INTERNATIONAL MONETARY FUND

Monetary and Exchange Affairs Department

ARUBA

OFFSHORE FINANCIAL CENTER ASSESSMENT

VOLUME I

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LIST OF ACRONYMS

AB	Official Gazette
AEC	Aruba Exempt Corporation
Afl	Aruban Florin
AML	Anti-Money Laundering
AOC	Aruba Offshore Company
BAFSA	Bureau Aruba Financial Services Authority
BCP	Basle Core Principles
BIS	Bank for International Settlements
CBA	Central Bank of Aruba
CFATF	Caribbean Financial Action Task Force
CP	Core Principle
CSP	Company Service Provider
EU	European Union
FATF	Financial Action Task Force
Fed	Federal Reserve System
FIU	Financial Intelligence Unit
FSF	Financial Stability Forum
GDP	Gross Domestic Product
IAS	International Accounting Standards
IAIS	International Association of Insurance Supervisors
IRS	Internal Revenue Service
KYC	Know Your Customer
LEG	IMF Legal Department
LMOT	Law on the Reporting of Unusual Transactions
LRUT	Law on the Reporting of Unusual Transactions
MAE	Monetary and Exchange Affairs Department
MoU	Memorandum of Understanding
NCCTs	Non-Cooperative Countries and Territories
NV	Naamloze Vennootschap
OCC	Office of the Comptroller of the Currency
OECD	Organization for Economic Co-operation and Development
OFC	Offshore Financial Center
QI	Qualified Intermediary
RCUT	Reporting Center for Unusual Transactions
SOCML	State Ordinance on the Criminalization of Money Laundering
SOFZ	State Ordinance Free Zone
SOIFS	State Ordinance on Identification for Rendering Financial Services
SORUT	State Ordinance on the Reporting of Unusual Transactions
SOSCS	State Ordinance on the Supervision of the Credit System
SOSIB	State Ordinance on the Supervision of the Insurance Business
UTR	Unusual Transaction Report

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PREFACE

In July 2000, the IMF's Executive Board approved a program of assessments of the extent to which offshore financial centers observed good standards of international practice with regard to the supervision and regulation of offshore financial services. The program of assessments is based on the paper presented to the Board "Offshore Financial Centers—The Role of the IMF."[1] This paper designed an assessment program in two phases: a Module I, consisting of a self assessment by the jurisdiction itself, assisted by experts or Fund staff, and a Module II, consisting of an external assessment carried out by the Fund. The Aruban authorities have carried out a Fund-assisted self-assessment, for which MAE/LEG missions visited Aruba in December 2000 and March 2001. The authorities, with the technical assistance of the Netherlands Bank, have produced a report on this self-assessment.

At the invitation of the authorities of the Kingdom of the Netherlands, a Module II offshore financial center (OFC) assessment of Aruba was carried out by an MAE/LEG mission from December 3–14, 2001.[2] In its assessment, the mission reviewed offshore as well as on-shore regulation and supervision, as there is no distinction between the supervision of these two sectors. As one of the purposes of Offshore Financial Sector assessments is to review anti-money laundering rules and practices, and in view of general international concerns about the potential use of free trade zones for money laundering and drug trafficking, regulation of the Free Zone Aruba was also included in the assessment. The assessment of Aruba's anti-money laundering rules and practices was conducted using the August 2001 version of the Bank-Fund methodology (prior to coverage of legal and institutional elements and of measures to combat terrorist financing).

The mission met with the Minister of Finance and Economic Affairs, Mr. N.J.J. Swaen; Dr. A.R. Caram, President of the Central Bank of Aruba (CBA); Ms. Deborah Bolton, Consul General of the United States; Mr. Peter Palmen, High Commissioner Aruba Financial Center; Mr. Kenneth Polvliet, Executive Director of the CBA; Mr. Prakash Mungra, Head of the Supervision Department of the CBA; Mr. Marion Agunbero, Deputy Head of the Supervision Department in charge of supervision of insurance; many other members of the staff of the CBA; Mr. Gregory Peterson, Managing Director of the Free Zone Aruba, Ms. Amalin Flanegin, Head of the Reporting Center for Unusual Transactions[3] (RCUT) and members of her staff; and representatives of the public prosecutor's office, the Aruban

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[1] SM/00/136.

[2] The mission, led by Jan Willem van der Vossen (Mission Chief, IMF/MAE), also consisted of Ms. Gabriella Ferencz (World Bank), Steve Butterworth (Guernsey Financial Services Commission), Ross Delston (Consultant, LEG), and Megan Thomas, Staff Assistant, MAE. Hassanali Mehran (MAE), joined the mission from December 10–13, 2001.

[3] The Reporting Center for Unusual Transactions is the Financial Intelligence Unit for Aruba.

Bankers' and Insurance associations, and many other representatives of the commercial banking and insurance sectors, the legal, auditing, and notarial professions, as well as of the company service providers (CSPs)[4] active on the island.

The Aruban authorities agreed to the use of the essential as well as additional criteria in performing the Basel Core Principles assessment in order to come to a more detailed assessment, as well as to the use of the draft money-laundering methodology. The authorities have the intention to publish the report when finalized.

The mission wishes to express its sincere gratitude for the excellent cooperation and openness of the authorities, and the warm hospitality extended to it by the CBA, all of which contributed greatly to the productive work of the mission. A special word of thanks goes out to Mr. Prakash Mungra, Head of the Supervision Department, for his excellent preparation and coordination of the mission.

[4] Company service providers are entities that assist in the formation and management of offshore companies in Aruba.

EXECUTIVE SUMMARY AND KEY RECOMMENDATIONS[5]

The Aruban authorities are to be commended for the very substantial progress made over the past years in addressing concerns about the scope and quality of financial sector regulation and supervision, offshore as well as onshore, and in taking anti-money laundering measures.[6] They have performed an assisted self-assessment of the scope and quality of offshore financial sector supervision, and committed themselves to a well-considered and ambitious program to address remaining issues. The mission strongly endorsed the action program developed by the CBA, as presented in Appendix I of Volume I of this report. It should be noted that the supervised off shore sector, serving only non-residents, consists of two banks, and six insurance companies, which is very small on a global basis, and even compared to most other Caribbean jurisdictions. The remainder of the offshore sector consists mainly of some 4,950 non-financial corporate vehicles. According to BIS figures, 0.3 percent of international debt securities originate in Aruba. The relative economic importance of the majority of these 4,950 entities cannot be established reliably, as they do not prepare or publish financial statements, nor information on ownership and activities. Taking into account that offshore and onshore financial supervision in Aruba are identical in scope and methodology, both types of supervision are relevant to anti-money laundering and impact the overall reputation of the jurisdiction, the mission has reviewed supervision of both the offshore and onshore sectors, and included the Free Zone Aruba, although not active in financial services, in its assessment. To handle the additional workload based on the recommendations issued by the mission an overall total between five and seven additional staff may be needed.

On the basis of its assessment, the mission has the following key recommendations to make, which are supplementary to the authorities' action plan laid down below.

Banking

The system for banking supervision and regulation in Aruba is compliant or largely compliant with 19 of the Basel Core Principles (BCP). It is materially non-compliant or non-compliant with 4 of the Basel Core Principles, relating to credit policies, loan evaluation and loan-loss provisioning, other risks (interest rate risk), and on- and off-site supervision. Country and market risk in offshore banks need to be addressed as well. Two Core Principles related to foreign branches were considered not applicable.

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[5] The recommendations in this section are supplementary to the authorities' action plan, as shown below.

[6] For a list of current legal and regulatory instruments in the area of financial sector and anti-money laundering regulation, see Appendix I.

In recent years, the Aruban supervisory authorities have successfully engaged in a process of rapid development and improvement of the system of rules and regulation, and in increasing its supervisory capacity. The mission is impressed by the determination of the authorities to strengthen the safety, soundness, and integrity of the banking system, onshore as well as offshore. Now the time has come to capitalize on these achievements. The mission recommends that the CBA—after a period of intensive regulatory activity—direct its focus to more in-depth scrutiny of some of the key risk areas in banks, and other financial institutions under its supervision. In particular, the strongly interrelated areas of credit risk analysis, loan classification, and provisioning deserve more frequent and intrusive targeted on-site inspections. The mission recommended:

- Strengthening the oversight of banks' risk management by requiring more frequent asset quality reports from banks, increasing as soon as possible the number of well focused on site credit risk reviews in order to decrease the reliance on the annual audit results of the external auditor;

- Reinforcing guidelines for banks credit policies, and refraining from getting involved in decisions on large loan exposures;

- Strengthening enforcement of limits on connected lending; and

- Development of guidelines and policies on banks management of interest rate risk.

Insurance

The law on regulation and supervision of the insurance sector has only been in force since July 1, 2001, and many implementation measures still need to be put in place. Once the currently ongoing implementation of the envisaged Aruban system for supervision of the insurance sector is completed, and all companies are relicensed and subject to supervision under the new legislative framework, Aruba will be observant or largely observant of 12 of the 17 IAIS Core Principles, if the State Decree and guidelines are adopted as drafted. The mission recommended:

- When drafting the regulations in implementation of the State Ordinance on the Supervision of the Insurance Business (SOSIB), the authorities need to consider providing more specificity and limiting the degree of discretion that is currently allowed under the SOSIB;

- Adequate staffing of the insurance supervision function of the CBA can become a serious issue in the medium term; the CBA needs to aggressively continue its efforts to address this issue. Good rules cannot be enforced without adequate staff;

- In the context of the (re)licensing of insurance companies, it is essential that the insurance supervisors be able to exchange information with the Reporting Center for

Unusual Transactions (RCUT)[7] and obtain information from the police in order to be able to assess whether managers are fit and proper;

- For the proper assessment of the solvency margins of the insurance companies, the CBA needs to prescribe the "approved assets" that can be taken into account for the calculation of solvency; and

- The market conduct of insurance advisors should be supervised and the quality of advice be improved through the use of codes of conduct.

Anti-Money Laundering

Aruba's determination to combat money laundering is also evidenced by its active participation in international efforts to introduce good anti-money laundering practices in jurisdictions in the Caribbean region. Aruba has successfully improved its rules and systems to combat money laundering. It is largely compliant with Basel Core Principle 15 on money laundering and according to its own assessment compliant with 25 of the 28 most relevant Financial Action Task Force (FATF) recommendations. It has cooperated fully with requests to monitor banks for possible terrorism related bank accounts or movements of funds. Aruba cooperates very effectively with efforts in other jurisdictions to combat money laundering. The mission recommended:

- Enhancing the capacity of the RCUT, charged with receiving and analyzing unusual transaction reports, by increased staffing and material support, for instance in the form of computers and software; more resources are needed to meet the increasing workload which is to be expected when the scope of the AML rules are expanded, measures for combating terrorist financing are required and an increasing number of entities are required to report suspicious transactions, including insurance companies and insurance intermediaries, company service providers, casinos, money remittance companies, etc.;

- AML laws should be strengthened by criminalizing the laundering of all assets, not just money, securities and gold. Furthermore the know your customer rules should be extended to cover non-life insurers and insurance intermediaries, company service providers, notaries, lawyers and accountants; the RCUT should be authorized by law to exchange information with other financial intelligence units without the need for a treaty, and to impose administrative penalties on non-compliant reporting institutions; and

- Immediate implementation of the Law on Export and Import of Cash.

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[7] The RCUT performs the function of financial intelligence unit.

Offshore Corporate Entities

Offshore corporate entities are currently virtually unsupervised, are highly non-transparent with regard to ownership, corporate governance and financial condition, and thus remain a prime risk from a money-laundering perspective, as well as a potential financial sector vulnerability, insofar as these entities are involved in international financial operations. Abandoned entities are not being removed from the sector and remain available for purchase without any form of scrutiny through the usual agencies or persons involved in setting up a company. To achieve better disclosure and to facilitate regulatory exchange of information with regard to these entities, additional measures need to be taken, including:

- Requiring that full knowledge on ownership, governance, and financial condition is available to the company service provider (CSP) that is acting as the legal representative or the local director or manager for the entity and that this information can be provided to the authorities when requested, and as appropriate, subject to satisfactory reciprocal arrangements, also to authorities in other jurisdictions;

- Requiring the keeping and auditing or filing of accounts by Aruban companies, collective investment funds, managers and other entities carrying on a business in Aruba; and

- Expedient removal of the 1,500 currently unresolved defunct entities, of a total of some 4,950 offshore corporate entities registered on the island.

Company Service Provider (CSP) Supervision

Currently, the companies that help set up and manage the offshore corporate entities—insofar as they do not engage in financial services—are not directly subject to any anti money laundering requirements, such as know your customer rules, reporting of unusual transactions, nor are they subject to any regulatory requirements such as due diligence into the ownership structure of the companies they create, fit and proper criteria with regard to the management of the CSPs, financial reporting and disclosure. This exacerbates the already very worrying opacity of the offshore legal entities themselves. The mission recommended:

- Strengthening the draft law currently under consideration by adding explicit fit and proper criteria, identifying and vetting indirect shareholders, prohibiting the issuance of bearer shares by companies formed or managed by the CSP, giving the CSP regulator the power to impose administrative penalties, and limiting the discretion of the regulator to exempt particular CSPs from the full requirements of the law; and

- Careful selection of the agency which will be designated as the supervisory authority for CSPs. Requirements are that the agency be authoritative, independent, have the required experience in supervising financial sector enterprises, have high quality staff and resources and is able to attract the required staff with the required specialized knowledge to perform this task. In light of potential economies of scale and synergies

in a small country, the CBA would be the best candidate, also in view of its proven track record in the supervision of banks, insurance and pension funds. The CBA would need to attract the necessary expertise on offshore activities, their structure and rationale, as well as on CSP practices.

Resources

In light of its expanding responsibilities, which includes much broader and more intensive insurance sector supervision, and could also come to include the implementation of important parts of the action plan and potentially the supervision of CSPs, the CBA needs to ensure that it has sufficient human resources. Good laws and regulations have no effect if good implementation is not possible due to insufficient human resources. The CBA has recruited additional staff in 2002, and has the financial resources to attract the necessary staff as appropriate. It also has the option of requesting additional technical assistance for specific tasks.

ACTION PLAN[8]

No.	Action	Implement By:
1	**General**	
1.1	Review staffing of the supervisory capacity of the agency that is to become responsible for supervising CSPs (either the CBA or the High Commissioner).	End-2002
1.2	Request legal advice on the protection of supervisory staff members against possible tort action.	2002
2	**Banking**	
2.1	Introduce a provision in the SOSCS requiring the CBA's prior approval of a bank's external auditor.	2003
2.2	Introduce a provision in the SOSCS requiring banks to publish their audited annual financial statements.	2003
2.3	Introduce a provision in the SOSCS allowing the CBA to impose monetary penalties on banks.	2003
2.4	Require more frequent reports on asset quality.	2002
2.5	Conclude MOU with Venezuela.	2002
2.6	Consider the introduction of a depositor protection scheme.	2002
2.7	Investigate the desirability of introducing capital requirements for market risks for the offshore banks.	2003
2.8	Investigate the desirability of introducing a regulation on interest rate risk for the offshore banks.	2003
3	**Insurance**	
3.1	Finalize State Decree Special Provisions Captives.	2002
3.2	Draft a State Decree on reinsurers.	2002
3.3	Finalize State Decree regulating changes in ownership of insurance companies.	2002
3.4	Finalize State Decree regulating appointment of local representatives.	2002
3.5	Issue guidelines on solvency margins.	2002
3.6	Issue guidelines on asset management.	Completed
3.7	Issue guidelines on technical provisions.	2002
3.8	Review anti-money laundering guidelines to conform to the forthcoming IAIS guidance.	2002
3.9	Introduce a requirement in the SOSIB for external auditors to report significant matters to the CBA.	2002
3.10	Introduce a provision in the SOSIB requiring insurers to publish their audited annual financial statements.	2002
3.11	Conclude MoUs with insurance supervisors in the Netherlands Antilles, Barbados, Trinidad and Tobago and the Netherlands.	2002
3.12	Consider extending the range of violations for which monetary penalties can be imposed.	2002
3.13	Consider the introduction in the SOSIB of market conduct requirements.	2002
3.14	Amend the SOSIB to regulate the use of the words insurance and reinsurance.	2002
3.15	State Decree regulating the authority of the Administrator.	2002
4	**Company Service Providers**	
4.1	Adopt an Ordinance on the Supervision of Trust Companies (i.e., CSPs).	2003
4.2	Remove the possibility of waivers from the draft Ordinance.	2003
5	**Anti-Money Laundering**	
5.1	Bring life insurance companies and insurance brokers and intermediaries under the scope of the SORUT.	2003
5.2	Consider bringing CSPs and free zone companies under the scope of the SORUT.	2003
5.3	Bring non-financial service providers (such as notaries, attorneys and accountants) under the scope of the SOIRFS and the SORUT.	2003
5.4	Revise the SOSCS and the SORUT to allow information exchange between the CBA and the RCUT.	2003
5.5	Revise the SORUT to facilitate information exchange between the RCUT and financial intelligence units outside the Dutch Kingdom.	2003
5.6	Introduce a law to bring money transfer companies under effective supervision.	2003
5.7	Make available better statistics on the number of prosecuted money laundering cases and the number of convictions.	Mid-2002

[8] Implementation of the Action Plan will also depend on factors some of which are outside the control of the agencies involved.

The table above provides a prioritized summary, prepared by the CBA, of the measures identified as necessary for bringing financial sector supervision in Aruba in line with international best practices. Implementation dates are provisional as they are not fully within the control of the CBA.

The mission fully supports this action plan, and in the specific chapters of this report has made additional recommendations based on its review of the Basel Core Principles, the IAIS Core Principles, and a detailed review of, in particular, Basel Core Principle 15 on anti-money laundering policies and practices.

I. INTRODUCTION

Aruba is a small, open economy, with a GDP of approximately US$2 billion, and, with a population of about 90,000, a per capita GDP of roughly US$22,000, one of the highest in the region. With the Netherlands Antilles and the Netherlands, Aruba is part of the Kingdom of the Netherlands, but is autonomous in its economic and financial policies, including its regulation and supervision of the financial sector and AML laws and policies. Since January 1, 1986, Aruba has had autonomous status within the Kingdom, and is no longer part of the Netherlands Antilles.

The Aruban economy is greatly dependent on tourism, which accounts for 43 percent of current account receipts. Around 70 percent of tourism originates from the United States. An oil refinery, "Coastal Aruba N.V.," imports oil and exports refined products. Other important economic activities include transshipment and warehousing conducted through the Aruba Free Zone, and financial and company services. The financial sector has an offshore component, with two offshore banks, consisting of a branch and a subsidiary of Citibank. Furthermore, of the 29 insurance companies, 6 are offshore and expected to apply for licensing. Also, around 4,950[9] offshore entities exist, managed by a company service provider sector consisting of around 16 active company service providers.[10] The offshore sector as a whole is estimated to employ around 120 persons. These 4,950 entities, consisting of Aruba Exempt Corporations (AEC) and Aruba Offshore Companies (AOCs)[11] mainly serve as vehicles for tax minimization, corporate revenue routing, captive insurance companies, asset protection, asset management, and finance. In 1995, a consulting firm attempted to estimate the economic importance of the offshore sector for Aruba, but due to lack of data did not come to an authoritative estimate. Representatives of the sector estimate direct and indirect revenues (including tax revenues) between $10 and $14 million, or between 0.5 and 0.7 percent of GDP (approximately US$2 billion).

In the wake of the international financial crises in the late 1990s, the offshore financial centers (OFCs) have come under scrutiny as possible channels of uncharted and potentially destabilizing financial flows. Furthermore, it was generally perceived that many of these offshore jurisdictions, often with relatively weak financial supervision, company formation and disclosure rules, were being used for money laundering. Since the events of September 11, tracking the flows of funds to terrorist organizations has become another area of concern.

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[9] Source: Companies Registry.

[10] In total, some 120-company service providers are listed by the Office of the High Commissioner for the Aruba Financial Center.

[11] See Chapter IV.D.

Prior to September 11, developments had already led the authorities to request the IMF to perform an OFC assessment, as part of its strategy to take stock of the improvements needed to bring Aruba's on- and off-shore financial sector regulation and supervision up to international standards and to prepare an action program for the implementation of these improvements. The overriding objective of the authorities is to improve the quality of Aruba as a financial center, and, in the context of their longer-term economic diversification and development strategy, to profile the jurisdiction internationally as a high-quality and well-regulated financial center.

II. Prior Assessments

In recent years, Aruba has been assessed by a number of agencies as to the quality of its financial, corporate taxation and anti-money laundering (AML) policies.

Financial Stability Forum (FSF)

In a perception-based survey published in April 2000, the FSF classified Aruba in the third category, as a jurisdiction "generally perceived as having legal infrastructures and supervisory practices and/or a level of resources devoted to supervision and cooperation that are largely of a lower quality."

Financial Action Task Force (FATF)

In January 1999, Aruba was subjected to the second mutual evaluation of its anti-money laundering rules, regulations and practices. A first evaluation took place in 1995. In its 1999 evaluation, the FATF concluded that "the active approach taken by Aruba in addressing its points of weakness has led to Aruba being in substantial compliance with most of the FATF 40 Recommendations". Since 1999, many additional measures have been taken.[12] Aruba is not cited by the FATF as one of the Non-Cooperative Countries and Territories (NCCTs).

United States Internal Revenue Service (IRS)

The IRS has recently granted Aruba the status of "Qualified Intermediary", thus recognizing the good quality of its "know-your-customer" regime. The status of "qualified intermediary" (QI) of a jurisdiction is required before U.S. tax citizens can obtain withholding tax relief on revenues paid from within the jurisdiction to these U.S. citizens. The IRS considers Know-Your-Customer rules to be a cornerstone of the QI regime.

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[12] See Chapter VIII on Anti-money Laundering.

International Narcotics Control Strategy Report

The United States diplomatic representatives for Aruba consider that the cooperation between Aruba and the United States in the areas of the fight against drugs and in AML are at the forefront of their relations. The United States authorities are very pleased with the level and quality of cooperation. Aruba stations a "Forward Operating Location" of the United States armed forces, which performs anti-drug trade monitoring, detecting, operational, and surveillance functions on and around the territory. The U.S. customs and immigration authorities have offices in Aruba, and pre-clear all travelers to the U.S. prior to departure. In the 2001 and 2002 International Narcotics Control Strategy Reports, the U.S. authorities consider Aruba to be "establishing a solid AML program," and that Aruban judicial authorities have maintained an excellent record of cooperation under the Mutual Legal Assistance Treaty with the U.S. The latest report states that Aruba routinely honors requests made under the MLAT and cooperates extensively with the U.S. on law enforcement matters at less formal levels.

III. BACKGROUND

A. Macroeconomic[15]

Aruba has a small open economy highly dependent on tourism, which generates 43 percent of current account receipts, and is the main target of foreign investment inflows. After an investment boom in the tourism sector and upgrades in the refinery that supported an average annual growth of 10 percent during the period from 1986 through the mid 1990s, output growth has declined to a more sustainable average slightly below 4 percent since 1995. Output growth picked up in 1999 and 2000, as a consequence of buoyant tourism receipts, foreign investment and domestic demand. Subsequently growth, already on a downward trend over the last two years, has slowed down considerably. While pre-September 11 estimates still put expected 2001 growth at 1 ½ percent, the CBA now expects, as a result of a slowdown in the tourism sector, resulting from the recession in the U.S. and the effects of the September 11 events, a shrinkage of the economy for the first time in 15 years.

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[13] Also see Chapter IV.E.

[14] See OECD News Release of July 2, 2001, and Press Release of the Ministry of Finance of the Kingdom of the Netherlands of June 7, 2001. As of July 2, 2001, similar commitments had been issued by Bermuda, the Cayman Islands, Cyprus, The Isle of Man, Malta, Mauritius, the Netherlands Antilles, San Marino, and the Seychelles.

[15] Based on Kingdom of the Netherlands—Aruba: 2001 Article IV Consultation-Staff Report, IMF Country Report No. 01/159, September 2001.

After falling for several years, inflation rebounded in 1999 and accelerated in 2000, owing mainly to imported fuel costs, but also to rapid domestic credit expansion through the first quarter of 2000, and government consumption outlays. The non-oil balance of payments experienced a slight deterioration in 2000, as a result of net financial outflows, despite a modest improvement in the current account. Following an initial fiscal consolidation effort in 1998–99 that failed to contain current outlays, the public finances experienced a deteriorating trend, with recurrent budgetary liquidity shortages and an accumulation of arrears.

The 2001 budget initially projected a small fiscal surplus, but due to unexpected setbacks and the effects of September 11, this is no longer considered realistic by the authorities. At the time of the mission, the CBA expected a fiscal deficit of around 4 percent of GDP, resulting from the expense of the recently implemented universal health coverage system, increased public employment, and subdued revenues, also as a result of the September 11 events.

The primary monetary policy objective of the CBA is to preserve the peg to the U.S. dollar,[16] supported by a strong foreign reserve position, and implemented through liquid reserve requirements and credit ceilings. The CBA maintained a cautious monetary stance in 2000, curbing bank credit and shoring up reserves by reimposing strict constraints on bank credit expansion. Foreign reserves are declining, although the overall position is expected to remain strong, at 5 ½ months of imports of goods and services.

B. Financial Sector Legal and Regulatory Environment

The infrastructure for a sound financial sector is broadly in place. The CBA supervises the banking and insurance sectors, and the mission recommended that it also supervise the company service providers (see below). Anti-money laundering rules and policies are implemented by the Reporting Center for Unusual Transactions (RCUT; the "FIU"), the police and the public prosecutor's office.

The *banking sector* is under the supervision of the CBA, based on the State Ordinance on the Supervision of the Credit System (SOSCS)[17] banks require a license from the CBA, which follows a very strict licensing policy. No new licenses have been issued since the early 90s. The banking sector has a well-developed supervisory and regulatory system, covering all the areas of international good practices, and broadly compliant with those standards. However, on several points practical implementation can be strengthened, notably on more intrusive review of banks' loan portfolios and risk management systems.

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[16] US$1=Afl 1.79. The peg has been in operation since the introduction of the Aruban Florin in 1986, when Aruba gained independent status within the Kingdom of the Netherlands.

[17] Effective since May 15, 1998.

