tax justice network

2013 Financial Secrecy Index

Summary of the Methodology

The Financial Secrecy Index (FSI) uses a combination of qualitative data and quantitative data to create a measure of each jurisdiction's contribution to the global problem of financial secrecy.

Qualitative data based on laws, regulations, cooperation with information exchange processes and other verifiable data sources, is used to prepare a **secrecy score** for each jurisdiction.

Secrecy jurisdictions with the highest secrecy scores are more opaque in the operations they host, less engaged in information sharing with other national authorities and less compliant with international norms relating to combating money-laundering. Lack of transparency and unwillingness to engage in effective information exchange makes a secrecy jurisdiction a more attractive location for routing illicit financial flows and for concealing criminal and corrupt activities.

Quantitative data is then used to create a **global scale weighting**, for each jurisdiction, according to its share of offshore financial services activity in the global total. To do this, we have used publicly available data about the trade in international financial services of each jurisdiction. Where necessary because of missing data, we follow International Monetary Fund methodology to extrapolate from stock measures to generate flow estimates. Jurisdictions with the largest weighting are those that play the biggest role in the market for financial services offered to non-residents.

The secrecy score is cubed and the weighting is cube-rooted before being multiplied to produce a **Financial Secrecy Index** which ranks secrecy jurisdictions according to their degree of secrecy and the scale of their trade in international financial services.

A jurisdiction with a larger share of the offshore finance market, and a high degree of opacity, may receive the same overall ranking as a smaller but more secretive jurisdiction. The reasons for this are clear – the ranking not only reflects information about which are the most secretive jurisdictions, but also the question of scale.

In this way, the Financial Secrecy Index provides an answer to the question: by providing offshore financial services in combination with a lack of transparency, how much damage is each secrecy jurisdiction actually responsible for?

Critics have argued that scale unfairly points to large financial centres. However, to dispense with scale risks ignoring the big elephants in the room. While large players may be slightly less secretive than other jurisdictions, their extraordinary financial sector size offers far more opportunities for illicit financial flows to hide. Therefore, the larger an international financial sector becomes, the better its regulations and transparency ought to be. This logic is reflected in the FSI and it therefore avoids the conceptual pitfalls of „usual suspects"-lists of tax havens – often remote islands whose overall share in global financial markets is tiny.

Although it lacks a consistent and agreed definition, the term "tax haven" continues to dominate political and academic debates around issues of "offshore tax evasion" and "illicit financial flows". However, in a world where economies are deeply integrated across borders and where more than 200 tax jurisdictions exist, any country might be a `haven' in relation to another country. Arguably, the lack of clarity, consistency and objectivity in defining and identifying tax havens has contributed to a failure to counter the associated problems.

The FSI provides a (partial) remedy to this problem by replacing the term tax haven with the term secrecy jurisdiction. We define it as a jurisdiction which "provides facilities that enable people or entities escape or undermine the laws, rules and regulations of other jurisdictions elsewhere, using secrecy as a prime tool".

We emphasize that a secrecy jurisdiction is not a natural phenomenon that is, or is not, observable[1]. Rather, we assume that all countries may have some attributes of secrecy jurisdictions, ranging on an imagined continuum from highly secretive to perfectly transparent. Based on those premises, we develop a set of 15 verifiable indicators (Key Financial Secrecy Indicators, KFSI) which allow an assessment of the degree to which the legal and regulatory systems (or their absence) of a country contribute to the secrecy that enables illicit financial flows. Taken together, these indicators result in one compound secrecy score allocated to each jurisdiction. The scores are normalised to a range zero to 100 and in practice vary between 32.4 (Sweden) and 87.6 (Samoa).

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[1] TJN prefers the term secrecy jurisdiction over tax haven but uses both interchangeably. For more background on this please read www.financialsecrecyindex.com/PDF/SecrecyWorld.pdf.

The FSI has two broad objectives. First, it contributes to and encourages research by collecting data and providing an analytical framework to show how jurisdictions facilitate illicit financial flows. Second, it focuses policy debates by encouraging and monitoring policy change globally towards more financial transparency, by engaging the media and public interest groupings.

The FSI has been released for the third time in 2013 after releases in 2009 and 2011[2]. Since its first release, reception has been wide and it is increasingly being used for rating purposes[3]. Country coverage has increased to 82 jurisdictions in 2013.

In 2013, the methodology has remained largely the same as for the FSI 2011. Only KFSI 2 has been refined beyond the margins to now reveal separately if trusts and private foundations are properly disclosed. Previously, both private foundations and trusts have been combined for the assessment. KFSIs 1 and 6 have been refined to take into account new data sources and/or recent policy developments.

This project continues to break new ground. Changes to the content, structure and emphasis of the database and the indicators are a natural reflection of both a learning process by all involved and a fast changing international tax and financial environment.

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[2] www.financialsecrecyindex.com/archive

[3] In addition to those uses explained in this paper (http://www.taxjustice.net/cms/upload/pdf/FSI_2012_Cut-Off-Point.pdf), the EIRIS Country Sustainability Ratings 2014 (first published in June 2013) have incorporated FSI-findings (http://www.eiris.org/wp-content/uploads/2013/04/EIRIS-Country-Sustainability-Ratings.pdf).