**FIT-FOR-PURPOSE REGULATION**

*The following excerpts are from a speech presented by Robert Mathavious, CEO of the BVI Financial Services Commission, at the Society of Trust and Estate Practitioners (STEP) Caribbean Conference in Panama on 5 May 2008.*

*The Financial Services Commission (FSC) is an autonomous regulatory authority responsible for the regulation, supervision and inspection of all financial services in and from within the British Virgin Islands.*

**1. Introduction**

Regulators everywhere recognise that regulation can be a blunt instrument. That's why we seek instead to apply the right level of regulatory oversight to the right type of business.

That is the short definition of fit-for-purpose regulation. I will illustrate my arguments by drawing on what I know best, which is how we at the BVI Financial Services Commission seek to achieve such regulation.

**2. Better regulation and reputation**

We meet in challenging times. Times of widespread market turmoil and market volatility. Times when regulators across the world find themselves being blamed for doing too little, or too much or indeed nothing at all to address the challenges of today.

Today more than ever, no regulator, no professional adviser and no jurisdiction can afford to ignore the international political and regulatory spotlight targeted on international financial centres. I firmly believe that the long-term competitiveness of financial centres across the world depends on our maintaining strong, independent and – yes – fit-for-purpose regulatory regimes which ensure that our industries operate to international standards.

The G7 countries and the supranational bodies they control, as well as financial institutions of integrity, will no longer tolerate regulatory environments that expose them to reputational risk. For a jurisdiction to win – and maintain – good, legitimate long-term business depends on their winning a good international reputation, which in turn depends on their putting good and effective regulation in place.

This does not mean that regulators should respond to every whim of the international community or dance to every tune of the regulated community. It does mean that they need to ensure a regulatory regime which responds effectively to legitimate demands while safeguarding the competitiveness of their own financial service industries. A regulatory regime which fits the purposes both of the international community and of their own business sectors.

There is no doubting the fact that good regulation has a value which extends beyond a jurisdiction's boundaries. Indicating that market participants in the jurisdiction can expect the regulator to act and enforce in a consistent, fair and predictable manner can give a jurisdiction a branding that signals quality and market integrity and increases its attractiveness. To put it in a nutshell, fit-for-purpose regulation wins a jurisdiction a good reputation which in turns wins good business.

**3. Characteristics of fit-for-purpose regulation**

So what are the characteristics of regulation that make it fit for purpose? How can regulators properly meet the challenge of discharging the various functions usually given to them by statute?
These functions include:

- Protecting investors;
- Protecting the jurisdiction's reputation;
- Facilitating market development and innovation;
- Educating market participants and other stakeholders on the regime and other relevant matters;
- Helping combat international financial crime; and
- Seeking to comply with relevant international standards.

The answer to the challenge, I would suggest, lies in fashioning a system of regulation that is based on five building blocks, those of **accountability, pragmatism**, **consultation**, **international cooperation** and **investment**.

**4. Accountability**

Accountability is a crucial part of building confidence in any regulatory system that it is fit for purpose in the way it operates and in its willingness constantly to learn and improve.
Although independent of government, regulators must not behave capriciously and as a law unto themselves.

In order to sustain confidence in their actions and decisions, it must be clear to those who deal with regulators and who watch them from outside how they operate and why they act as they do. To ensure that regulators operate with due transparency, therefore, a system of political accountability and judicial redress needs to be put in place.

Let me illustrate what I mean by referring to the BVI Financial Services Commission.
We are an independent regulatory body and not part of the government. Since 2001, we have been an autonomous authority tasked both with regulating the BVI financial services industry and with fostering the industry's healthy development.

We are independent, but we are not a law unto ourselves. An autonomous Board of Commissioners sets our policies and oversees how we implement them. We must also provide annual accounts, work plans and periodic management reports to the BVI Cabinet and House of Assembly.

Furthermore, the BVI's Financial Services Appeal Board, comprised entirely of private sector representatives, can hear appeals against our decisions and refer matters back to us. It is also open to aggrieved parties to seek judicial review of our decisions. Only last month, a regulated entity sought redress in the BVI courts against what they perceived as an abuse of our regulatory powers. I am glad to say that the court delivered a swift verdict upholding the Commission's use of its powers on every count.

Accountability must exist in reality and not just on paper. It must not be a sham. In the BVI, the Commission's adherence to the corporate governance principles enshrined in BVI law underpins the support we enjoy among a wide range of stakeholders.

Equally, accountability must mean a willingness to be reviewed periodically by regulatory peers and by the international community. Jurisdictions that are not afraid to hold up their standards and practices for others to judge win on two counts. They strengthen their reputation by obtaining international recognition for doing what is right and proper. And they gain outside views that help them to improve and become more attractive. I would admit also that the knowledge that they will regularly be assessed is an extra way of keeping regulators on their toes.