The *onshore and offshore insurance sector*, of which previously only the onshore life insurance sector was supervised on the basis of a gentleman's agreement, has formally been placed under the supervision of the CBA by the State Ordinance on the Supervision of the Insurance Business (SOSIB),[18] which entered into force on July 1, 2001. The SOSIB provides a general framework for supervision, but requires much subordinate regulation, which in large part is still under preparation. Supervision is starting to take effect, as insurance companies had a six-month period until January 1, 2002, within which to apply for a license. Nine applications have been received at the time of writing, and the CBA faces a challenge to conduct a careful screening of the applicants when they come forth. As supervision is not yet being practically implemented, not much information was available on the activities of the offshore and non-life domestic insurance companies at the time of the mission.

There is no system for supervision of investment activities, as these are insignificant.

The legal and judicial system relevant to banking business functions well. The rules on security and loan collection are effective, and the judicial system is well capable of taking timely, impartial and independent decisions on such cases. Mortgages can be foreclosed without court intervention, based on the notarized contract between the borrower and the lender. Effective bankruptcy rules are in place.

Article 22 of the State Ordinance on the Supervision of the Credit System obliges banks to prepare annual audited financial statements and to submit these to the CBA. The accounts are made up according to IAS. Publication of the accounts through the Company Registry is required for all deposit taking institutions, but not all banks comply with this requirement, and the obligation has not been enforced thus far. This requires urgent attention of the authorities. Currently, this area is covered by a policy paper issued by the CBA. There is a well-trained and regulated accounting and auditing profession, with legally regulated accession to the profession, formal training and certification standards, and a code of conduct.

Improvements are needed specifically on corporate disclosure and governance. Corporate entities are not required by law to prepare and publish annual financial statements. Insufficient information is available on ownership and beneficial ownership of companies. The latter weakens the anti-money laundering framework, especially with regard to the 4,600 offshore corporate entities, which is exacerbated by the widespread use of bearer shares, making the identification of beneficial owners extremely difficult, if not impossible. Many of the offshore entities, the Aruba Exempt Corporations (AECs) and the Aruba Offshore Companies (AOCs), do not have bank accounts in Aruba, so that they escape Aruban banks' know-your-customer rules. The virtual absence of audited financial statements makes credit

[18] Effective since July 1, 2001.

risk assessment by banks more difficult, although in a small economy such as Aruba's, with only approximately 12–15 large borrowers, banks have access to informal information.

IV. Aruba as an Offshore Center

A. Introduction

Historically, the attractiveness of Aruba as an offshore center is based on a number of factors:

- An attractive tax regime for offshore companies;
- Very limited financial disclosure;
- A good legal and judicial system;
- Good quality financial and company service providers;
- Political stability; and
- Convenient location and good airline and telecommunications connections.

The offshore sector in Aruba consists of two offshore banks with a combined balance sheet total of Afl. 2 billion (see Tables 1 and 2), an Aruba Free Zone for offshore warehousing and services provision, and some 4,950 offshore corporate entities, in the form of Aruba Exempt Corporations (AEC) and Aruba Offshore Corporations (AOC).[19] [20] Offshore companies, financial as well as non-financial, are only permitted to do business with non-residents. The contribution of the offshore sector to the Aruban economy is difficult to assess. Representatives of the sector estimate direct and indirect revenues (including tax revenues) at between $10 and $14 million, or less than 1 percent of GDP (approximately US$2 billion).[21] Assets of the sector as a whole cannot be determined, as the AECs and AOCs do not submit financial statements. Revenues are derived from small fixed annual registration fees by the offshore corporations, services income of the company service providers including lawyers, notaries, accountants and auditors. Tax revenues consist of income tax and social security premiums paid by those employed in the sector. The non-bank offshore sector is serviced by only 16 active company service providers.

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[19] Also known as Offshore NVs (Naamloze Vennootschap, or limited liability company).

[20] Approximately 4,200 AECs and 740 AOCs; Source: Companies Registry.

[21] AOCs are taxed at rates of between 2 and 3.4 percent.

Table 1. Aruba: Balance Sheet Totals (September 2001)[22]

Category	Number	Balance Sheet Total (Afl. millions)[23]	Percent of 2000 GDP
Commercial banks	5	2305	61
Offshore banks	2	2010	53
Mortgage banks	2	378	10
Credit unions	2	2	-
Finance companies	1	52	1
Other financial institutions 1/	1	120	3

1/ Aruban Investment Bank, NV.

Table 2. Aruba: Balance Sheet of Offshore Banks
(End-of-period figures; AFL million; 1 US$ = Afl 1.79)

	1997	1998	1999	2000	2001 Q3
1. Assets					
a. Cash & due from banks	1,065.6	570.7	540.6	445.3	791.8
b. Investments	495.6	471.0	410.1	569.4	73.1
c. Loans	994.8	1,086.0	958.2	1,074.0 1/	1,134.8
d. Other assets	33.9	26.1	24.0	32.1	11.0
Total assets	2,589.9	2,153.8	1,932.9	2,120.8	2,010.7
2. Capital & liabilities					
a. Deposits	2,191.2	1,852.9	1,600.4	1851.9	1,763.6
-Demand	588.5	26.0	220.6	417.2	675.9
-Time	1,602.7	1,826.9	1,379.8	1,434.7	1,087.7
b. Other liabilities	259.4	158.0	169.2	123.3	74.6
c. Capital & reserves 1/	139.3	142.9	163.3	145.6	172.5
Total capital & liabilities	2,589.9	2,153.8	1,932.9	2,120.8	2,010.7

1/ Corrected for unallocated reserves.
2/ Including general (unallocated) reserves.

B. Offshore Banks

In Aruba, offshore banks are subject to the same licensing and prudential standards as onshore institutions. The two offshore banks licensed in Aruba—respectively a branch and a subsidiary of Citibank—have no physical presence in Aruba. The management and the administration of these two banks are located in Venezuela. This situation is the result of the grand fathering policy of the CBA, applied to these two institutions when the new SOSCS

[22] Source: CBA.

[23] 1 US$=Afl 1.79.

and the CBA's new admissions policy were introduced. The new law, and the CBA's admission policy no longer permit licensing of banks that do not have a physical presence in Aruba.

These banks are also subject to consolidated supervision by the U.S. Office of the Comptroller of the Currency and the Federal Reserve Board. One of these banks, which both belong to the Citibank group, is engaged in intragroup finance and sovereign bonds, the other is mainly engaged in intragroup Latin American sovereign bond and loan trading, underwriting of bonds and shares for customers and other general banking services.

The CBA recently conducted an inspection of the two institutions, requiring the records and administrative documents of the two banks to be physically brought to Aruba. Once a year, consultations take place between the management of these banks and the CBA, and exchanges of letters have taken place between the CBA, the OCC, and the Fed on the supervision of these banks.

C. The Aruba Free Zone

The Aruba Free Zone,[24] incorporated in 1996, is a duty free zone for the provision of entrepot and export/services with combined import and export of Afl 275 million (see Table 3). As such, it does not perform financial services. Free Zone companies pay only 2 percent tax on profits generated by free zone activities. Twenty-seven companies operate in the free zone. The Aruba Free Zone is supervised by the "Aruba Free Zone NV," a state owned corporate entity, of which the terms of reference have formally been enhanced and renewed by the State Ordinance Free Zone, of September 1, 2001, which replaced the State Ordinance Free Zones of 1988.

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[24] The CFATF defines a free zone as "an area or regime within a country under special customs and/or tax controls, in which enterprises are licensed to conduct business or provide services for export purposes through the granting of special incentives to stimulate their development. These areas could include, *inter alia,* the receipt of goods duty free for processing and export, the provision of financial services such as banking, brokerage services, insurance, tourism and gambling, technology based services, petroleum related services;" see Caribbean Action Task Force "Money Laundering Prevention Guidelines for CFATF Governments, Free Trade Zone Authorities, and Merchants," Port of Spain, March 29, 2001.

Table 3. Aruba: Free Zone Exports 1995–2001[25]
(1 US$ = 1.79 Afl.)

	1995	1996	1997	1998	1999	2000	2001(1-3q)
Value (US$ x 1000)	333,793	314,275	353,051	331,799	262,978	185,557	86,712
Annual growth rate (%)	-	-5.8%	12.3%	-6.0%	-20.7%	-29.4%	-53.3%
Volume (kg x 1000)	80,683	74,178	80,388	51,572	95,054	82,164	53,396
Annual growth rate (%)	-	-8.1%	8.4%	-35.8%	84.3%	-13.6%	-35.0%

In general, the potentially porous separation between free trade zones and onshore economic activities, gives rise to serious concerns internationally with regard to the use of free zones for evading import duties, trade in illicit substances, and money laundering. In the context of the Caribbean Financial Action Task Force, work is underway to identify more clearly the possible abuses of free zones and to develop an international benchmark for the regulation of free zones. The CFATF meeting on April 3, 2001 adopted guidelines for free zone authorities, CFATF governments, and free zone enterprises, to prevent money laundering, upon recommendation by a working group chaired by Aruba.

Key provisions in the CFATF agreed guidelines are:

- Introduction of comprehensive legislative regimes for free trade zones, which should include licensing to operate in the free zones, record keeping and reporting requirements, and definition of the terms of reference of the supervisory authorities over the free zones;

- Supervisory authorities should have authority to enforce regulations and impose sanctions;

- Anti-money laundering compliance programs must be put in place, including independent reviews and internal audits; appointment of compliance officers is strongly recommended;

- Enterprises in the free zones should be subject to know-your-customer rules and report suspicious transactions;

[25] Source: Central Statistical Office.

- Authorities should be required to create specialized units in the free zone responsible for anti-money laundering operations, training of the businesses in the free zone in anti-money laundering practices, and production of anti-money laundering manuals;

- Coordination should be established between administrative and other authorities to combat money laundering; and

- Data collection systems should be created and measures taken to enable sharing this data with other governments.

The new Aruban "State Ordinance Free Zone," effective as of September 1, 2001, meets or creates the conditions to meet a significant number of these guidelines:

- Introduces a licensing and license revocation regime for free zone enterprises; companies already active in the Aruba Free Zone must re-apply for a license;

- Provides the authority to require any relevant information from the free zone companies and conduct on site inspections;

- Establishes fit and proper criteria for free zone enterprise managers;

- Authorizes the supervisory body, the Aruba Free Zone NV, to require that companies adhere to a compliance program;

- Requires companies to maintain an up-to-date shareholder registration;

- Requires companies to maintain financial records, subject to an external audit once per year; and

- Requires companies to report cash- and/or suspicious transactions.

The Aruba Free Zone is designated by the State Ordinance as the supervisory authority. Its staff should have legal protection against civil liability when reporting in good faith to the RCUT.

Free zone companies are permitted to do business with residents. Onshore companies can be suppliers and in some cases buyers, as free zone companies are permitted to sell a percentage of their turnover (except services) to the local market (currently 25 percent, to be lowered over a seven-year period to 5 percent.

Tax and other revenues are derived from free zone companies are more diverse than derived from the "traditional" offshore sector. Free zone companies pay a 2 percent tax on profits generated by free zone activities. Profits generated by non-free zone activities such as sales to the local market, warehouse rental income, etc. are taxed at the normal domestic rates. Free zone companies pay a free zone facility charge of 1.1.percent of turnover to the Free Zone Aruba.

The Free Zone Aruba also offers the possibility for export oriented light industrial activities.

D. Offshore Legal Entities

Currently, some 5,000 offshore legal entities are registered in Aruba.[26] Some 3,380 "Aruba Exempt Companies" (AEC) and around 575 "Aruba Offshore Companies" (AOC) are registered. These companies provide a variety of services to their offshore owners. A prime function is to serve as tax minimization vehicles, but they also perform asset protection, investment and asset management services. A few internationally active banks use these vehicles as an administrative unit for intercompany financial transactions. Figures published by the BIS show that less than 0.3 percent of all outstanding international debt securities originate from offshore group financial vehicles established in Aruba. However, if the outlier, the Cayman Islands, which alone accounts for more than half of the total, is disregarded, Aruba is the fourth largest offshore channel for such funds (see Table 4). However, all of these securities were issued on behalf of large international banks, and one large well-known foreign non-bank trading company. The identity of all issuers is known to the CBA and the High Commissioner Aruba Financial Center.

Table 4. Aruba: International Debt Securities by Country of Residence
(In US$ billions)

Countries	Amounts Outstanding			
	1999 (Year End)	2000 (Year End)	2001 March	2001 June
All countries	5,360.7	6,383.5	6,521.4	6,698.8
Offshore centers	453.9	511.5	523.8	535.4
Aruba	20.2	18.6	17.7	18.3
Bahamas	3.4	3.6	3.3	2.7
Bermuda	16.1	21.2	21.1	20.6
Cayman Islands	272.3	330.3	343.7	354.9
Hong Kong	29.5	28.8	28.3	29.8
Lebanon	4.7	6.4	6.4	7.4
Netherlands Antilles	89.3	83.0	81.1	79.3
Panama	2.2	2.6	3.6	3.6
Singapore	7.2	9.5	9.4	10.4
West Indies U.K.	8.6	7.1	8.5	8.0

Source: BIS.

The AECs are basically zero-tax companies, whereas the AOCs attract between 2 and

[26] Aruba Chamber of Commerce; The Chamber of Commerce also operates the companies register, on the basis of the State Ordinance on the Trade Registry, most recently amended by State Ordinance of December 7, 1990.

3.4 percent taxation in Aruba. Both types of companies are thus attractive as revenue routing vehicles, providing substantial tax savings for their principals. They are set up and managed on behalf of their owners by a network of company service provider enterprises established in Aruba.

While the activities of AECs and AOCs can in principle are perfectly legitimate, the conditions for their creation and operation give rise to serious concerns, primarily from the perspective of anti-money laundering:

- There is no legal obligation under current legislation for company service providers (CSP) that help set up and manage these companies, including lawyers, notaries and accountants/auditors, to apply know your customer and suspicious transaction reporting rules with regard to these corporations, their beneficial owners and their activities, unless the CSPs engage in financial services. Also otherwise CSPs are currently not directly subject to licensing requirements, "fit and proper" criteria, financial disclosure and disclosure of beneficial ownership; however, legislation is under preparation to address these aspects; [27]

- The "Declaration of No Objection" required from the Minister of Justice for the creation of a corporation can only be refused on very limited formal grounds. The deed of incorporation should not violate public decency, public order or statutory provisions in Aruba. Secondly, it should not be likely that the corporation will be used for unlawful purposes. In practice the latter criterion can be fulfilled by producing—if possible—a certificate from the home authorities that the applicant has no criminal record. The police and judicial authorities are not involved in the examination of the history of the applicant. With regard to foreign applicants such information is virtually impossible to obtain or verify;

- There is no legal obligation for AECs and AOCs, once set up, to disclose the identity and financial condition of their beneficial owners to the Companies Registry or to the public;

- The objectives of the AECs and AOCs as stated in the Articles of Association of the corporation are very broad, which in practice allows substantial changes in the activities of the entities without notification to the Companies Registry or disclosure to the public; they are not allowed, however, to engage in banking business. All AOCs and AECs and their articles of association must be registered at the Companies Registry. The registry is open to the public;

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[27] Also see Chapter VII on the draft CSP Law.

- There is no legal obligation for these companies to file financial statements. AECs can also include in their articles that they shall not prepare nor publish financial statements;

- There is no legal obligation for AECs and AOCs to operate a bank account in Aruba, thus further dispersing the information on the entity, creating additional in transparency, making effective oversight virtually impossible, and rendering the rigorous know your customer and suspicious transaction reporting rules of the Aruban banks inapplicable; and

- There is no adequate legal system for the efficient removal of some 1500 defunct AECs or AOCs from the register, dissolving their corporate shell, and liquidating their assets and liabilities. These three steps currently require three different legal procedures and no single agency is responsible for all three steps. The CSPs do not take responsibility, as the defunct corporations are no longer paying management fees, and the Companies Registry does not have the requisite legal powers.

These concerns, which are especially salient from an anti-money laundering—anti-terrorist finance angle, need to be addressed.

V. Banking Sector

A. Overview

Three of the five onshore commercial banks licensed in Aruba which together have a balance sheet total of almost Afl 2.5 billion (see Table 5) maintain their head offices in Aruba and are supervised by the CBA as home supervisor. Two are domiciled in the Netherlands Antilles and are also supervised on a consolidated basis by the supervisory authority in their home country. The two offshore banks are respectively a subsidiary and a branch of Citibank and are also supervised, on a consolidated basis, by the Office of the Comptroller of the Currency and the Federal Reserve Board, respectively. There are no formal arrangements in place between the CBA and the U.S. regulatory authorities, although an exchange of letters took place to confirm the consolidated supervision by the U.S. authorities. Information is shared on an ad-hoc basis.

All banks supervised by the CBA are only allowed to conduct the activities mentioned in their license. Thus, the offshore banks are only allowed to conduct business with non-residents. The commercial banks can engage both in domestic and international business. In practice, the products and services of the commercial banks are mainly in the traditional retail sector, with interest on domestic credit remaining the predominant source of income. Occasionally, they extend loans to non-residents (in most cases to residents of the Netherlands Antilles). They have practically no funds owned by non-residents under management. The mortgage banks are only allowed to grant housing mortgages. They attract their funds from parent companies, other financial institutions and institutional investors. The

credit unions are only allowed to attract savings from their members and to provide their members with loans, and the finance company is only allowed to extend consumer loans. The mortgage banks, the credit unions and the finance company are not allowed to attract deposits from the public. The Aruban Investment Bank NV is a development bank, which is mainly active in local project finance.

Table 5. Aruba: Commercial Banks' Consolidated Balance Sheet, (September 2001)
(In Afl million)

End of period	Total	Resident	Non-resident
Assets			
Cash	34.2	24.4	9.8
Central bank	246.2	246.2	0.0
Due from banks	299.8	11.6	288.1
Loans	1,673.3	1,515.8	157.5
Enterprises	659.8	550.0	109.9
Individuals	370.5	365.7	4.8
Mortgage	642.7	599.8	42.9
Government	0.3	0.3	0.0
Securities	94.6	63.6	31.0
Treasury bills	52.3	47.9	4.4
Government bonds	35.7	9.7	25.9
Other	6.6	6.0	0.6
Sundry	53.3	33.1	20.2
Fixed assets	62.4	57.4	5.0
Total	**2,463.7**	**1,952.1**	**511.6**
Liabilities			
Current account deposits	586.9	527.6	59.3
Savings deposits	463.4	422.5	41.0
Time deposits	949.3	767.2	182.1
Due to banks	69.1	7.8	61.2
Other liabilities	274.7	264.2	10.4
Capital and reserves	120.4	117.4	3.0
Total	**2,463.7**	**2,106.7**	**357.1**
Supervisory ratios 1/			
Capital/risk-weighted assets ratio	10.1		
Loan/deposit ratio	73.2		
Liquidity ratio 2/	28.5		

1/ Supervisory ratios cannot be derived from the consolidated balance sheet.

2/ The liquidity ratio (minimum 20 percent) consists of liquid assets over total assets; liquid assets are the sum of cash, claims on the CBA, claims on deposit money banks, Treasury bills and government bonds, and other marketable securities.

B. Banking Supervision

The CBA has a good framework within which to conduct banking supervision. Laws, regulations, information requirements and inspection authority, provide the tools for effective supervisory oversight. However, the CBA approach continues to be largely compliance oriented. The implementation of its supervisory oversight role would be greatly improved by a more proactive risk based approach. This is reflected in the assessments of BCPs 7, 8, 13, and 16 in the template in Volume II. Although informal contacts take place between the banks and the CBA, formal on site inspections of onshore banks are too infrequent—generally every two to three years—to provide the supervisors with timely information with which to assess and verify that banks are adhering to sound risk management practices. Banks considered higher risk can be inspected more frequently.

However, the tools to establish whether a bank is high risk are not based on inspections, as these take place only infrequently. Off site surveillance collects provisioning data, but does not analyze credit risk; no loan information is collected or analyzed. It is suggested that credit risk oversight needs substantial strengthening, as credit risk continues to be the greatest danger to banks' portfolios. In the future, the CBA will undertake more frequent, targeted, inspections, focused on credit risk.

Interest rate risk management is not required of the banks nor does the CBA oversee it in its supervisory role. However, banks' loan contracts typically have a three-month repricing clause, which limits their risk of an interest rate mismatch. Margins are also very wide, and banks can absorb a certain level of mismatch. Furthermore, rates have historically been very stable.

Although the CBA receives audited annual reports of its banks, they do not provide the CBA with timely information. Supervisory oversight of offshore operations has been weak; an on site examination is now in process and there is little contact with the home country supervisors. The offshore banks have been under supervision only since 1998.

C. Basel Core Principles Assessment—Main Findings

General

With the concurrence of the Central Bank of Aruba (CBA), the mission assessed compliance with the Basel Core Principles for Banking Supervision using the Core Principles Methodology (see Table 6). The assessment was based on the CBA's self assessment of compliance with the Core Principles, a review of the relevant laws and regulations, interviews with the staff of the CBA and discussions with the Bankers Association and onshore and offshore banks.

Table 6. Summary Compliance of the Basel Core Principles

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Compliant	15	1,1; 1,2; 1,3; 1,4; 1,6; 2; 3; 4; 5; 6; 10; 14; 19; 20; 22
Largely compliant	9	1.5; 9; 11; 12; 15; 17; 18; 21; 25
Materially non compliant	3	7; 8; 16
Non compliant	1	13
Not applicable	2	23; 24

Objectives, autonomy, powers, and resources (CP 1)

Most of the elements of CP 1 were found to be compliant with the exception of (1) 5—legal protection of supervisors, which was largely compliant. There is no explicit mention in the law of protection of the supervisory staff nor is there mention of covering the costs incurred in defending their actions while discharging their duties. It is understood to be implicit in the law that a state agency is responsible for the actions of its employees in the normal conduct of their job, if the employees are acting in a responsible manner. The CBA is planning to request legal assistance from the Dutch Central Bank to explore the possibility of explicit legal protection of supervisory staff. There are currently six staff members in supervision, including the director, supported by one secretary. There are currently two open positions. The average supervisory experience is about six years. All staff members hold at least university degrees. The head of supervision also holds a degree in accountancy.

Licensing and structure (CPs 2–5)

These criteria were found to be compliant. Licensing criteria are sufficiently broad; although there have been informal inquiries, no new license applications have been received for a number of years. The law adequately defines significant ownership and controlling interest and there are legal requirements to obtain supervisory approval for proposed changes in ownership and control. The CBA has established adequate criteria for reviewing major acquisitions or investments by banks.

Prudential regulations and requirements (CPs 6–15)

Prudential Regulations are generally adequate in scope. However, significant improvements in implementation are possible and necessary, especially with regard to the oversight by the CBA of banks' credit risk management. The CBA's directives on risk management are sufficiently broad but they are not detailed enough to give banks adequate guidance on what they need to do, particularly regarding credit risk. The elements of CBA's oversight of banks' loan evaluation and loan loss provisioning are compliant with minimum standards. However, due to the lack of frequency of on site examinations and off site surveillance, the CBA is not in a position to provide supervisory oversight in a timely manner. CBA has no requirements for banks to manage interest rate risk and it does not oversee the risk profile of the banking system. The mission recommended that they require the banks to address this

risk and that they provide supervisory oversight of it. The CBA's oversight of internal control and internal audit was found to be compliant. CP 15 regarding Money Laundering was found to be largely compliant. No major deficiencies in the money-laundering regime for bank supervisors covered by the CP were found.[28] (See separate Anti Money Laundering Template).

Methods of on-going supervision (CP 16–20)

There are pronounced weaknesses in the CBA's off-site surveillance and on site supervision and this CP was found to be materially non-compliant. Credit risk is not adequately addressed in the scope of examinations. While credit risk is examined during on site examinations, they are conducted only every two to three years—too infrequent to provide the supervisory authorities with current, in-depth asset quality information. With relatively little additional resources, and in view of the limited number of banks and their straightforward lending activities, more intensive loan portfolio review can be relatively easily achieved. Off site surveillance does not address credit risk at all. Interest rate risk is not required of the banks nor is it addressed in off site surveillance and on site examinations.

Information requirements (CP 21)

The CBA requires that banks submit annually audited financial statements, which are generally prepared in accordance with International Accounting Standards. External auditors have the legal duty to report matters of material significance to the supervisor.

Formal powers of supervisors (CP 22)

The CBA has adequate formal powers and the authority to take corrective measures if it determines that a bank is not complying with its directives regarding solvency, liquidity or risk management. It has the authority to restrict a bank's operations and to revoke its license. The CBA's action plan envisages introducing the possibility to impose fines.

Cross-border banking (CP 23–25)

Aruba has five onshore banks of which two are branches of banks in the Netherlands Antilles. There is a MoU with the Netherlands Antilles and regular meetings with the supervisors. Aruba's domestic banks do not have any foreign branches or subsidiaries. The offshore operations consist of a branch and a subsidiary of Citibank, supervised by the Fed and the OCC, respectively. The operations are physically located in Venezuela and are currently undergoing an examination by the CBA. They have been under supervision only since 1998.

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[28] See Chapter VIII and Volume II, Chapter III.

Although an exchange of letters has taken place with the U.S. supervisory authorities in which these confirm that they are responsible for consolidated supervision of these institutions, it is unclear whether the U.S. regulators have actually exercised any form of hands on supervision, and when, if any, substantive on site review of the activities by the U.S. authorities took place. It is also unclear as well to what extent the Venezuelan regulator feels responsible. There is no MoU with Venezuela. There are no formal arrangements for information sharing or regular contacts with the U.S. regulators with respect to these operations nor have there been any onsite examinations by the CBA until now.

VI. Insurance and Pensions Sector

A. Introduction

The SOSIB allowed six months, i.e., until December 31, 2001, for the existing 29 insurance companies to submit relicensing applications under the new law. At the time of the mission, nine life insurers had submitted applications. A further six are expected prior to December 31, 2001. Applications for non-life insurers are beginning to be submitted. All these insurers cover risks in the domestic market. In addition, there are three expected captive insurer applications and a possible three other applications from insurance AECs (see below) although it is probable that these will not materialize.

Statistics for the life insurance sector show gross premium income for 2000 to be nearly US$27 million (1999 US$21 million) with aggregate life funds of $130 million (1999 US$115 million) (see Table 7). After the relicensing has been completed, Aruba is expecting the same number, i.e., 29 insurance companies, six of which are offshore. Of these companies, nine are engaged in life insurance.

Nine company pension funds (see Table 8) are also under CBA supervision. The mission was not able to review the laws, regulations relating to the government controlled pension funds, and their financial condition. These funds, and the way they are managed, are currently not under any form of supervision, although they are much larger than the company pension funds. It is key that the government-controlled funds be subject to proper oversight, as any shortfalls would very likely need to be considered a contingent fiscal liability.

