be nationally focused (Joint Forum, 2001). Insurance companies are increasingly growing outside domestic borders, however, which enhances the need for home and host supervisor exchange of information. The standards for insurance supervision require that internationally active insurance companies are subject to effective supervision and that efficient and timely exchange of information is taking place among supervisory bodies, both within the insurance sector and across the financial services sector.

The securities regulators have a much broader role in cooperation and information exchange than do either the banking or insurance supervisors, reflecting both the differences in their general roles and the wider range of the bodies they regulate.⁴ Securities regulators have traditionally been focused on ensuring that firms make correct disclosures to customers and markets. They also set rules for a range of entities and purposes—organized markets and settlement systems, business conduct of intermediaries, structure and sale of collective investment schemes, and issuers’ disclosure. Since nonregulated entities can violate these rules and perpetrate fraud in security markets, many securities supervisors have enforcement powers, which allow them to initiate legal proceedings against regulated and nonregulated persons (Joint Forum, 2001). Hence, securities regulators would exchange information for enforcement reasons to a greater extent than do banking and insurance supervisors. In addition, the most significant securities markets are international, so cross-border information exchange is more widely needed and used. The specific standards demand a clear separation between when and how regulators should share public and nonpublic information with their foreign counterparts.

Financial intelligence units are central, national agencies “responsible for receiving, (and, as permitted, requesting), analysing and disseminating to the competent authorities, disclosures of financial information: (i) concerning suspected proceeds of crime and potential financing of terrorism, or (ii) required by national legislation or regulation, in order to counter money laundering and terrorism financing” (Egmont Group, 2004). FIUs therefore have information generation and exchange at the very center of their mandate and, in keeping with their criminal prevention and detection roles, are expected to be more concerned with enforcement and actions resulting from enforcement than prudential agencies. In this case, the standards require extensive cooperation powers, including the capacity of competent authorities to conduct inquiries on behalf of foreign counterparts, or the authorization of law-enforcement agencies to conduct investigations on behalf of foreign counterparts (where permitted by domestic law).

We therefore expect securities regulators and FIUs to have more exacting and sensitive demands for information, in that these may need to be legally defensible; more information on customers is likely to be sought; and, in the latter case, such requests often relate to suspicions of a criminal offense, requiring

⁴As the IOSCO Objectives and Principles for Securities Regulation indicate, securities regulators oversee self-regulatory organizations, issuers, collective investment schemes, broker dealers and investment advisors (market intermediaries), and secondary-market arrangements themselves—exchanges and trading systems.

more careful handling. There were extensive discussions at the conference, however, on the converging cooperation requirements for sectoral supervisors.

In addition to these sectoral viewpoints, the spread of universal banks and the growing degree of conglomeration of financial firms (De Nicoló and others, 2004) also mean that there is an increased need for cooperation and information between the different types of agencies. There are now several integrated or unified regulatory bodies, combining in a single agency regulation and supervision of all three sectors (banking, insurance, and securities), although the degree of integration differs across jurisdictions (de Luna Martinez and Rose, 2003). Although some bodies have begun to apply a uniform approach to regulation and supervision of the three sectors, other countries continue to maintain sector-specific practices. The differences in integration and approach suggest that their information-sharing needs or practices may not be uniform, or even closely correlated with the different sectors they supervise, and we therefore can make few assumptions.

III. Mechanisms Used for Information Exchange

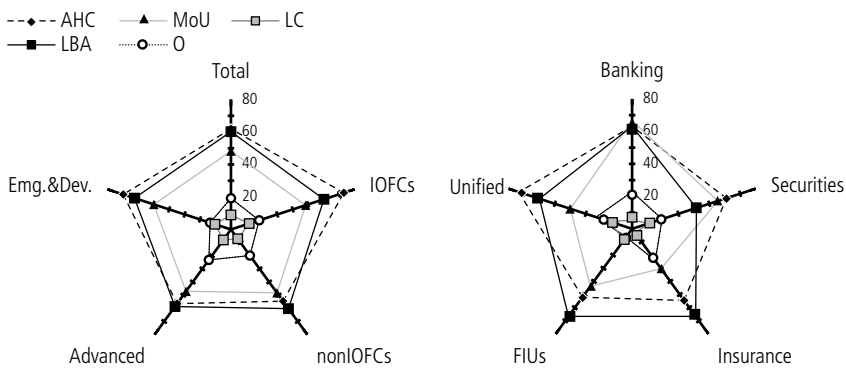
The questionnaire distinguished four specific mechanisms for information exchange: legally binding agreements/arrangements (LBAs), MoUs, letters of commitment (LCs), and ad hoc contacts (AHCs); there was also an “other” category, ranging from the most legally powerful to the least. In “other,” respondents were allowed to supply their own mechanisms. The mechanisms cited were limited to legislative provisions (included with LBAs in the subsequent discussion) and meetings of regional or international groups such as the EU, standard setters, regional supervisory groupings, and informal/personal contact. These respondent-provided mechanisms and discussions during the conference (discussed previously) indicated that MoUs and AHCs are often initiated or facilitated through contacts at such meetings and, together with the results discussed later on, this suggests that participation in peer organizations may well be key to much information exchange, since it helps participants to establish national contacts and to understand key gateways.

Mechanisms Used for Information Exchange Domestically (Question 2)

Domestically, information exchange is taking place mostly in an informal manner (ad hoc contacts) or by virtue of legally binding arrangements, including legal and statutory provisions (Figure 18.1 and Appendix A, Table A.18.1). The respondents attach an almost equal degree of usefulness to AHCs and LBAs, each of which ranks at around 60 out of 100—the maximum value of

Figure 18.1. Domestic Mechanisms for Information Exchange, Ranked by Usefulness (Question 2)

(Mechanisms rated from 0 = not important to 100 = most important)



Notes: LBA denotes legally binding arrangements (including legal and statutory provisions); MoU denotes memoranda of understanding; LC denotes letters of commitment; AHC denotes ad hoc contacts; O denotes other; and Emg. & Dev. denotes emerging market and developing countries.

the usefulness index constructed for quantifying the answers to Questions 2 and 3 (see note to Appendix A, Table A.18.1 for the index methodology). MoUs are considered less important (usefulness index of 48), and LCs have only marginal importance (usefulness index of 9). Other mechanisms, of which the most frequently mentioned were interagency committees and working groups, are important to some extent (usefulness index of 19).

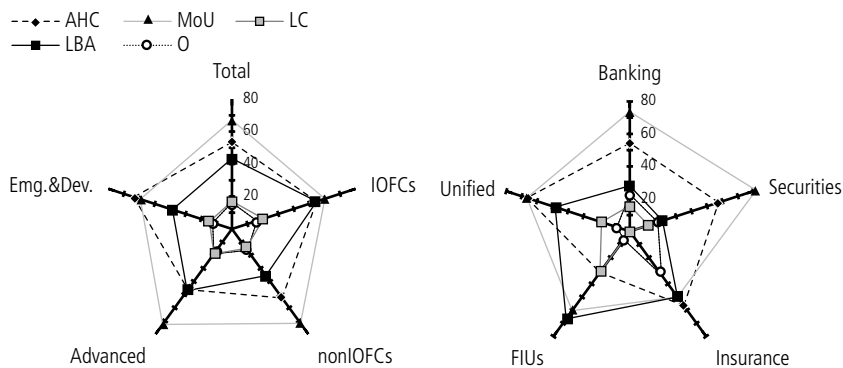
AHCs are the most important mechanisms for information exchange used domestically by IOFCs, emerging and developing countries, and securities and unified regulators (Figure 18.1). LBAs are the most important mechanisms for information exchange for nonIOFCs, advanced economies, and insurance supervisors, as well as for FIUs (Figure 18.1). For banking supervisors, the most useful mechanisms for information exchange are MoUs, closely followed by AHCs and LBAs (Figure 18.1).

Mechanisms Used for Information Exchange Internationally (Question 3)

Internationally, the most useful mechanisms were found to be MoUs, with a usefulness index number of 67 (Figure 18.2 and Appendix A, Table A.18.1). MoUs rank first in both IOFCs and nonIOFCs (with usefulness index numbers of 60 and 72, respectively), as well as in advanced economies (with a usefulness index number of 73). MoUs are also the most important mechanisms used by banking and securities authorities (with usefulness index numbers of

Figure 18.2. International Mechanisms for Information Exchange, Ranked by Usefulness (Question 3)

(Mechanisms rated from 0 = not important to 100 = most important)



Notes: LBA denotes legally binding arrangements (including legal and statutory provisions); MoU denotes memoranda of understanding; LC denotes letters of commitment; AHC denotes ad hoc contacts; O denotes other; and Emg. & Dev. denotes emerging market and developing countries.

74 and 82, respectively). Together with AHCs, they are also the most important for unified regulators.

AHCs are the most important mechanisms to emerging market regulatory authorities (with a usefulness index of 64), and to insurance supervisors (with a usefulness index number of 57), and the second most important mechanism to nonIOFCs, as well as to banking supervisors and securities regulators. The advanced economy regulatory authorities attach virtually the same degree of importance to LBAs⁵ as to AHCs, a pattern similar to that of IOFC regulators. These associations between wealth/economic category of jurisdiction and preferred mechanism suggest that more complex or extensive financial activities (the factor we assume that IOFCs and advanced economies have in common) require more formal mechanisms of cooperation.

LBAs (including legal and statutory provisions) are judged the most important information exchange mechanism by FIUs (with a usefulness index number of 67) and rank second for insurance supervisors (Figure 18.2). LCs are used to a greater extent internationally than domestically and are distinctly more important for FIUs (with a usefulness index number of 31) than for other agencies.

⁵Note also that MoUs are legally binding in some countries.

IV. Purpose and Volume of Information Most Frequently Exchanged

Types of Requests for Assistance Made and Received (Questions 4 and 11)

The survey provided respondents with a choice of four purposes for which information is exchanged—licensing, ongoing supervision, enforcement, and action from enforcement. Respondents were also asked to indicate the subject of the request—either regulated financial business (RFB) or a client of the institution (C). A discussion of these purposes is provided in Appendix A of Pratt and Schiffman (Chapter 17 in this volume) but are briefly explained here as follows:

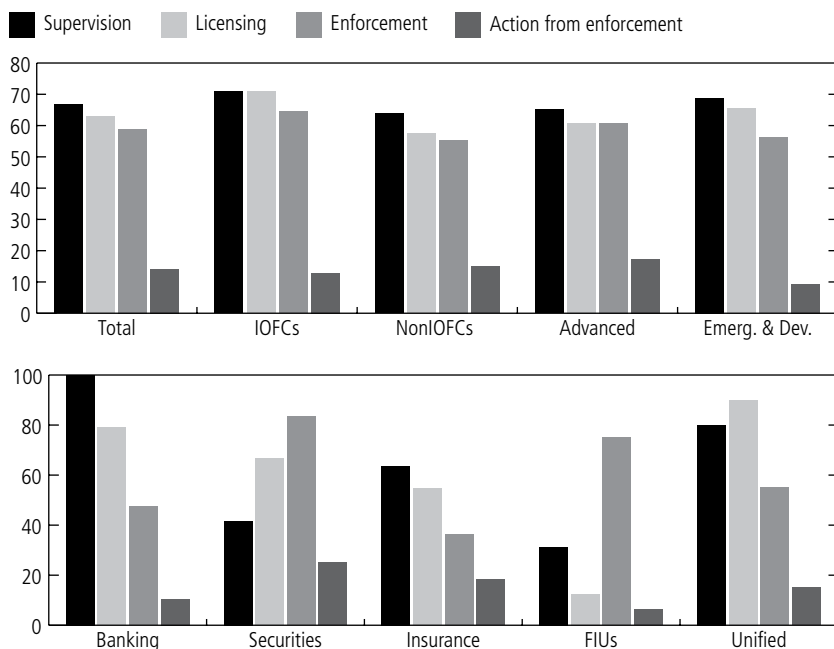
- ♦ Licensing information is required when a regulatory authority is faced with an application from a regulated financial business and wishes to learn, inter alia, about the regulatory track record of the applicant, its financial status, the owners, and controllers of the applicant.
- ♦ Ongoing supervision information relates to the conduct of business by the RFB in the home or host jurisdiction, the extent to which the home or host regulations are being observed in the respective jurisdictions, on-site inspections, factors that might pose risks, regulatory developments in jurisdictions, and clientele in different jurisdictions.
- ♦ Enforcement information covers matters such as solvency or capital, records to assist in an investigation, information on customers, and documents to assist in investigations.
- ♦ Action from enforcement would relate to the freezing of assets, assistance with referrals to prosecutors, and the use of sanction powers such as a windup.

