Summary

The project – *Considering the Consequences: the Developmental Implications of Initiatives on Taxation, Anti-money Laundering and Combating the Financing of Terrorism* – was commissioned by the Commonwealth Secretariat and financed by the Financial Sector Reform and Strengthening (FIRST) Initiative. Its objective was to assess the impact of recent multilateral regulatory initiatives on small Commonwealth international financial centres (IFCs). This final report draws together, distils and synthesises the results of three country studies, assessing the costs and benefits of these initiatives for Barbados, Mauritius and Vanuatu. The country studies are themselves based on survey data (quantitative and qualitative) compiled by local consultants in each jurisdiction in conjunction with the two lead consultants.

Although this report cannot be taken as definitive, given the need for further investigation of this issue, the authors find that recent multilateral regulatory initiatives have had a significant net negative impact on the three IFCs under consideration. That is, the costs involved in meeting the new standards have exceeded the identifiable benefits that have resulted for both the public and private sectors. More of the scarce public revenues of these three small developing island states has had to be diverted towards regulating their international financial services (IFS) sectors. The majority of private firms and banks operating in the IFS sector in all three countries have experienced a significant increase in compliance costs, in some cases sufficient to threaten their future business viability.

A few specific examples illustrate these developments. In Barbados, over 27 per cent of corporate services providers (CSPs) state that compliance costs have increased so much that they are now thinking of exiting the market. Vanuatu now spends four times as much public money regulating the IFS sector in 2005 than it did in 2000, while the IFS sector now provides only half the government revenue it did in 2000. In Mauritius, CSPs (known locally as management companies or MCs) have witnessed a sharp decline in their profitability: in the four years 2002-05, the aggregate net profits of MCs amounted to about US$17 million, while incremental costs for meeting new anti-money laundering/countering financing of terrorism (AML/CFT) compliance requirements came to over $27 million.

Rather than reflecting local circumstances and priorities, the single most important factor explaining the adoption of these new international standards in all three countries has been fear of the consequences of being blacklisted by international organisations in the event of non-compliance. The most common benefit identified in adopting the new standards is enhancing the reputation of the IFC. That, in each case, is the perception of regulators, external interlocutors and many members of the IFS industry. Whether that is the perception of their global clientele is another matter altogether and constitutes an aspect that could not be confirmed by the availability of any hard evidence to that effect. Yet in each case, the significance of this benefit has been

undermined by the inability of the same respondents to identify any associated increase in competitiveness or other tangible benefits. Despite these serious challenges, all three countries remain determined to retain their IFCs, and to meet whatever international standards are imposed on them to remain in the global market for IFS.

Although a relatively clear picture emerges on the broad impact of recent IFS regulatory initiatives in the three countries under consideration, this report calls for further research to be conducted to assess the extent to which the experiences of Barbados, Mauritius and Vanuatu are typical of other small state IFCs – and from the Commonwealth Secretariat's viewpoint especially, those that are members of the Commonwealth.

The authors wish to extend their gratitude and appreciation to all those who gave up their time to complete the questionnaires and participate in the regional workshops.