Insurance supervision in Aruba is currently in a period of change. Therefore, this assessment can only cover the existing and proposed legislation. It cannot cover the application of the legislation by the CBA although there is comment below on its resources and skills. The assessment by the Fund is based upon the Core Principles of Insurance Supervision developed by the IAIS, supplemented, where necessary, by Guidelines and Principles formulated by the Offshore Group of Insurance Supervisors. A great deal of the preparatory work for this mission was already completed and presented to the mission by the CBA at the commencement. This included an up-to-date IAIS self-assessment and comprehensive written answers to our questions. These documents included the CBA's own indications of

their weaknesses, and, as a result many of the following recommendations originate with the CBA, and are endorsed by the mission.

Table 7. Aruba: Onshore Life Insurance Companies
(End-of-year figures in Afl million)

	1999	2000
Assets		
Investments	245.7	286.2
Fixed assets	0.2	0.1
Affiliated companies	41.2	55.9
Current assets	23.9	30.0
Other assets	12.2	10.1
Intangibles	0.0	0.0
Total assets	323.2	382.3
Capital and Liabilities		
Technical provisions	205.9	232.7
Capital loans	0.6	0.6
Current liabilities	67.4	93.2
Capital and reserves	49.4	55.8
Total Capital and Liabilities	323.3	382.3

Source: Central Bank of Aruba.

Table 8. Aruba: Company Pension Funds
(End-of-year figures in Afl million)

	1999	2000
Assets		
Investments	187.2	197.9
Fixed assets	0.1	0.1
Current assets	9.2	6.6
Total assets	196.4	204.6
Capital and Liabilities		
Technical provisions	180.4	194.2
Long-term liabilities	0.5	0.6
Current liabilities	2.0	1.4
Capital and reserves	13.5	8.4
Total Capital and Liabilities	196.4	204.6

Source: Central Bank of Aruba.

The State Ordinance for the Supervision of Insurance Business (SOSIB) and its Implementation Ordinance became effective on July 1, 2001, bringing all insurers operating in or from Aruba under the CBA's supervision. Before this date, only the domestic life insurance companies had been under the CBA's supervision, initially (until it was superceded by the new banking law in 1998) under the State Ordinance on the Banking and Credit System, and more recently under documented gentlemen's agreements. These agreements were considered null and void effective July 1, 2001.

The new SOSIB is a first important step to bring both the domestic and the offshore insurance industry under effective supervision. The CBA is now in the process of building up experience with supervising domestic non-life (general) and all offshore insurance companies. When the important supervisory regulations (many of which have already been drafted) are issued, from January 1, 2002, Aruba should achieve a high degree of compliance with international best practices for insurance supervision.
Under the SOSIB and its Implementation Ordinance, all existing insurance companies operating in or from Aruba are required to request a license from the CBA by December 31, 2001.[29] The CBA has until June 30, 2002 to take a decision on the license applications received. Insurance companies that wish to establish in Aruba after July 1, 2001, need to have a license before they can commence their activities. The SOSIB provides that separate State Decrees may be issued for the supervision of certain categories of insurers, such as captives and reinsurers (section 2, paragraph 4 of the SOSIB). The action plan of the authorities, shown in the executive summary of this report lists the proposed legislation changes and their current status.

There is a great deal of supervisory discretion written into the SOSIB and the proposed State Decrees. This is a feature of offshore legislation. It is not necessarily detrimental, if the supervisors are skilled and strong-minded and supervise, as do many offshore supervisors, on a risk profile and liability exposure basis. It would be prudent however, to set some limits to supervisory discretion in the regulations, and in due course in the law itself.

B. Offshore Insurance Companies

The offshore insurance sector is thought to be very small, although its size cannot be established directly, as no data is currently available on these companies. They are not considered to pose any threat to financial stability especially now that the insurance AECs will be supervised.

In view of the size of the offshore insurance sector, the Government of Aruba may wish to consider whether or not to promote itself as an international insurance center. A small sector will inevitably not have an abundance of the necessary skills needed to grow the industry, from both a commercial, and from a regulatory perspective. On the other hand a well-run

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[29] Insurance brokers and agents are not subject to supervision.

sector of medium size can bring substantial direct and indirect (linked with the tourist and banking sectors) economic benefit.

Insurance in Aruban Exempt Corporations (AECs)[30]

AECs can also be used as an insurance company and are exempt from taxation. They can issue bearer shares and are almost completely exempt from disclosure of financial condition, owners and beneficial owners. There are concerns about abuse of these AECs especially in the financial services area, and the Government is committed to enact legislation to create more transparency in their operations and ownership.

The mission was informed that, in any event, the SOSIB takes precedence over the AEC legislation in all matters, including the sharing of information with other regulators (under certain conditions) on all insurance AECs, past and present. For certainty and in order to bring Aruba's reputation to the highest level, it is recommended that the AEC legislation be changed to eliminate any areas conducive to lack of transparency. These developments, more than anything else in the insurance sector, demonstrate to us that Aruba is prepared to play its part in the proper supervision of the international finance sector.

Captives

Aruba has issued a Special Decree on January 1, 2002, entitled the "Admission Policy for Captive Insurance Companies in Aruba." Within the definition of captives are included special purpose vehicles and insurers that primarily deal with the parent group but also can assume unrelated risks. The CBA requires details of the ultimate beneficial owners of the captive, and needs to approve the appointment of all Board and senior management appointments. The captive has to conduct its financial administration from Aruba and to maintain minimum solvency, depending upon the type of group to which it belongs, at between $170,000 and $560,000. The CBA may prescribe additional solvency based on the type, magnitude, and nature of the risks undertaken.

We consider it would be more prudent to use the greatest of the above or a prescribed solvency percentage (say 20 percent) of net (reduced by commissions and reinsurance outwards) premium income. The CBA should have the discretion to reduce the minimum margin of solvency only in cases where it is satisfied that the risks and exposures can be met by the available funds.

In our opinion, captives should be regulated in a similar manner to domestic insurers, using net premium income as the solvency indicator and undertaking a comprehensive check of the reinsurance program. The fact that most of the captives are only insuring their own risks should not be a reason to relax regulation and supervision. There are third parties (especially

[30] Also see Chapter IV.D. of this report.

employees and customers) relying upon the insured to have a workable insurance program in place.[31]

There has been a State Decree drafted requiring an insurer to have a local presence. It is vital that this is brought in to the legislation as soon as possible.

IAIS do not mention captive insurance managers because they do not feature in many jurisdictions. In those that they do, captive insurance managers are licensed so, that the supervisor can take action if the fitness and propriety, especially the competence, drops below the required standard.

Supervision of captives in a more comprehensive way will again imply resource needs, which will need to be addressed.

C. Pensions

There are currently no recognized international standards for the supervision of pensions schemes.

Social security (including health insurance) and pension aspects for Aruban resident individuals come under separate legislation not supervised by the CBA. Private (top-up) pensions policies are also issued by licensed insurers, regulated by the SOSIB. These two areas represent a major risk to the economy of Aruba. We have not inquired into the details of supervision in these areas.

The legislation, promulgated in 1985 (partially based on Dutch law) was amended in 2001 in order to strengthen supervision aspects. The legislation covers private domestic group pensions, although it would also cover any offshore group pensions, if any were to exist.

The aggregated funds for the year 2000 show $109 million.

Guidelines have been issued covering general matters (submissions, procedures, and changes), solvency and actuarial matters. Pensions schemes are constituted under "foundations" with a Board consisting of at least 50 percent employees. The law calls for an independent chairman but this has been proven not to work, in practice, and exemptions have had to be given. In view of this, it is recommended that the auditor be required to certify that the minutes of the Board meetings have been inspected, that all actions have been taken in good faith, and have been for the general benefit of all of the past, present, and future employees.

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[31] The SOSIB envisages the possibility of a lighter regulatory regime for captive insurance companies.

Further amendments within the pensions legislation are planned but have not been detailed. It is recommended that one of the primary focuses should be prescribed changes regulating the quality of assets, including a total ban on any investments (e.g., equity, loans, debentures) within the group, which has set up the pension foundation.

D. Protection of Claims

It is recommended that the CBA considers what arrangements could be put in place, in the eventuality of one or more of the insurers or pension schemes were to be unable to meet their liabilities through negligent or fraudulent actions. It is especially important, where the insurers are branches of overseas insurers, to establish what protection is in place for Aruban policyholders if the group has problems meeting their liabilities. If there is no protection, consideration needs to be given to this area.

E. Assessment of Observance of IAIS Core Principles

General

The assessment of the observance by Aruba of the IAIS Core Principles (see Table 9) was conducted using the established Methodology for these assessments. The assessment was based on a review of the laws and regulations applicable to the supervision of insurance in Aruba, onshore as well as offshore, and on discussions with staff of the regulatory agency, the CBA, the Association of Insurers, representatives of the insurance sector, and anti-money laundering authorities.

Table 9. Summary Observance of IAIS Insurance Core Principles and the Draft Principle on Anti-Money Laundering

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Observed	3	e.g., CP 3 (prov), 13 (prov), and 17
Broadly observed	12	1, 2 (prov), 4 (prov), 5 (prov), 6 (prov), 7 (prov), 8 (prov), 9 (prov), 12 (prov), 14, 15, and 16
Materially non-observed	2	10, 18 (prov) (anti-money laundering)
Non-observed	1	11
Not applicable	-	

Main findings and recommendations

Organization of an Insurance Supervisor (Principle 1)

It is recommended that the CBA review the human resources within the Supervisory Department and look closely at the insurance expertise (life and non-life, as these are separate areas of expertise) with a view to providing succession planning and assuring adequate resources, also in light of increased responsibilities for supervision. The personnel should be able to cover all aspects of insurance supervision with the appropriate trainees in

each area being brought to the appropriate standards. The CBA should consider instituting a structured insurance training program for some of its existing talented inspectors and employ more trainees as support staff. It is further recommended that legislation be passed to provide the CBA and its staff with immunity of suit in all cases (including negligence) except for those involving an act of bad faith. It is further recommended that legislation be passed to make third parties used by the CBA (e.g., auditors and actuaries used during investigations) subject to the same legal requirements, in particular containing confidentiality, as the CBA. The CBA should be able to take action against such parties in cases of negligence or bad faith. Where the legislation and regulation permits discretion, the CBA should prescribe in more detail the limits to the use of discretion. After two or three years experience with the SOSIB, the law and the regulations should be reviewed and consolidated to produce modern insurance legislation of the highest international standards, in compliance with all appropriate IAIS Core Principles and the Offshore Group of Insurance Supervisors Guidelines and Principles.

Licensing (Principle 2)

It is recommended that either the SOSIB is changed to include the licensing of captive insurance managers or, if administered by the CBA, the proposed company service provider legislation is changed to include captive insurance managers as a separate licensee with fit and proper requirements. It is further recommended, as absolutely essential, that the CBA should have a fast and effective access to police and RCUT information. Fit and proper checks are incomplete without access to information that these bodies hold. It is further recommended that Section 5 of the SOSIB be clarified so that "the public" includes all persons including corporations and other organizations. The mission recommends that there should be no exemptions to the ban on composites unless there are *de minimis* examples (e.g., a fully funded key man policy or short term reinsured credit life) or there were to be some future statutory life fund protection.

Changes in Control (Principle 3)

As indicated in the template in Volume II of this report, the State Decree, which will supervise changes in control, has already been drafted, and can expect to be introduced by mid-2002.

Corporate Governance (Principle 4) and Internal Control (Principle 5)

Some work has yet to be done on the introduction of these Principles although the SOSIB under Section 10 permits guidelines to be issued and has other relevant aspects (e.g., structure of the Supervisory Board). Certain of the guidelines also contain aspects pertaining to these Principles. For instance, those on asset management have a comprehensive section on the duties of the Supervisory Board from aspects of corporate governance and also of internal control.

Assets (Principle 6)

It is recommended that the CBA prescribe "approved assets" to be used in the calculation of the minimum margin of solvency. Such approved assets could exclude related party (including head office current accounts) unless adequately collateralized. Such a prescription should also include a "spread of assets requirement." The CBA should develop the risk-based approach that has already been drafted, but should review the percentages of deductions for certain assets. The CBA should look at each insurer and class of investment separately, and in some detail.

Liabilities (Principle 7)

The CBA is currently working with consulting actuaries to produce guidelines addressing the oversight of the adequacy of the technical provisions of all insurers (life and non-life). The technical provisions contain the most important element of an insurers balance sheet and it is recommended that the work outlined above is comprehensive, expedited and, when completed, prescribed within the legislation.

Capital and Solvency (Principle 8)

The CBA may wish to consider implementing the "regulatory ladder" approach whereby corrective actions become mandatory when certain pre-defined levels of solvency are reached. These corrective actions can range from the implementation of an action plan by the insurer to the appointment of an administrator.

Derivatives and "Off-balance Sheet" Items (Principle 9)

The CBA may wish to consider, when prescribing approved assets mentioned above within Principle 6—Assets), prohibiting investments in derivatives and "off-balance sheet," except for instruments used for hedging purposes, unless specifically approved by the CBA in individual cases.

Reinsurance (Principle10)

For clarity it is recommended that the definition of insurance business in the SOSIB be amended to also include reinsurance and retrocessional business. It is further recommended that the proposed State Decree regulating the supervision of reinsurance companies is quickly drafted, and implemented as soon as possible. It should also include provisions for the use of reinsurance and retrocession arrangements, by insurers and reinsurers respectively.

Market Conduct (Principle 11)

We strongly recommend that changes be made in order to supervise market conduct, including the supervision of all insurance intermediaries (insurance agents—directly or indirectly through their employer or principal—and insurance brokers). The CBA should consider instituting compulsory codes of conduct to prevent the public from receiving

misleading advice on what can be an individual's largest lifetime investment e.g., an endowment mortgage insurance policy. The mission advises the CBA to consider introducing compulsory qualification standards for insurance advisors (agents and brokers). The mission is not advocating that The CBA should interfere with the market structure, rate setting, design of insurance contracts and other business related matters. If the above recommendation is effected, the CBA should not be the body that adjudicates on complaints. This should, preferably, be an independent ombudsman (who could arbitrate for all sectors of financial services) and, in the last resort, the Courts.

Financial Reporting (Principle 12)

The problem with reporting systems in most jurisdictions is that the information reported to the insurance supervisor is usually out of date. It is recommended that any material changes to the business plan agreed by the CBA, need to be notified to the CBA in advance of the change. This would enable the CBA to take action if the changes were not to their liking, but would not involve any delay to implementation of the change. Material changes would include new products and lines of business, greatly increased exposures, business concentrations, changes to the reinsurance program, and, changes to the underwriting policies. We also recommend that the SOSIB should mandate that external auditors and actuaries report any unusual circumstances to the CBA as soon as these are discovered. The SOSIB should provide the necessary legal protection for the informant.

On-site Inspection (Principle 13)

It is recommended that, as well as using the risk profile method to assess the work to be undertaken during an on-site inspection, the CBA reverts to the more structured visits, used in the past, including the utilization of checklists.

Sanctions (Principle 14)

We recommend that the CBA be given the powers to:

- Apply penalties and sanctions against individual members of management and/or supervisory board;
- Suspend, on a temporary basis and/or permanently bar (for at least 10 years), senior management;
- Limit the payment of dividends of an undercapitalized insurer;
- Remove or disqualify an external auditor;
- Retain a special auditor (at the expense of the insurer), where appropriate; and
- Extend the range of violations for which monetary penalties can be imposed (already proposed by the CBA.

Cross-border Business Operations (Principle 15), Coordination and Cooperation (Principle 16) and Anti-Money Laundering (Draft Principle 18, suggested to IAIS by the Fund)

With regard to anti-money laundering, there does not appear to be the means of controlled exchange of information with international bodies, other than financial services supervisors, nor even with bodies in Aruba, such as the police or the RCUT. This aspect should be investigated with a view to facilitating the exchange of information in the interests of the prevention and the detection of crime (including money laundering). In our view it is essential that the CBA be informed about the findings of investigations into fraud and money laundering involving the financial services sector. It is recommended that there are explicit requirements for the insurer or the insurance intermediary to inform the supervisor on fraud or money-laundering cases. While life insurers and insurance intermediaries selling life insurance will come under the anti-money laundering legislation in the first quarter of 2002, there are no current plans to extend this to non-life insurance. Although the FATF has not yet required that non-life insurance be brought within the scope of the FATF recommendations, the mission is aware of the potential use of non-life vehicles for money laundering and it is our strong recommendation that these types of insurers and insurance intermediaries should come under the legislation as soon as possible.[32]

Confidentiality (Principle 17)

This Principle is fully observed.

VII. Company Service Providers[33]

Company service provider regulation

Although Aruba does not currently regulate company service providers (CSPs), there is a draft law now before parliament that proposes to do so. The mission has reviewed an earlier version of the draft law and, in comments to the authorities on a number of key issues, strongly encouraged the introduction of rigorous regulation and supervision of CSPs. In particular, the mission previously commented that the self-regulatory approach taken in the earlier version would not be effective, that the regulator should not be a newly created agency but rather the CBA, that the applications process relied too heavily on a statement by the applicant rather than an assessment by the regulator, that there were substantial gaps in addressing AML concerns such as know your customer (KYC) requirements and the

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[32] It should be noted, however, that the FATF has not yet required that non-life insurers be subject to AML rules.

[33] Also see Chapter IV.D.

obligation to make unusual transaction reports (UTRs), and that enforcement measures were inadequate.

While improvements in the draft law are noteworthy and demonstrate a clear understanding on the part of the authorities of the need for more rigorous supervision of this sector, and the concept of self-regulation has been effectively abandoned, there remain a number of significant issues that should be addressed before the law is adopted in final form. The Fund would be pleased to provide technical assistance on these issues if desired by the authorities.

Anti-money laundering concerns. A significant deficiency in the draft CSP law is that it does not contain any requirement for CSPs to file UTRs under the LMOT, except when they are engaging in financial services. [34] For this possibility to be activated, the Ministries of Justice and Finance will need to issue a list of indicators for unusual transactions that CSPs should apply to any financial services activities they engage in.

Fit and proper criteria. The information required in the applications process outlined in Article 4 does not provide the basic criteria in the law for 'fit and proper' qualifications for the applicant, such as having no criminal convictions, not having been declared bankrupt or having been a director or senior official of a company that has been declared bankrupt, or possessing a university degree. While the authorities intend to draft more detailed fit and proper criteria in subordinate legislation, the law should nevertheless contain the basic criteria, which the subordinate legislation would elaborate, pursuant to Article 5 of the law.

Identification of indirect shareholders. Although the draft law requires information on the identity and qualifications to be submitted with the licensing application, the draft law does not require this information on the identity and suitability of indirect shareholders or connections to groups of controlling shareholders be vetted as part of the applications process. This could result in unacceptable parties having controlling interests in Aruban CSPs. Similarly, changes in control of a CSP should be subject to prior approval by the regulator.

Treatment of bearer shares. Article 9 of the draft law permits bearer shares to be issued by a client company of a CSP, with the shares kept in custody by a financial institution in Aruba or elsewhere. Ownership information would easily become inaccurate when shares are transferred. This can easily be remedied by prohibiting bearer shares in companies formed by CSPs, although the complete prohibition of bearer shares is still a subject of discussion, and the sector admits that bearer shares can be a problem if not dealt with properly. General company law still permits bearer shares, and a prohibition of their use would require an amendment of the Companies Law.

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[34] Professionals who are involved in company formation and operations, such as notaries, lawyers, and external accountants, should also be required to follow KYC and UTR requirements, consistent with the amended EU AML Directive.

Enforcement measures. The enforcement measures set forth in Article 13 of the law are inadequate, and should include, at a minimum, the ability for the regulator to impose administrative money penalties, to remove directors, officers and external auditors, to appoint a temporary administrator, and to appoint an administrator to oversee the liquidation of a CSP under Article 15. Using the threat of license withdrawal to force the resignation of managers risks being a disproportionate remedy, and thus difficult to apply in practice.

Information sharing. The information-sharing provisions set forth in Article 20 are too narrowly drawn and would not permit the BAFSA to share information with other agencies in Aruba, including the CBA and the RCUT, or with foreign supervisory agencies that are not CSP regulators, such as central banks and financial regulators. The explanatory memorandum to this provision seems to envisage a broader possibility of information exchange, but the text of the draft law does not seem to reflect this. Under the commitments that have been given by Aruba to the OECD to eliminate harmful tax practices, information on Aruban companies and other business entities would also need to be shared with foreign tax authorities.

Response to misinformation by companies. Article 10 of the draft law provides that CSPs shall refrain from providing services to companies that are clients of the CSP if certain provisions of the law have not been complied with. However, it does not require that CSPs should refrain from providing services to companies that have made material omissions or misstatements of fact with respect to information required by Aruban law. A broader requirement to refrain from providing services is being considered.

Exemptions from the law. Article 4(3) the draft law gives the chief of the Bureau Aruba Financial Services Authority (the "BAFSA") wide and virtually unfettered discretion to grant exemptions from the requirements of the applications process of Articles 4 and further of the law, which could lead to weak licensing practices, and disparate treatment of existing CSPs that would defeat the purposes of the law. The use of discretion to exempt applicants should be limited and clearly circumscribed by the law. Removal of paragraph 3 from this provision is being considered.

Definition of 'trust office.' The definition of 'trust office' in Article 1 is rather narrowly drawn and does not explicitly include any reference to activities typically engaged in by CSPs, such as the sale of companies and , the provision of premises for use as a registered office of a company, and arranging for others to act as director, . Redrafting of this definition is being considered.

CSP regulatory entity. A fundamental issue is what entity is best qualified to act as the regulator of the CSP sector based on the merits, and taking into account many of the issues set forth above.

The agency to be appointed regulator of the CSPs should meet a number of basic criteria:

- Well established authority as a regulatory body;
- Autonomy and operational independence, based in law;
- The ability to attract and retain high quality staff and resources;
- Expertise in the CSP sector, or the ability to attract such expertise;
- The ability, resources and experience to perform the required on and offsite analysis of the supervised entities;
- In depth expertise in financial sector supervision; and
- No conflict between its role as supervisor and any promotional role.

Furthermore, in an economy with the size of Aruba's and the inherent scarcity of resources, optimal use should be made of existing supervisory skills and capacity. Currently such experience is available in the CBA. Provided the CBA attracts sufficient expertise with regard to the CSP sector, the CBA would meet many, if not all of the criteria that a CSP supervisory agency should meet. The mission therefore recommends that the CBA be designated as the CSP supervisory agency.

The current draft law designates a new governmental agency, the Bureau Aruba Financial Services Authority (BAFSA), as the CSP regulator,[35] which could not optimally meet some of the criteria mentioned above. This approach is also not consistent with the approach recommended by previous Fund missions.

Finally, it is noteworthy that there is currently no jurisdiction other than the Netherlands Antilles that regulates CSPs in a new and separate regulator. For example, Guernsey, Jersey, the Isle of Man, Gibraltar, and the Cayman Islands all have designated the lead financial regulator, typically an agency regulating banks, capital markets firms and insurance companies, as the regulator of CSPs. This is in line with an international trend to consolidate the regulation and supervision of the financial sector in a single agency, as may be seen in jurisdictions such as Denmark, Norway, Peru, Sweden, and the United Kingdom.

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[35] The draft organic law for the BAFSA is only available in Dutch, so that comments on it will be provided at a later date, once the draft has been translated into English.

VIII. Assessment of Anti-Money Laundering Rules and Practices

A. General

With the explicit concurrence of the CBA, the Aruban anti-money laundering (AML) system was assessed using the August, 2001 Fund/Bank Draft Methodology Document for assessment of financial supervisory principles in the prevention of money laundering. The assessment is based on a partial review[36] of the legislation and financial regulations, and interviews with staff of the Central Bank of Aruba (CBA), the Reporting Center for Unusual Transactions (RCUT), the Bureau of the Attorney-General, the Legislative Department and the Public Prosecutor's Office in the Ministry of Justice, as well as representatives of banks, insurance companies, trust companies, and of professional groups, such as notaries, lawyers and accountants.

The Aruban AML framework applies to banks (since 1996) , exchange bureaus and money remitters (since (1999), the Postal Service (since 1999) and casinos (since 2001). These financial and non-financial institutions are obliged to report unusual transactions to the RCUT. The life insurance companies and insurance intermediaries are expected to become obliged to report unusual transactions to the RCUT in the first quarter of 2002. Non financial corporate entities are not within the scope of the AML rules, and the draft law placing company service providers under the AML rules has not yet been adapted.

B. Overview of AML Measures

Legal framework

The legal provisions governing AML measures in Aruba implement the relevant international treaties applicable to the Kingdom of the Netherlands, including the 1988 Vienna Convention and the Council of Europe Convention of 1990, as well as recommendations of the Financial Action Task Force ("FATF"). The principal laws, decrees and directives that govern this area are as follows:

- The State Ordinance on the Criminalization of Money Laundering (SOCML) of 1993, makes it a crime for a person to acquire, possess or transfer money, securities or claims if such person knew or should have known that such money, securities or claims were acquired through a criminal offense (SOCML Article 1(1)(a)) or transfers such assets acquired through the commission of a criminal offense (Article 1(1)(b)). Penalties range from Afl 250,000–1,250,000 and imprisonment from four to 16 years (Articles. 1–3) and are such offenses are considered felonies (Article 4).

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[36] The mission did not do a full review of the criminal laws relating to the AML framework as part of the assessment.

All crimes constitute predicate crimes for this offense, whether or not committed in Aruba.

- The State Ordinance on Identification for Rendering Financial Services (SOIFS) of 1995 that requires providers of a specified list of financial services to meet certain know-your-customer (KYC) criteria (SOIFS Article 2). Five categories of services are listed: safekeeping of assets; opening of accounts to keep any amount of cash or other assets; renting a safe deposit box; making a payment on bonds or similar securities; providing a service concerning a transaction or series of transactions having an amount to be determined by the Minister of Finance; as well as a sixth category consisting of other services to be designated by State Decree (SOIFS Article 1(b)). Penalties for violation of the SOIFS range from Afl 250,000–500,000 and imprisonment from one to four years. The SOIFS sets forth documents which are to be used by the financial service provider to do due diligence to meet the KYC criteria, such as a driver's license or identity card for natural persons, and a certified extract from the register of the Aruban Company Registry for a legal entity (SOIFS Article 3). The financial service provider is required to establish the identity of the customer before rendering any financial service (Article 4(1)) and may not provide such service unless the requirements of the law have been met (Article 8). The financial service provider must determine whether the customer, if a natural person, is acting for a third party (Article 4(2)) in which case the service provider must establish the identity of the ultimate beneficiary (Article 4(3)). The financial service provider is also required to record all of the data in an accessible form (Article 6) and to preserve the data for five years after the termination of the client agreement or transaction (Article 7).