Requests Made for Assistance (Question 4)

Overall, the requests for assistance made to foreign agencies are predominantly for supervision, licensing, and enforcement purposes (67, 63, and 59 percent, respectively, of all respondents; see Figure 18.3), while only a limited number of requests target information on action resulting from enforcement cases (14 percent of respondents). Domestically, there is an almost equal distribution of requests for information on supervision, licensing, and enforcement (about 55 percent of respondents for each purpose), with more requests for information on action resulting from enforcement (21 percent of respondents, see Appendix A, Table A.18.3a).

Figure 18.3. Information Requested from Foreign Regulatory Authorities, by Purpose (Question 4)

(Percent of responses in each category)



Notes: See footnotes in Appendix A, Table A.18.2a.

At the sectoral level, most requests from banking and insurance supervisors and unified regulators to foreign counterparts were made for supervisory or licensing purposes (Figure 18.3),⁶ although securities regulators' and the FIUs' most numerous requests are for enforcement purposes (Figure 18.3).⁷ Of all agency types, securities regulators ask most frequently for information on

⁶Although the proportions shown for insurance supervisors are lower, 3 of the 11 supervisors in the insurance group did not respond to this question.

⁷An unusual result should be mentioned. Two (four) FIUs indicated that they seek information internationally (domestically) for licensing purposes (see Appendix A, Tables A.18.2a and A.18.3a). In one of the two cases of international exchange, the respondent is the specialized AML/CFT regulator classified with FIUs. One FIU among the four is known to be responsible for AML/CFT supervision generally, including the issuance of licenses for some entities. The other two cases may reflect both such activity and the involvement of FIUs in investigations where an entity is required to have a license and/or loses a license as a result of criminal activity.

action resulting from enforcement cases (25 percent of securities regulators) (Figure 18.3). Domestically, banking supervisors and FIUs are far more likely to request information for action from enforcement than they do at the international level (Appendix A, Tables A.18.2a and A.18.3a).

Most requests concern regulated financial services businesses rather than clients (Appendix A, Table A.18.2a). As one would expect, however, in cases where information is requested for enforcement purposes and action from enforcement, a higher proportion of requests concern the client of the regulated financial businesses (Appendix A, Table A.18.2a). The same patterns are observed at the domestic level (Appendix A, Table A.18.3a).

There were some differences among regulatory authorities by type of market (IOFC and nonIOFC) and income (advanced and emerging market countries). For example, agencies in IOFCs were more likely to request information for licensing and supervision purposes than were those in nonIOFCs.

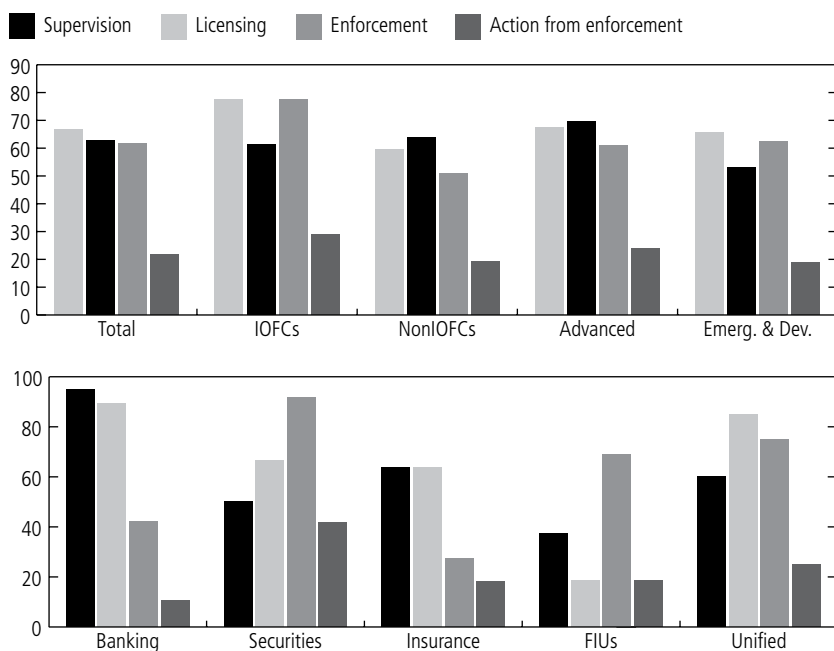
Requests Received for Assistance (Question 11)

Overall, the foreign requests for assistance received by respondents are mainly for licensing, supervision, and enforcement purposes (67, 63, and 62 percent, respectively, of all respondents) (Figure 18.4). This distribution by purpose is very similar to that for requests made. However, the respondents receive more requests than they make concerning action resulting from enforcement cases (22 percent as compared with 14 percent). Domestically, the most important purpose for which information is requested is enforcement, regardless of the location of the regulatory authority—whether in IOFCs, nonIOFCs, or in advanced and emerging market and developing economies (Appendix A, Table A.18.3b).

The purpose of information requested from respondents varies significantly by sector. Thus, although banking supervisors are mainly requested to provide information on supervision (95 percent of banking supervisors' responses) and licensing (89 percent), which is not unlike the experience of insurance supervisors, securities regulators provide information mainly on enforcement (92 percent) and licensing (67 percent).⁸ FIUs' assistance is offered for enforcement (69 percent) and supervision purposes (38 percent), and the unified regulators primarily offer information on licensing (85 percent) and enforcement (75 percent). At the domestic level, there is a much greater emphasis placed on enforcement and action from enforcement for banking supervisors than there is at the international level (Appendix A, Tables A.18.3a and A.18.3b).

⁸Since each regulatory authority or agency type received requests for more than one purpose, the percentages provided for each purpose do not sum to 100.

Figure 18.4. Information Provided to Foreign Regulatory Authorities, by Purpose (Question 11)
(Percent of responses in each category)



As concerns subject, the respondents provide information to foreign regulatory authorities and agencies most frequently on regulated financial businesses (Appendix A, Table A.18.2b). By and large, clients of the regulated financial businesses are more frequently the subject of the assistance provided when the purpose of information is enforcement or action resulting from enforcement cases (Appendix A, Table A.18.2b). When providing information for these two purposes, the IOFCs' agencies provide more information on clients than do the other jurisdictions (Appendix A, Table A.18.2b). More information on clients is also provided by securities regulators, unified regulators, and FIUs (Appendix A, Table A.18.2b). Only the banking supervisors provide more information on clients domestically than internationally (Appendix A, Tables A.18.2b and A.18.3b).

The relatively high exchange of information for enforcement purposes by securities regulators and FIUs will be considered again in Section V, which discusses agency satisfaction with assistance.

Importance of Diagonal Requests (Questions 4 and 11)

The survey was not designed to capture cooperation relationships cross sectorally, but did capture diagonal requests between FIUs and prosecuting agencies, on the one hand, and financial regulatory authorities, on the other hand.

Although our key interest remains the cross-border exchange of information, we begin here by considering domestic information exchange, given the important domestic role of FIUs in the investigation and prosecution of money laundering. Of all prudential agencies, banking supervisors are the most likely to exchange information domestically with FIUs (47 percent and 53 percent, respectively, of banking supervisors request information from, and are requested to provide information by, FIUs), suggesting that the banking sector continues to generate the greatest volume of suspicious transactions reports. Consistent with this, a high proportion of unified regulators make requests to (30 percent), and receive requests from (35 percent), FIUs. In our sample, less than 20 percent (securities) and 10 percent (insurance) of the other authorities exchange information with FIUs. Surprisingly, the responses suggest that banking supervisors have almost as much information exchange contact with domestic prosecuting agencies as do securities regulators, while, as expected, FIUs have the most such contacts (Appendix A, Table A.18.4).

Internationally, the picture changes in the expected directions—cross-border contacts between the prudential supervisors (banking, insurance, and securities) and FIUs are very low or nonexistent, with the information exchange being made FIU to FIU (since most systems are organized to accomplish it in this way) and 19 percent of FIUs exchange information with cross-border prosecuting agencies. Between 10 and 16 percent of banking and unified supervisors exchange information directly with FIUs. A relatively higher proportion of unified supervisors receive requests from (25 percent), and make requests to (20 percent), prosecuting agencies.

Volume of Requests for Assistance Made and Received (Questions 5 and 12)

The volume of requests for assistance made or received seems to be correlated with the level of the financial activity in the respondent jurisdictions and with their trade in financial services. Thus, on average, IOFCs request and provide more assistance than nonIOFCs—503 versus 238 made and 331 versus 200 received. Tellingly, the volume in advanced IOFCs is between 4 and 13 times

Table 18.3. Volume of Requests for Assistance Made or Received, by Type of Jurisdiction or Agency*(Average of last two years)*

	Made (Q5)	Received (Q12)
IOFCs	503	331
Advanced ¹	701	441
Developing ¹	52	97
Non IOFCs	238	200
Advanced ¹	387	279
Emerging and developing ¹	64	92
Advanced¹	575	375
Emerging and developing¹	57	92
Sectoral breakdown		
Banking supervisors	112	144
Securities regulators	180	120
Insurance supervisors	109	142
FIUs, AML/CFT supervisors	585	381
Unified regulators	539	356

¹According to IMF's World Economic Outlook classification.

bigger than in developing IOFCs, many of which actually have low levels of activity. Similarly, advanced jurisdictions make and receive 10 and 4 times, respectively, the amount of information requests that emerging market and developing economies do (Table 18.3).

When volume of requests is considered in terms of agency type, function, and scope of supervision appear to be the factors determining volume. Consistent with their statutory role as producers and disseminators of information, FIUs make and receive, on average, the most requests for assistance (585 and 381, respectively) among the agencies considered. The FIUs are closely followed by unified regulators, who also need to exchange information intensively owing to their expanded supervisory responsibilities, with 539 requests for assistance made and 356 requests for assistance received on average (Table 18.3).

A notable observation about these data is the excess of requests made over requests received. This appears to be explained by two factors that would tend to reduce the number of received requests reported. First, large jurisdictions often do not maintain a tally of the requests received, given their large volume, and thus were not able to go back and count them. Second, and more speculatively, our sample does not contain several of the larger home supervisors, which would tend to receive more requests than the average number of requests reported here.

“Freely” Provided Information⁹ (Question 16)

Survey results suggested that there are virtually no restrictions on the types of information that can be shared domestically, and few on the types of supervisory information that can be shared cross-border. These findings conform to assumptions about information exchange, although the low number of relevant responses (see footnote 9) limits their applicability.

