

**Liechtenstein: Assessment of the Supervision and Regulation of the Financial Sector  
Volume II—Detailed Assessment of Observance of Standards and Codes**

This detailed assessment of observance of standards and codes in the financial sector of **Liechtenstein** in the context of the offshore financial center program contains technical advice and recommendations given by the staff team of the International Monetary Fund in response to the authorities of Liechtenstein's request for technical assistance. It is based on the information available at the time it was completed on **August 2003**. The staff's overall assessment relating to financial sector regulation and supervision can be found in Volume I. The views expressed in these documents are those of the staff team and do not necessarily reflect the views of the government of **Liechtenstein** or the Executive Board of the IMF.

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**ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE  
FINANCIAL SECTOR**



**Volume II: Detailed Assessment of Observance of  
Standards and Codes**

**Principality of Liechtenstein**

**AUGUST 2003**

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## ACRONYMS

AML	Anti-money laundering
BA	Banking Act
BC	Banking Commission
BO	Banking Ordinance
BCP	Basel Core Principles for Effective Banking Supervision
BSD	Banking Supervision Department
CFT	Combating the Financing of Terrorism
DDA	Due Diligence Act
DDEO	Due Diligence Executive Ordinance
DDU	Due Diligence Unit
EEA	European Economic Area
EU	European Union
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
FSA	Financial Services Authority
FT	Financing of Terrorism
IAIS	International Association of insurance Supervisors
IOSCO	International Organization of Securities Commissions
ISA	Insurance Supervisory Authority
MFD*	Monetary and Financial Systems Department
ML	Money laundering
MOU	Memorandum of Understanding
OFC	Offshore Financial Center
SAR	suspicious activity report
UCITS	Undertakings for collective investments for transferable securities (investment funds, mutual funds)

\* The IMF's Monetary and Exchange Affairs Department (MAE) was renamed the Monetary and Financial Systems Department (MFD) as of May 1, 2003. The new name has been used throughout the report.

## I. BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

### A. General

1. An assessment of observance of the Basel Core Principles for Effective Banking Supervision (Basel Core Principles) was conducted as part of an offshore financial center assessment in the Principality of Liechtenstein.

#### **Institutional and macroprudential setting, market structure overview**

2. Liechtenstein has a GDP of CHF 4 billion, of which 42 percent comes from industry and 28 percent from financial services. The employed population is 30 thousand, and there are 34 thousand residents (including 34 percent foreigners).

3. Seventeen banks and two finance companies operate in Liechtenstein. Finance companies—which are also supervised by the FSA—are permitted to engage in general banking activities with the exception of deposit taking; one is a subsidiary of a major bank and is currently being wound up, the other engages in lending activities.

4. At end-2001, banking assets were CHF 34 billion, and assets under management were CHF 106 billion.<sup>1</sup> The market is highly concentrated with the three major banks accounting for 90 percent of the total banking assets; the fourteen other institutions have set up operation over the last 10 years. Regulations allow universal banking activities. Only the three largest banks conduct retail and corporate banking with mainly resident customers. The credit activities in banks are largely comprised of mortgage and Lombard loans. All banks report high capital adequacy ratio above 15 percent (and 16 above 20 percent at end-2001) with a minimum capital of CHF 20 million. The major business is in private banking and wealth management. The downturn in the financial markets has affected industry profits; in 2001, nine banks made profits, six broke even or made marginal profits or losses, and the two newest recorded substantial losses.

5. Two of the three largest banks are publicly quoted on the Swiss stock exchange; the third was once listed but is now privately held by the family of the Prince of Liechtenstein. Ten of the banks are subsidiaries of foreign banks (five from Austria, three from Switzerland, one from Germany, and one from France). The remaining four banks are owned by local interests. Four of these institutions have operations in foreign countries, generally in the form of banks and investment and trust companies, located mainly elsewhere in Europe and in the Caribbean. The total staff working in the banking sector is 1,760 people.

6. As a member of the European Economic Area (EEA) since 1995, Liechtenstein is obliged to transpose European Union (EU) legislation into national legislation. Accordingly, all its banking and accounting legislation is based on the relevant EU Directives. The Swiss

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<sup>1</sup> Only four banks published the amount of assets under management.

franc is the official currency, and the Swiss central bank acts as lender of last resort. The Liechtenstein banks maintain close links with the Swiss financial system. These links include the stock exchange (two Liechtenstein banks are security dealers), interbank clearing, bankers association (six Liechtenstein banks are members), external auditors, accounting rules, and training.

7. In the nineties, the establishment of new banks, along with EEA membership, required that an efficient supervisory system be in place. At present, banking supervision is governed by the banking act of 1992 as amended, and the banking ordinance of 1994, as amended. Both the government and the Financial Services Authority<sup>2</sup> (FSA) share responsibility for banking supervision. The government is responsible for the granting, withdrawing, and revocation of licenses. The FSA is responsible for ongoing supervision. It operates an “indirect supervisory system” whereby onsite inspections are carried out by external auditors, licensed by the FSA. The banking act also provides for the establishment of a banking commission, which advises the government on banking supervisory matters; particularly, on licensing issues; it is also charged with counseling the independent work of the FSA. A due diligence unit (DDU) deals with anti-money laundering issues across the financial and related services sectors, including customer and transaction requirements for banks. Planning is underway to establish an integrated financial services supervisory authority that would bring together the oversight of banking, securities, and insurance activities. The creation of the new agency is now planned for early 2005, with legislative changes to be completed in mid 2004.