- The State Ordinance on the Reporting of Unusual Transactions (SORUT) of 1995, in addition to providing for the creation of an RCUT as described below, requires that anyone who renders a financial service, as defined in the law or subsequent decree, is required to promptly report to RCUT any transaction performed or intended to be performed which is deemed to be unusual based on indicators determined by the Ministers of Finance and Justice (Article 11(1)).

- Ministerial Regulation of May 19, 1999 (No. 19) adds bureaux de change and money transmitters to the entities covered by the AML laws and contains a set of indicators for the filing of unusual transaction reports (UTRs) consisting of "objective" and "subjective" indicators. Objective indicators include the size of the transaction or the type of transaction, such as cash transactions involving exchanging currency over Afl 20,000 (Article 3(d) of the regulation); cash deposits or withdrawals over Afl. 100,000 (Articles. 3(b) and (c)); and any cash purchase or sale of securities or precious metals (Article 3(d)). Subjective indicators require reporting when combined with stated minimum amounts of currency and involve a judgment or observation by the reporting entity, such as "the client is nervous without any apparent cause" (Article 4(c)(7)), "the client is being accompanied and checked by a third person

((c)(8)), and "the transaction has no understandable legal purpose, or no visible connection with (business) activities" ((c)(10)).

- State Decrees and Ministerial Regulations have designated additional services and types of entities as follows: purchases and sales of securities; casinos; the Aruban Post Office; and life insurance companies and intermediaries (effective first quarter of 2002).

- The State Ordinance Obligation to Report Import and Export Transactions (AB 2000, No. 27) requires that cash transactions involving the import and export of cash over Afl 20,000 be reported to the Customs Office. It is expected to be implemented by April 2002.

- The State Ordinance Free Zones 2000 (SOFZ) requires that admission to the Free Zone may be made only by companies the ownership of which is fit and proper and may be terminated by convictions of economic crimes, including money laundering (SOFZ Article 5). The SOF2 and its implementing decree require that the Aruban Free Zone Authority file UTRs under regulations to be prepared by the RCUT.

- The CBA has issued directives for deterring and detecting money laundering (CBA Directives) as part of the Prudential Supervision Manual Credit Institutions and contain detailed instructions for banks on compliance with the AML framework, including KYC requirements, submission of UTRs to the RCUT, treatment of private and commercial accounts, and compliance programs for banks.

Organizational framework

Several official organizations play a role in Aruba's anti-money laundering effort: the Ministry of Finance is responsible for the RCUT (LRUT Article 2) and for the Customs Office (which, under a new law not yet in effect, will be receiving reports on the export and import of cash); the Ministry of Justice is responsible for prosecuting ML crimes, drafting AML legislation and related decrees, as well as the cooperation with domestic and international law enforcement agencies that falls within their mandate; and the CBA is responsible for examination of banks and, in January 2002, insurance companies, to determine AML compliance. There is a draft law currently being considered that would transfer the responsibility for the RCUT from the Ministry of Finance to the Ministry of Justice. This could however, undermine the original rationale of creating an RCUT separate from the law enforcement bodies, to avoid banks having to report directly to law enforcement agencies. These organizations participate in international work related to Aruba's membership of, for example, the Caribbean Financial Action Task Force and the Egmont Group.[37]

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[37] The Egmont group is an international consultative group consisting of representatives of financial intelligence units. The group is named after Egmont Castle in Belgium where the group was created.

Role of the RCUT

The RCUT is charged with seven principal tasks (Article 3):

- To collect, record, process and analyze information;
- To furnish information to the authorities in conformity with the law;
- To inform the person making a report regarding the disposition of the report;
- To inquire into developments in the field of money laundering and improving methods of detection;
- To make recommendations after consulting with the CBA for the introduction of adequate procedures to the industry sectors covered by the law;
- To provide information on the nature and prevention of money laundering; and
- To report annually to the Minister of Finance and the Minister of Justice.

In particular, the RCUT is required to keep a register of information lawfully obtained by it (Article 4) and is authorized to inspect the registers of agencies and officials charged with criminal prosecutions (Article 5). It also has the power to request additional information from any reporting entity, as well as from any person involved in a transaction that was reported (Article 12(1)), to inspect books and records that are reasonably necessary for the performance of its tasks from any person (Article 23(3)(a)), as well as to enter all non-residential buildings without a court order (Article 23(3)(b)). The RCUT is required to provide law enforcement officials with information giving rise to a reasonable suspicion that money laundering or the predicate offense has been committed (Article 6(a)), as well as information of importance to the detection of money laundering or the predicate crimes (Article 6(b)). The RCUT is authorized to provide information to other FIUs only on the basis of a treaty (Article 7(2)). The RCUT's budget is determined by the Minister of Finance after consultation with the Minister of Justice (Article 9).

Operations of the RCUT and public prosecutor

As shown in Table 10, the data for the year 2001 suggests that reports are being filed and referred onward to law enforcement authorities at a significantly higher rate than last year. In the year 2000, the Public Prosecutor brought ten charges based on ML offenses as part of one large criminal case, all of which followed a conviction on the predicate offense of drug trafficking. In the year 2001 to date, charges have been brought against 15 individuals on AML offenses, ten of which have been convicted on the basis of the predicate offense of drug trafficking. The other five cases are pending. It is our understanding that the Public Prosecutor prefers to bring cases based on the predicate offense, such as drug trafficking, which is easier to prove than money laundering offenses.

Table 10. Aruba: Unusual Transaction Reports

	1998	1999	2000	2001[1]
Banks	...	...	1923	3256
Money transmitters	...	...	321	419
Total reports filed	3522	2120	2244	3675
Number of RCUT investigations	177	172	160	304
Referrals to law enforcement	110	101	122	185

Source: RCUT.
1/ Through June 30, 2001.

C. AML Implementation for Banks

Record keeping

The SOIFS requires that all financial service providers retain KYC data for at least five years after the termination of the agreement with the customer or after the execution of a transaction (SOIFS Article 7). The CBA Directives require that banks maintain an accessible centralized record keeping system, and sets forth details of what type of information must be kept and in what form (Sec. 3.5). The Aruban Commercial Code requires that records of limited liability companies, including banks, be kept for a period of 10 years.

Training

The CBA Directives require training for bank personnel "in all aspects of regulatory and internal policies and procedures" that is explicitly directed at AML efforts. (Sec. 3.4.2) and that on-going training be provided at regular intervals (Sec. 3.4.2(e).

Compliance and audit

The CBA Directives require banks to adopt internal procedures to combat money laundering, including an internal compliance program, the designation of a compliance officer, and at least annual independent testing of the internal controls by the internal or external auditor (Secs. 3.4 and 3.4.1). In addition, the LRUT gives the RCUT the authority to make recommendations to the reporting sectors concerning the introduction of procedures for internal control in order to prevent money laundering (LRUT Article 3(e)). To date, RCUT has not done so.

Cooperation with supervisors and competent authorities

With respect to the exchange of information between the CBA and the RCUT, the principal concern is that the CBA does not have the explicit authority to share information that it obtains in the course of an inspection of a bank with the RCUT.

Supervisory arrangements

The CBA conducts on-site inspections of banks to assess compliance with the CBA Directives, including the adoption of internal controls, appointment of a qualified compliance officer, and annual independent testing of internal controls. The RCUT also conducts on-site inspections of banks, focusing on reporting issues.

D. Strengthening the AML Framework

The legal framework

- As identified by the FATF, the main weakness of the State Ordinance on the Criminalization of Money Laundering is that the reach of the law is limited to the laundering of money, securities or claims, and does not cover all assets. In addition, concerns have been raised by the FATF and by Aruban authorities that the requirement in Article 1 of the law that the predicate criminal offense must be proven as an element of the money laundering offense may be an impediment to prosecution. Consideration should be given to further review of this issue to determine whether revising the statutory language would lessen the burden of proof while continuing to safeguard the rights of criminal defendants.

- The principal weakness of the SOIFS is that the list of financial services is not complete, even with the additional services added by subsequent laws, ministerial regulations and state decrees. Financial services not included in the legal framework that are listed in the Annex to FATF Recommendation No. 9, List of Financial Activities Undertaken by Business or Professions Which are Not Financial Institutions, are the following: financial leasing (para. 3 of FATF Annex), financial guarantees and commitments (para. 6), trading for the account of customers (para. 7), participation in securities issues (para. 8) and portfolio management (para. 9). While it may be the case that Aruban financial institutions are not currently engaged in many of these activities, it is always possible that such activities could be provided in the future, or that an offshore institution might do so.

- The State Ordinance on the Reporting of Unusual Transactions (SORUT) should be strengthened in a number of areas, for which the authorities have prepared draft legislation. Article 3(c), which requires that reporting parties be notified of the disposition of their report, should be clarified to explicitly state what has become the practice of the RCUT, that any such notification shall only be made at the final disposition of the case, to ensure that no harm to any investigation or prosecution occurs. The authorities have responded to stress that the reporting of findings of the RCUT is limited to the police and the public prosecutor in order to safeguard the interests of effective investigation and prosecution.

- As identified by the FATF, Article 5, which provides that the RCUT may inspect registers of law enforcement agencies and officials, is too narrowly drawn and should

provide the RCUT with the authority to inspect the registers of all agencies and officials, including the tax authorities, customs office and social insurance agency.

- As identified by the FATF, Article 7, which authorizes the RCUT to provide information to other FIUs only on the basis of a treaty, should be revised to allow informal exchanges, with appropriate safeguards, at the discretion of the RCUT.

- Consideration should be given to amending the LRUT to provide the RCUT with the ability to impose a range of administrative fines on legal and natural persons who violate the AML laws, in addition to the criminal penalties already in the law. Administrative fines have a number of advantages over criminal penalties, including a lower burden of proof, as well as the ability for the RCUT to impose fines directly.

Other issues

- Consideration should also be given to amending the AML legal framework to conform to the new amendments to the EU Anti-Money Laundering Directive, which will require additional services, professions and businesses to be included within the scope of the relevant laws, including auditors, external accountants, tax advisors, and real estate agents. Further, lawyers and notaries acting for clients in certain specified transactions, such as buying and selling real property or businesses; managing client money; opening of bank accounts; and organizing companies or trusts. Finally, dealers in high-value goods (precious stones, metals or art) when receiving payment is in cash above EUR 15,000 are now to be covered. (Article 2a(3)-(6) of amendment to EU Directive).

- Company service providers need to be put under the scope of the AML rules as soon as possible.

- An issue relating to the sharing of information by the CBA arises from Sec. 34 of the SOSCS, which authorizes the CBA to share information with a foreign supervisory institution, but not with the RCUT. This could lead to a situation where the CBA obtains relevant information in the course of an examination of a bank or insurance company but would be unable to pass it along to the RCUT.

- Amendments will be needed to the AML framework, including expansion of the list of objective and subjective indicators, in order to adopt the FATF Special Recommendations on Terrorist Financing (October 2001). In particular, the recommendations on alternative remittance (VI), wire transfers (VII), and non-profit organizations (VIII) should be analyzed to determine how best to provide for such measures in Aruban law.

- Amendments will be needed to the SOF2 and/or the State Decree thereunder to ensure that no liability attaches to the Free Zone Agency when it submits UTRs to the RCUT under Sec. VI (5)(d) of the State Decree.

Organizational framework

CBA

The CBA's on-site AML examinations of banks need to be done on a more frequent basis. Given the division of labor between the CBA and the RCUT regarding on-site inspections, [38]and given the infrequency of CBA inspections and the difference in focus between the CBA and the RCUT in the inspection process, greater efforts need to be made to coordinate the inspection of banks by both organizations, and both need to conduct more frequent inspections of banks. Consideration should be given by the CBA, in consultation with the RCUT, to preparing an examination manual to provide guidance to examiners and bankers. A guideline has been prepared for banks on the on-site process, informing them of what to expect during an inspection.

RCUT

- As recommended by the FATF, RCUT should use its authority pursuant to the LRUT to prepare recommendations, in consultation with the CBA, to the reporting sectors other than banks on AML issues. The RCUT should prepare regulations under the State Ordinance on the Aruba Free Zone, Sec. VI (5)(d) and (6)(b), for the reporting of cash and /or unusual transactions.

- In order to make communications and reports between and among the RCUT, the police, the Public Prosecutor and Attorney General more effective, consideration should be given to meeting on a regular basis to discuss UTR referrals.

- Concerns were expressed with respect to the access by the RCUT to information maintained by government law enforcement agencies and officials, particularly the tax and customs authorities. Efforts should be made at the ministerial level to ensure that all such data is available to the RCUT on a real-time basis.

- The RCUT should be given autonomy in its operations and the use of its budget, so that it may act more quickly in adding needed staff and purchasing needed goods and services.

Based on discussions with officials in the RCUT, as well as in commercial banks, the CBA and the Ministry of Justice, there is a consensus that additional staff and budget are needed for the RCUT, which now has a director, three professionals, and one support person.

The need for additional staff is based on the following:

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[38] The RCUT also inspects money remitters, bureaux de change, the Postal Department and casinos, and has limited resources.

- The RCUT will, in the near future, be charged with additional responsibilities with respect to life insurance companies as well as the export and import of cash;

- The RCUT needs to continue to conduct training and on-site inspections of reporting institutions, particularly banks, money transmitters and casinos;

- Measures to combat the financing of terrorism that are contained in the recent FATF Special Recommendations will become necessary in the near future;

- A recent Aruban government study concluded that six more positions are needed; and

- In light of the concerns about staffing, and to foster cooperation with and training of law enforcement authorities, consideration should be given to further training for prosecutors, having police and/or customs officers seconded to the RCUT for one to two year periods, notwithstanding that this may diminish somewhat the perceived destigmatizing buffer function of the RCUT between the banks and the investigators/prosecutors.

The need for additional financial resources is based on the following:

- The collection and analysis of data depends on state of the art hardware and software;

- The aggregate number of UTRs is increasing on an annual basis, necessitating additional inputs to the database;

- Inspection of reporting institutions (such as the offshore banks) requires additional travel expenditures; and

- There is a continuing need for staff training to keep up with developments in the field.

LAWS AND REGULATIONS PERTAINING TO THE FINANCIAL AND OFFSHORE SECTORS

General

Central Bank Ordinance (AB 1991, no. GT 32) (effective January 1, 1986)

State Decree giving directives for the President, Executive Directors and Supervisory Directors (AB 1992, no. GT 4)

State Decree containing general provisions regulating the supervisory task (AB 1998, no. 70) (effective 28 October 1998)

Banking

Ordinances and State Decrees

State Ordinance on the Supervision of the Credit System (AB 1998, no. 16), amended (AB 1999, no. 11) (Effective May 15, 1998)

Implementation Ordinance on the supervision of the credit system (AB 1998, no. 17) (AB 1998, no. 26) (Effective May 15, 1998)

State Decree determining equity capital State Ordinance on the Supervision of the Credit System (AB 1998, no. 21) (Effective date May 15, 1998)

Ministerial regulation in pursuance of section 48, paragraph 1 of the State Ordinance on the supervision of the credit system (AB 1998, no. 24)

State Decree in pursuance of section 1, paragraph 2, of the State Ordinance on the supervision of the banking and credit system (AB 2000, no. 29) (regulating group finance companies) (Effective date 27 July 2000)

Regulations and policy papers

Admission policy credit institutions in Aruba

Solvency directives (pursuant to section 13 of the SOSCS)

Liquidity directives (pursuant to section 14 of the SOSCS)

Credit extensions to a group of connected clients (pursuant to section 13 of the SOSCS)

Credit extensions to insiders (pursuant to section 13 of the SOSCS)

Anti-money laundering directives (pursuant to section 15 of the SOSCS)

Policy paper on sound corporate governance practices (pursuant to section 15 of the SOSCS)

Policy paper on credit institutions' administrative organization (pursuant to section 15 of the SOSCS)

Policy paper on the reliability and continuity of electronic data processing (pursuant to section 15 of the SOSCS)

Policy paper with respect to the implementation of Section 48, paragraph 3, of the SOSCS

Insurance

Ordinances and State Decrees

State Ordinance on the Supervision of Insurance Business (AB 2000, no. 82) (Effective date July 1, 2001)

Implementation Ordinance on the supervision of insurance business (AB 2001, no. 91) (Effective date July 1, 2001)

State Ordinance third-party insurance motor vehicles (AB 1999, no. GT 12) amended (AB 2001, no. 91) (Effective before 1986)

State Decree in pursuance of the State Ordinance third-party insurance motor vehicles (AB 1999, no. GT 13) (This state decree will be revoked on January 1, 2002)

Draft State Decree special provisions captive insurance companies

Draft State Decree regulating changes in ownership insurance companies

Draft State Decree regulating the authority of the administrator

Regulations and policy papers

Admission policy for insurance companies operating in or from Aruba

Anti-money laundering guidance notes for life insurance companies (pursuant to section 10 of the SOSIB)

Guidelines transfer of rights and obligations insurance policies (pursuant to section 22 of the SOSIB)

Admission policy for captive insurance companies

Draft actuarial guidelines for insurance companies (pursuant to section 13 of the SOSIB)

Draft guidelines asset management (pursuant to section 10 of the SOSIB)

Draft policy paper on solvency margins (pursuant to section 14 of the SOSIB)

Pension funds

Ordinances and State Decrees

State Ordinance Company Pension Funds (AB 1998, no. GT 17), amended (AB 2001, no. 91) (Effective before 1986)

Ministerial Decree in pursuance of section 4, paragraph 2, of the State Ordinance Company Pension Funds (AB 1991, no. GT 79)

Regulations and policy papers

General guidelines for company pension funds (pursuant to section 9 of the SOCPF)

Actuarial guidelines for company pension funds (pursuant to section 12 of the SOCPF)

Solvency guidelines for company pension funds (pursuant to section 13 of the SOCPF)

Anti-money laundering

Ordinances and State Decrees

State Ordinance on the criminalization of money laundering (AB 1993, no. 70) (effective December 23, 1993)

State Ordinance identification for rendering financial services (AB 1995 no. 86), amended (AB 1998, no. 73) (effective date February 1, 1996)

State Ordinance obligation to report unusual transactions (AB 1995 no. 85) (effective date February 1, 1996)

State Ordinance obligation to report import and export transactions (AB 2000, no.27) (not yet effective)

State Decree regulating identification requirements (AB 1996, no. 46)

State Decree designating casino transactions (AB 2001 no. 25) (designating casinos as financial services)

State Decree designating financial services (AB 2000 no. 23)

State Decree identification requirements legal entities (AB 1999 no. 4)

State Decree regulating indicators for casinos (AB 2001 no. 98) (regulating reporting requirements for casinos)

State Decree regulating financial services (AB 1999 no. 19) (designating money transfer companies as financial services)

State Decree regulating indicators banks (AB 1996 no. 54) (regulating reporting requirements for banks) (effective date September 6, 1996)

State Decree regulating Section 10 first paragraph, of the State Ordinance obligation to report unusual transactions (AB 1996 no. 22)

Draft State Decree regulating indicators life insurers and intermediaries (regulating reporting requirements for life insurance companies and intermediaries)

Draft State Decree designating Life Insurance Companies (designating life insurance companies and intermediaries as financial services)

Company service providers

Draft State Ordinance on the Supervision of Trust Companies

Draft external audit protocol

Import and export of cash money

State Ordinance reporting import and export of cash money (AB 2000, no. 27)

State Decree reporting import and export of cash money (AB 2000, no. 88)

Free Zone

State Ordinance Free Zone (AB 2000, no. 28) (Effective September 1, 2001)

Implementation Ordinance State Ordinance Free Zone (AB 2001, no. 106) (Effective September 1, 2001)

INTERNATIONAL MONETARY FUND

Monetary and Exchange Affairs Department

ARUBA

OFFSHORE FINANCIAL CENTER ASSESSMENT

VOLUME II

Jan Willem van der Vossen (Head), Ross Delston (Consultant, LEG), Gabriella Ferencz (World Bank), and Steve Butterworth (Guernsey Financial Services Commission)

June 2002

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I. Assessment of Implementation of the Basel Core Principles for Effective Banking Supervision

A. Basel Core Principles Assessment—Main Findings Summary

General

With the concurrence of the Central Bank of Aruba (CBA), the mission assessed compliance with the Basel Core Principles for Banking Supervision using the Core Principles Methodology (see Tables 1 and 2). The assessment was based on the CBA's self assessment of compliance with the Core Principles, a review of the relevant laws and regulations, interviews with the staff of the CBA and discussions with the Bankers Association and onshore and offshore banks. A recommended action plan is provided in Table 3.

Objectives, autonomy, powers, and resources (CP 1)

Most of the elements of CP 1 were found to be compliant with the exception of (1) 5—legal protection of supervisors, which was largely compliant. There is no explicit mention in the law of protection of the supervisory staff nor is there mention of covering the costs incurred in defending their actions while discharging their duties. It is understood to be implicit in the law that a state agency is responsible for the actions of its employees in the normal conduct of their job, if the employees are acting in a responsible manner. The CBA is planning to request legal assistance from the Dutch Central Bank to explore the possibility of explicit legal protection of supervisory staff.

Licensing and structure (CPs 2–5)

These criteria were found to be compliant. Licensing criteria are sufficiently broad; although there have been informal inquiries, no new license applications have been received for a number of years. The law adequately defines significant ownership and controlling interest and there are legal requirements to obtain supervisory approval for proposed changes in ownership and control. The CBA has established adequate criteria for reviewing major acquisitions or investments by banks.

Prudential regulations and requirements (CPs 6–15)

Prudential Regulations are generally adequate in scope. However, significant improvements in implementation are possible and necessary, especially with regard to the oversight by the CBA of banks' credit risk management. The CBA's directives on risk management are sufficiently broad but they are not detailed enough to give banks adequate guidance on what they need to do, particularly regarding credit risk. The elements of CBA's oversight of banks' loan evaluation and loan loss provisioning are compliant with minimum standards. However, due to the lack of frequency of on site examinations and off site surveillance, the CBA is not in a position to provide supervisory oversight in a timely manner. CBA has no requirements for banks to manage interest rate risk and it does not oversee the risk profile of the banking system. The mission recommended that they require the banks to address this

risk and that they provide supervisory oversight of it. The CBA's oversight of internal control and internal audit was found to be compliant. CP 15 regarding Money Laundering was found to be largely compliant. No major deficiencies in the money-laundering regime covered by the CP were found.[1](See separate Anti-Money Laundering Template)

Methods of on-going supervision (CP 16–20)

There are pronounced weaknesses in the CBA's off site surveillance and on site supervision and this CP was found to be materially non-compliant. Credit risk is not adequately addressed in the scope of examinations. While credit risk is examined during on site examinations, they are conducted only every two to three years—too infrequent to provide the supervisory authorities with current, in-depth asset quality information. Off site surveillance does not address credit risk at all. Interest rate risk is not required of the banks nor is it addressed in off site surveillance and on site examinations.

Information requirements (CP 21)

The CBA requires that banks submit annually audited financial statements, which are generally prepared in accordance with International Accounting Standards. External auditors have the legal duty to report matters of material significance to the supervisor.

Formal powers of supervisors (CP 22)

The CBA has adequate formal powers and the authority to take corrective measures if it determines that a bank is not complying with its directives regarding solvency, liquidity or risk management. It has the authority to restrict a bank's operations and to revoke its license. The CBA's action plan envisages introducing the possibility to impose fines.

Cross-border banking (CP 23–25)

Aruba has five onshore banks of which two are branches of banks in the Netherlands Antilles. There is an MOU with the Netherlands Antilles and regular meetings with the supervisors. Aruba's domestic banks do not have any foreign branches or subsidiaries. The offshore operations consist of a branch and a subsidiary of Citibank, supervised by the Fed and the OCC, respectively. The operations are physically located in Venezuela and are currently undergoing an examination by the CBA. They have been under supervision only since 1998.

Although an exchange of letters has taken place with the U.S. supervisory authorities in which these confirm that they are responsible for consolidated supervision of these institutions, it is unclear whether the U.S. regulators have actually exercised any form of

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[1] See Chapter VIII and Volume II, Section III.

hands on supervision, and when, if any, substantive on site review of the activities by the U.S. authorities took place. It is also unclear as well to what extent the Venezuelan regulator feels responsible. There is no MoU with Venezuela. There are no formal arrangements for information sharing or regular contacts with the U.S. regulators with respect to these operations nor have there been any onsite examinations by the CBA until now.

Detailed Assessment

Table 1. Detailed Assessment of Compliance of the Basel Core Principles

Principle 1.	**Objectives, Autonomy, Powers, and Resources** An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to the authorization of banking establishments and their ongoing supervision; powers to address compliance with laws, as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Principle 1(1)	An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.
Description	The Central Bank of Aruba (the CBA) is solely responsible for the supervision of banks in Aruba. Its responsibilities and objectives are detailed in the Central Bank Ordinance (AB 1991 No. GT 32) and the Supervision of the Credit System (AB 1998 No. 16) (SOSCS). The SOSCS, together with supporting prudential regulations, provide a framework of minimum standards that banks must meet. CBA is responsible for the prudential supervision of banks. In its supervisory function, CBA monitors compliance with laws and regulations, monitors solvency and liquidity through off-site surveillance and on-site inspections, and issues supervisory directives, guidelines, and policy papers. The President of the CBA, assisted by the executive directors, determines the policies of the Bank. Chapter VIII of the SOSCS sets forth Emergency Regulations. Subsequent to petition by the CBA, a Court can declare special measures to be taken in the event that the solvency or liquidity of a bank is endangered. In the event that a problem bank is deemed likely to continue to be a going concern, Section 15 of the SOSCS grants the CBA the authority to give banks recommendations or directives for the conduct of their business. Proposals for legislative changes are initiated and prepared by the CBA and are submitted to the Minister of Finance. Upon his approval, the proposals go to the Legislative Department that acts on the instruction of the Minister. Proposals become effective after they have been enacted by Parliament. **Additional Criteria:** In accordance with Section 50 of the SOSCS, a report is submitted annually to the Minister of Finance, in which he is informed of the most important supervisory developments over the prior year. CBA's annual report includes relevant supervisory developments and aggregated key financial data of its supervised institutions. The annual reports, together with quarterly bulletins, provide published information about the financial strength and performance of the industry.
Assessment	Compliant.