Extensive information can be shared at the domestic level. A large proportion of the respondents indicated that all information requested, both public and nonpublic, by domestic authorities can be provided, including information on individuals and clients of the regulated financial businesses. The domestic regulatory authorities have unrestricted access to each other’s information and, in some cases, participants specified that professional secrecy cannot be invoked among domestic regulatory agencies. Notably, a large number of the FIUs specified that they can share information only for AML/CFT investigation, detection, or prosecution. Also, in several cases, the FIUs need to conclude MoUs with domestic supervisors in order to be able to share intelligence information.

At the international level, respondents indicated that there are no restrictions in providing public information (for example, industry statistics—aggregate financial and prudential ratios as well as developments in national legislation and supervisory standards). Also, a large majority of the respondents can “freely” share information for supervisory purposes, such as information on directors, officers, operations of a licensee, and prudential and financial ratios of financial institutions, as well as information on beneficial owners and enforcement actions. Further, if requested for supervisory purposes, information on clients of the regulated financial businesses can be provided.

Only a limited number of respondents specifically indicated that the information they can share for supervisory purposes does not depend on the requesting authority, and these respondents had no common characteristics (three were IOFCs). Two regulatory authorities specified that they could not pass on information to overseas regulatory authorities¹⁰ and one that it could not share

⁹That is, information that can be provided—without a court order, subpoena, or other referral—to either domestic or international authorities. Although the question had a high response rate (75 of the 78 responses), respondents gave widely varying responses, with some repeating earlier answers on impediments to information exchange. In consequence, the findings described reflect only the comments of the limited number of respondents who actually described the types of information that can be “freely” shared.

¹⁰These statements seemed inconsistent with other responses, so we reexamined the original submissions. In one case, the supervisor in question was in a small, shallow securities market and

information with foreign FIUs. Two securities supervisors from advanced countries indicated that they could provide investigatory assistance on behalf of foreign regulators, and one small FIU specified that evidential information could be provided only by the appropriate legal authorities.

Two regulatory authorities stated that they could not provide information on individual financial institutions or their clients. Other restrictions mentioned by respondents included providing information subject to legal professional privilege, information that deals with industrial or commercial secrets, or information that concerns a fiscal offense.

Regional cooperation agreements (such as the one in place in the EU) seem to help financial regulatory authorities to share information more freely. Likewise, beyond the legal and institutional capacity to share information, a cooperative stance and habits can make important contributions to improving the information exchange. For example, several respondents indicated that they voluntarily and regularly provide inspection reports on foreign banks to the banks' home supervisors.

V. Satisfaction with Assistance Received or Provided

Quality of Responses to Requests for Assistance Made and Received (Questions 6 and 13)

Agencies were asked to indicate the approximate percentage of the requests for information or assistance they had made (in Question 6) or received (in Question 13) in the last two years that had not been responded to, had been inadequately answered, or had been satisfactorily answered. The percentages were averaged for each category of agency.

Overall, and in each category, the regulatory authorities and FIUs judged the quality of the responses they supplied to be greater than the quality of the responses they received, with the exception of agencies in IOFCs, who indicated that the quality of both types of responses was similar. Taking account of a probable degree of excess satisfaction with their own responses, the responses we received suggest that securities regulators and FIUs have had the least success in obtaining satisfactory assistance.

explained that major reform of their legislation was required. The second submission was quite incomplete and related to an even less developed securities market. Neither of these jurisdictions were IOFCs.

Table 18.4. Quality of Responses to Requests for Assistance Made and Received (Questions 6 and 13)*(Average percentage of total requests made or received for each category)*

Requests for Assistance	Unanswered	Inadequately Answered	Satisfactorily Answered	Total
Requests made by respondent				
Total countries	5	11	84	100
Total IOFCs	3	7	90	100
Total nonIOFCs	6	14	81	100
Advanced ¹	3	12	85	100
Emerging market and developing ¹	6	10	84	100
Sectoral breakdown				
Banking supervisors	3	6	91	100
Securities regulators	8	16	77	100
Insurance supervisors	3	16	82	100
FIUs, AML/CFT supervisors	7	16	77	100
Unified regulators	3	7	90	100
Requests received				
Total countries	3	5	92	100
Total IOFCs	4	7	89	100
Total nonIOFCs	3	4	93	100
Advanced ¹	5	6	89	100
Emerging market and developing ¹	1	5	95	100
Sectoral breakdown				
Banking supervisors	1	4	95	100
Securities regulators	9	2	89	100
Insurance supervisors	0	3	97	100
FIUs	5	9	85	100
Unified regulators	1	7	92	100

Notes: Each entry averages the "satisfaction" percentages given by supervisors in each group. Figures are rounded and, hence, may not add up to the total.

¹According to IMF's World Economic Outlook classification.

Among the jurisdictions, a significantly higher degree of satisfaction with the answers received is noticed among IOFCs, where, on average, 90 percent of the answers received were regarded as satisfactory, compared with 81 percent recorded in the nonIOFCs (Table 18.4).¹¹ However, a higher proportion of requests to IOFCs (11 percent) than to nonIOFCs (7 percent) was left unanswered or inadequately answered. Advanced countries also provided less satisfactory answers. Details of the results also suggest that small, poor jurisdictions neither receive nor provide very satisfactory responses.

¹¹Twenty of the 31 supervisors from IOFCs considered 90 percent or more of their requests to have been satisfactorily answered; three found 80–90 percent of responses satisfactory; for four agencies, 60–70 percent of responses were satisfactory; and four of the agencies did not respond to this question. Conversely, only one supervisor found that as much as 20 percent of their requests were unanswered.

Sectorally, an average of more than 90 percent of the responses made and received by banking supervisors and unified regulators surveyed are judged satisfactory. In contrast, securities regulators and FIUs are not only least likely to receive satisfactory assistance (they consider 77 percent of the answers they receive satisfactory, as compared with 82, 90, and 91 percent among insurance, unified, and banking authorities, respectively) but also less satisfied with their own answers. Only an average of 89 percent and 85 percent, respectively, of the answers they themselves provided were considered satisfactory by securities regulators and FIUs. Furthermore, they were the most likely to be unable to answer. Averages of 8 percent of requests made, and of 9 percent of requests received, went unanswered among securities regulators; similar averages were found for FIUs (7 percent and 5 percent, respectively).

These results are consistent with those on the purpose of information exchange. As discussions during the conference made clear, enforcement-related information is more difficult to exchange. Not only is its subject matter likely to be more sensitive, to refer more frequently to individuals than institutions, but it also needs to be of higher quality to better support the case being made. Their larger role in such exchange therefore helps explain the result that about one-quarter of securities regulators' and FIUs' requests are inadequately addressed.

Timeliness of Assistance Received or Provided (Questions 7 and 14)

Timeframe for Receiving Assistance (Question 7)

The timeframe for receiving information solicited is usually less than a month (68 percent of all agencies) with some variations between IOFCs (where only 59 percent of the jurisdictions indicated that they receive information in less than a month) and the agencies in nonIOFC jurisdictions (where 74 percent of the jurisdictions indicated that they most frequently received the information within a month). Considered by sector, the majority of financial regulatory authorities and agencies most frequently receive the information requested within a month, with the exception of securities regulators, most of whom indicated that they most frequently received the information solicited between one and three months afterward (Appendix A, Table A.18.5).

Timeframe for Providing Assistance (Question 14)

The timeframe for providing information solicited is usually less than a month. (Eighty-six percent of the jurisdictions indicated that they most frequently provided the information requested in less than a month.) Considered by sector, the survey results indicate that between 100 percent (banking) and 67 percent

(securities) of the financial supervisors and agencies most frequently provided the information requested within a month (Appendix A, Table A.18.5).

VI. Challenges and Obstacles in Sharing Information

Only 60 percent of participants in the survey provided answers to Questions 8 and 11, which asked for reasons given for not providing cross-border information to/by respondents if the information requested was not supplied (see notes to Tables A.18.6a and A.18.6b in Appendix A). These results should therefore be interpreted cautiously even for the sample. They are consistent, however, with the responses to Questions 6 and 13, which indicated a low proportion of nonresponse to information requests. Indeed, some nonrespondents indicated that the questions did not apply, since information requests were usually met. Less than 20 percent of agencies answered the question for domestic exchange.

The questions provided eight (including “other”) options among which respondents could choose as reasons for not providing information (see Appendix B for the questionnaire). The most frequently selected included “secrecy laws or other confidentiality restrictions” (SC), lack of powers in the requested agency to collect the information (LPC), the requesting agency’s inability to give necessary confidentiality undertakings (nonSC), providing/requesting agency’s lack of similar or equivalent functions (SIM), and absence of formal arrangements (AFA).

Requesting Information (Question 8)

Challenges and Obstacles in Requesting Information Internationally (Question 8)

Considering responses by category of jurisdiction first, almost half of the respondents to Question 8 (44 percent) indicated that the main impediments to receiving the information requested were secrecy laws or other confidentiality restrictions. The proportion of those confronted with secrecy or other confidentiality restrictions was higher in IOFCs (53 percent of the respondent IOFCs) than in other jurisdictions (40 percent of the respondent nonIOFCs). SC is also a reason given to many financial supervisors and agencies from advanced economies (indicated by 58 percent of the respondents from advanced economies) when they do not receive requested information.

Since the international standards include a requirement that supervisors ensure an adequate degree of protection for the confidentiality of the infor-

mation exchanged (see Box 18.1), the importance of SC seems to indicate an absence of adequate gateway provisions. Responses to Question 10, which complements Question 8, show that in obtaining the information sought, financial regulatory authorities and agencies are often obstructed by either poorly understood or insufficient gateways for sharing information.

For the financial regulatory authorities from emerging and developing economies, the main impediment to obtaining the information solicited is represented by “other” reasons for refusal (given by 42 percent of the respondent emerging and developing economies). In most cases, respondents indicated “other” when they had not been given a reason by the nonresponsive agency to which the request was addressed.

“Other” reasons for refusal are also the second most frequently specified impediment to obtaining the information requested by both the IOFCs and the nonIOFCs, as well as by the advanced economies (Figure 18.5). Other important reasons for not obtaining the information requested are the limited powers of the requested agency to collect the information requested, followed distantly by AFAs (Figure 18.5).

The reasons for refusal given to financial regulatory authorities and agencies vary considerably by type of agency (Figure 18.5) and seem to be related to the roles they play and their specific needs for cooperation. Thus, banking supervisors and unified regulators are refused because of secrecy laws or other confidentiality restrictions. Securities regulators and FIUs are confronted with the limited powers of the requested agency; and, finally, insurance supervisors are primarily refused owing to “other” reasons and inability to guarantee that the confidentiality of the information will be maintained (Figure 18.5). Notably, for securities regulators, the “other” reasons for refusal and the limited powers of the requested agency were as important as the secrecy or other confidentiality barriers (Figure 18.5).

Challenges and Obstacles in Requesting Information Domestically (Question 8)

In general, information requested from domestic authorities was obtained, since only about 20 percent of the participants indicated that their requests had not been satisfied domestically (note to Tables A.18.7a and A.18.7b in Appendix A). More than half of respondents to Question 8 were refused owing to SC, which was the main impediment for nonIOFCs; both advanced and developing countries; banking, securities, and unified regulatory authorities; and FIUs. The IOFCs’ requests were refused domestically mainly because of the limited power or in-house capacity of their domestic counterparts (Appendix A, Table A.18.7a).