**5. Pragmatism**

A fit-for-purpose regulatory regime needs to operate on a commonsense basis and with a light touch – or perhaps I should say a right touch: that is, one which is differentiated and discriminating. This does not mean regulating everything that moves. On the contrary, it means an avoidance of regulation for its own sake. It means recognising that too much regulation – or over-regulation – produces unnecessary bureaucratic burdens, stifles innovation, hampers success and destroys business.

Yes, regulators must ensure they carry out their duties effectively and efficiently.
But they must ensure that they do so in such a manner as to avoid dislocations and disruptions to business activity. They must minimise bureaucracy and red tape and not adopt a one-size-fits-all approach. This does not mean that regulators should be frightened of doing what is needed to fulfil their statutory remit. To do so would be in the interest neither of the regulated businesses nor of the jurisdictions in which they operate – nor, indeed, of the international trade and business which their jurisdictions facilitate.

Instead, it must also be recognised that regulation which is too weak, inadequate or unclear risks leading to avoidable failures and creating a lack of confidence; and that under-regulation can destroy business just as much as over-regulation. This is true across the gamut of financial services activity, from the provision of trust and company services, to hedge funds, to insurance to – as we are seeing today – banking. When regulation fails, so do businesses; and in the worst cases, it is not just investors but governments and citizens that have to pick up the pieces.

Regulators must strike a delicate and proportionate balance. On one hand, they must be fully compliant with international standards and obtain international recognition for doing so. On the other hand, they must maintain a favourable commercial and business-friendly environment to facilitate the conduct of legitimate and productive business activities. They must protect the public interest and maintain market confidence. But they must do so without hindering the ability of their financial market to compete.

The key here is for regulators to adopt a pragmatic, differentiated and risk-focused approach, one which makes discriminating use of the arsenal of regulatory and supervisory instruments within the regulator's toolkit. This means regulating according to the riskiness of the business, with a lighter touch for low risk activities. Hence the bulk of supervisory resources should be focused on those firms and activities which pose the greatest reputational risk to the jurisdiction.

In the BVI, for example, our risk-based model – which both examines offsite documentary evidence and uses on-site compliance inspection tools – is fashioned around the principles of self-regulation, market discipline and official oversight. It places greater emphasis on sound internal controls and risk management systems.

Our approach is thus not overly prescriptive but rather seeks pragmatically to set the parameters of what is acceptable behaviour and what is not.

**6. Consultation**

For the principles of self-regulation, market discipline and official oversight to operate effectively, a common understanding among all players is needed. It is important for regulators to maintain an open dialogue and build a consensus with the private sector and the government. In this way, they can remain alert at all times to the effects of their actions on those they regulate. Consultation is thus an important part of ensuring accountability.

Maintaining an effective dialogue between private sector, government and regulator helps jurisdictions to sustain international and domestic confidence in their institutions and products. And this in turn

helps their markets to grow and innovate. It ensures that their financial services jurisdictions evolve effectively and organically and remain relevant.

For example, in the BVI, industry-related programmes and laws are generally forged on the anvil of exhaustive public and private sector debate and discussion. We have set up a range of consultative committees with the private sector and the government and we rely intensively on their input to help shape our financial services policies, programmes and practices.

We also consult widely with our overseas counterparts. The Commission has entered into memoranda of understanding with a number of regulators in major centres, and we are active members of numerous international regulatory groupings. We also welcome every opportunity for discussion with users and potential users overseas, in fora such as this.

We further benchmark and enhance our processes against regulators in other leading finance centres to ensure that we maintain a balanced, proportionate and competitive regulatory regime. This pragmatic and consultative approach consistently proves its value. For example, when we in the BVI came to deal with the FATF's Non-Cooperative Countries and Territories initiative (the NCCT exercise), including the control of bearer shares, it was our close collaboration and cooperation with industry that enabled us to devise a fit-for-purpose solution which turned the potential nightmare of transitioning to the new requirements to our advantage.

Similarly, it was our collaborative and consultative efforts with the private sector that championed the successful renewal of our corporate legislation through our new Business Companies Act, which enabled the BVI to remain the platinum standard for company incorporation.

Equally, when our trust industry, led by our local branch of STEP – with whom we have a long history of successful cooperation – pressed us to put in place a fit-for-purpose regime for private trust companies, the Commission took what STEP proposed and built on it through dialogue with all interested parties. As a result, we created what is generally agreed to be an exceptionally effective private trust company regime, one which enables the BVI efficiently and automatically to grant exemption from regulation to qualifying family trusts and unremunerated trust businesses.

Finally, only this March, our partnership approach led to further enhancement of the BVI's anti-money laundering regime, with new procedures for identifying, recording and reporting transactions, and the enactment of a detailed anti-money laundering and anti-terrorist financing Code of Practice. This new Code of Practice will serve as a practical tool for practitioners to comply with international standards. It represents just one of the many positive and forward-looking steps that the BVI regulator, government and private sector, working together, have taken to deter and confront financial crime.