Comments	
Principle 1(2)	Each such agency should possess operational independence and adequate resources.
Description	The Central Bank Ordinance provides that the CBA is a legal entity with an autonomous position within Aruba's public sector. No operational guidance is given to the CBA by the Finance Minister and it operates with no significant evidence of interference in its operations. CBA is independent from the Government's budgetary process. It is funded independently through revenue from investments of its foreign exchange reserves; revenues above those required to finance supervisory activities are used for other CBA operations. There are sufficient resources to provide for current operations, and to hire additional staff , should additional supervisory tasks be entrusted to it. There are currently six staff members in supervision, including the director, supported by one secretary. The average supervisory experience is about six and a half years, and there are currently two vacant positions. Both the director and all staff members hold university degrees, obtained either in the Netherlands (4 persons, the U.S. (one person) or the Netherlands Antilles (two persons). The head of the supervision department is a Dutch-trained certified public accountant with experience in auditing financial institutions, gained partly in the Netherlands. **Additional Criteria:** The President is appointed on the recommendation of the Supervisory Board of the Governor of Aruba, who is the representative on Aruba of the Queen of the Netherlands. Both the Governor and the directors are appointed for an indefinite period. Upon recommendation of the Supervisory Board of the CBA, the President and directors can be suspended or dismissed by the Governor, by means of a state decree setting forth the reasons for the action.
Assessment	Compliant
Comments	Salary scales attract and retain qualified staff and other budget resources are sufficient to meet the needs to hire experts and for training, travel and equipment. Additional resources, both human and other resources will be required as the responsibilities of CBA expand with regard to oversight of the insurance industry, expanded anti money laundering supervisory responsibilities and potentially the supervision of company service providers and money transfer companies. The additional criteria call for fixed term appointments for the head of the agency and for public disclosure of the reasons for removal of the head of the agency. Neither of these elements of the additional criteria is met.
Principle 1(3)	A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Description	Under Section ? of the SOSCS, a banking license from the CBA is required, prior to conducting banking activities. Once a license is granted, a credit institution has to comply continuously with the licensing requirements. Under Section 11 of the SOSCS, the CBA has the authority to revoke a bank's license. The conditions under which a bank's license can be revoked are specified in Section 11 of the SOSCS. Section 15 of the SOSCS grants the CBA the authority to give banks recommendations or directives for the conduct of the business. The SOSCS empowers the CBA to require information from the banks in the form and frequency it deems necessary.
Assessment	Compliant
Comments	
Principle 1(4)	A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws, as well as safety and soundness concerns.
Description	(See description under BCP 22 regarding enforcement powers)

Assessment	Compliant
Comments	
Principle 1(5)	A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	Aruban law does not contain an explicit provision with respect to the legal protection of supervisory staff. Aruban civil law provides for a general tort action, which can be filed against the CBA or one of its employees. The performance of the CBA or its employees, with regard to the execution of their supervisory tasks, could be brought forward to prove an alleged tort. There is no explicit mention in the law of the protection of the supervisory agency and its staff against the costs incurred in defending their actions while discharging their duties. However, it is understood to be implicit in that Dutch law, the basis for much of Aruban law, holds that an employer is responsible for the actions of its employees in the normal conduct of their job, if the employees are acting in a responsible manner.
Assessment	Largely Compliant.
Comments	The CBA is planning to request legal assistance from the Dutch Central Bank regarding this issue of explicit legal protection of supervisory staff.
Principle 1(6)	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	Section 34 of the SOSCS provides the CBA with the authority to share information with foreign supervisory agencies. The law also explicitly calls for the safeguarding of the confidentiality of the information provided and for safeguards to ensure that the information is used for the purpose for which it was furnished. Section 35 of the SOSCS calls for maintaining the secrecy of information obtained in the course of supervision, except as provided for in Section 34, and as called for in court orders.
Assessment	Compliant
Comments	
Principle 2.	**Permissible Activities** The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.
Description	Section 49 of the SOSCS prohibits the use of the word "bank" or derivation thereof, by enterprises or institutions, unless they have been registered as credit institutions. Section 1 of the SOSCS defines the term credit institution as an enterprise or institution, not being the Bank (CBA), whose business is to receive funds repayable on demand or subject to notice being given, and to grant credits or investments for its own account. Section 2 of the SOSCS states that credit institutions are subject to supervision by the CBA. Banking licenses set forth the allowed activities and conditions to which a bank is permitted to engage in. Per Section 2 of the SOSCS, the CBA can place restrictions on the licenses granted with regard to the type of banking activities, which are permitted.
Assessment	Compliant
Comments	
Principle 3.	**Licensing Criteria** The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.

Description	Sections 5 of the SOSCS set forth the bank licensing criteria. A license from the CBA is required to conduct banking activities in Aruba. Once granted, a bank has to comply with the licensing requirements continuously. Under Section 6 of the SOSCS, the CBA has the right to reject applications if the conditions stipulated are not fulfilled, or if the CBA has reason to assume that the enterprise or institution has applied for a license in order to evade supervisory regulations of a foreign country. Subsections b, c, and d, state that the CBA determines that the proposed statutory and managerial structure of the bank will not hinder effective supervision. The CBA has to determine the suitability of major shareholders with a significant interest (voting rights) and the transparency of the ownership structure. A minimum initial capital amount is stipulated for all credit institutions under Section 8, subsection 1 of the SOSCS. By Ministerial Decree, the minimum capital requirement for credit institutions has been set at AFL 5 million (approximately US$3 million). Per Section 6, sub b and c of the SOSCS, the CBA evaluates prospective directors and senior management as to expertise and integrity (fit and proper test). The fit and proper criteria include (1) skills and experience in relevant financial operations commensurate with the intended activities of the bank and (2) no past record of criminal activities or adverse regulatory judgments that would make a person unfit. In accordance with Section 5, sub 1e and f, the applicant has to submit a program of operations, which should include the envisaged administrative, organizational and management controls, which the CBA reviews in line with its Guidance Note on Corporate Governance. The elements of an operational structure are evaluated in line with the proposed activities of the bank and continue to be ongoing supervisory requirements. In accordance with Section 3, section 1d of the SOSCS, the applicant has to submit annual accounts and projections, which have been signed by an external auditor. Based on these documents, the CBA conducts an assessment of the adequacy of financial strength to determine if it supports the proposed strategic plan. Financial information is requested and reviewed on the principal shareholders. The home country supervisor is required to provide the CBA with a written statement approving the establishment of the new bank and confirming that its establishment will fall under the consolidated supervision of the home country supervisor. The license granted by the CBA can be revoked in the event that false information was provided and the license would not have been provided if true information had been provided. **Additional Criteria:** The assessment of the application includes the ability to supply additional financial support, if needed. The directors must have a sound knowledge of each of the types of financial activities the bank intends to pursue. The CBA monitors compliance with supervisory requirements, as well as the progress of new entrants in meeting their business and strategic goals via its offsite surveillance and onsite examinations.
Assessment	Compliant
Comments	
Principle 4.	**Ownership** Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.

Description	Section 1 of the SOSCS defines significant ownership as a direct or an indirect holding of more than 5 percent of the issued share capital of an enterprise or institution or the ability to exercise directly or indirectly more than 5 percent of the voting rights, or the ability to exercise directly or indirectly, a comparable degree of control in an enterprise or institution. There is a legal requirement to obtain supervisory approval for proposed changes that would result in a change of ownership or in the exercise of voting rights over a particular threshold or a change in controlling interest. (SOSCS Section 16, para. 1b.; Section 17, para. 1a) In accordance with Sections 16 & 17 of the SOSCS, the CBA has the authority to reject any proposal for a change in significant ownership or controlling interest, or prevent the exercise of voting rights in such investments. **Additional Criteria:** Section 19 (2) of the SOSCS requires all credit institutions to report all persons and companies with a qualified shareholding, as well as beneficial owners of shares held by custodians, on an annual basis.
Assessment	Compliant
Comments	
Principle 5.	**Investment Criteria** Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	Per Section 16 of the SOSCS, the prior written consent of the CBA is required to hold, acquire or increase a qualifying holding an another enterprise or institution. Permission shall be granted, unless the CBA is of the opinion that the acquisition or investment would or could endanger the solvency of the institution, could conflict with sound banking policy and/or could have other negative consequences. Notification of acquisition or investment should always be in advance, not after the event.
Assessment	Compliant
Comments	
Principle 6.	**Capital Adequacy** Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.
Description	Section 13 of the SOSCS grants banks the authority to give credit institutions directives regarding their solvency. Based on this directive, the CBA sets the minimum risk weighted capital ratio for commercial banks at 10 percent. Offshore banks are required to maintain a minimum risk weighted capital ratio of 8 percent. The required capital ratios are calculated for each bank and include risk weighting for assets and include on and off balance sheet items. The components of capital are set forth in the calculation required in Appendix 7 of the required financial information the banks are required to submit to the CBA on a monthly basis. The calculations are made on a consolidated bank basis. Section 20 of the SOSCS gives the CBA the authority to take measures should a bank fall below the minimum capital ratio.

	Additional Criteria: The definition of capital is broadly consistent with the Basel Capital Accord. Section 20 of the SOSCS sets out the actions to be taken if capital falls below the minimum standard. The capital adequacy requirements take account of the conditions under which the local banking system operates. Because of the extra risks associated with a small, undiversified economy, the minimum capital requirements for domestic banks is set at 10%. Capital adequacy ratios are calculated on both a consolidated and a solo basis. Per Ministerial Decree, the minimum required capital is AFL 5 million (approx. US$3 million).
Assessment	Compliant
Comments	
Principle 7.	**Credit Policies** An essential part of any supervisory system is the independent evaluation of a bank's policies, practices, and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.
Description	Per Section 15 of the SOSCS, the CBA may give recommendations or general directives for the conduct of banks' business with regard to administrative organization and internal controls. There is a guideline/policy paper on Credit Institutions Administrative Organization, which sets forth in general terms elements of risk management, but not specifically to credit risk or any other specific risk. Banks are required to form a credit committees to ensure that an institution's lending policies are adequate and adhered to as are applicable laws and regulations regarding credit extensions. The general elements of risk management which the directive sets forth as desirable are • active Board and senior management oversight • adequate policies, procedures and limits • adequate risk measurement, monitoring and MIS • adequate and comprehensive internal controls There are general guidelines in the policy paper for the adequacy of policies, procedures and limits, but these too do not specifically address credit risk or any other specific risk. Policies, procedures, and limits should • Provide for adequate identification, measurement, monitoring, and control of the risks posed by banks' activities • Are consistent with the institution's stated goals and objectives and the overall financial strength of the institution • Clearly delineate accountability and lines of authority across the institution's activities • Provide for the review of new activities to ensure that the infrastructure necessary to identify, monitor, and control risks is adequate With regard to risk management systems in general, the CBA considers whether the following conditions exist • Risk management practices and reports address all material risks • Key assumptions, data sources and procedures used in measuring and monitoring risk are appropriate and adequately documented and tested for reliability • Reports are consistent with a bank's activities; compare actual with expected performance; are accurate and timely and contain sufficient information to identify trends During on site examinations, which are performed every 2-3 years, compliance with these guidelines is assessed.

	Additional Criteria: The CBA advises that major credit and investment decisions that exceeding a certain threshold or are especially risky, or otherwise not in line with the mainstream of a bank's activities, are taken on a senior level. The CBA requires that banks have MIS that provides sufficient information on the condition of the loan and investment portfolios. The CBA verifies that management monitors the total indebtedness of entities to which they extend credit.
Assessment	Essential Criteria – Materially Non Compliant Additional Criteria – Largely Compliant
Comments	The guidelines in the directive/policy paper are sufficiently broad to address the general topics associated with risk management in banks. However, the elements is not detailed enough to give banks adequate guidance on what they should do with regard to each risk category, particularly credit risk. Credit risk is the major risk faced by banks and continues to be the major cause of bank failures. Banks need more detailed guidance to formulate their policies and procedures as well as their risk measurement, monitoring and management information systems. Banks need to understand what minimum standards the supervisors will be evaluating them against. It is also unclear how compliance with the guidelines listed above relate to the actual details reviewed in a loan portfolio during an on-site examination. The elements of loans and credit administration reviewed during on site examinations include a review of • a sample of loans including large and doubtful loans and past dues • minutes of the loan committee and findings of the external/internal auditors • adequacy of loan loss reserve and unallocated loan loss provision • evaluation of overdraft procedures • evaluation of the structure of the credit department for organization/procedures Supervisory on site examinations are too infrequently performed to enable the CBA to provide adequate oversight to the credit risk in banks. Off site surveillance does not now assess asset quality data although the CBA is considering collecting more information from the banks. The mission strongly urges the CBA to collect and analyze asset quality information from the banks more frequently.
Principle 8.	**Loan Evaluation and Loan-Loss Provisioning** Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan-loss provisions and reserves.
Description	As described in the Description section of BCP 7 above, the CBA's guidance paper sets forth general guidelines for risk management, though not specifically for credit risk management. The explicit guidelines on loan classification have not been given to the banks. Each credit institution has to annually submit to the CBA its audited financial statements (per Section 22 of the SOSCS), based on IAS and to account for possible impairment of loans. The CBA relies on the professional judgment of the external auditors in their review of the valuation of loan portfolios. Each year, at a minimum, loan loss provisions have to be established. All banks have their own loan classification systems. During on site examinations, 1) the quality of classification and provisioning systems are reviewed as are 2) the appropriateness of policies and procedures for charge-offs as well as 3) procedures for the ongoing oversight of problem credits and for collection of past due loans. Off balance sheet exposures are required to be included. The CBA has the authority to require a bank to strengthen its lending practices, credit granting standards, level of provisions and reserves, and if deemed necessary, its overall financial strength.

	In accordance with IAS, loans are required to be classified as impaired when there is reason to believe that principal and/or interest will not be paid according to the original loan agreement and the valuation of collateral is required to reflect the net realizable value. **Additional Criteria:** Loans are classified as delinquent when payments are in arrears. Refinancing of loans does not lead to improved classification. The CBA requires that valuation, classification and provisioning for commercial or large loans be conducted on an individual item basis.
Assessment	Essential Criteria – Materially Non Compliant Additional Criteria – Largely Compliant
Comments	The elements of CBA's oversight of banks loan evaluation and loan loss provisioning are largely compliant with minimum standards. However, the lack of frequency of the evaluation of the elements thorough on site examinations and off site surveillance does not allow the CBA to provide oversight of the standards in a timely manner. The lack of frequency of evaluations could allow for deterioration of loan evaluation standards and loan loss provisioning standards. The CBA is contemplating requiring more frequent periodic information on asset quality and the mission strongly urges them to do so. The CBA only performs asset quality reviews during on site examinations, and these are only scheduled to occur every 2 to 3 years. The infrequency of the on site examinations is compounded by the total lack of analysis of asset quality information during off site surveillance. No asset quality monthly reports are required of the banks. Therefore, the only information that the CBA receives and reviews between on site examinations are the annual audited statements. However, given that the requirement to receive the annual reports is six months from the end of the year, by the time the CBA receives the information it is already stale. In any event, external auditors' review of the adequacy of banks' loan loss provisioning should not be instead of supervisory credit risk oversight, but rather, should be another element in oversight of the industry. CBA should conduct more frequent reviews of banks' loan evaluation and loan loss provisioning policies, practices and procedures and the adequacy of their provision. Supervisors in many other jurisdictions review asset quality on a quarterly basis in their off site surveillance function given the importance of credit risk to the financial health of a bank. The mission recommends that the CBA do the same as well as perform on site targeted examinations for asset quality annually, at a minimum CBA's asset classification guidelines should be given to the banks. When asset quality deteriorates, it can do so rapidly. Banks may be reluctant to take the appropriate measures to recognize deterioration and classify and provision loans accordingly due to the negative impacts on their financial statements. It is the role of a supervisory oversight agency to ensure that banks adhere to asset quality guidelines in a timely manner. Given the lack of frequent on-site supervisory oversight, the banks could be inclined to adopt a 'wait and see' approach before taking action, in the hopes that the situation will turn around. For example, Aruba is currently experiencing a slump in tourism as a direct result of September 11th. The banks and the supervisors should be extra vigilant in anticipating and addressing the likely deterioration in asset quality as a result. A more proactive approach by the CBA in its oversight of asset quality is recommended.
Principle 9.	**Large Exposure Limits** Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.

Description	Large loans are defined as all loans to a single client or a group of related clients in excess of AFL 500,000 and/or 15 percent of total regulatory capital (the sum of tier 1 and tier 2 capital). Large loans in excess of 25 percent of regulatory capital are not allowed, unless the CBA has given its prior written approval. The CBA bases its approval on its determination of the financial strength and track record of the client and an evaluation of the collateral. Total large loans may not exceed 800 percent of a credit institution's capital base. Loans granted to local Government and credit institutions supervised by the CBA are exempted from both the large exposure rule and the 800 percent exposure limit. Section 15 of the SOSCS given the CBA the authority to require banks to have proper MIS in plans. The quality of banks' MIS is assessed during on-site examinations. The CBA verifies through on-site examinations and offsite surveillance that bank management monitors that prudential limits are not exceeded. Appendix 3 of the required monthly reports to the CBA lists all loans over 15 percent of total regulatory capital. **Additional Criteria:** By allowing large loans in excess of 25 percent of regulatory capital they exceed the additional criteria limit.
Assessment	Largely compliant with essential criteria. Materially non compliant with additional criteria.
Comments	CBA approval is required for large loans over 25 percent of regulatory capital. Supervisory authorities should not make lending decisions for banks—it is a conflict with their oversight function. Bank management needs to be held accountable for actions taken. Exceeding the 25 percent large loan additional criteria is explained by the authorities as due to a lack of opportunity for diversification in the tourism-based economy in Aruba. There is credit risk in lending to other financial institutions. By exempting supervised institutions from the large exposure rule and the 800 percent exposure limit, credit risk in the banking sector is increased. See Comments section for CP 10.
Principle 10.	**Connected Lending** In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.
Description	Definitions of connected clients and insiders are set forth in the Supervisory Directive in the Prudential Supervision Manual. According to the Directive, the aggregate amount of all credit extensions to insiders may not exceed 2 percent of the institution's capital base, or 1 percent in the case of an individual credit extension. Credit extensions in excess of this amount need the prior written approval of the CBA, whose approval is contingent on the well-defined collateral for the amount extended, which is in excess of the stated limits. The Directive states that if no formal approval has been obtained, the CBA reserves the right to deduct the amount in excess of the 2 percent limit from the credit institution's capital. The Directive requires only that credit extensions to insiders may not be on more favorable terms and conditions than those granted to non-related borrowers. There is no such requirement for connected clients. Banks' policies and procedures are required to include the explicit requirement that limits that are exceeded are approved by the bank's board of directors. This is confirmed during on site examinations through a review of the Board minutes. Bank's policies and procedures are also required to prevent persons who benefit from loans from being part of the loan evaluation and decision process. This is reviewed during on site examinations.

	Additional Criteria: An insider is defined as any manager, director and/or shareholder including partners or relatives in the first and second degree. The prudential limits for exposures to insiders is stricter than those for single or connected borrowers.
Assessment	Essential criteria – Compliant Additional Criteria - Compliant
Comments	The scope of the Directive requiring that credit extensions to insiders may not be on more favorable terms and conditions than those granted to non-related borrowers should be extended to connected clients.
Principle 11.	**Country Risk** Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring, and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.
Description	Banks policies and procedures for addressing country risk are reviewed during onsite examinations in the course of review of loan and investment portfolios and internal controls. The required solvency ratio of 10 percent for onshore banks is considered sufficient to cover country risk and transfer risk in their portfolios as more than 90 percent of their loan portfolios are local. Country risk exists in the offshore book. Country risk provisioning is at head office level for the offshore banks and the CBA depends on the parent bank and the home country supervisor to address country risk issues.
Assessment	Largely compliant
Comments	CBA needs to assess the scale of country risk during the course of examinations. Are they going to assess country risk in off shore exams. Offshore banks are currently undergoing examination by CBA and have not previously been examined onsite. Therefore the adequacy of their provisioning has not been evaluated to date.
Principle 12.	**Market Risks** Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor, and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposure, if warranted.
Description	There are no specific capital charges for market risk and foreign exchange risk given the very limited participation of onshore banks in this activity. The 10 percent capital ratio for onshore banks is meant to cover market risks in banks. Foreign exchange positions are limited to the U.S. dollar and the Netherlands Antilles guilder; both the Aruban florin and the Antilles guilder are pegged to the dollar and have been stable.
Assessment	Largely compliant
Comments	While these risks may be covered by the 10 percent capital charge for the onshore banks there is a need to address market risk in the offshore banks. The CBA's action plan calls for investigating the desirability of introducing capital requirements for market risks for the offshore banks by 2003. The CBA is assessing market risk management in its onsite examination of offshore operations that are currently underway.
Principle 13.	**Other Risks** Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks.
Description	CBA does not require banks to have in place interest rate risk management processes and procedures. They state that there is no need to introduce regulations on interest rate risk for domestic banks as the risk is considered insignificant due to the oligopolistic market structure of the industry. CBA does not require the offshore banks to have interest rate risk management either.

	Supervision of banks' liquidity is based on Section 14 of the SOSCS, which sets a prudential liquidity ratio, defined as liquid assets divided by total assets, at 20 percent. In addition, there is a maximum loan to deposit ratio of 80 percent. Maturity spreads are monitored through off-site surveillance for liquidity purposes, but not for interest rate risk management purposes. Off balance sheet liabilities are taken into account. Banks are required to report individual large depositors, so that the potential volatility of deposits can be monitored. Reporting is monthly. The CBA requires banks to monitor operational risk in accordance with its Guidance Note on Corporate Governance. The major issues addressed with regard to corporate governance are strategic objectives and corporate values, lines of responsibility and accountability, role of board and senior management, adequacy of risk management, internal controls, and financial disclosure. Adherence to supervisory and internal guidelines are tested during on site examinations.
Assessment	Non compliant
Comments	The lack of an interest rate risk management oversight by the CBA results in the risk to a bank's earnings, and hence its capital, posed by movements in interest rates and maturity mismatches not being addressed. This risk should be monitored, measured and proactively managed so that banks take prudent interest rate risks. The CBA's action plan calls for investigating the desirability of introducing a regulation on interest rate risk for offshore banks. The desirability of doing so for onshore banks should also be investigated.
Principle 14.	**Internal Control and Audit** Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls, as well as applicable laws and regulations.
Description	The specific responsibilities of the Board of Directors are spelled out in the Code of Commerce as well as in the policy paper on Sound Corporate Governance Practices. The responsibilities of the Board include ensuring management is competent, that plans and policies are appropriate, monitoring operations to ensure compliance and adequate control and receiving timely information so as to oversee the business' performance. The SOSCS gives the CBA the authority to assess the qualifications of the Board of Directors and senior management and to require changes in the composition of the board and management. The supervisor has access to the reports of the audit function. The policy note sets forth the elements of the quality of internal controls assessed during on-site examinations • The system of internal controls is appropriate to the type and level of risks posed by the institution's activities • The organizational structure establishes clear lines of authority and responsibility for monitoring adherence to policies, procedures, and limits. • Reporting lines provide sufficient independence of the control areas from the business lines and there is adequate separation of duties • Organizational structures reflect actual operating practices • Financial, operational and regulatory reports are reliable, accurate, and timely; exceptions are noted and promptly investigated • Adequate procedures exist for ensuring compliance with applicable laws and regulations • Internal audit or other review related practice provide for independence and objectivity • Internal controls and information systems are adequately tested and reviewed;

	coverage, procedures, findings and response to audits and review tests are adequately documented; identified material weaknesses are given appropriate and timely attention. • The Board, in consultation with senior management, annually reviews the effectiveness of internal audits and other review activities.
Assessment	Essential Criteria – Compliant Additional Criteria – Largely Compliant
Comments	With regard to the additional criteria, 1 and 3 are not applicable. The supervisor recommends, but does not require that the internal audit function report to an Audit Committee.
Principle 15.	**Money Laundering** Banking supervisors must determine that banks have adequate policies, practices, and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.
Description	Under the AML Supervisory Directive, banks are required to adopt internal procedures to combat money laundering, including an internal compliance program, the designation of a compliance officer, and at least annual independent testing of internal controls by the internal or external auditors. The CBA examines for compliance during on site examinations. It has done targeted anti money laundering examinations apart from its regular schedule of full scope on site examinations, which are every 2–3 years. The CBA reviews compliance with know-your-customer guidelines and the adequacy of processes and procedures to report suspicious transactions. It checks the adequacy of processes and procedures by reviewing organizational and/or procedural changes, it reviews the findings of the compliance officer, reviews follow up to information requests from the Court of Justice and it analyzes the list of accounts closed since the previous examination. Given resource constraints, the RCUT assists in the exercise of some of CBA's supervisory responsibilities for examination and training with regard to money laundering. [2]. The RCUT has done one on-site inspection at each onshore bank. Offshore banks have not had anti money laundering inspections although they are required to report suspicious transactions. RCUT's inspections which it carries out under its own responsibility focus on compliance with reporting requirements and have also included assessments of the adequacy of policies, staffing, compliance with the law, and spot checks on the completed transactions by analyzing specific accounts. RCUT does not coordinate its inspections with the CBA. When deficiencies are found, RCUT advises banks on how to correct them. Both the CBA and RCUT have the legal authority to ensure enforcement of the supervisory requirements for anti money laundering. RCUT's planning does not now include regular on site inspections at banks in 2002 due to resource constraints and the expansion of its responsibilities. After conducting on site inspections on the onshore banks and 33 money remitters and bureaux de change in 2000 and 2001, the focus is shifted at this point in time to the casinos and the life insurance companies and intermediaries, considering that these are new institutions which need to be sensitized on the need to report. RCUT has done training at all the onshore banks twice yearly. Although there are no formal plans to continue to do this in the future due to resource constraints, RCUT has stated it will be available to banks on an ad hoc basis.

[2] RCUT: Reporting Center for Unusual Transactions.