Box 18.1. Protecting Confidentiality: International Standards

Basel Core Principles (September 1997)

Principle 1(6): *“Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.”*

Core Principles Methodology (October 1999)

Essential criteria to Principle 1(6):

“3. The supervisor:

- may provide confidential information to another financial sector supervisor;
- is required to take reasonable steps to ensure that any confidential information released to another supervisor will be treated as confidential by the receiving party;
- is required to take reasonable steps to ensure that any confidential information released to another supervisor will be used only for supervisory purposes.

4. The supervisor is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession.”

Insurance Core Principles and Methodology (October 2003)

ICP 3 Supervisory authority

“The supervisory authority: (. . .)

- *treats confidential information appropriately.”*

Essential criteria:

“t. (. . .) Other than when required by law, or when requested by another supervisor who has a legitimate supervisory interest and the ability to uphold the confidentiality of the requested information, the supervisory authority denies requests for confidential information in its possession.”

ICP 5 Supervisory cooperation and information sharing

“The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.”

Essential criteria:

“f. The supervisory authority is required to take reasonable steps to ensure that any information released to another supervisor will be treated as con-

fidential by the receiving supervisor and will be used only for supervisory purposes.”

Objectives and Principles of Securities Regulation (May 2003)

11. *“The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.”*

13. *“The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.”*

“(. .) It is important that assistance can be provided not only for use in investigations but also for other types of inquiry, as part of a compliance program for the purpose of preventing illicit activities. There may also be a need to exchange general information about matters of regulatory concern, including financial and other supervisory information, technical expertise, surveillance and enforcement techniques, and investor education. (. .)

Where assistance to another authority is provided through the provision of confidential information gathered by the regulator in the exercise of its functions and powers, particular care must be taken to ensure that the information is provided subject to conditions which, to the extent consistent with the purpose of the release, preserve the confidentiality of that information.”

FATF Standards and Methodology for Assessing Compliance (February 2004)

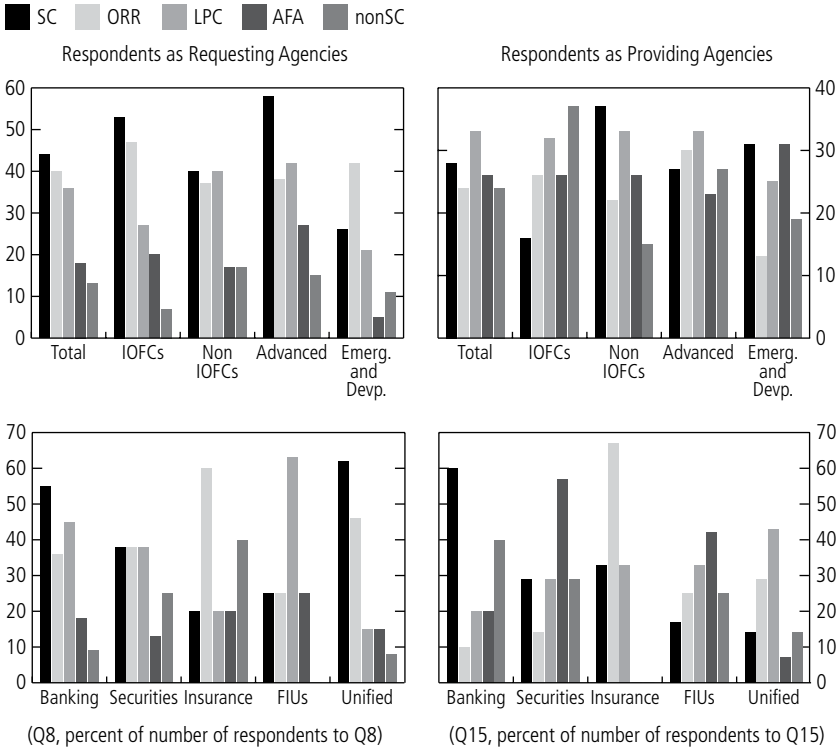
Recommendation 40: “Countries should ensure that their competent authorities provide the widest possible range of international cooperation to their foreign counterparts. (. .) Exchanges should be permitted without unduly restrictive conditions. In particular: (. .)

- b) Countries should not invoke laws that require financial institutions to maintain secrecy or confidentiality as a ground for refusing to provide cooperation.

(. .) Countries should establish controls and safeguards to ensure that information exchanged by competent authorities is used only in an authorized manner, consistent with their obligations concerning privacy and data protection.”

Figure 18.5. Main Reasons for Refusal When Information Requested Was Not Provided (Questions 8 and 15)

(Percent of responses in each category)



Notes: Bars refer to the percentage of respondents in each category giving the cited reason. SC denotes secrecy laws or other confidentiality restrictions; SIM denotes non-equivalent (nonsimilar) functions of providing/requesting authority; LPC denotes that requested authority does not have the powers to collect the information requested; AFA denotes the absence of a treaty or a formal arrangement; nonSC denotes that the requesting authority is unable to give necessary confidentiality undertakings; Emerg. & Devp. denotes emerging market and developing countries; and ORR denotes other reasons for refusal.

Providing Information (Question 15)

Challenges and Obstacles in Providing Information Internationally (Question 15)

The main obstacle to providing the information requested cited by the participants in the survey was their limited power to collect the information solicited

(30 percent of the respondents).¹² Again, considering information exchange by category of jurisdiction, this reason for refusal is claimed, in almost equal proportion, by the IOFCs and nonIOFCs (Figure 18.5). Surprisingly, a larger proportion of agencies from advanced economies cite lack of powers than do agencies from emerging and developing economies (Figure 18.5 and Table A.18.6b, Appendix A). Similarly, about one-third of agencies from IOFCs (who represent almost half of the agencies from advanced economies) gave this reason.

The second major impediment to providing information was SCs, accounting for 28 percent of the responses. SC is the main reason invoked by financial regulatory authorities and agencies from nonIOFCs and from emerging and developing economies (Figure 18.5). For the financial supervisors and agencies from emerging and developing economies, SC and AFA are the main reasons for inability to assist requesting agencies (Figure 18.5).

Only 16 percent of the respondent IOFCs mentioned SCs as the main reason for inability to provide requested information. This could reflect, in part, the efforts undertaken by numerous IOFCs to improve their legal and institutional frameworks in an attempt to remove the widespread perception that they conceal secretive financial operations of a possibly less-than-lawful nature. More interestingly, the respondent IOFCs indicated that the main reason for refusal was the inability of the requesting agency to provide the necessary confidentiality undertakings (cited by 37 percent of the respondent IOFCs).

At the sectoral level, the reasons for refusal varied considerably by type of agency. Banking supervisors were mainly concerned with secrecy and confidentiality requirements (60 percent of banking supervisor respondents), demanding at the same time that adequate confidentiality provisions be observed by their counterparts (40 percent).

For securities regulators and FIUs, the main reason given when the information requested is not provided is AFAs (by 57 percent and 42 percent, respectively, of these agencies). This AFA reason is not consistent with standard setters' usual advice that an MoU or other formal arrangement not be a prerequisite to information exchange. It may be, however, that, as often discussed, a formal arrangement provides the supervisor with an element of comfort in

¹²This result may be misleading, since it also appears to capture cases where the requested agencies were asked to provide information on institutions outside of their mandates or where the information was judged too expensive to collect. In some cases, the respondents indicated that the questions received were redirected to the appropriate agencies.

sharing information, or its negotiation provides valuable information about the reliability of their foreign counterparts. Furthermore, as highlighted in the discussion of our expectations about agencies, the securities regulators and the FIUs need to obtain sensitive information (i.e., on clients and preponderantly for enforcement purposes, as was discussed in Section III). In these cases, it would seem important that adequate mechanisms, including adequate disclosure capacity by both parties, be in place for facilitating and securing the exchange of information. A multitude of reasons for refusal rank second for securities: LPC, SCs, nonSC, and SIM (each accounting for 29 percent of the respondent securities regulators). For FIUs, the second most important reason for refusal is LPC (33 percent of respondent FIUs).

Two of the three insurance supervisors responding to this question gave “other” reasons and one gave LPC and SC as the main rationales for not providing the information requested. One supervisor (a nonIOFC) specified that the “other reasons” referred to unavailability of the information requested.

Finally, the main reasons given by the unified regulators for not providing information included LPC (43 percent of respondents), followed by “other” reasons for refusal (29 percent of respondents), and SCs and nonSC (each cited by 14 percent of respondents). This result may be consistent with the findings of the World Bank’s recent “International Survey of Integrated Financial Sector Supervision,”¹³ which found that some unified regulatory authorities have relatively limited regulatory and supervisory powers.

Challenges and Obstacles in Providing Information Domestically (Question 15)

Only a limited number of participants (about 16 percent) indicated that they did not meet requests for information from domestic agencies (see notes to Tables A.18.7a and A.18.7b, Appendix A). In those cases, the most frequently invoked reason was SCs (indicated by 77 percent of the respondents to Question 15). Only two respondents indicated other grounds, such as LPC or “other reasons” for refusal (Table A.18.7b, Appendix A), for inability to provide domestic assistance.

Reasons for Refusal, by Purpose of Information (Questions 8 and 15)

The questions on reasons for not obtaining/providing requested information also asked that the corresponding purpose of information be indicated, distinguishing the four purposes discussed earlier: licensing, supervision,

¹³See de Luna Martinez and Rose (2003).

enforcement, and action from enforcement. In the case of licensing, the replies received from cross-border agencies by respondents indicated a lack of power on the part of the foreign requested agencies to collect the information (27 percent of total respondents requesting information for licensing purposes) or secrecy laws or other confidentiality restrictions (23 percent). Since most supervisors are able to collect information for licensing purposes, this may indicate an inability to collect information on behalf of a foreign supervisor—perhaps because there is no domestic need for the information.

When the information was requested for supervision, enforcement, and action resulting from enforcement purposes, SCs (accounting for about 25 percent in each case) were the major impediment. As could be anticipated, in action resulting from enforcement cases, the requested agencies also refused to pass on the information because of the inability of the requesting agencies to provide the necessary confidentiality undertakings or the lack of formal arrangements to share the information (Figure 18.6 and Appendix A, Table A.18.8a).

Respondents providing purpose-specific reasons for their own inability to provide information indicated that, in the instances of requests for licensing, supervision, or action resulting from enforcement information, the main reasons for refusal were SCs, LPC, SIM, and nonSC (see Figure 18.4). In enforcement cases, the main reason was nonSC (Figure 18.6 and Appendix A, Table A.18.8b).

Other Challenges or Impediments to Information Exchange (Questions 10 and 17)

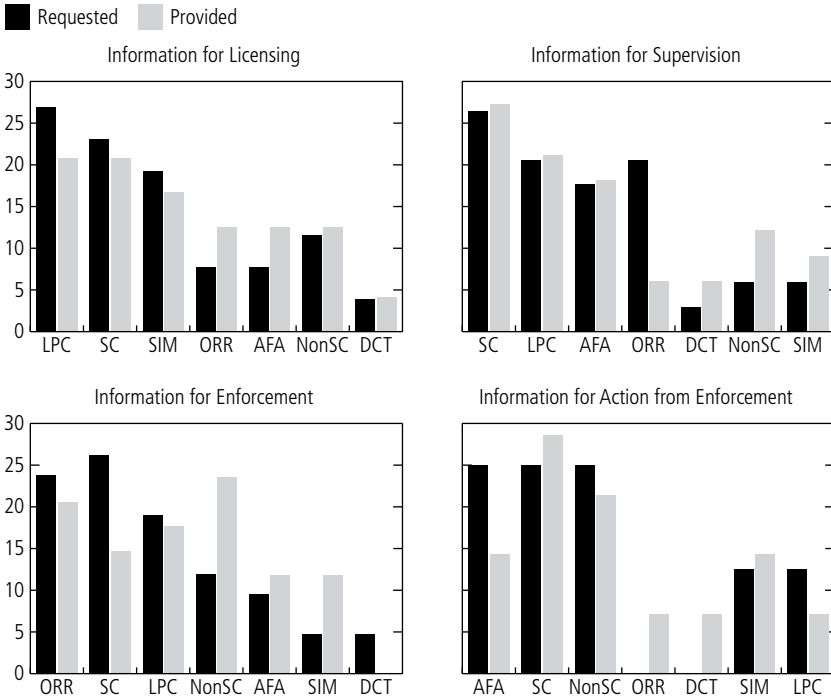
Questions 10 and 17 complemented Questions 8 and 15 by asking respondents to provide their own descriptions of obstacles to obtaining and providing information, respectively. We have aggregated the responses in four (for the responses provided, see Table 18.5) and six (for the responses provided, see Table 18.6) descriptors. The responses suggested practical reasons for the inability to provide international assistance, which are relatively significant since 60 of the 78 agency categories responded to Question 17, and 47 of them to Question 10.