**7. International cooperation**

Tackling the ethically challenged is, of course, core business for regulators. It is also a matter which extends beyond the borders of any one jurisdiction. Good regulators must be prepared to commit the resources to consulting and cooperating internationally. They must engage actively with international initiatives, not seek to evade them. They must participate actively in international groupings to ensure that new standards are fit for purpose.

This type of active international engagement requires regulators to work together with their business community from an early stage to develop appropriate strategies to protect their industry. For example, as part of a select working group within the Offshore Group of Banking Supervisors (OGBS), the BVI helped develop a statement of international best practice for the regulation of trust and corporate service providers. This represents the leading global yardstick for ensuring the compliance of those gatekeepers now being brought within the scope of the FATF's forty-plus-nine recommendations.

Our active and balanced response to meeting international concerns means that BVI has never been on any international blacklist. We will continue to do whatever is right and proper to avoid blacklisting without sacrificing our users right to privacy. For instance, the statutory mandates and regulations established by the BVI to foster and improve international cooperation and information exchange are clearly set out in a comprehensive handbook that the Commission, in collaboration with the BVI government, has published as a guide for law enforcement officials and regulators. I commend this handbook to you. It can be found on our website at www.bvifsc.vg.

The handbook shows that the BVI operates a robust statutory gateway regime for cross border co-operation which permits the exchange of information if requests pass a requisite "means test". It demonstrates our determination both to crack down on unethical behaviour such as white-collar crime, money laundering and terrorist financing and at the same time to protect the confidentiality of legitimate transactions.

Those not engaged in financial crime, however, have no reason to fear that the confidentiality offered to those legitimately using BVI structures will not be preserved. Privacy will still continue to be the norm. Disclosure will remain the abnormal behaviour. We will not facilitate fishing expeditions.

Accountability must mean a willingness to be reviewed periodically by regulatory peers and by the international community. I will not pretend that all the independent reviews we go through are not at times exhausting. But although the BVI may be offshore in the sense that we are a group of islands not too far from the coast of the United States, when it comes to the standards we apply, we are resolutely onshore. We thus welcome every opportunity to demonstrate that the Commission is a world-class regulator applying mainstream standards.

We welcome that fact that KPMG, the UK's Foreign & Commonwealth Office, the UK's National Audit Office, the FATF, the CFATF, the IMF, the OECD and most recently IOSCO and the OGBS have all recognised that the BVI financial services sector is compliant with – and in some instances exceeds – the relevant international requirements.

We also welcome the positive outcomes that such recognition brings. We were delighted when, only last month, the BVI's status as a leading finance centre was confirmed by practitioners from across the world, with the inclusion for the first time of the British Virgin Islands in the Global Financial Centres Index published by the City of London. The index is based on nearly 19,000 assessments from business professionals worldwide. The BVI entered in 27th place among 69 major centres.

**8. Investment**

World-class regulation does not come cheap. All stakeholders must recognise and agree that regulators can be made impotent if not given a guaranteed and sufficient source of funding to discharge their functions effectively.

In turn, regulators must be prepared to make the full investment necessary in their own organisations to ensure that they are financially and operationally resourced to fulfil the myriad of complex tasks within their statutory remit. Within the BVI Financial Services Commission, as our remit has grown, so have our employee numbers, which now stand at almost 130. We have introduced new technology and systems, and we evaluate and upgrade as required. We also ensure at all times that we maintain legislation with sufficient teeth to prevent and prosecute malfeasance, drawing on external expertise as necessary.

Equally, regulators have a duty to ensure that their regulated sector invests fully in meeting the requisite legislative requirements and international standards. That is why with our regulated sector,

as well as within the Commission, we enunciate good practice and champion a range of important objectives. These include:

- Effective and appropriate training and development of staff;
- Recognition of the importance of professional qualifications;
- Identification and provision of industry-specific training;
- Career progression;
- Programmes and procedures to counter money laundering and the financing of terrorism;
- Proper handling of client complaints; and
- Disaster recovery planning.

In short, the Commission invests the time and money required to be fit for purpose and it expects the same from its regulated community.

## 9. Conclusion

Fit-for-purpose regulation means that regulators must be independent from undue industry influences and governmental pressures, yet remain accountable and responsible for their actions and accessible to – and engaged with – all stakeholders. It means responding strategically to international initiatives to protect the public interest and the economic interests of the jurisdiction. And it means maintaining market confidence without hindering the ability of the market to compete and innovate.

In this way, regulators can ensure that their jurisdiction's legislative framework and policies remain current and proportionate, and that the business community is able to continue to provide legitimate and market-driven solutions to international needs. And what could be more fitting or purposeful than that?