	The CBA does not have the explicit authority to share information that it obtains in the course of its on site examinations with the RCUT. In addition, the RCUT is prohibited from sharing information with FIUs without a treaty. However, CBA can share information with other supervisory authorities, although not with other FIUs. Banks are required to report suspicious activities and material frauds. The compliance officer at banks is typically charged with the responsibility to ensure a bank's anti money laundering policies and procedures are in accordance with statutory and regulatory requirements. In addition, suspicious transactions within a bank are reported to the compliance officer. Banks report suspicious transactions to the RCUT and can go directly to the Prosecutor's office as well. Bank's staff members and the Bank itself, cannot be held liable for the reporting in good faith of suspicious transactions to the RCUT. During on site examinations, the CBA determines whether banks have policy statements on ethics and professional behavior and that these are clearly transmitted to all staff. **Additional Criteria:** The anti money laundering directives contain minimum standards for sound and effective know-your-customer policies. During on site examinations, the RCUT has determined that the adequacy of staff training and the CBA reviews this during it's on site examinations. At the present time, the CBA is not legally obligated to inform the judicial authorities of suspicious transactions (although the banks are required to report them to the RCUT). The CBA has knowledge of financial fraud and anti money laundering obligations and the RCUT has specialist expertise.
Assessment	Essential Criteria – Largely Compliant Additional Criteria – Largely Compliant
Comments	The lack of ability to share information between the CBA and the RCUT needs to be addressed as well as the prohibition against RCUT's sharing of information with foreign FIUs (although it is authorized to receive information, it cannot, in turn, provide information). The CBA's examinations are too infrequent—on site examinations are only every 2–3 years. In addition, there are no plans going forward to do more fuller scope of anti money laundering assessments as which have been done by RCUT. There is a need for more frequent on site examinations of banks' anti money laundering policies and procedures that could be accomplished by more frequent targeted examinations. There is a need for CBA to expand the scope of its on site money laundering inspections to capture the elements assessed by RCUT during its inspections. Failure to expand the scope and frequency of the on site examinations would result in a materially non-compliant rating for this principal. RCUT should be given additional resources to enable it to continue to effectively carry out its tasks in analysis of suspicious transactions, bank inspections and training, as well as its work with other institutions including insurance, casinos, money remittance services, company service providers, etc.
Principle 16.	**On-Site and Off-Site Supervision** An effective banking supervisory system should consist of some form of both on-site and off-site supervision.
Description	The frequency with which the CBA conducts regular on-site examinations at the banks it supervises depends to a large extent on the risk profile of each institution. The risk profile of each institution is based on • The nature and size of its activities • The legal structure • Off site analysis

	• Discussions with senior management • Previous on site findings • Professional judgment Asset quality and non-performing loans are part of the risk profile assessment of an institution, to the extent that they were part of the previous on site examination. However, full scope on-site examinations are generally carried out only once every three years at the branches and subsidiaries of foreign banks and every two years at the local banks. No on site examinations have been done at the two offshore banks in the past; however they're an examination of their administration currently underway and relevant documents have been brought to Aruba for inspection. More frequent inspections may be carried out if the risk profile indicates a need for this and limited scope examinations are done. Many of the limited scope examinations in recent years have been focused on anti money laundering procedures and controls. During its on site examinations the CBA focuses on the quality of the loan portfolio, the adequacy of the loan loss provisions, the quality of MIS, the administrative organization and anti money laundering procedures. During on site examinations, the CBA meets with internal auditors and reviews their work program and its scope. Based on any findings as a result of the meeting with internal auditors, the scope of the CBA's on site examination may expand. Preliminary on site findings are discussed with internal auditors prior to being discussed with senior management. Based on the findings, the CBA may issue directives and/or guidelines. Off site surveillance consists of analysis of monthly reports and appendices submitted by the banks, the certified annual reports and management letters prepared by the external auditors. The monthly reports include information regarding claims, loans and investments by type and by sector, large exposures, interest rates charged and paid, movements in balance sheet items, maturity spreads, risk weighted solvency testing, liquidity testing, etc. Neither interest rate risk nor credit risk are meaningfully addressed in off site surveillance neither in the information that is required of the banks nor in the analysis which takes place. The monthly information required of the banks does not include asset quality information, past due loans, non-accruals, nor changes in loan classifications. The banks themselves typically review the adequacy of their loan loss provisions at least twice yearly, based on their own internal requirements. This information is not required to be submitted to the CBA. **Additional Criteria:** The CBA has the right to access copies of reports submitted to the board by both internal and external auditors. The supervisors methodology for assessing risk is based on a CAMEL based approach for on site examinations. Per Section 35 of the SOSCS, data and information about individually supervised institutions should be treated as confidential; the CBA is allowed to disclose information to foreign supervisory authorities. The CBA is able to place reasonable reliance on internal audit work that has been competently and independently performed. The quality and scope of internal audit is reviewed during on site examination.
Assessment	Essential Criteria – Materially Non Compliant. Additional Criteria – Largely Compliant
Comments	Credit risk, the major cause of bank failures worldwide, is not adequately addressed in the scope of both on site examinations and off site surveillance performed by the CBA. Credit risk is examined during on site examinations, but they are too infrequent to provide the supervisory authorities with current, in depth asset quality information necessary to analyze a specific bank as well as the banking sector. Off site surveillance does not address credit risk issues.

	The CBA relies on the annual external auditors to examine the adequacy of loan loss provisions. However, while this is an important function, it is insufficient in two regards. The external audit function should be one of the "checks and balances" available to the CBA to verify a bank's findings as well as the supervisory findings on the same issues; it should not be a substitute for the supervisor's role in oversight of the asset quality of the banking sector. In addition, the information received by the CBA based on the external auditors' work is not timely. The loan portfolio analysis performed by the external auditors is done once a year and is relatively stale information by the time the supervisory authorities receive it. The timeliness of the information received from the work of the external auditors is insufficient to detect changes in asset quality and to allow the supervisory authorities to effectively oversee banks' management of credit risk. The CBA's oversight of bank's credit risk management would be greatly enhanced by more frequent on site examinations, targeted at credit risk. In addition, off site surveillance reporting should require asset quality information and it should be analyzed with a periodicity that enables the CBA to monitor loan portfolio trends and react more proactively in its oversight function with regard to credit risk. The CBA needs to develop a methodology to examine for interest rate risk at individual banks. It is one of the major risks banks face and it needs to be measured, monitored and managed and the CBA needs to ensure that banks don't take undue interest rate risk and have the appropriate risk management tools available to them.
Principle 17.	**Bank Management Contact** Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.
Description	At least once a year, meetings are held with senior management of all supervised institutions, both onshore and offshore, to discuss the financial other developments at their banks. During onsite examinations, supervisors meet with the department heads of the areas, which will be examined including the Comptroller, operations, internal audit, credit and personnel. Discussion include strategy, corporate governance, performance, internal controls, etc. The banks are required by law to notify the supervisors of any substantive changes in their activities. The quality of management is evaluated during licensing as well as during routine supervision. The supervisors have a reasonable understanding of the activities of their banks. However, due to the weaknesses in credit risk and interest rate risk oversight, discussed in BCP 16, they are not fully aware of these risks on a timely basis.
Assessment	Largely compliant
Comments	See Comments in BCP 16. Supervisors would be better informed about the risk profile of the institutions they supervise if they were more proactive in the oversight of credit and interest rate risk management practices and policies at the institutions they supervise.
Principle 18.	**Off-Site Supervision** Banking supervisors must have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.
Description	By virtue of Section 30 of the SOSCS, banks must submit to the CBA statements of assets and liabilities and appendices, on a monthly basis. The appendices include loan information by industry, large borrowers, liability maturity schedules, maturity spreads of assets and liabilities, solvency analysis, etc. Loan classification and provisioning is only obtained during on site examinations and from the externally audited annual reports. The CBA has the authority to establish the principles and norms to be used in consolidation of accounts as well as the accounting techniques to be used. In general banks apply IAS.

	Sections 30 through 33 of the SOSCS grant the CBA the means to enforce compliance. Under Section 53, a credit institution acting in violation of the above-mentioned provisions shall be liable either to imprisonment or fine. Per Section 52 of the SOSCS, the CBA is authorized to request all information, demand inspection of all books, records and other data carriers. It is authorized to enter all places, if necessary with the aid of the police. The CBA has an analytical framework to analyze the monthly information it receives, with the exception of loan classification and provisioning information. It receives a maturity spread report monthly but does not perform an interest rate risk analysis nor require the banks to report on their interest rate risk and analyze its impact on bank earnings and capital. The collected information is a component of on site examination planning. The CBA also collects data from all commercial banks and analyses the information on a comparable basis. The CBA collects data from the commercial banks both weekly and monthly. In addition, each credit institution is required to submit to the CBA, within six months after the end of the financial year, its annual accounts, accompanied by the external auditor's report. To repeat, information collected on asset quality, classifications and provisioning is too infrequent. It is reviewed during on site examinations, which are every 2-3 years. In addition, it is reviewed upon receipt of the annual accounts but the information is not timely.
Assessment	Largely Compliant
Comments	The CBA needs to collect financial information with regard to asset quality, loan classification and provisioning, as well as non accruals, past dues, etc. to better understand, monitor and oversee the quality of banks' loan portfolios. In addition, while it requires banks to submit a maturity of assets and liabilities report monthly, there is no analysis as to the impact of maturity mismatches on bank earnings.
Principle 19.	**Validation of Supervisory Information** Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.
Description	The CBA conducts periodic on site examinations using in-house examiners. The areas examined are the quality of the loan portfolio, the quality of the loan loss provision, the quality of the administrative organization and the anti money laundering procedures. Per Section 23 of the SOSCS, the CBA can request the external auditors to give additional information and can also request to discuss the results of their work. Per Section 23 of the SOSCS, the CBA can monitor the quality of the work done by the external auditors for supervisory purposes. The CBA has the authority to appoint external auditors to conduct supervisory tasks. In accordance with Section 1, sub 1, the auditor must be registered at the Netherlands Institute of Chartered Accountants or elsewhere at a similar institute and is subject to, in the opinion of the CBA, a regime of conduct, professional code and discipline. The CBA has no explicit authority to revoke the appointment of a bank's auditor. Per Section 23, the CBA can make use of external auditors to examine specific aspects of a bank's operations. The section also sets forth the responsibilities of the external auditor. The CBA can request the external auditor to give addition information if required. The external auditor is required by law to report to the CBA matters, which they believe to be material. Per Section 52 of the SOSCS, the CBA has full access to all bank records, and access to the board, management and staff for the performance of its tasks.

	Per Section 30 of the SOSCS, a credit institution must periodically submit to the CBA statements regarding its business. The December monthly statement must be certified by an external auditor. Also, in accordance with Section 22, each credit institution is required to submit its annual accounts to the CBA, accompanied by the auditor's opinion. **Additional Criteria:** The CBA meets with management annually to discuss general matters. The financial status of the institution will only be discussed if necessary as the CBA feels that the monthly analysis and discussions surrounding them are sufficient. The CBA meets with management after each on site examination, which take place every 2–3 years. If necessary, the CBA will meet with the external auditor during an on-site examination. However, an institutionalized forum between the CBA and the audit firms does not presently exist.
Assessment	Essential Criteria – Compliant. Additional Criteria – Largely Compliant
Comments	The CBA's action plan includes introducing a provision in the SOSCS, by the end of 2002, requiring its prior approval of a bank's external accountant.
Principle 20.	**Consolidated Supervision** An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.
Description	The supervisors are informed as to the structure of the banks they supervise. However, it should be noted that none of the onshore banks have foreign branch offices or subsidiaries. During onsite examinations, the non-banking activities conducted by the banks are evaluated. The offshore operations consist of a foreign bank branch and subsidiary of Citibank. The onsite examination of these offshore operations in currently underway. The CBA has the legal authority to review the overall activities of a bank and there are no impediments to the direct supervision of affiliates or subsidiaries. The CBA has the authority to impose prudential standards on a consolidated basis and consolidated financial information is collected for each banking organization. In accordance with Section 16 of the SOSCS, the CBA has the authority to limit or circumscribe the range of activities the consolidated banking group may conduct. **Additional Criteria:** The CBA has no authority to review the activities of parent companies and of companies affiliated with the parent. The CBA does require its written permission to change a qualifying holding in a bank and to exercise any control attached to a qualifying holding. The supervisor has the authority to take remedial actions regarding parent companies if the transactions would have an impact on the bank.
Assessment	Compliant
Comments	
Principle 21.	**Accounting Standards** Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.
Description	Each institution under the CBA's supervision is required by law to provide the CBA, on a yearly basis, within 6 months of the end of the year, its audited financial statements. The reports are reviewed and if necessary discussed with management, sometimes in the presence of the external auditor. In general, financial statements are prepared in accordance with IAS.

	In accordance with Section 76 of the Code of Commerce, each financial institution has to submit its condensed financial statement to the Chamber of Commerce to enable the public to have access to them. Most banks do not comply with this requirement. The CBA ensures that information from bank records is verified periodically through onsite examinations and/or external audits. By virtue of Section 23 of the SOSCS, the CBA ensures that there are open lines of communication with external auditors. The supervisor requires banks to use IAS for valuation purposes, in principal. The CBA does not have the authority to establish the scope of external audits in individual banks. In order to have audit scopes address issues of particular interest to the CBA, it would need to go through the banks to have them make the request to their auditors. In accordance with Section 35 of the SOSCS all data or information about individual enterprise or institutions furnished or obtained under the SOSCS is confidential. The CBA requires banks to produce annual audited financial statements based on IAS. The statements are audited under U.S. or Dutch GAAP, although this is not a CBA requirement. The CBA has no explicit legal authority to revoke the appointment of a bank's auditor. Auditors have the legal duty to report to the supervisor matters of material significance, including failure to maintain the licensing criteria, or breaches of banking or other laws. The law protects auditors from breach of confidentiality when information is communicated in good faith. Auditors also have the legal duty to report matters to the supervisor, which they believe, are likely to be of material significance to the functions of the CBA. **Additional Criteria:** The supervisor promotes periodic public disclosures of timely, accurate and comprehensive information through its requirement for audited financial information and through the requirement to submit financial to the Chamber of Commerce. The supervisor does not give guidelines on the scope and conduct of audit programs. In accordance with Section 23 of the SOSCS, the auditors are required to report to CBA all significant matters and those like to be of material significance to the functions of the supervisors. The law protects auditors from breach of confidentiality when information is communicated in good faith.
Assessment	Largely Compliant
Comments	The CBA's action plan includes introduction of a provision to the SOSCS requiring the CBA's prior approval of a bank's external auditors as well as a provision requiring banks to publish their audited annual financial statements.
Principle 22.	**Remedial Measures** Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.
Description	CBA's authority to take corrective measures is contained in Section 20 of the SOSCS. If the DBA determines that a credit institution does not comply with the directives regarding the solvency, liquidity or administrative organization, it notifies the institution. It may, at the same time, provide a directive on the course of action to be pursued. If, within two week of the date

	of notification of the directive, the CBA has not received an answer from the credit institution which it regards as satisfactory, or is it is determined that the directive has not been or has been insufficiently complied with, the CBA may 1. Give the credit institution written notification that, as of a certain date, all or parts of the credit institution may only exercise their powers after approval has been obtained from one or more persons appointed by the CBA and with due observance of the instructions given by these persons; to be effective immediately upon notification of the institution 2. Give the credit institution written notification that the CBA will publish the directive, which publication shall, if so requested by the credit institution, also comprise the correspondence between the CBA and the institution concerning the directive 3. Enter into consultation on the matter with the chairman of the institution if the CBA considers this in the interests of the creditors. If the CBA considers that immediate action is required, it can proceed with actions (1) and (3) simultaneously, after having given the credit institution the opportunity to present its views about implementation. 4. Per Section 18 of the SOSCS, a bank's license can be changed or withdrawn by the CBA in case of failure to comply with the conditions attached to the license. 5. In the event that the solvency or liquidity of a bank is considered 'dangerous' and improvement is not considered likely, the CBA can request the Court to apply emergency regulations (Sections 37–47 of the SOSCS) Management and the board could be held liable for imprisonment or fines. **Additional Criteria:** The CBA can take corrective actions when it considers them appropriate. Section 20 of the SOSCS authorizes the CBA to give written notification regarding remedial actions to the board and can request progress reports be submitted to it.
Assessment	Essential Criteria – Compliant Additional Criteria – Compliant
Comments	Banking laws should be broadened to give the CBA the authority to impose a tiered system of administrative fines on banks for violations of law, including those related to anti money laundering. The fines should be against banks as well as directors and officers personally. The CBA should be given the authority to ban persons in banks who violate laws. In addition, the CBA should be given the authority to approve external auditors and to ban them if they violate laws. The two-week waiting period after non-compliance with a CBA direction should be eliminated. The CBA should be able to take immediate action.
Principle 23.	**Globally Consolidated Supervision** 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.
Description	None of the locally incorporated banks have foreign branches or subsidiaries
Assessment	Not applicable
Comments	
Principle 24.	**Host Country Supervision** A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.

Description	Aruban banks have no foreign operations.
Assessment	Not Applicable
Comments	
Principle 25.	**Supervision Over Foreign Banks' Establishments** Banking supervisors must require the local operations of foreign banks to be conducted with 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.
Description	In accordance with Section 24 of the SOSCS, branches of foreign banks have to comply with the same requirements as domestic banks. The CBA is knowledgeable about the approach and scope of the supervision conduct of the home country supervisors, the U.S. Fed and OCC. The local operations of foreign banks are the two offshore Citibank operations, whose operations were 'grand fathered' due to their long-standing presence here. No new licenses have been issued in the past few years. By virtue of Section 34 of the SOSCS, the CBA has the authority to furnish data or information obtained during the performance of its tasks to foreign supervisors which have been charged by law with the supervision of financial markets, provided that 1) furnishing the data would not provide SOSCS' interests 2) that the purpose for which the data or information will be used is sufficiently specific and clear for the CBA 3) sufficient safeguards are in place to ensure that the data or information will not be used for a purpose other than that for which they have been furnished 4) the data is kept confidential and 5) data can be exchanged on the basis of reciprocity. Because the offshore operations are physically located in Venezuela, it is the Venezuelan authorities that can give access to the local offices for safety and soundness purposes. The CBA can provide the home country supervisors with information on any remedial action, as needed. The CBA has an MOU with the Netherlands Antilles to exchange prudential information with regard to its branches in Aruba. They meet bi-annually and on an ad hoc basis, as needed. There is no MOU with Venezuela where the offshore branches are physically located. The CBA has stated that it will not license another offshore operation unless it has a physical present in Aruba. Citibank was an exception and was grandfathered due to its long-standing presence in Aruba. There is no formal arrangement with the OCC and the Fed as to the offshore operations of which they are the regulators. Although they have acknowledged their responsibility for consolidated supervision. The U.S. regulators have not done an examination of the offshore operations since 1993, but they did provide CBA with a report of their findings at that time. **Additional Criteria:** The CBA has received information in the past from the home country supervisors, most of which was publicly available information.
Assessment	Compliant – Essential Criteria. Largely Compliant – Additional Criteria
Comments	There is an over reliance on the part of CBA on the perception that Citibank is "too big to fail" or is under another country's jurisdiction and that therefore its local operations are sound. Whether Citibank is "too big to fail" or not, it is still a distinct possibility that its local operations could experience significant problems, be poorly managed or be taking undue risk. Citibank infrequently sends its internal audit and internal loan review to evaluate the local operation and the U.S. regulators have never been here. CBA understands that it needs to be more proactive in its oversight of these offshore operations and is doing onsite examinations of these operations now.

	In addition, the OCC informed the CBA that it is Citibank's policy to establish effective money laundering/detection programs, which are designed to ensure compliance with money laundering prevention laws of the host country. Although Citibank reports unusual transactions to the RCUT, there is a need to do an onsite examination of its compliance with anti money laundering policies and procedures. To do so, the permission of the Venezuelan authorities is needed to physically go on site and the CBA is planning to pursuer this matter with the Venezuelan authorities.

Table 2. Summary Compliance of the Basel Core Principles

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Compliant	15	1,1; 1,2; 1,3; 1,4; 1,6; 2; 3; 4; 5; 6; 10; 14; 19; 20; 22
Largely compliant	9	1.5; 9; 11; 12; 15; 17; 18; 21; 25
Materially non compliant	3	7; 8; 16
Non compliant	1	13
Not applicable	2	23; 24

Recommended Action Plan

Table 3. Recommended Action Plan to Improve Compliance with the Basel Core Principles[3]

Reference Principle	Recommended Action
Adequate Resources (CP 1 (2))	Acquire additional resources as CBA responsibilities will expand to accommodate responsibilities for re insurance, anti money laundering, CSPs and money transfer companies.
Credit Policies (CP 7)	CBA needs to provide banks with more detailed guidance to formulate their policies and procedures as well as their risk measurement, monitoring and management information systems. CBA needs to provide banks with the standards against which they will be evaluated.

[3] These recommendations are additional to the Action Plan of the authorities as laid out in the Executive Summary of this report.

Reference Principle	Recommended Action
Loan Evaluation & Loan Loss Provisioning (CP 8)	CBA should give banks its loan loss classification criteria. CBA should require more frequent reporting on asset quality. CBA should analyze this information at least quarterly and discuss major issues with bank management. CBA should conduct more frequent reviews of banks' loan evaluation and loan loss provisioning policies, procedures and the adequacy of their provisions. CBA should do targeted asset quality examinations at least annually at all banks.
Large Exposure Limits (CP 9)	CBA should stop requiring its approval for large loans over 25 percent of regulatory capital. This responsibility should be taken by the institutions, not the CBA. CBA should set clear guidelines and limits for the granting of large exposures. Banks should be required to make the decisions, to establish policies and limits within their institutions, and be accountable for keeping within the limits of their own policy. CBA should be notified of all large loans and those exceeding limits.
Connected Lending (CP 10)	The scope of the Directive requiring that credit extensions to insiders may not be on more favorable terms and conditions than those granted to non-related borrowers should be extended to connected clients.
Country Risk (CP 11)	CBA needs to assess country risk during on site examinations.
Other Risks (CP 13)	Introduce regulations requiring the monitoring, measuring and management of interest rate risk. CBA needs to assess compliance during onsite examinations and offsite surveillance.
Money Laundering (CP 15) (Also see Anti Money Laundering Template)	Enact law-allowing CBA to share findings of bank examinations with MOT. CBA needs to ensure compliance with anti money laundering policies and procedures and training requirements through annual on site targeted examinations.
On Site and Off Site Supervision (CP 16)	CBA should begin evaluating credit risk in off site surveillance. Target examinations for credit risk should be annual. Include interest rate risks in risks being assessed.
Off Site Supervision (CP 18)	CBA needs to more frequently collect and analyze information on asset quality, loan classification and provisions, non-accruals, past dues, etc. It needs to collect and analyze information related to interest rate risk.
Validation of Supervisory Information (CP 19)	CBA should require prior approval of banks' external auditors and the power to appoint a special auditor, when needed.
Accounting Standards (CP 21)	CBA should require banks to publish their audited annual financial statements and enforce compliance.

Reference Principle	Recommended Action
Remedial Measures (CP 22)	Banking laws should be amended to grant the CBA the authority to impose a tiered system of administrative fines on banks for violations of law, including those related to money laundering. Fines should be against banks, as well as directors and officers personally. The CBA should be give the authority to ban persons in banks who violate laws. In addition, the CBA should be given the authority to approve external auditors and to ban them if they violate laws. The two-week waiting period after non-compliance with a CBA directive should be eliminated.
Supervision over Foreign Banks' Establishments (CP 25)	CBA needs to enhance its oversight of offshore operations; needs to do regularly scheduled examinations (one in process); needs to begin to assess credit risk, interest rate risk, market risk on an ongoing basis. CBA needs to discuss arranging an MOU with Venezuelan banking supervisors.

Authorities' Response to the Assessment

The authorities were in broad agreement with the great majority of the assessments.

With regard to the assessment on supervision of interest rate risk, as a component of BCP 13, the authorities were of the opinion that Aruban banks did not incur interest rate risk. Banks' loans are predominantly floating rate, thus limiting the scope for mismatch. Furthermore, margins between deposit and lending rates are high, at an average of 6 percent, and can buffer substantial interest rate swings. Also, rates have been very stable, and bank profitability is strong, at 46 percent ROE.

With regard to the assessment of compliance with BCP 9, on large exposures, the CBA will consider redefining the policy of assessment by the CBA of the quality if the borrower and of collateral before approving loans in excess of the large exposure limit of 25 percent of own funds. The CBA agrees that it should not be seen to take any responsibility in the loan decision, which should be fully for account of the bank.

The CBA agrees to schedule more frequent small scale inspections of banks credit portfolios, and to request banks to submit on a regular basis more complete credit quality information, for analysis by the CBA. Thus, the CBA will obtain more timely asset quality information and be less dependent on the annual assessments by the external auditors.

II. Assessment of Observance of the IAIS Core Principles

A. Main Findings—Summary

General

The assessment of the observance by Aruba of the IAIS Core Principles (see Table 9) was conducted using the established Methodology for these assessments. The assessment was based on a review of the laws and regulations applicable to the supervision of insurance in Aruba, onshore as well as offshore, and on discussions with staff of the regulatory agency, the CBA, the Association of Insurers, representatives of the insurance sector, and anti-money laundering authorities.

Main Findings and Recommendations

Organization of an Insurance Supervisor (Principle 1)

It is recommended that the CBA review the human resources within the Supervisory Department and look closely at the insurance expertise (life and non-life, as these are separate areas of expertise) with a view to providing succession planning and assuring adequate resources, also in light of increased responsibilities for supervision. The personnel should be able to cover all aspects of insurance supervision with the appropriate trainees in each area being brought to the appropriate standards. The CBA should consider instituting a structured insurance training program for some of its existing talented inspectors and employ more trainees as support staff. It is further recommended that legislation be passed to provide the CBA and its staff with immunity of suit in all cases (including negligence) except for those involving an act of bad faith. It is further recommended that legislation be passed to make third parties used by the CBA (e.g., auditors and actuaries used during investigations) subject to the same legal requirements, in particular containing confidentiality, as the CBA. The CBA should be able to take action against such parties in cases of negligence or bad faith. Where the legislation and regulation permits discretion, the CBA should prescribe in more detail the limits to the use of discretion. After two or three years experience with the SOSIB, the law and the regulations should be reviewed and consolidated to produce modern insurance legislation of the highest international standards, in compliance with all appropriate IAIS Core Principles and the Offshore Group of Insurance Supervisors Guidelines and Principles.