Obtaining Information (Question 10)

Only a very limited number of the respondents to Question 10 referred to challenges or impediments that they had to overcome domestically.¹⁴ The

¹⁴Two of the respondents to Question 10 mentioned challenges or impediments they had to overcome domestically—namely, cases when a criminal investigation/prosecution was in process or when privacy laws prohibited the disclosure of private client information.

Figure 18.6. Main Reasons for Refusal, by Purpose of Information, When Requests Were Denied (Questions 8 and 15)
(Percent of total respondents who exchanged information for specified purposes)



Notes: SC denotes secrecy laws or other confidentiality restrictions; SIM denotes non-equivalent (nonsimilar) functions of providing/requesting authority; LPC denotes that requested authority does not have the powers/in-house capacity to collect the information requested; AFA denotes the absence of a treaty or a formal arrangement; nonSC denotes that the requesting authority is unable to give necessary confidentiality undertakings; DCT denotes that the offense in question is not an offense in the requested jurisdiction; ORR denotes other reasons for refusal.

respondents emphasized that, at this level, the information exchange poses no special problems because of well-established relationships among national agencies and their relatively broad powers to collect the information needed.

At the international level, the main challenge, identified by almost half of the respondents (47 percent), is the poor understanding of the gateways for international cooperation and information exchange. Participants in the survey have difficulties in understanding the differences in the legal and institutional frameworks across jurisdictions that ultimately obstruct the identification of the appropriate sources of information. This included difficulty in identifying the appropriate authorities or persons to whom to address their requests, or in

Table 18.5. Challenges or Impediments in Obtaining Information (Question 10)*(Percent of respondents, by type)*

	Poorly Understood Gateways for Cooperation (<i>jurisdictional differences, lack of knowledge</i> ¹)	Absence of Legal Gateways to Share Information ²	Lack of Procedures/Mechanisms in Exchanging Information ³	Timeliness Problems, Other Practical Impediments ⁴
Total	47	43	13	26
IOFCs	45	35	15	25
NonIOFCs	44	48	11	25
Emerging and developing countries	50	40	10	35
Advanced	44	44	14	18
Sectoral breakdown				
Banking	33	78	22	0
Securities	57	57	0	57
Insurance	57	28	14	0
FIUs	33	22	22	33
Unified	53	33	6	33

Note: Percentages do not total 100 because agencies usually listed more than one factor in their responses.

¹Jurisdictional differences and lack of knowledge of institutional arrangements in other jurisdictions.

²No legal gateway to share information through secrecy or confidentiality barriers; requested agency's lack of legal authority to transmit the information.

³Lack of procedures/mechanisms to exchange information (i.e., formal arrangements—MoUs).

⁴Timeliness problems and other practical issues (information no longer maintained in the records, poor telecommunications technology, etc.).

understanding the regulatory framework of the requested agency and thus the channels for cooperation. This type of problem seems to be equally encountered by IOFCs and nonIOFCs, as well as by both advanced and emerging and developing economies (Table 18.5).

A second major challenge, identified by 43 percent of the respondents, was the lack of legal gateways to share information, particularly those through secrecy or other confidentiality barriers that prohibit the disclosure of specific information or entering into cooperation arrangements, as well as the lack of legal authority of the requested agency to transmit the information. This impediment is most frequently encountered by nonIOFCs (48 percent of respondents) and advanced economies (44 percent of respondents).

Another obstruction in obtaining required information resulted from delays and other practical issues (such as poor telecommunication technology or the fact that the information was no longer maintained in the records), accounting for more than one-quarter of the respondents (26 percent). This is a problem that equally affects IOFCs and nonIOFCs (25 percent of both respondent categories), but is much more frequently encountered by emerging and devel-

Table 18.6. Challenges or Impediments in Providing Information (Question 17)*(Percent of respondents, by type)*

	Considerations for Information Exchange ¹	Reciprocity of Assistance ²	Relevance, Seriousness of Request ³	Mechanisms for Information Exchange Should Be in Place ⁴	Other Authorities' Approval Needed for Disclosure ⁵	Information on Clients Cannot Be Disclosed ⁶
Total	72	18	15	12	8	10
IOFCs	81	22	19	0	7	7
NonIOFCs	63	15	18	21	9	9
Emerging and developing countries	76	8	12	20	8	16
Advanced	68	26	14	6	9	6
Sectoral breakdown						
Banking supervisors	100	0	7	7	0	14
Securities regulators	75	38	0	13	13	13
Insurance supervisors	50	25	0	13	0	13
FIUs	55	18	27	18	18	0
Unified regulators	68	21	21	11	11	11

Note: Percentages do not total 100 because agencies usually listed more than one factor in their responses.

¹Need for similarity in institutional arrangements, secrecy provisions, and certain protection clauses (no disclosure that affects national security, sovereignty, security, or public interest).

²Reciprocity of assistance.

³Reasoning/relevance of information, seriousness of the matter.

⁴Adequate mechanisms for information sharing should be in place (e.g., MoUs).

⁵Other authorities'/bodies' approval needed for disclosure (court order, attorney general's consent, etc.).

⁶No information on clients can be disclosed.

oping economies (35 percent of respondents) than by agencies in advanced economies (18 percent of respondents).

Finally, 13 percent of the respondents identified the lack of procedures or mechanisms in exchanging information (e.g., lack of MoUs). This challenge affects IOFCs and the nonIOFCs similarly (15 and 11 percent, respectively, of respondents), as well as advanced, and emerging and developing economies (14 percent and 10 percent of respondents, respectively).

At the sectoral level, more than two-thirds of the banking supervisors (78 percent) are affected by inadequate information-sharing gateways because of secrecy or other confidentiality rules and the lack of legal authority of the requested agency. The most important impediment encountered by more than half of the securities regulators, insurance supervisors, and unified regulators results from limited understanding of the differences in the legal and institutional frameworks across jurisdictions (Table 18.5). FIUs are affected by both the differences in the legal and institutional frameworks across juris-

dictions, and the lack of timeliness in receiving the information requested (Table 18.5).

Providing Information (Question 17)

Most respondents¹⁵ identified the considerations that they have to take into account in providing solicited information. The most frequently cited considerations included the need to ensure that (1) the requesting agency is bound by adequate professional and/or official secrecy so as to guarantee the confidentiality of the information received (including restrictions on onward disclosure—that is, requiring the prior consent of the providing agency); (2) the information is requested for a proper supervisory purpose or will enable the recipient to carry out its functions; (3) the information requested will not prejudice the sovereignty, security, essential economic interests, public policy, or order in the country of the providing agency.¹⁶ The first two considerations represent typical components of the arrangements for sharing information among financial sector agencies and are clearly stated in the standards relevant to each sector (see Box 18.1). The third type of consideration is also common and appears to be a safeguard for protecting sovereign interests.

The considerations identified can occasionally become impediments to exchanging information if, for example, it is expected that the requesting agency perform exactly the same functions as the providing agency (which clearly inhibits cross-sectoral requests) or it is required that civil, commercial, and sovereign rights apply in a way that ensures that those rights are protected in the same way as in the requested jurisdiction. Other impediments arise when the purpose of information disclosed is constrained to specific supervisory/statutory functions (i.e., to be used only for AML/CFT purposes).

Almost three-quarters of the respondents to Question 17 (72 percent) stated that the requests for assistance have to take into account one, all, or a combination of the considerations stipulated previously for the information to be released. A larger proportion of IOFCs and of the emerging market and developing nations emphasize these considerations more than nonIOFCs and the advanced economies, respectively (Table 18.6).

¹⁵Sixty of the 78 agency categories represented answered this question.

¹⁶Other similar considerations are, for example, ensuring that no criminal proceedings have been undertaken in the providing country on the basis of the same facts or against the same persons, or when those persons have already been condemned by a final judgment on the basis of the same facts, or that disclosure will not endanger the life or safety of any person.

Almost one-fifth of the respondents (18 percent) also indicated that an important condition on information provision is whether the requesting agency is capable of offering reciprocal corresponding assistance. This requirement is made by a larger proportion of IOFCs and advanced economies than of nonIOFCs and emerging and developing economies (Table 18.6). The relevance or seriousness of the request was also a consideration for 15 percent of the respondents.

Actual impediments to sharing information with other competent authorities are the absence of mechanisms for information exchange (e.g., MoUs) (indicated by 12 percent of respondents), restrictions on disclosing client information (indicated by 10 percent of respondents), and the need for additional approvals from other authorities for the information to be released (indicated by 8 percent of respondents).

The considerations cited in the preceding can also be examined in terms of the sector of the respondent agency. All banking supervisors take account of such considerations, as do a large proportion of the securities and unified regulators (Table 18.6). Among all financial regulatory authorities and agencies, the securities regulators were the most likely to refer to the need for reciprocity in assistance (38 percent of respondents), while the FIUs attached the most importance to the purpose of information in a restrictive way (limiting the information provided to strictly AML/CFT purposes) (27 percent of respondents). The FIUs also requested most frequently that mechanisms of information exchange be in place (18 percent of respondents) and have most need of other authorities' approval before the information is released (18 percent of respondents). Almost equal shares (about 13 percent each) of banking, securities, insurance, and unified regulatory authorities do not disclose information on clients of regulated financial businesses (Table 18.6).

Alternative Sources of Information (Question 9)

If requested information could not be obtained from the authority to which a request was addressed, one-third of the respondents to Question 9 indicated that they were unable to obtain the information needed from other sources.¹⁷ Among the available alternative sources of information, the most important was assistance from other authorities (31 percent of the respondents), followed by public sources (such as the Internet, media, and public databases—mentioned by 16 percent of respondents) and the cooperation received directly from the persons holding the information (such as the regulated entities and their parent companies—mentioned by 16 percent of respondents).

¹⁷Fifty-five of the 78 agencies responded to Question 9.

Table 18.7. Alternative Sources of Information (Question 9)*(Percent of respondents, by type)*

	Other Authorities' Cooperation	Public Sources ¹	Cooperation of Persons Holding the Information ²	Other Sources	No Other Sources
Total	31	16	16	7	33
IOFCs	43	33	14	14	29
Non IOFCs	24	6	18	3	35
Emerging and developing countries	33	21	4	4	25
Advanced	29	13	26	10	39
Sectoral breakdown					
Banking	33	27	13	0	33
Securities	11	11	33	22	44
Insurance	0	13	25	13	25
FIUs	60	0	0	0	30
Unified	38	23	15	8	31

Note: Percentages do not total 100 because agencies usually listed more than one factor in their responses.

¹Internet, media, public databases, etc.

