

ABSTRACT

Offshore financial centres and the shadow banking system

The financial crisis has brought to light the crucial role of the shadow banking system in the propagation of systemic risk. This system refers to most of the little or unregulated financial institutions, among which some took advantage of the potential regulatory circumventions by using offshore jurisdictions. “Tax haven”, the usual French term, has become too restrictive to apply to those jurisdictions, which are not only used to evade taxes, but also as regulatory and legal havens. The offshore financial centres (OFCs) or “prudential havens” are nowadays seen as “fault lines” of the macroprudential supervision needed to ensure the stability of the entire financial system. How can we prevent these “blind spots” in financial regulation from being overlooked?

Their recurring appearance in suspicious financial strategies gives a hint of their dodgy role. However, the lack of data and operational analysis usually prevents us from going further than the usual “naming and shaming”. This report intends to better understand OFCs, a vague concept from a legal standpoint, by examining the following characteristics: low or zero tax, secrecy, and political stability. Exploring the data highlights their major role in the production of financial engineering for the rest of

the world, leading us to compile a list of jurisdictions that we classify as OFCs. Finally, the report determines their degree of financial integration with traditional financial centres, which played a decisive role during the global crisis and thus leads to four key proposals.

To minimize the appeal of those “blind spots” in financial regulation, one possible solution for the regulator is to raise the costs of going offshore for the conventional banking institutions. In order to improve oversight of OFCs, the first step will be to ensure adequate surveillance regarding fiscal, legal and prudential matters occurring in those jurisdictions. To curb the transactions between regulated and unregulated institutions, offshore exposure must be fully disclosed by the conventional banking system. With that information, the authority responsible for regulation can ensure that those institutions are sufficiently capitalized in regards to risky positions.

Proposals:

1. Make a ranking of those jurisdictions, using a range of different criteria (tax level, prudential ratios, the size of

shadow banking operations, etc.), in order to improve the transparency of their fiscal and prudential regulation.

2. Make “onshore” banks reveal the effective location of their ultimate exposure to risks, including their exposition offshore.

3. Install, at the IMF or the Bank for International Settlements, a division charged with systemic risks, financial re-

gulation and innovation – including that created offshore.

4. Ensure that financial institutions have enough capital relative to their contribution to systemic risk, taking into account all their international interdependences. ■

 [Access the Note d'analyse 222 \(Full version in French\)](#)