Licensing (Principle 2)

It is recommended that either the SOSIB is changed to include the licensing of captive insurance managers or, if administered by the CBA, the proposed company service provider legislation is changed to include captive insurance managers as a separate licensee with fit and proper requirements. It is further recommended, as absolutely essential, that the CBA should have a fast and effective access to police and RCUT information. Fit and proper checks are incomplete without access to information that these bodies hold. It is further recommended that Section 5 of the SOSIB be clarified so that "the public" includes all

persons including corporations and other organizations. The mission recommends that there should be no exemptions to the ban on composites unless there are *de minimis* examples (e.g., a fully funded key man policy or short term reinsured credit life) or there were to be some future statutory life fund protection.

Changes in Control (Principle 3)

As indicated in the template in Volume II of this report, the State Decree, which will supervise changes in control, has already been drafted, and can expect to be introduced by mid-2002.

Corporate Governance (Principle 4) and Internal Control (Principle 5)

Some work has yet to be done on the introduction of these Principles although the SOSIB under Section 10 permits guidelines to be issued and has other relevant aspects (e.g., structure of the Supervisory Board). Certain of the guidelines also contain aspects pertaining to these Principles. For instance, those on asset management have a comprehensive section on the duties of the Supervisory Board from aspects of corporate governance and also of internal control.

Assets (Principle 6)

It is recommended that the CBA prescribe "approved assets" to be used in the calculation of the minimum margin of solvency. Such approved assets could exclude related party (including head office current accounts) unless adequately collateralized. Such a prescription should also include a "spread of assets requirement." The CBA should develop the risk-based approach that has already been drafted, but should review the percentages of deductions for certain assets. The CBA should look at each insurer and class of investment separately, and in some detail.

Liabilities (Principle 7)

The CBA is currently working with consulting actuaries to produce guidelines addressing the oversight of the adequacy of the technical provisions of all insurers (life and non-life). The technical provisions contain the most important element of an insurers balance sheet and it is recommended that the work outlined above is comprehensive, expedited and, when completed, prescribed within the legislation.

Capital and Solvency (Principle 8)

The CBA may wish to consider implementing the "regulatory ladder" approach whereby corrective actions become mandatory when certain pre-defined levels of solvency are reached. These corrective actions can range from the implementation of an action plan by the insurer to the appointment of an administrator.

Derivatives and "Off-balance Sheet" Items (Principle 9)

The CBA may wish to consider, when prescribing approved assets mentioned above within Principle 6—Assets), prohibiting investments in derivatives and "off-balance sheet," except for instruments used for hedging purposes, unless specifically approved by the CBA in individual cases.

Reinsurance (Principle10)

For clarity it is recommended that the definition of insurance business in the SOSIB be amended to also include reinsurance and retrocessional business. It is further recommended that the proposed State Decree regulating the supervision of reinsurance companies is quickly drafted, and implemented as soon as possible. It should also include provisions for the use of reinsurance and retrocession arrangements, by insurers and reinsurers respectively.

Market Conduct (Principle 11)

We strongly recommend that changes be made in order to supervise market conduct, including the supervision of all insurance intermediaries (insurance agents—directly or indirectly through their employer or principal—and insurance brokers). The CBA should consider instituting compulsory codes of conduct to prevent the public from receiving misleading advice on what can be an individual's largest lifetime investment e.g., an endowment mortgage insurance policy. The mission advises the CBA to consider introducing compulsory qualification standards for insurance advisors (agents and brokers). The mission is not advocating that The CBA should interfere with the market structure, rate setting, design of insurance contracts and other business related matters. If the above recommendation is effected, the CBA should not be the body that adjudicates on complaints. This should, preferably, be an independent ombudsman (who could arbitrate for all sectors of financial services) and, in the last resort, the Courts.

Financial Reporting (Principle 12)

The problem with reporting systems in most jurisdictions is that the information reported to the insurance supervisor is usually out of date. It is recommended that any material changes to the business plan agreed by the CBA, need to be notified to the CBA in advance of the change. This would enable the CBA to take action if the changes were not to their liking, but would not involve any delay to implementation of the change. Material changes would include new products and lines of business, greatly increased exposures, business concentrations, changes to the reinsurance program, and, changes to the underwriting policies. We also recommend that the SOSIB should mandate that external auditors and actuaries report any unusual circumstances to the CBA as soon as these are discovered. The SOSIB should provide the necessary legal protection for the informant.

On-site Inspection (Principle 13)

It is recommended that, as well as using the risk profile method to assess the work to be undertaken during an on-site inspection, the CBA reverts to the more structured visits, used in the past, including the utilization of checklists.

Sanctions (Principle 14)

We recommend that the CBA is given the powers to:

- Apply penalties and sanctions against individual members of management and/or supervisory board;
- Suspend, on a temporary basis and/or permanently bar (for at least 10 years), senior management;
- Limit the payment of dividends of an undercapitalized insurer;
- Remove or disqualify an external auditor;
- Retain a special auditor (at the expense of the insurer), where appropriate; and
- Extend the range of violations for which monetary penalties can be imposed (already proposed by the CBA.

Cross-border Business Operations (Principle 15), Coordination and Cooperation (Principle 16) and Anti-money Laundering (Draft Principle 18, suggested to IAIS by the Fund)

With regard to anti-money laundering, there does not appear to be the means of controlled exchange of information with international bodies, other than financial services supervisors, nor even with bodies in Aruba, such as the police or the RCUT. This aspect should be investigated with a view to facilitating the exchange of information in the interests of the prevention and the detection of crime (including money laundering). In our view it is essential that the CBA be informed about the findings of investigations into fraud and money laundering involving the financial services sector. It is recommended that there are explicit requirements for the insurer or the insurance intermediary to inform the supervisor on fraud or money-laundering cases. While life insurers and insurance intermediaries selling life insurance will come under the anti-money laundering legislation from January 1, 2002, there are no current plans to extend this to non-life insurance. The Mission is aware of the use of non-life vehicles for money laundering and it is our strong recommendation that these types of insurers and insurance intermediaries should come under the legislation as soon as possible.[4]

[4] It should be noted, however, that the FATF has not yet required that non-life insurers be subject to AML rules.

Confidentiality (Principle 17)

This Principle is fully observed.

Detailed Assessment

Table 4. Detailed Assessment of Observance of the IAIS Insurance Core Principles

Principle 1.	**Organization of an Insurance Supervisor** The insurance supervisor of a jurisdiction must be organized so that it is able to accomplish its primary task, i.e., to maintain efficient, fair, safe, and stable insurance markets for the benefit and protection of policyholders. It should, at any time, be able to carry out this task efficiently in accordance with the Insurance Core Principles. In particular, the insurance supervisor should: – be operationally independent and accountable in the exercise of its functions and powers; – have adequate powers, legal protection, and financial resources to perform its functions and exercise its powers; – adopt a clear, transparent, and consistent regulatory and supervisory process; – clearly define the responsibility for decision-making; and – hire, train, and maintain sufficient staff with high professional standards that follow the appropriate standards of confidentiality.
Description	The CBA is a legal entity in itself ('sui generis') with an autonomous position within Aruba's public sector. The responsibilities and objectives of CBA with respect to its supervisory tasks are laid down in the Central Bank Ordinance (AB 1991 No. GT 32). The CBA is financed in such way that does not undermine its autonomous position and permits it to conduct effective supervision and oversight. This includes, inter alia, salary scales that allow it to attract and retain qualified staff; the ability to hire outside experts; a training budget and program that provides ample training opportunities for staff and a budget for computers and other equipment. The management of the CBA is entrusted to the president, assisted by two executive directors. According to the Central Bank Ordinance the president and the directors are appointed and can be suspended or dismissed by the Governor of Aruba (upon recommendation of the Supervisory Board of the Bank). The Supervision department, which directly falls under an executive director, consists of seven (7) staff members (including one support staff member). Presently six staff members are directly involved in the supervision activities. The executive director and all six staff members have university degrees and regularly attend insurance training programs, conferences, courses and seminars. The legal officer of the CBA is also an advisor on supervisory matters with legal implications. The CBA has its own fringe benefits that are comparable to the benefits of the private sector. The responsibilities of the CBA as an insurance supervisor are clearly stated in the SOSIB. The SOSIB also grants the CBA the authority to issue directives and guidelines on specific topics, such as money laundering and corporate governance, with the objective to further its scope for supervision in more detail.

The States Ordinance for the Supervision of Insurance Business (SOSIB) and its Implementation Ordinance became effective on July 1, 2001, bringing all insurers operating in or from Aruba under the CBA's supervision. Before this date, only the domestic life insurance companies had been under the CBA's supervision, initially, (until it was superceded by the new banking law in 1998), under the State Ordinance on the Banking and Credit System, and latterly under documented gentlemen's agreements. These agreements were considered null and void effective July 1, 2001.

The new SOSIB is a first important step to bring both the domestic and the offshore insurance industry under effective supervision. The CBA is now in the process of building up experience with supervising domestic non-life (general) and all offshore insurance companies. With the introduction of the SOSIB and the important supervisory regulations (many of which have already been drafted), which are due to be issued from January 1, 2002, Aruba should achieve a high degree of compliance with international best practices for insurance supervision.

Under the SOSIB and its Implementation Ordinance, all existing insurance companies operating in or from Aruba are required to request a license from the CBA by December 31, 2001.[5] The CBA has until June 30, 2002 to take a decision on the license applications received. Insurance companies that wish to establish in Aruba after July 1, 2001 need to have a license before they can commence their activities. The SOSIB provides that separate State Decrees may be issued for the supervision of certain categories of insurers, such as captives and reinsures (section 2, paragraph 4 of the SOSIB). A table of the proposed legislation changes and their status is as follows:

	Proposed legislation changes	**Expected implementation date and status of documentation**
1	Finalize State Decree Special Provisions on Captives.	Early-2002 Already drafted
2	Draft a State Decree on reinsures.	Mid-2002 Not yet considered
3	Finalize State Decree regulating changes in ownership of insurance companies.	Mid-2002 Already drafted
4	Finalize State Decree regulating appointment of local representatives.	Mid-2002 Already drafted
5	Issue guidelines on solvency margins.	Early-2002 Already drafted
6	Issue guidelines on asset management.	Early-2002 Already drafted
7	Issue guidelines on technical provisions.	Early-2002 In discussion with Consulting Actuaries
8	Review anti-money laundering guidelines to conform with the forthcoming IAIS guidance.	Mid-2002 Awaiting final IAIS paper (expected in January 2002)
9	Introduce a requirement in the SOSIB for external auditors to report significant matters to the CBA.	End-2002 SOSIB change required

[5] Insurance brokers and agents are not subject to supervision.

	Proposed legislation changes	**Expected implementation date and status of documentation**
	10 Introduce a provision in the SOSIB requiring insurers to publish their audited annual financial statements	End-2002 SOSIB change required
	11 Conclude MOUs with insurance supervisors in the Netherlands Antilles, Barbados, Trinidad and Tobago, Canada, USA and the Netherlands.	End-2002 Considerations will commence now that SOSIB is in place
	12 Consider extending the range of violations for which monetary penalties can be imposed.	End-2002 SOSIB change required
	13 Consider the introduction in the SOSIB of market conduct requirements.	End-2002 SOSIB change required
	14 Control of the use of the words insurance, reinsurance or cognate expressions such as indemnity or guarantee in the names of insurers.	End-2002 SOSIB change required
	15 State Decree regulating the authority of the Administrator	Mid-2002 Already drafted
	The CBA will supervise both insurers incorporated in Aruba and local branch offices or agencies of insurers incorporated outside Aruba. The SOSIB stipulates that a company can only carry out either life or general insurance business within one and the same legal entity (principle of specialization). Companies that were already conducting business in both life insurance business and accident and health insurance business before July 1, 2001 (the date that the SOSIB became effective) can continue to do so, provided that they maintain separate bookkeeping and accounting records. The SOSIB covers both domestic and offshore insurers and, except where there are special decrees (e.g., for captives) it is intended that the method of supervision be exactly the same for both categories. The bank is operationally independent from both political influence and from the insurance companies that it supervises, has clearly defined responsibilities for decision making, and it is in the process of adopting a clear, consistent regulatory and supervisory process.	
Assessment	Largely observed	
Comments	Although the CBA appears to have adequate funding, we have concerns with the powers, legal protection and with the lack of insurance expertise available to the CBA. The CBA does not separate the Supervisory Department into Banking and Insurance Divisions but would like their staff to have experience across the breadth of the financial services sector. We have seen similar systems, which did not work well because the insurance expert was not involved in the policy decisions and important considerations were consequently ignored. It would be regrettable if this were to happen in the CBA. We have found that the system may work well at the lower levels but the diversity of the insurance sector warrant skills at inspector level and above that are rarely (if ever) all found in one individual. The CBA has recognized this and the Deputy Department Head of the Supervision Department of the CBA supervises the insurance sector. He has a relevant university degree (has have all of the inspectorate staff of the Supervision Department). He also has a professional qualification (FLMI) in life insurance and is very well regarded by the Fund. Due to administration changes required within the new Ministry of Finance, he has been seconded for three months to that Ministry. Unfortunately, the inspector responsible (and trained specially) for insurance is leaving the CBA on December 31, 2001. Due to a close cooperation with the Netherlands Antilles, Aruba has fortunately secured from them a secondment of a senior insurance examiner for a three-month period.	

	The CBA is very vulnerable in the insurance human resource area at the present time. It has advertised for two new examiners, and because terms and conditions within the CBA are relatively attractive, the positions are expected to fill quickly by competent individuals. The CBA should consider instituting a structured insurance training program for some of its existing talented inspectors and employ more trainees as support staff. It is recommended that the CBA review the human resources within the Supervisory Department and look closely at the insurance expertise (life and non-life, as these are separate areas of expertise) with a view to providing succession planning. The personnel should be able to cover all aspects of insurance supervision with the appropriate trainees in each area being brought to the appropriate standards. It is expected that one insurance trained inspector and a trainee will be required in order to meet the requirements of the on-site and off –site inspection processes. There is a great deal of discretion written into the SOSIB and the proposed State Decrees, which means that the application of the legislation by the CBA will have to include a great deal of subjectivity. It is essential to know in which circumstances and to what extent, discretion is allowed. It is recommended, where there is discretion contained within the legislation, that the CBA prescribes the exact circumstances and conditions and the type of discretion allowed in those circumstances. It is further recommended that after two or three years experience of using the SOSIB, it, and the State Decrees and Guidelines are reviewed and consolidated to produce modern insurance legislation produced to the highest international standards, including all of the appropriate IAIS Core Principles of Supervision and the OGIS Guidelines and Principles applicable to offshore jurisdictions. It is further recommended that legislation be passed to provide the CBA and its staff with immunity of suit in all cases (including negligence) except for those involving an act of bad faith. It is further recommended that legislation be passed to make third parties used by the CBA (e.g., auditors and actuaries used during investigations) subject to the same legal requirements, in particular containing confidentiality, as the CBA. The CBA should be able to take action against such parties in cases of negligence or bad faith.
Principle 2.	**Licensing** Companies wishing to underwrite insurance in the domestic insurance market should be licensed. Where the insurance supervisor has authority to grant a license, the insurance supervisor: – in granting a license, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include proforma financial statements, a capital plan, and projected solvency margins; and – in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent.
Description	The licensing of insurers is covered in sections 5, 6, and 7 of the SOSIB and in the Guidance Notes entitled "Admission Requirements for Insurance Companies Operating in or from Aruba" and "Admission Policy for Captive Insurance Companies in Aruba". The licensing requirements together with the two sets of Guidance Notes are comprehensive in nature. It is prohibited for an insurance business operating in or from Aruba to approach, either directly or indirectly the public without a license from the CBA. A license is granted either to engage in life insurance business or general (non-life or property and casualty) insurance.

	The non-life insurance business is divided into the following five groups (business lines): a. accident and health insurance; b. motor vehicle insurance; c. maritime, transport and aviation insurance; d. fire insurance and other property insurance; and e. other indemnity insurance. The application for a license must contain at least contain information on: a. the number, the identity, and the antecedents of the Managing Director(s), and the members of the Supervisory Board or a similar body of the applicant; b. the identity of those who have a qualified holding in the applicant, as well as the size of the holding; c. annual financial statements or an opening balance sheet, which shall to be accompanied by an auditions report, signed by an auditor; d. a program of activities which the applicant intends to conduct (business plan); e. the envisaged administrative and management controls, including the financial accounting system and the internal controls; and f. the applicant's deed of incorporation, articles of incorporation and bylaws. In the event that the applicant constitutes part of a group, also the data on the formal and actual control structures within the group, and a list of names of the persons who determine or co-determine the group's policy should be submitted. The CBA must decide on the application within thirteen weeks after the date of receipt hereof. Exceeding the period referred to in the third paragraph shall be similar to a refusal for granting the license. The CBA can only grant an insurance company a license, provided that the following conditions are met: a. the applicant's day-to-day management is determined by at least one natural person; b. in so far it concerns a legal entity, the applicant has a Supervisory Board or a similar body, consisting of at least three natural persons; c. the expertise of the persons, is sufficient for the conduct of the insurance business; d. the intentions or antecedents of the persons, are such that they could not endanger the interests of the insurants, the insured, or other persons entitled to insurance payments; e. as a result of the qualified holding in the applicant there is without any doubt undesirable influence on the applicant which is contrary to a sound policy for insurers, or of a circumstance that could bring this about; f. the annual financial statements or opening balance sheet, give a true and fair view of the financial position of the applicant; g. the applicant is able to realize its intentions, or meet the requirements to be imposed on it in connection with the supervision; h. the granting of a license to the applicant does not lead to an undesirable development of the insurance sector, or to a circumstance that could bring this about; and i. there is the required minimum solvency margin. The CBA can, and does, exchange information with other Supervisors in order to facilitate the licensing process.
Assessment	Largely observed (provisional)
Comments	It is recommended, as absolutely essential, that the CBA should be able to have a fast and effective exchange of information with the police and with the AML (MOT). Fit and proper checks are incomplete without access to information that these bodies hold.

	It is further recommended that Section 5 of the SOSIB be clarified so that "the public" includes all persons including corporations and other organizations. The captive guidelines state that the CBA can exceptionally allow composites if the management of the life business is separated from the management of the non-life business. This does not help in the case of liquidation, where the life funds could be used by the liquidator, to pay the non-life liabilities. We recommend that there should be no exemptions to the ban on composites unless there are de minimums examples (e.g., a fully funded key man policy or short term reinsured credit life) or there were to be some future statutory life fund protection.
Principle 3.	**Principle 3: Changes in Control** The insurance supervisor should review changes in the control of companies that are licensed in the jurisdiction. The insurance supervisor should establish clear requirements to be met when a change in control occurs. These may be the same as, or similar to, the requirements which apply in granting a license. In particular, the insurance supervisor should: – require the purchaser or the licensed insurance company to provide notification of the change in control and/or seek approval of the proposed change; and – establish criteria to assess the appropriateness of the change, which could include the assessment of the suitability of the owners as well as any new directors and senior managers, and the soundness of any new business plan.
Description	The CBA has drafted a State Decree regulating changes in ownership of insurance companies. This State Decree will give the CBA explicit authority to require parties acquiring or increasing a qualifying holding in an insurance company to request the prior approval of the CBA.
Assessment	Observed (provisional)
Comments	As indicated in the table the State Decree which will supervise changes in control has already been drafted, and can expect to be introduced by mid-2002.
Principle 4.	**Corporate Governance** It is desirable that standards be established in the jurisdictions, which deal with corporate governance. Where the insurance supervisor has responsibility for setting requirements for corporate governance, the insurance supervisor should set requirements with respect to: – the roles and responsibilities of the board of directors; – reliance on other supervisors for companies licensed in another jurisdiction; and – the distinction between the standards to be met by companies incorporated in his jurisdiction and branch operations of companies incorporated in another jurisdiction.
Description	Section 10 of the SOSIB empowers the CBA to issue directives and recommendations with respect to corporate governance and internal control (see next Principle). The SOSIB contains other relevant aspects of corporate governance and internal control (e.g., structure of the Supervisory Board). Certain of the guidelines also contain aspects pertaining to these Principles. For instance, those on asset management have a comprehensive section on the duties of the Supervisory Board from aspects of corporate governance and also of internal control.
Assessment	Largely observed (provisional)
Comments	Some work has yet to be done on the specific introduction of this Principle and, at the same time, on Principle 5 (Internal Control).

Principle 5.	**Internal Controls** The insurance supervisor should be able to: – review the internal controls that the board of directors and management approve and apply, and request strengthening of the controls where necessary; and – require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investment and liquidity management.
Description	**Practice:** Section 10 of the SOSIB empowers the CBA to issue directives and recommendations with respect to the management structure and operations of the insurance companies. This includes the administrative organization and the accounting system and internal controls. However, specific directives on the complete aspects of internal control have been planned but not yet been issued. Certain aspects are contained within the SOSIB and some of the Guidelines.
Assessment	Largely observed (provisional)
Comments	The comments are covered in those for Principle 4 (Corporate Governance)
Principle 6.	**Assets** Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction. Where insurance supervisors have the authority to establish the standards, these should apply at least to an amount of assets equal to the total of the technical provisions, and should address: – diversification by type; – any limits, or restrictions, on the amount that may be held in financial instruments, property, and receivables; – the basis for valuing assets which are included in the financial reports; – the safekeeping of assets; – appropriate matching of assets and liabilities; and – liquidity.
Description	According to Section 13 of the SOSIB an insurer is required to maintain adequate technical provisions, fully covered by assets. In order to ensure that an insurer can meet its contractual liabilities to policyholders, such assets must be managed in a sound and prudent manner. The CBA can issue directives with respect to the asset management. The CBA is also authorized to raise objections against the nature and valuation of these assets, which objections must be promptly met by the insurer. The CBA must ensure that, insurers have in place effective procedures for monitoring and managing their asset/liability position so that their investment activities and asset positions are appropriate to their liability profiles. The CBA has issued a detailed set of guidelines on asset management and drafted some "Supervisory Guidelines on the Coverage Test", based very loosely on the risk based capital method developed by the National Association of Insurance Commissioners in the USA. Both of these guidelines are only relevant to the domestic insurers and offshore insurers, excluding captives. There is a 40–60 percent localization of investments rule (brought out for monetary purposes), which may be too restrictive in certain supervisory circumstances. However it is understood that there is a certain amount of discretion, which can be applied during its application.
Assessment	Largely observed (provisional)

Comments	While there is merit in a prescriptive approach, it seems to us to be less appropriate in a small jurisdiction, where branches of overseas insurers provide much of the capacity, and the sector is small enough to consider each class of investment separately, and in some detail. There is great merit in a risk based approach and this should be developed in order to achieve an optimum solution for Aruba. The CBA, with life insurers, in practice, already focuses on the important issues, which are relevant to their insurers (such as the size of the branch current account with the overseas head office). Under the proposed system, it seems to us that there are no "spread of assets requirements", except for a general statement in the asset management guideline. This could mean, for instance, that a non-life insurer could invest 100 percent in doubtful real estate, take a 10 percent reduction under the coverage test, and still meet the solvency requirements, even though there is little liquidity. Some of the percentages used in the formula are too high and do not reflect the underlying asset risks such as non-collectability, illiquidity, etc. It is recommended that the CBA look again at the Guidelines and the "approved assets" to be used in the calculation of the margin of solvency. This should include a "spread of assets" requirement and the ability to reassess groups of assets and adjust the allowable percentages in line with economic expectations. They should also specifically state which assets are "not approved" when calculating the solvency margin. The asset rules should be contained in the SOSIB or in the State Decrees in order for them to have the sufficient force of law, recognized by the industry.
Principle 7.	**Liabilities** Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. In developing the standards, the insurance supervisor should consider: – what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary; – the standards for establishing policy liabilities or technical provisions; and – the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectability.
Description	The SOSIB requires the insurer to maintain adequate technical provisions, fully covered by assets. To check the adequacy the CBA will rely upon the external auditors and actuaries (where applicable), and also on investigations during the on-site inspection visits. The CBA may object to the nature and valuation of these assets, which objection must be promptly met by the insurer. The CBA can issue general guidelines with regards to the contents and the magnitude of the technical provisions. The CBA has not yet issued such guidelines. The adequacy of the technical provisions can be tested through on-site and of-site inspections. A life insurer, or if deemed applicable, a non-life insurer, must submit to the CBA annually an actuarial report and certificate. The CBA is authorized to conduct on-site examinations in order to assess the adequacy of the technical provisions. The CBA is currently working with consulting actuaries to produce guidelines addressing the oversight of the adequacy of the technical provisions of all insurers (life and non-life).
Assessment	Largely observed (provisional)
Comments	The technical provisions contain the most important element of an insurers balance sheet and it is recommended that the work outlined above is comprehensive, be expedited, and, when completed be prescribed within the legislation.