²Regulated entities, parent companies, financial group holding companies, etc.

Some variations among the alternative sources of information mentioned depend on the type of jurisdiction or supervisor (Table 18.7). A larger proportion of the respondent IOFCs and emerging and developing economies were able to rely on the cooperation of other authorities compared with the respondent nonIOFCs and advanced economies, respectively. Likewise, for banking supervisors and unified regulators, as well as for FIUs, the most important alternative source of information was other authorities' cooperation, while the securities regulators and insurance supervisors benefited primarily from the assistance offered directly by the persons holding the information (Table 18.7). Since the securities regulator is the financial supervision agency with most difficulty in obtaining satisfactory responses to requests for information (see Section V and Table 18.4), these results suggest that this is the category of authority requiring the most improvement in information exchange, since nearly half of the securities regulators surveyed found no other sources for the information sought.

VII. Improving Information Exchange

The final question of the survey, Question 18, sought respondents' views on how their agencies could improve the receipt or provision of information. A large majority recognize that more can be done to improve international cooperation and information exchange by developing gateways to facilitate

interaction with other financial sector agencies, enhancing market transparency and public access to information, or adopting internal measures. Eighty-two percent (64 of 78 agencies) of the sample provided a response to this question. Only 6 percent of the respondents declared that they saw no room for improvement of the existing information-sharing frameworks.

Almost half of the respondents to Question 18 (45 percent) indicated that entering into formal arrangements (mainly MoUs) could boost international cooperation and information exchange. A larger proportion of IOFCs than non-IOFCs appreciated the usefulness of formal arrangements. More than half of the respondents from emerging and developing countries (52 percent) consider that international cooperation and information could be improved through an extensive use of formal arrangements such as the MoUs.

Another important way to facilitate the information exchange, indicated by a fifth of the respondents, was improvement of the domestic financial legislation with a view to removing the legal impediments such as secrecy barriers or limited supervisory powers. Among those who sought improvement in their legislation, more than 60 percent were IOFCs, of which more than half indicated that the needed amendments were under way.

A small number of the respondent financial regulatory authorities and agencies (14 percent) considered that it was important to strengthen informal relationships and to promote an ongoing dialog. The informal cooperation could be achieved through participation or membership in regional/international forums and organizations or via meetings and conferences, training, etc. Other tools considered useful in achieving good information exchange were enhancement of market transparency and public accessibility to information and the development of a compilation of supervisory structures across jurisdictions with relevant contact details (each indicated by 6 percent of the respondents).

Some participants also specified that it would be useful to develop multilateral MoUs,¹⁸ following the model promoted by IOSCO, for banking supervisors or for unified regulators (5 percent of the respondents). IOSCO has assumed the task of screening the signatories to the multilateral MoU,¹⁹ releasing

¹⁸The Basel Committee on Banking Supervision issued a model MoU for bilateral relationships, "Essential Elements of a Statement of Cooperation Between Banking Supervisors," in 2001.

¹⁹In fact, IOSCO announced, at its 2005 Annual Conference, that one of its major priorities is to have every member country become either a signatory of, or committed to sign, the multilateral MoU by January 1, 2010. This represents a major change in stance of this standard setter, given the fact that entering into formal arrangements was not previously regarded as a prerequisite for cooperation.

countries from the burden of conducting their own due-diligence process. The process is burdensome, because it is important that screening be done in a very transparent manner and that there be adequate accountability of the institution performing the screening.

Nonetheless, one-fifth of the respondents recognize that it is also important to improve internal mechanisms through a more efficient allocation of resources (including the appointment of contact persons in charge of maintaining the contacts and processing the requests for assistance received), a better framing of the requests received, superior staff competence, and improvement of the information and data-management systems.

Likewise, a number of participants consider that the information exchange could be improved by an adequate flow of information from home supervisors to host supervisors (5 percent of the respondents, all of which were from emerging and developing countries), including through improved procedures of notification when important events occur.

VIII. Conclusions

This study has described the key findings of the Survey on Cross-Border Cooperation and Information Exchange among Financial Sector Regulators and Agencies, conducted during May–December 2004, of 74 financial sector regulatory authorities and agencies from 52 countries.

The results of the survey suggest that cooperation, including information exchange, in the countries covered is generally adequate at both national and international levels. There is a high degree of satisfaction regarding the assistance received and provided, and the timeliness for solving the requests for assistance is good. Both formal and informal mechanisms are used to facilitate the international and domestic exchange of information.

The survey indicates that advanced economies place more emphasis on formal arrangements, although the cooperation in emerging markets and developing countries is taking place at a more informal level. This may reflect the latter's more limited capacity to develop formal arrangements and, as suggested by the lower volume of information exchanged, their lesser need for investment in formality. Financial regulatory authorities and agencies from the emerging and developing countries believe, however, that entering into formal arrangements could boost international cooperation.

Although the evidence regarding the absence of MoUs is only indicative, the survey suggests that MoUs could make an important contribution to

information exchange. They not only establish a formal mechanism but also enable the signatories to go through a discovery and due-diligence process with each other, which may be especially helpful when they are faced with large volumes of demand for information.

There is a positive correlation between the volume of cross-border information exchange and the level of income and financial activity in the respondent jurisdictions. On average, the advanced economies and the IOFCs exchange more information than the emerging market and developing economies and the other jurisdictions (nonIOFCs), respectively.

In terms of purpose, the flows of information are almost equally shared among supervision, licensing, and enforcement. Most of the information exchanged targets regulated financial businesses, with relatively little information shared on their clients.

As expected from knowledge of their roles and the specific standards, results suggest that among the financial sector agencies, the securities regulators and FIUs, among which enforcement-related cooperation is dominant, experience the most difficulties in exchanging information. Reinforcing this effect is the result that FIUs are among the agencies that exchange the largest volume of information, particularly on clients. Such information requires expanded legal powers of the requested agency to share information and formal arrangements in place.

Taken together, the results suggest that inadequate gateways resulting from confidentiality requirements, or deficient institutional procedures or mechanisms to exchange information explain many of the difficulties in exchanging information. Another major challenge stems from a poor comprehension of the gateways for cooperation as highlighted by the difficulties encountered by participants in understanding other jurisdictions' legal and institutional arrangements.

An interesting result of the survey is that, contrary to some popular beliefs, the IOFCs claim to have few secrecy or confidentiality restrictions in exchanging information. In fact, the financial supervisors and agencies from IOFCs are preoccupied with ensuring that their counterparts meet the essential criteria for the information to be released, including adequate confidentiality undertakings.

Participants in the survey recognized that there is work to be done to improve cross-border information exchange by developing gateways to facilitate cooperation with other supervisory agencies, entering into formal arrangements, strengthening informal relationships, or improving deficient legislation.

Participants also consider that international cooperation could be boosted by enhancing market transparency and public accessibility to information, as well as by adopting internal measures aimed at addressing requests for assistance in a more efficient way.

Appendix A Tables

Table A.18.1. Mechanisms Used for Information Exchange, by Usefulness (Questions 2 and 3)

(Mechanisms rated from 0 = not important to 100 = most important¹)

	Domestically				Internationally					
	Legally binding arrangements ²	Memoranda of understanding	Letters of commitment	Ad hoc contacts	Other	Legally binding arrangements ²	Memoranda of understanding	Letters of commitment	Ad hoc contacts	Other
Total countries	60	48	9	62	19	43	67	17	53	16
Total IOFCs	60	48	12	73	18	55	60	20	55	16
Total nonIOFCs	60	48	7	55	20	36	72	15	53	16
Advanced	59	47	8	56	23	47	73	19	46	19
Emerging/developing	62	50	10	70	14	39	59	15	64	12
Sectoral breakdown										
Banking supervisors	63	67	5	63	23	28	74	16	54	23
Securities regulators	42	56	11	61	19	21	82	12	58	18
Insurance supervisors	67	30	3	55	24	50	50	0	57	33
FIUs ³	67	44	8	52	6	67	60	31	31	6
Unified regulators	60	40	15	73	23	48	67	18	67	8

¹The responses to Questions 2 and 3 have been compiled according to the following methodology: Each mechanism has been assigned a usefulness index ranging from 0 (not important) to 100 (most important), calculated as a weighted average of the number of importance ratings assigned by respondents (1, 2, 3, and 4 for those where no rating was provided) weighted by importance (1 = 100, 2 = 66.6, 3 = 33.3, 4 = 0—where 100, 66.6, 33.3, and 0 represent coefficients assigned to show importance).

²Including legal and statutory provisions.

³Included among the FIUs is one specialized AMU/CFT supervisor.

Table A.18.2a. Information Requested from Foreign Regulators and Agencies, by Purpose (Question 4)*(Percent of agencies in each category)¹*

	Total	IOFCs	NonIOFC	Advanced	Emerg. & Dev.	Banking	Securities	Insurance	FIUS ²	Unified
Total licensing	63	71	57	61	66	79	67	55	13	90
Info regarding RFB	63	71	57	61	66	79	67	55	13	90
Info regarding C ³	8	0	13	13	0	11	25	9	0	0
Total supervision	67	71	64	65	69	100	42	64	31	80
Info regarding RFB	62	65	60	63	59	100	42	64	19	70
Info regarding C	18	16	19	24	9	16	17	9	25	20
Total enforcement	59	65	55	61	56	47	83	36	75	55
Info regarding RFB	46	52	43	50	41	47	83	36	31	40
Info regarding C	36	39	34	43	25	21	50	9	50	45
Total action from enforcement	14	13	15	17	9	11	25	18	6	15
Info regarding RFB	13	10	15	17	6	11	25	18	6	10
Info regarding C	8	10	6	11	3	5	8	0	6	15

Notes: RFB denotes regulated financial businesses; C denotes clients of regulated financial businesses; and "Emerg & Dev." denotes emerging market and developing economies. For every purpose, agencies often indicated both RFB and C as subjects, so the percentages for RFB and C may exceed the total for any purpose. For example, 57 percent of agencies in nonIOFCs requested information for licensing, and the subject of all these queries were RFBs; however, only 13 percent of agencies in IOFCs requested information on clients when making queries for licensing purposes.

¹Entries are calculated as the number of respondents citing each purpose as a percentage of the number of respondents in each category, where the categories are (a) all respondents, (b) respondents in each of the four jurisdiction types, and (c) respondents from each of the five financial agency types.

²Included among FIUS is one specialized AMU/CFT supervisor. An FIU may request information for licensing purposes when, for example, it has de facto licensing authority for certain financial intermediaries (i.e., money remitters or trust and company service providers); the FIU could also request information for licensing purposes because it has better international contacts and can act as an intermediary for other domestic regulators.

³Information about clients may be requested for licensing purposes when, for example, a (host) regulator needs to know information about the clients of the parent institution supervised by another regulator.

Table A.18.2b. Information Provided to Foreign Regulators and Agencies, by Purpose (Question 11)
(Percent of total types of requests most frequently received)¹

	Total	IOFCs	NonIOFC	Advanced	Emerg. & Dev.	Banking	Securities	Insurance	FIUs ²	Unified
Total licensing	67	77	60	67	66	89	67	64	19	85
Info regarding RFB	64	77	55	65	63	89	58	55	19	85
Info regarding C ³	13	13	13	17	6	5	25	27	6	10
Total supervision	63	61	64	70	53	95	50	64	38	60
Info regarding RFB	55	55	55	59	50	95	42	55	13	60
Info regarding C	21	19	21	28	9	16	25	9	38	15
Total enforcement	62	77	51	61	63	42	92	27	69	75
Info regarding RFB	45	55	38	48	41	42	67	27	44	45
Info regarding C	49	65	38	48	50	37	75	0	56	65
Total action from enforcement	22	29	19	24	19	11	42	18	19	25
Info regarding RFB	18	23	15	22	13	11	25	18	19	20
Info regarding C	15	26	9	17	13	11	33	0	19	15

Note: RFB denotes regulated financial businesses; C denotes clients of the regulated financial businesses; and "Emerg & Dev." denotes emerging market and developing economies.
¹Entries are calculated as the number of respondents citing each purpose as a percentage of the number of respondents in each category, where the categories are (a) all respondents; (b) respondents in each of the four jurisdiction types, and (c) respondents from each of the five financial agency types.
²Included among FIUs is one specialized AMU/CFT supervisor. An FIU may request information for licensing purposes when, for example, it has de facto licensing authority for certain financial intermediaries (i.e., money remitters or trust and company service providers); the FIU could also request information for licensing purposes because it has better international contacts and can act as an intermediary for other domestic regulators.
³Information about clients may be requested for licensing purposes when, for example, a (host) regulator needs to know information about the clients of the parent institution supervised by another regulator.

Table A.18.3a. Information Requested from Domestic Regulators and Agencies, by Purpose (Question 4)*(Percent of total responses received)¹*

	Total	IOFCs	NonIOFC	Advanced	Emerg. & Dev.	Banking	Securities	Insurance	FIUs ²	Unified
Total licensing	55	61	51	57	53	74	58	45	25	65
Info regarding RFB	55	61	51	57	53	74	58	45	25	65
Info regarding C ³	5	3	6	9	0	5	17	0	6	0
Total supervision	56	58	55	59	53	89	42	55	25	60
Info regarding RFB	55	55	55	59	50	89	42	55	19	60
Info regarding C	12	13	11	15	6	21	8	9	13	5
Total enforcement	56	55	57	61	50	47	75	45	69	50
Info regarding RFB	50	55	47	54	44	47	58	45	56	45
Info regarding C	36	32	38	39	31	26	67	18	56	20
Total action from enforcement	21	19	13	22	19	26	17	18	38	5
Info regarding RFB	19	16	19	17	22	26	17	18	25	5
Info regarding C	17	13	17	17	16	21	8	9	31	5

Notes: RFB denotes regulated financial businesses; C denotes clients of regulated financial businesses; and "Emerg & Dev." denotes emerging market and developing economies.

¹Entries are calculated as the number of respondents citing each purpose as a percentage of the number of respondents in each category, where the categories are (a) all respondents, (b) respondents in each of the four jurisdiction types, and (c) respondents from each of the five financial agency types.

²Included among FIUs is one specialized AMU/CFT supervisor. An FIU may request information for licensing purposes when, for example, it has de facto licensing authority for certain financial intermediaries (i.e., money remitters or trust and company service providers); the FIU could also request information for licensing purposes because it has better international contacts and can act as an intermediary for other domestic regulators.

³Information about clients may be requested for licensing purposes when, for example, a (host) regulator needs to know information about the clients of the parent institution supervised by another regulator.

Table A.18.3b. Information Provided to Domestic Regulators and Agencies, by Purpose (Question 11)
(Percent of total responses received)

	Total	IOFCs	NonIOFC	Advanced	Emerg. & Dev.	Banking	Securities	Insurance	FIUs	Unified
Total licensing	42	42	43	54	25	53	58	55	19	35
Info regarding RFB	42	42	43	54	25	53	58	55	19	35
Info regarding C	8	3	11	13	0	11	25	0	6	0
Total supervision	53	45	57	52	53	89	33	55	19	55
Info regarding RFB	50	42	55	52	47	89	33	55	13	50
Info regarding C	17	10	21	13	22	32	17	0	19	10
Total enforcement	67	74	62	61	75	79	75	36	63	70
Info regarding RFB	50	55	47	46	56	74	67	36	38	35
Info regarding C	53	52	53	48	59	63	50	18	56	60
Total action from enforcement	21	19	21	20	22	32	17	18	13	20
Info regarding RFB	17	10	21	17	16	32	17	18	6	10
Info regarding C	17	19	15	15	19	21	17	9	13	20

Notes: RFB denotes regulated financial businesses; C denotes clients of regulated financial businesses; and "Emerg & Dev." denotes emerging market and developing economies.

Table A.18.4. Importance of Diagonal Requests*(Percent of total respondents, by type)*

		Requests for Information Made by		Requests for Information Received by	
		Domestically	Internationally	Domestically	Internationally
Banking supervisors					
to/from	SRA	95	100	84	100
	SRO	21	11	11	5
	FIU	47	11	53	16
	PA	42	11	53	0
	O	16	5	16	11
Securities regulators					
to/from	SRA	83	83	58	92
	SRO	50	33	25	8
	FIU	17	0	17	0
	PA	42	17	58	8
	O	17	0	0	0
Insurance supervisors					
to/from	SRA	73	64	73	64
	SRO	9	18	9	9
	FIU	9	0	9	9
	PA	18	9	27	9
	O	18	18	18	18
FIUs					
to/from	SRA	63	25	44	25
	SRO	25	13	6	0
	FIU	19	88	19	88
	PA	56	19	63	19
	O	25	0	6	0
Unified regulators					
to/from	SRA	60	90	50	80
	SRO	30	15	15	10
	FIU	30	10	35	10
	PA	30	20	55	25
	O	0	5	10	10

Notes: SRA denotes statutory regulatory agencies; SRO denotes self-regulatory organization; FIU denotes financial intelligence unit; PA denotes prosecuting agency; and O denotes other authorities.

Table A.18.5. Timeliness for Addressing Requests for Information (Questions 7 and 14)
(Percent of total agency category)

	Total	Advanced	Emerg. & Dev.	IOFC	NonIOFC	Banking Sup.	Securities Reg.	Insurance Sup.	FIUs	Unified Reg.
Requests for information addressed within a month										
Made by respondent										
Most frequently	68	66	71	59	74	68	45	78	87	61
Less frequently	25	29	19	31	21	26	27	22	13	33
Least frequently	7	5	10	10	5	5	27	0	0	6
Total	100	100	100	100	100	100	100	100	100	100
Received by respondent										
Most frequently	86	88	83	90	84	100	67	88	94	78
Less frequently	11	7	17	7	14	0	25	13	6	17
Least frequently	3	5	0	3	2	0	8	0	0	6
Total	100	100	100	100	100	100	100	100	100	100
Requests for information addressed in 1–3 months										
Made by respondent										
Most frequently	39	46	31	46	35	32	70	43	25	39
Less frequently	61	54	69	54	65	68	30	57	75	61
Least frequently	0	0	0	0	0	0	0	0	0	0
Total	100	100	100	100	100	100	100	100	100	100
Received by respondent										
Most frequently	14	8	21	7	18	14	14	14	8	24
Less frequently	85	89	79	89	82	85	85	86	85	76
Least frequently	2	3	0	4	0	2	2	0	8	0
Total	100	100	100	100	100	100	100	100	100	100

Table A.18.5. (concluded)

	Total	Advanced	Emerg. & Dev.	IOFC	NonIOFC	Banking Sup.	Securities Reg.	Insurance Sup.	FIUs	Unified Reg.
Requests for information addressed after more than 3 months										
Made by respondent										
Most frequently	0	0	0	0	0	0	0	0	0	0
Less frequently	9	7	10	13	6	6	33	0	0	6
Least frequently	91	93	90	87	94	94	67	100	100	94
Total	100	100	100	100	100	100	100	100	100	100
Received by respondent										
Most frequently	4	7	0	4	3	0	11	0	0	7
Less frequently	2	3	0	4	0	0	0	0	10	0
Least frequently	95	90	100	92	97	100	89	100	90	93
Total	100	100	100	100	100	100	100	100	100	100

Notes: "Emerg. & Devel." denotes emerging market and developing economies. Table entries indicate the proportion of respondents in each category designating the indicated period with the indicated frequency. For example, 66 percent of advanced jurisdictions' agencies indicated that over the last two years, their requests for assistance had been most frequently answered within a month.

Table A.18.6a. Main Reasons for Refusal Given to Requesting Jurisdictions (Question 8)*(Percent of total respondents in each category)*

Requesting Jurisdiction	Internationally						
	SC	ORR	LPC	AFA	NonSC	SIM	DCT
Total	44	40	36	18	13	11	9
IOFCs	53	47	27	20	7	13	7
NonIOFCs	40	37	40	17	17	10	10
Advanced	58	38	42	27	15	12	15
Emerging market and developing economies	26	42	21	5	11	11	5
Banking supervisors	55	36	45	18	9	27	9
Securities regulators	38	38	38	13	25	0	25
Insurance supervisors	20	60	20	20	40	0	0
FIUs, AML/CFT supervisors	25	25	63	25	0	0	13
Unified regulators	62	46	15	15	8	15	0

Notes: Percentages do not total 100 because agencies named more than one reason for not providing the information; SC denotes secrecy, confidentiality restrictions; SIM denotes non-equivalent functions of providing/requesting authority; LPC denotes that requested authority does not have powers to collect the information requested; ORR denotes other reasons for refusal; AFA denotes the absence of a formal arrangement; nonSC denotes that the requesting authority cannot guarantee that the information received will be kept confidential; and DCT denotes that the offense in question is not an offense in the requested jurisdiction.

Table A.18.6b. Main Reasons for Refusal When Information Requested from Supervisors Is Not Provided (Question 15)*(Percent of total respondents in each category)*

Providing Jurisdiction	Internationally						
	LPC	SC	NonSC	SIM	AFA	ORR	DCT
Total	33	28	24	13	26	24	9
IOFCs	32	16	37	11	26	26	5
Non IOFCs	30	37	15	15	26	22	11
Advanced	33	27	27	20	23	30	13
Emerging and developing economies	25	31	19	0	31	13	0
Banking supervisors	20	60	40	30	20	10	10
Securities regulators	29	29	29	29	57	14	14
Insurance supervisors	33	33	0	0	0	67	0
FIUs, AML/CFT supervisors	33	17	25	8	42	25	17
Unified regulators	43	14	14	0	7	29	0

Notes: Percentages do not total 100 because agencies named more than one reason for not providing the information; SC denotes secrecy, confidentiality restrictions; SIM denotes non-equivalent functions of providing/requesting authority; LPC denotes that requested authority does not have powers to collect the information requested; ORR denotes other reasons for refusal; AFA denotes the absence of a formal arrangement; nonSC denotes that the requesting authority cannot guarantee that the information received will be kept confidential; and DCT denotes that the offense in question is not an offense in the requested jurisdiction.

Table A.18.6c. Total Number of Respondents to Questions 8 and 15, by Category: International Exchange

	Q8	Q15
Total	45	46
IOFCs	15	19
NonIOFCs	30	27
Banking	11	10
Securities	8	7
Insurance	5	3
FIUs	8	12
Unified	13	14
Advanced	26	30
Emerging and developing economies	19	16

Table A.18.7a. Main Reasons for Refusal Given to Requesting Jurisdictions (Question 8)

(Percent of total respondents in each category)

Requesting Jurisdiction	Domestically			
	SC	ORR	LPC	SIM
Total	53	20	20	13
IOFCs	0	33	67	33
NonIOFCs	67	17	8	8
Advanced	44	22	33	11
Emerging and developing economies	67	17	0	17
Banking supervisors	100	0	25	0
Securities regulators	33	33	0	33
Insurance supervisors	0	50	0	0
FIUs, AML/CFT supervisors	33	33	33	33
Unified regulators	67	0	33	0

Notes: Percentages do not sum to 100 because agencies cited more than one reason for not providing the information; SC denotes secrecy, confidentiality restrictions; SIM denotes non-equivalent functions of providing/requesting authority; LPC denotes requested authority does not have powers to collect the information requested; and ORR denotes other reasons for refusal.