Principle 8.	**Capital Adequacy and Solvency** The requirements regarding the capital to be maintained by companies which are licensed, or seeking a license, in the jurisdiction should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity, and business risks of the company in the jurisdiction.
Description	An insurer engaged in the life insurance business must have a solvency margin amounting to four percent of the provision for insurance obligations at the end of the preceding financial year, without taking the reinsurance of these obligations into account. An insurer engaged in non-life insurance business must have a solvency margin equal to the highest outcome of one of the following calculations: a. Fifteen percent of the gross premium booked in the preceding financial year, or b. Fifteen percent of the average gross claims booked in the past three financial years.
Assessment	Largely observed (provisional)
Comments	There are no percentages of solvency as set by IAIS, because of the subjectivity involved. A single percentage for the claims calculation has been the tradition in many jurisdictions but the CBA should look at its own prescribed groups and ascertain the need to use higher percentages for the low frequency/high value claims groups. The SOSIB allows for the CBA to intervene if there is a dangerous development (undefined) relating to the solvency level. This level of intervention requires application to the Court. Prior to this level of "dangerous" development the CBA may use SOSIB Section 15 to issue directives. The CBA may wish to consider implementing the "regulatory ladder" approach whereby there are different prescribed steps, which must be taken as various defined levels of solvency are reached. These range from, the implementation of an action plan by the insurer, to the appointment of an administrator or liquidator. The CBA should consider bringing in legal provisions mandating that the assets covering the required solvency margin should be unencumbered (real estate is already dealt with in this way in the Guidance notes).
Principle 9.	**Derivatives and 'Off-Balance Sheet' Items** The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form a part of the financial report of a company licensed in the jurisdiction. In setting these requirements, the insurance supervisor should address: – restrictions in the use of derivatives and other off-balance sheet items; – disclosure requirements for derivatives and other off-balance sheet items; and – the establishment of adequate internal controls and monitoring of derivative positions.
Description	The CBA is authorized to conduct on-site examinations in order to assess the internal controls and audit procedures with respect to the use financial instruments. In the new financial reporting forms the insurance companies are required to disclose off-balance sheet items. The CBA intends to issue guidelines regulating financial instruments. This document will be based on the IAIS Supervisory Standard on Derivatives. The guideline on asset management states, inter alia, that senior management of an insurer should formulate policies, which specify an overall policy on the use of financial derivatives as part of the general portfolio management process or of structured products that have the economic effect of derivatives.
Assessment	Largely observed (provisional)

Comments	The CBA may wish to consider (during the process of prescribing approved assets, mentioned above) of making investment in derivatives and off-balance sheet items prohibited, except for those instruments used for hedging purposes, unless specifically approved by the CBA in individual cases.
Principle 10.	**Reinsurance** Insurance companies use reinsurance as a means of risk containment. The insurance supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsures in determining an appropriate level of exposure to them. The insurance supervisor should set requirements with respect to reinsurance contracts or reinsurance companies addressing: – the amount of the credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collectability of the reinsurance recoverable and may take into account the supervisory control over the reinsurer; and – the amount of reliance placed on the insurance supervisor of the reinsurance business of a company, which is incorporated, in another jurisdiction.
Description	**Practice:** The SOSIB does not have explicit provisions regulating reinsurance contracts. However, the CBA can issue general guidelines and recommendations. In addition the CBA can conduct on-site examinations, to review all contracts, including the reinsurance contracts. The CBA is also able to exchange data, including reinsurance details, with other supervisory authorities (refer also to principle 16). Section 2 paragraph 4 of the SOSIB allows the CBA, through a state decree, to supervise the activities of reinsurance companies (professional reinsures) operating in and from Aruba. Such decree has not been issued yet. The CBA has confirmed that it will review its existing on-site examinations programs by which reinsurance arrangements can be reviewed. At the moment there are no professional reinsurance companies operating in or from Aruba. During the on-site and off-site inspection visits, we are informed that the CBA will inspect the reinsurance programs to assess their adequacy. The SOSIB does not itself mention reinsurance (reinsurance is mentioned in the explanatory notes to the SOSIB) but as shown in the table, the words "insurance and reinsurance" and cognate expressions are to be controlled by a future amendment.
Assessment	Materially non-observed (provisional)
Comments	For clarity it is recommended that the definition of insurance business in the SOSIB be amended to also include reinsurance and retrocessional business. It is further recommended that the proposed State Decree regulating the supervision of reinsurance companies is quickly drafted, and implemented as soon as possible. It should also include provisions for the use of reinsurance and retrocession arrangements, by insurers and reinsures respectively.

Principle 11.	**Market Conduct** Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills, and integrity in dealing with their customers. Insurers and intermediaries should: – at all times act honestly and in a straightforward manner; – act with due skill, care, and diligence in conducting their business activities; – conduct their business and organize their affairs with prudence; – pay due regard to the information needs of their customers and treat them fairly; – seek from their customers information which might reasonably be expected before giving advice or concluding a contract; – avoid conflicts of interest; – deal with their regulators in an open and cooperative way; – support a system of complaints handling, where applicable; and – organize and control their affairs effectively.
Description	Market conduct is not regulated by the SOSIB. The CBA does not presently concern itself greatly with market conduct issues, initially concentrating, rightly, on prudential supervisory matters. It has however indicated (see table) that it is considering changes to the SOSIB with regard to market conduct.
Assessment	Non-observed
Comments	We strongly recommend that the necessary changes be made, including the supervision of all insurance intermediaries (insurance agents—directly or indirectly, through their employer or principle—and insurance brokers). The CBA should consider instituting compulsory codes of conduct to prevent the public from receiving misleading advice on what can be an individual's largest lifetime investment e.g., an endowment mortgage insurance policy. We gained the impression that there are widely different levels of competence within the insurance advisory sector. We would advise the CBA to consider bringing in compulsory qualification standards for insurance advisors (agents and brokers). We are not advocating that The CBA should interfere with the market structure, rate setting, design of insurance contracts and other business related matters. If the above recommendation is effected, the CBA should not be the body that adjudicates on complaints. This should, preferably, be an independent ombudsman (who could arbitrate for all sectors of financial services) and, in the last resort, the Courts.

Principle 12.	**Financial Reporting** It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis, supported by information obtained through special information requests, on-site inspections, and communication with actuaries and external auditors. A process should be established for: – setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports, actuarial reports, and other information; – setting the accounting requirements for the preparation of financial reports in the jurisdiction; – ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and – setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction. In so doing, a distinction may be made: – between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared for the insurance supervisor; and – between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in another jurisdiction.
Description	The SOSIB has requirements for the submission of audited (on a true and fair basis) financial statements within 6 months of the financial year-end. The CBA can, and does, perform on-site inspections on the life insurers, and this process will be extended to the non-life and offshore sectors as soon as the licensing process has been completed. The CBA has drafted forms of financial statements for both the life and non-life sectors.
Assessment	Largely observed (provisional)
Comments	The problem with reporting systems in most jurisdictions is that the information reported to the insurance supervisor is usually out of date. It is recommended that any material changes to the business plan agreed by the CBA, need to be notified to the CBA in advance of the change. This would enable the CBA to take action if the changes were not to their liking, but would not involve any delay to implementation of the change. Material changes would include new products and lines of business, greatly increased exposures, business concentrations, changes to the reinsurance program, and, changes to the underwriting policies. The CBA may, after consultation with the sector and the auditors, be able to reduce the reporting period from 6 months to 4 months. A good way of ensuring that information is as current as possible is to ask for management accounts, as soon as they are available. The CBA may like to consider bringing into the legislation the specific aspects of this Principle, which are not already required. These include the requirements for, information on both a solo and a consolidated basis; more frequent and more comprehensive reports; information, stipulating consistent, realistic, and prudent principles and valuation rules; and the ability for insurers to hire, using their own resources, independent auditors or actuaries for specific investigations required by the CBA.

Principle 13.	**On-Site Inspection** The insurance supervisor should be able to: – carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates; and – request and receive any information from companies licensed in its jurisdiction, whether this information be specific to a company or be requested of all companies.
Description	The CBA is able to inspect all books, documents, and other information relating to the business, and to make copies, or to take temporary possession for the purposes of supervision. It can enter all places, except for dwelling houses without specific permission of the occupant, accompanied by persons to be designated by them. The on-site inspections performed on the life sector consist of a review of the quality of the management information system, the administrative organization and internal controls, risk management, the quality of the investments and technical provisions. The CBA discusses the findings with the insurance companies. The CBA has three categories of insurer: high, medium, and low risk, which they inspect on-site at different intervals, but cover all of them at least once, during a 3-year period. They assess the risk profile, and concentrate on the weaker aspects of each insurer during their visits.
Assessment	Observed
Comments	It is recommended that, as well as using the above procedure, the CBA reverts to more structured visits, they used to use, including the utilization of checklists. However the existing procedures manuals, which were prepared in the mid -nineties need revising as they are much too detailed, and if used in that form, there is the danger that important issues could be subsumed by the minutia. Consideration should also be made to allow inspections, even if the insurers' books and records are contained within a dwelling house.
Principle 14.	**Sanctions** Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The insurance supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered. The legislation should set out the powers available to the insurance supervisor and may include: – the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions; – the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice; and – the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the license of a company or imposing remedial measures where a company violates the insurance laws of the jurisdiction.
Description	The CBA may revoke a license if the insurer: a. no longer meets the regulations for obtaining the license laid down by, or by virtue of this State Ordinance; b. in the opinion of the CBA fails to comply with statutory regulations in force in Aruba or abroad concerning the pursuit of the insurance business; c. fails to comply with a directive as mentioned in Section 15, first paragraph; and d. has not commenced the business operations within six months after the day the license was granted. The CBA is able to issue a directive whenever the insurer is not in compliance with the requirements of reporting or reserving.

	There are penalties if an insurer does not comply with the reporting requirements. The CBA can impose a fine of AFL 1,000 ($560) for each day it has been in default. The fine shall be for the benefit of the CBA and the amount may be adjusted up to the rate of inflation. In the event that the solvency of an insurer entered shows signs of a dangerous development, or there are otherwise signs, that threaten the continued existence of an insurer, and no improvement in this development may be expected in reason, the Court may, on the petition of the CBA declare that the insurer is in a position requiring a special measure (e.g., a silent trustee in charge of the management of the insurer) in the interest of the combined creditors. The CBA may file a petition at the Court to adjudicate the insurer bankrupt, if it appears to it that the insurer has a negative equity, and either the purpose to be achieved by the measure described above, can no longer be achieved. A person who contravenes the cooperation, transfer of business or confidentiality requirements, or who writes insurance business without being licensed shall be liable to either imprisonment not exceeding one year, and a fine not exceeding two hundred and fifty thousand Florins ($140,000), and double the penalties for intentional acts. The CBA is able to take corrective actions or impose actions, by issuing directions, in the event that the insurance company no longer complies with the requirements of the SOSIB (please refer to principle 4).
Assessment	Largely observed
Comments	We recommend that the CBA is given the powers to: • apply penalties and sanctions against individual members of management and/or supervisory board; • suspend, on a temporary basis and/or permanently bar (for at least 10 years), senior management; • limit the payment of dividends of an undercapitalized insurer; • remove or disqualify an external auditor; • retain a special auditor (at the expense of the insurer), where appropriate; and • extend the range of violations for which monetary penalties can be imposed (already proposed by the CBA.
Principle 15.	**Cross-Border Business Operations** Insurance companies are becoming increasingly international in scope, establishing branches and subsidiaries outside their home jurisdiction, and sometimes conducting cross-border business on a services basis only. The insurance supervisor should ensure that: – no foreign insurance establishment escapes supervision; – all insurance establishments of international insurance groups and international insurers are subject to effective supervision; – the creation of a cross-border insurance establishment is subject to consultation between host and home supervisors; and – foreign insurers providing insurance cover on a cross-border services basis are subject to effective supervision.
Description	The CBA is allowed to supervise all insurers incorporated in Aruba, and the branches and agencies of insurers operating in Aruba, which have a registered office outside Aruba. The SOSIB empowers the CBA to exchange information, under certain acceptable conditions, with foreign supervisors.
Assessment	Largely observed

Comments	It is recommended that the SOSIB has explicit provisions requiring prior approval from the CBA for an insurer to open a cross-border establishment.
Principle 16.	**Coordination and Cooperation** Increasingly, insurance supervisors liaise with each other to ensure that each is aware of the other's concerns with respect to an insurance company that operates in more than one jurisdiction, either directly or through a separate corporate entity. In order to share relevant information with other insurance supervisors, adequate and effective communication should be developed and maintained. In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor: – is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (i.e., insurance, banking, or securities) to share information or otherwise work together; – is permitted to share information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors who have agreed, and are legally able, to treat the information as confidential; – should be informed of findings of investigations where power to investigate fraud, money laundering, and other such activities rests with a body other than the insurance supervisor; and – is permitted to set out the types of information and the basis on which information obtained by the insurance supervisor may be shared.
Description	Section 24 of the SOSIB authorizes the CBA to furnish data or information, obtained in the performance of the duties entrusted to it in pursuance of this State Ordinance, to a supervisory authority or a body charged in any country by or by virtue of a law with the supervision of insurers and institutions and the natural persons employed in the insurance business, or an umbrella organization of supervisory authorities or bodies as mentioned above, provided that: a. furnishing hereof is not or could not become contrary, in reason to the interests this State Ordinance seeks to protect; b. the CBA ascertains itself of the purpose for which the data or information shall be used; c. it is sufficiently guaranteed that the data or information shall not be used for another purpose than for which they were furnished, unless the CBA's prior permission has been obtained for that use; and d. the secrecy of the data or information to be furnished is guaranteed sufficiently, and e. data and information can be exchanged on a reciprocal basis.
Assessment	Largely observed
Comments	It is recommended that there are explicit requirements for the insurer or the insurance intermediary to inform the supervisor on fraud or money-laundering cases. Now that the SOSIB is operational there are gateways that allow the exchange of information (with certain provisos—including the maintenance of confidentiality of the information) with other supervisory bodies. There does not appear to be the means of controlled exchange of information with other international bodies or even with bodies in Aruba, such as the police or the MOT. This aspect should be investigated with a view to facilitating the exchange of information in the interests of the prevention and the detection of crime (including money laundering). In our view it is essential that the CBA be informed about the findings of investigations into fraud and money laundering involving the financial services sector. While life insurers and insurance intermediaries selling life insurance will come under the anti-money laundering legislation from January 1, 2002, there are no current plans to extend this to non-life insurance. The Fund is aware of the use of non-life vehicles for money laundering purposes and it is our strong recommendation that these types of insurers and insurance intermediaries should come under the legislation as soon as possible.

Principle 17.	**Confidentiality** All insurance supervisors should 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. The insurance supervisor is required to hold confidential any information received from other insurance supervisors, except where constrained by law or in situations where the insurance supervisor who provided the information provides authorization for its release. Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and jurisdictions where information received from another insurance supervisor cannot be kept confidential, are urged to review their requirements.
Description	**Practice:** The SOSIB requires that, anyone who performs any duty in connection with the implementation of the SOSIB, shall be obligated to secrecy with regard to data or information provided, or received from a foreign body, or data or information obtained in the examination of books, documents or other information carriers, and, shall be obligated not to make further or other use of, or to disclose further or in another way the data, other than required for the performance of duty.
Assessment	Observed
Comments	This Principle is fully observed.
Draft Principle 18	Anti-money laundering
Assessment	Materially non-observed (provisional)
Comments	See comments on Principle 16.

Table 5. Summary Observance of IAIS Insurance Core Principles and the Draft Principle on Anti-Money Laundering

Assessment Grade	Count	Principles Grouped by Assessment Grade List
Observed	3	e.g., CP 3 (prov), 13 (prov), and 17
Broadly observed	12	1, 2 (prov), 4 (prov), 5 (prov), 6 (prov), 7 (prov), 8 (prov), 9 (prov), 12 (prov), 14, 15, and 16
Materially non-observed	2	10, 18 (prov) (anti-money laundering)
Non-observed	1	11
Not applicable	-	

Recommended Action Plan

Table 6. Recommended Action Plan to Improve Observance of the IAIS Core Principles

Reference Principle	Recommended Action
Organization of an Insurance Supervisor	
i.e., CP 1	• Review the insurance expertise within the CBA and the succession plan and resource accordingly. • Institute a structured insurance and management-training plan. • Ensure third parties used in investigation are subject to the same legal requirements (especially confidentiality) and that action can be taken against such parties, where appropriate. • Amend the SOSIB to give the CBA and employees immunity of suit for all acts except those of bad faith. • After two years of operation, the SOSIB, the State Decrees and Guidelines are reviewed and consolidated to produce modern legislation produced to the highest international standards, including all of the appropriate IAIS Core Principles of Supervision and the OGIS Guidelines and Principles.
Licensing and Changes in Control	
i.e., CPs 2–3	• Introduce in the appropriate legislation the ability to exchange information with the police, MOT, and similar organizations outside Aruba. • Clarify, within the SOSIB, the definition of "public" so that it quite clearly includes commercial organizations. • Bring out the State Decree (already drafted) relating to changes in control.
Corporate Governance and Internal Controls	
i.e., CPs 4–5	• Bring out a State Decree covering corporate governance and internal controls.
Prudential Rules	

Reference Principle	Recommended Action
i.e., CPs 6–10	• Bring out a State Decree to supercede the Supervisory Guidelines on the Coverage Test, which, inter alia, addresses the spread of assets and prohibiting derivatives (except for hedging purposes). • Expedite, with the help of the Consulting Actuary, the State Decree covering Technical Provisions. • Consider amending the SOSIB to include a regulatory ladder of intervention procedures. • Ensure provisions are in place so assets used for minimum solvency purposes are unencumbered. • Expedite the drafting of the State Decree on the regulation of reinsures and include provisions for the use of reinsurance. • Consider changing the captive solvency points to include the greater of the existing proposal or a percentage of net premium income.
Market Conduct	
i.e., CP 11	• Amend the SOSIB in order to supervise insurance advisors (agents and brokers) either directly or indirectly, including the use of Codes of Conduct and minimum standards. • Introduce a financial services ombudsman service for complaint resolution.
Monitoring, Inspection, and Sanctions	
i.e., CPs 12–14	• Bring in a requirement to notify the CBA of material changes to the business plan and make other changes to the financial reporting requirements. • Bring more structure to on-site visits. • Amend the SOSIB to make the sanctions more specific.
Cross-Border Operations, Supervisory Coordination and Cooperation, and Confidentiality	
i.e., CPs 15–17	• Require prior approval for cross border establishments by licensed insurers. • Ensure that non-life insurers and intermediaries are urgently brought within the AML framework.
Offshore	• Amend AVV legislation to ensure no secrecy and no bearer shares. • Amend State Decree to include the greater of the existing monetary solvency requirement or a premium-based solvency. • License captive managers.

Reference Principle	Recommended Action
Pensions	• Introduce a requirement that the auditor be required to certify that the minutes of the Board meetings have been inspected, that all actions have been taken in good faith, and have been for the benefit of all past, present and future employees.
Life and Pensions	• Consider policyholder protection arrangements (in the eventuality of one or more insurers or pensions schemes being unable to meet their liabilities).

Authorities' Response to the Assessment

The authorities were in agreement with the assessment.

III. Assessment of Compliance with Anti-Money Laundering Supervisory Requirements

(August 2001 Methodology)

A. Main Findings—Summary

General

Legal and organizational framework

The legal framework consists of three principal laws, that cover the criminalization of money laundering, know your customer due diligence, and reporting of unusual transactions. The organizational framework consists of consists of the Reporting Center for Unusual Transactions (RCUT), which collects, analyzes, and as appropriate, passes these reports on to the prosecuting authorities. The CBA monitors whether the banks and other financial institutions under its supervision comply with the requirements of the AML framework. The Customs Office will in the near future receive reports on import and export of cash. The minister of Justice is responsible for coordination of AML policy. The Minister of Finance is responsible for the activities of the RCUT and the Customs Office. Improvements of the framework are possible, specifically in broadening the scope for exchange of information with domestic and foreign agencies, coverage of all assets by the criminalization law, not only cash, gold and securities, and in providing more resources to the RCUT.

Know Your Customer (KYC) Due Diligence

Banks and other financial institutions use two sets of criteria to determine whether transactions need to be reported to the RCUT, objective indicators, such as the amount and type of transactions, and subjective indicators, which require judgment of bank staff.

Amounts above Afl. 20,000 and deposits or withdrawals over Afl. 100.000 need to be reported, or for instance suspicious transactions or those which do not seem to have an understandable legal purpose, or are fraudulent. Suspicious transactions within a bank are to be reported to the compliance officer. KYC records are required to be maintained for at least five years after the transaction took place.

Training and dissemination of information

Banks are required to provide training for bank staff in all aspects of AML and regulatory policies and procedures and provide refresher courses. The RCUT also provides training for banks and financial institutions semi-annually.

Compliance and audit

Banks are required to adopt internal procedures to combat money laundering, including an internal compliance program, the designation of a compliance officer, and at least annual independent testing of the internal controls by the internal or external auditor.

Supervisory arrangements

The CBA reviews compliance during routine on site examinations, although it has performed targeted anti-money laundering examinations apart from its regular schedule of full scope on site examinations, which take place every two to three years. The CBA reviews compliance with KYC and the reporting systems for unusual transactions. It reviews the findings of the compliance officer, and follow up to requests for information. The RCUT has performed on site inspections of each on-shore bank. Offshore banks are required to report unusual transactions, but are not inspected. The only offshore banks are actually located in Venezuela, although they are registered in Aruba. The RCUT has also reviewed adequacy of policies staffing, compliance with the AML laws, and spot checks on transactions. The insoections are not coordinated with those of the CBA. The CBA and RCUT need to continue their inspections and increase frequency, but coordinate inspections better.

Detailed Assessment

Table 7. Detailed Assessment of Compliance with the Banking Supervision AML Requirements

Legal and Organizational Framework	
Description	The legal framework consists of three principal laws: the SOCML, which criminalizes money laundering, the SOIFS, which requires that KYC due diligence be conducted for any bank customer, and the LRUT, which requires the UTRs be filed and establishes the RCUT. The organizational framework consists of the CBA, which monitors compliance by banks with the AML framework; the RCUT, which receives and analyzes UTRs, and the Customs Office, which will, in the near future, receive reports on the importation and exportation of cash, both part of the Ministry of Finance; and the Public Prosecutor, which prosecutes AML cases, the Bureau of Attorney General which coordinates AML policy, and the Legislative Department,

	which drafts AML laws, all part of the Ministry of Justice.
Assessment	Largely compliant
Comments	The legal framework requires a number of improvements, including amendments to the SOSCS to allow the CBA to share information with domestic and foreign agencies, the SOCML to include all assets, not just cash and securities; to the LRUT, to allow the RCUT to exchange information with foreign FIUs without a treaty and to provide the RCUT with the power to impose administrative fines; and to the legal framework generally to take into account new initiatives by the FATF and the EU. The organizational framework needs improvement primarily in providing additional budgetary resources for the RCUT to purchase additional hardware and software, and to expand its staff. The RCUT should remain within the Ministry of Finance and should have operational autonomy.
KYC Due Diligence	
Description	The legal framework requires that certain documents are to be used by banks to do due diligence to meet the KYC criteria, such as a driver's license or identity card for natural persons, and a certified extract from the register of the Aruban Company Registry for a legal entity. Banks are required to establish the identity of the customer before rendering any financial service and may not provide such service unless the requirements of the law have been met. Banks must determine whether the customer, if a natural person, is acting for a third party in which case the bank must establish the identity of the ultimate beneficiary.
Assessment	Compliant
Comments	The CBA needs to continue to do on-site inspections to ensure that banks are complying with KYC due diligence and the CBA Directives generally, and RCUT needs to continue its on-site inspections, focusing on reporting issues, but each needs to do so on a more frequent basis and with greater coordination between the two organizations.
Monitoring and Reporting of Unusual Transactions	
Description	The filing of UTRs by banks is based on criteria consisting of objective indicators such as the size of the transaction or the type of transaction, including cash transactions involving exchanging currency over Afls. 20,000; cash deposits or withdrawals over Afls. 100,000; and subjective indicators that require reporting when combined with stated minimum amounts of currency and involve a judgment or observation by the bank, such as "the client is nervous without any apparent cause" or "the transaction has no understandable legal purpose, or no visible connection with (business) activities." Banks are required to report suspicious activities and material frauds. The compliance officer at banks is typically charged with the responsibility to ensure a bank's anti money laundering policies and procedures are in accordance with statutory and regulatory requirements. In addition, suspicious transactions within a bank are reported to the compliance officer. Banks report suspicious transactions to the RCUT and can go directly to the Prosecutor's office as well. Bank's staff members and the CBA itself, cannot be held liable for the reporting in good faith of suspicious transactions to the RCUT.
Assessment	Compliant
Comments	
Record Keeping	
Description	Banks are required to retain KYC data for at least five years after the termination of the agreement with the customer or after the execution of a transaction and to maintain an accessible centralized record keeping system. The Aruban Commercial Code requires that records of limited liability companies, including banks, be kept for a period of 10 years.
Assessment	Compliant
Comments	
Training and Organizational Dissemination of Information.	
Description	Banks are required to provide training for bank personnel in all aspects of AML and regulatory internal policies and procedures, as well as on-going training at regular intervals. The RCUT also provides training for banks semi-annually.
Assessment	Compliant
Comments	The RCUT should continue to provide training to banks.

Compliance and Audit	
Description	Banks are required to adopt internal procedures to combat money laundering, including an internal compliance program, the designation of a compliance officer, and at least annual independent testing of the internal controls by the internal or external auditor.
Assessment	Compliant
Comments	This area should be a focal point in CBA's on-site inspections.
Supervisory Arrangements	
Description	The CBA examines for compliance during on site examinations. It has done targeted anti money laundering examinations apart from its regular schedule of full scope on site examinations, which are every 2–3 years. The CBA reviews compliance with know-your-customer guidelines and the adequacy of processes and procedures to report suspicious transactions. It checks the adequacy of processes and procedures by reviewing organizational and/or procedural changes, it reviews the findings of the compliance officer, reviews follow up to information requests from the Court of Justice and it analyzes the list of accounts closed since the previous examination. The RCUT has done one on-site inspection at each onshore bank. Offshore banks have not had anti money laundering inspections although they are required to report suspicious transactions. RCUT's inspections focus on compliance with reporting requirements and have also included assessments of the adequacy of policies, staffing, compliance with the law, and spot checks on the completed transactions by analyzing specific accounts. RCUT does not coordinate its inspections with the CBA. When deficiencies are found, RCUT advises banks on how to correct them.
Assessment	Non-compliant
Comments	The CBA needs to continue to do on-site inspections to ensure that banks are complying with KYC due diligence and the CBA Directives generally, and RCUT needs to continue its on-site inspections, focusing on reporting issues, but each needs to do so on a more frequent basis and with greater coordination between the two organizations.

Recommended Action Plan

Table 8. Recommended Action Plan to Improve Compliance with the AML Supervisory Requirements—Banking Supervision

AML Requirements	Recommended Action
Legal and Organizational Framework	A number of revisions to the legal framework are needed, including amendments to: • the SOSCS to allow the CBA to share information with domestic and foreign agencies; • the SOCML to include all assets, not just cash and securities; to the LRUT, to allow the RCUT to exchange information with foreign FIUs without a treaty and to provide the RCUT with the power to impose administrative fines; and • to the legal framework generally to take into account new initiatives by the FATF and the EU in the area of terrorist financing and treatment of non-financial service providers. Finally, the law requiring reporting of the importation and exportation of cash should be implemented immediately. The organizational framework needs improvement primarily in providing additional budgetary resources for the RCUT to purchase additional hardware and software, and to expand its staff.
Training and Organizational Dissemination of Information	The RCUT should continue to provide training to banks.
Supervisory Arrangements	The CBA needs to continue to do on-site inspections to ensure that banks are complying with KYC due diligence and the CBA Directives generally, and RCUT needs to continue its on-site inspections, focusing on reporting issues, but each needs to do so on a more frequent basis and with greater coordination between the two organizations.

Authorities response to the assessment

The authorities are in broad agreement with the assessment. A number of technical and factual comments have been incorporated.