Table A.18.7b. Main Reasons for Refusal When Information Requested from Regulators and Agencies Is Not Provided (Question 15)*(Percent of total respondents in each category)*

Providing Jurisdiction	Domestically			
	SC	LPC	ORR	SIM
Total	77	15	15	0
IOFCs	25	25	25	0
Non IOFCs	100	11	11	0
Advanced	63	25	25	0
Emerging and developing economies	100	0	0	0
Banking regulators	100	17	0	0
Securities supervisors	0	0	0	0
Insurance supervisors	50	0	100	0
FIUs, AML/CFT supervisors	67	0	0	0
Unified regulators	50	50	0	0

Notes: Percentages do not sum to 100 because agencies cited more than one reason for not providing the information; SC denotes secrecy, confidentiality restrictions; SIM denotes non-equivalent functions of providing/requesting authority; LPC denotes requested authority does not have powers to collect the information requested; and ORR denotes other reasons for refusal.

Table A.18.7c. Total Number of Respondents to Questions 8 and 15, by Category: Domestic Exchange

	Q8	Q15
Total	15	13
OFCs	3	4
NonOFCs	12	9
Banking	4	6
Securities	3	0
Insurance	2	2
FIUs	3	3
Unified	3	2
Advanced	9	8
Developing	6	5

Table A.18.8a. Main Reasons for Refusal Given to Requesting Jurisdictions (Question 8)*(Percent of total respondents who requested information for specified purpose)*

Purpose of Information	Domestically				Internationally						
	SIM	LPC	ORR	SC	SIM	SC	NonSC	LPC	ORR	DCT	AFA
Licensing	33	0	0	0	19	23	12	27	8	4	8
Supervision	0	14	14	43	6	26	6	21	21	3	18
Enforcement	8	17	17	42	5	26	12	19	24	5	10
Action resulting from enforcement	25	0	25	0	13	25	25	13	0	0	25

Notes: SC denotes secrecy, confidentiality restrictions; SIM denotes non-equivalent functions of providing/requesting authority; LPC denotes that the requested authority does not have powers to collect the information requested; ORR denotes other reasons for refusal; AFA denotes the absence of a formal arrangement; nonSC denotes that the requesting authority cannot guarantee that the information received will be kept confidential; and DCT denotes that the offense in question is not an offense in the requested jurisdiction.

Table A.18.8b. Main Reasons for Refusal When Information Requested from Regulators and Agencies Is Not Provided (Question 15)
(Percent of total respondents who provided information for specified purpose)

Purpose of Information	Domestically			Internationally							
	SIM	LPC	ORR	SC	SIM	SC	NonSC	LPC	ORR	DCT	AFA
Licensing	0	0	25	50	17	21	13	21	13	4	13
Supervision	0	10	20	60	9	27	12	21	6	6	18
Enforcement	0	13	13	63	12	15	24	18	21	0	12
Action resulting from enforcement	0	0	33	67	14	29	21	7	7	7	14

Notes: SC denotes secrecy, confidentiality restrictions; SIM denotes non-equivalent functions of providing/requesting authority; LPC denotes that the requested authority does not have powers to collect the information requested; ORR denotes other reasons for refusal; AFA denotes the absence of a formal arrangement; nonSC denotes that the requesting authority cannot guarantee that the information received will be kept confidential; and DCT denotes that the offense in question is not an offense in the requested jurisdiction.

Appendix B

Questionnaire on Cross-Border Cooperation and Information Exchange Among Financial Sector Regulators and Agencies

1. Please indicate if you are a banking, insurance or securities regulator or a combination of two or more of these, or other agency.

If you are a **regulator of more than one sector**, please indicate if the answers to any question would be different for the different sectors for which you are responsible. If so, please provide a **separate response per sector**, using the indicated format.

2. Select from the following list and rank in terms of importance (1,2,3 with 1 being the most useful), the mechanisms in place, both formal and informal, that provide for **exchange of information with other domestic regulators** and/or government agencies, including financial intelligence units (FIUs).

- | | |
|----------------------------|-------|
| legally binding agreements | _____ |
| memoranda of understanding | _____ |
| letters of commitment | _____ |
| ad hoc contacts | _____ |
| others (please specify) | _____ |

3. Select from the following list and rank in terms of importance (1,2,3 with 1 being the most useful), the mechanisms in place, both formal and informal, that provide for **international cooperation and exchange of information** with foreign regulators and/or government agencies, including FIUs.

- | | |
|----------------------------|-------|
| legally binding agreements | _____ |
| memoranda of understanding | _____ |
| letters of commitment | _____ |
| ad hoc contacts | _____ |
| others (please specify) | _____ |

Requesting Information

4. Please provide a list of the type(s) of **information that your agency frequently requests from** other regulators and/or government agencies,

including FIUs (considering the last two years). Please differentiate between domestic and foreign entities, and indicate whether the information requested relates to a regulated financial services business or a customer of that business. Please also indicate the type of agency from whom you request the information, and the purpose for which the information is requested (see table below).

Domestic			Foreign		
Agency ¹	Purpose of information ²	Subject of information ³	Agency ¹	Purpose of information ²	Subject of information ³

¹Types of agency:
a statutory regulatory agency
a self regulating organization
an FIU
a prosecuting agency

²Purposes of information include:
licensing
financial condition for on going supervision
information relating to enforcement investigation
action resulting from enforcement cases (e.g., asset seizing)

³Indicate whether information relates to:
regulated financial services business
customer of that business

5. How many requests for assistance has your agency made in the last 2 years?

6. What approximate percentage of your agency's requests in the past two years has:

- not been responded to _____
- been inadequately answered _____
- been satisfactorily answered _____

7. When your request for information is met, how much time does it take to receive a response (please rank in order of frequency, where 1 is most frequent)?

- less than one month _____
- one to three months _____
- more than three months _____

8. If information you requested is not provided, describe briefly the reason(s) given for not providing this information. Please categorize the agency and the purpose of information (see table below).

Domestic			Foreign		
Agency ¹	Purpose of information ²	Reason for refusal ³	Agency ¹	Purpose of information ²	Reason for refusal ³

¹See list for question 4.

²See list for question 4.

³Reasons for refusal:

- secrecy laws or other confidentiality restrictions
- the offence in question was not an offence in the requested jurisdiction
- the requested regulator did not regard your agency as having equivalent functions
- the requested agency had no domestic interest in the matter
- the requested agency did not have the powers to collect the information requested
- your agency was unable to give the necessary confidentiality undertakings
- absence of a treaty or formal arrangement
- other

9. If you were unable to obtain information from the authority to which you addressed your request, were you able to obtain similar information from other sources? Please list examples of these other sources.

10. Describe other challenges or impediments in obtaining information from foreign and domestic regulators, and other government agencies, including FIUs.

Providing Information

11. Please provide a list of the type(s) of **information frequently requested from your agency** by other regulators and/or government agencies (considering the last two years). Please differentiate between domestic and foreign entities and indicate whether the information requested relates to a regulated financial services business or a customer of that business. Please categorize the agency and the purpose of information (see table below).

Domestic			Foreign		
Agency ¹	Purpose of information ²	Subject of information ³	Agency ¹	Purpose of information ²	Subject of information ³

¹See categories for Question 4.

²See categories for Question 4.

³See categories for Question 4.

12. Please indicate how many requests for assistance has your agency received in the last 2 years.

13. What approximate percentage of requests made to your agency in the past two years has:

- not been responded to _____
- been inadequately answered _____
- been satisfactorily answered _____

14. When you meet a request for information, how much time does it take for you to send it (please rank in order of frequency, where 1 is most frequent)?

- less than one month _____
- one to three months _____
- more than three months _____

15. If you do not provide the information requested, describe briefly your reason(s) for not providing information. Please categorize the agency and the purpose of information as requested in question 4, and indicate reason for refusal (see table below).

Domestic			Foreign		
Agency ¹	Purpose of information ²	Reason for refusal ³	Agency ¹	Purpose of information ²	Reason for refusal ³

¹See categories in Question 4.

²See categories in Question 4.

³Reasons for refusal:

- secrecy laws or other confidentiality restrictions
- the offence in question was not an offence in your jurisdiction
- you did not regard the requesting regulator as having equivalent functions
- your agency had no domestic interest in the matter
- your agency did not have the powers to collect the information requested
- the requesting agency was unable to give the necessary confidentiality undertakings
- absence of treaty or formal agreement
- other

16. Describe the type(s) of information that your agency is permitted to provide to domestic and foreign regulators, and government agencies including FIUs without a court order, subpoena, or a reference to any other external body. Do they vary by requesting agency? Please provide examples.

17. Describe other challenges or impediments in providing information to foreign and domestic regulators, and other government agencies, including FIUs. Please indicate what factors your agency must consider before providing confidential information to other regulators, and whether there are any factors in your law that would prompt you to refuse to provide assistance.

Improving Information Exchange

18. Describe ways in which your agency could improve its ability to provide or to receive information from other regulators.

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Appendix

Aide-Mémoire of the Conference on Cross-Border Cooperation and Information Exchange Washington, DC, July 7–8, 2004

The conference underlined the critical importance of international cooperation and information exchange among financial sector agencies in view of the growing integration of world markets and deepened international operations of financial firms. Participants agreed that the conference had been a very useful contribution to strengthening communications across sectors and jurisdictions, and in elaborating the major approaches and impediments to information exchange and cooperation.

The conference concluded that

- Effective channels for cooperation and information exchange are needed;
- An appropriate balance must be achieved between the public interest in obtaining and using information and the protection of civil rights;
- While there are historical differences in emphasis in the objectives of cooperation and information exchange in the different sectors—banking and insurance were focused on solvency while securities focused on enforcement investigation—anti-money laundering/combating the financing of terrorism (AML/CFT) customer due-diligence requirements and conglomeration in the financial services industry are bringing the requirements closer together;
- There are a spectrum of instruments that facilitate cooperation, including informal contacts and memoranda of understanding (MoUs). Many jurisdictions emphasized the value of informal and flexible arrangements,

while acknowledging that, without legal gateways, informal contacts may not be adequate for civil and criminal proceedings; and

- It is essential that national laws provide the basic gateways and do not impede cooperation and information exchange.

To enhance cooperation, the conference strongly encouraged

- Standard setters to consider making information on contact persons more readily available to relevant agencies;
- National authorities to consider publishing information on contacts, gateways, and requirements indicating “how” to communicate with them, including their statistics on information sharing as well as unsolicited transmission; and
- The IMF, in collaboration with the standard setters, to conduct a stock taking of barriers, gateways, and practices on the basis of an expanded IMF survey and information from financial sector assessment program (FSAP) and offshore financial center (OFC) assessments. The stock taking could include a comparison of the four standards’ principles on information exchange to identify common elements and differences and ways to help facilitate compliance with the standards.



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Methodology for Assessing Compliance with FATF Recommendations

<http://www.fatf-gafi.org/dataoecd/46/48/34274813.PDF>

Basel Committee Core Principles

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Core Principles Methodology

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The Supervision of Cross-Border Banking

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IOSCO Objectives and Principles of Securities Regulation

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Methodology for Assessing Compliance with IOSCO Objectives and Principles

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IOSCO Multilateral MoU

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IAIS Core Principles and Methodology

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IAIS Concordat on Cross-Border Insurance Supervision

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IMF and World Bank: Financial Intelligence Units: An Overview

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