8. The Liechtenstein Bankers Association is active, employing four full-time staff. As part of its supportive role to the banking system, it manages a deposit and investment protection scheme based on the corresponding EU Directive. As a result of a working group initiated by the FSA, an independent foundation has been formed, which can call upon its member banks to cover customers’ deposits in cash and securities up to Euro 20 thousand each and a maximum of CHF 300 million.

### **Information and methodology used for assessment**

9. The assessment of fulfillment of the core principles is not, and is not intended to be an exact science. Banking systems differ from one country to the next, as do their domestic circumstances. Furthermore, banking activities are changing rapidly around the world, and theories, policies, and best practices of supervision are swiftly evolving. Nevertheless, it is internationally acknowledged that the core principles are seen as minimum standards.

10. This assessment of compliance with each Principle has been made on a qualitative basis. A five-part assessment system is used: compliant, largely compliant, materially noncompliant, noncompliant, and not applicable. To achieve a “compliant” assessment with a Principle, all “essential” criteria generally must be met without any significant deficiencies.

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<sup>2</sup> Created in 1993, the Bank Supervisory Board was transformed into the FSA in 1999.

There may be instances where a country can demonstrate that the principle has been achieved through different means. Conversely, due to specific conditions in individual countries, the essential criteria may not always be sufficient to achieve the objective of the principle, and therefore, one or more additional criteria and/or other measures may also be deemed necessary by the assessor to judge that compliance is achieved. A “largely compliant” assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority’s ability to achieve the objective of that principle. A “materially non-compliant assessment” is given when the shortcoming is sufficient to raise doubts about the authority’s ability to achieve compliance, but substantive progress had been made. A “non-compliant” assessment is given when no substantive progress towards compliance has been achieved, or when insufficient information was available to allow a reliable determination that substantive progress had been made towards compliance. An assessment of “Not applicable” is rendered for a principle deemed by the assessors to not have relevance.”<sup>3</sup>

11. The assessment has been conducted in Liechtenstein under the OFC assessment program. It was carried out on the basis of the Law on Banks and Finance Companies (banking act) of October 21, 1992, as amended, and the Ordinance implementing the banking act of February 22, 1994, as amended. The assessors held working sessions with current and former representatives from the Financial Services Authority (FSA), the bankers association, and the auditors association, as well as commercial banks and banks’ external auditors. The mission was provided with written information on various issues and reviewed external auditor reports. Access to consolidated prudential data was limited due to the lack of resources within the offsite monitoring unit of the FSA.

### **General preconditions for effective banking supervision**

12. The banking system operates in small, but highly developed, economy. It is expected that international standards and best practices are applied by all participants.

### **B. Main Findings**

13. The assessment concluded that of the thirty principles (CP1 is comprised of six sub principles), Liechtenstein is compliant or largely compliant with 25 principles and materially non-compliant with the five other principles.

### **Supervisory framework (CP 1)**

14. Since it joined the EEA in 1995, Liechtenstein has made significant efforts to incorporate all relevant EU Directives into its legal system. The banking act and the banking ordinance provide an adequate framework for banking supervision. On the legal side, clarification is required on two important aspects: firstly, the scope of banking secrecy is not

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<sup>3</sup> Core Principles Methodology, Basel Committee on Banking Supervision October 1999.

defined within Article 36 of the banking act. A recent court ruling has reduced legal uncertainty regarding the banks ability to provide information to the FSA upon request of a foreign supervisory authority; however, sharing of client information in practices remains a concern. Secondly, fixed term appointment and disclosure of grounds for removal are required to ensure the independence of the FSA head. However, the most critical problem is the serious lack of resources within the Banking Supervision Department, notably in staff.

### **Licensing and structure (CP 2–5)**

15. Banking activity and licensing criteria for banks and financial companies are consistent with international practices. They encompass strong governance requirements and, notably, a fit-and-proper test is applied to directors, senior managers, and heads of internal audits.

### **Prudential regulations and requirements (CP 6–13)**

16. Banks operate within a well-defined prudential regulatory framework, in accordance with the EU and Basel standards that is largely modeled after the framework in Switzerland. Beside detailed provisions in the banking ordinance, the FSA, however, has not defined more specific guidelines for operational risk or for credit risk assessment but instead relies extensively on the external auditors who conduct the onsite examinations. Moreover, the absence of such specific guidelines means that more consistent and rigorous policies in these areas may not be applied across the industry.

### **Governance (CP 14, 15, 21)**

17. The banking act and the banking ordinance have comprehensive provisions on corporate governance; banks must have a dual management structure with a board of non-executive directors and a management board; the internal audit function is defined as well as the external auditor function. All of them are subject to supervisory authorities' scrutiny in the form of fit-and-proper tests for banks' officials and licenses for audit firms. Based on the comprehensive DDA, AML policies and procedures are in place.

### **Methods of ongoing supervision (CP 16–20 and 22)**

18. The supervisory authority's ability to carry out its functions is materially undermined by the lack of staff and expertise. Current resources are limited to the head of the FSA, who took his position on October 1, 2001, a consultant, who is largely involved in the transposition of EU Directives, and an administrative staff. The limited staff prevents the Banking Supervision Department from conducting timely offsite monitoring of banks and from analyzing external audit reports promptly and thoroughly. The Department should aim at having a more comprehensive understanding of banks' activities, risks and financial situations. In addition, enforcement powers, in the form of "orders" issued by the FSA, should be more detailed and specific.

**Cross border banking (CP 23–25)**

19. Consolidated supervision can be carried out whether Liechtenstein is the home or the host country; although, the FSA has not established MOUs with any foreign regulators. Specific provisions should be included in the legislation for Liechtenstein banks proposing to establish abroad.

Table 1.1 Detailed Assessment of Compliance of the Basel Core Principles

**C. Detailed Assessment**

<b>Principle 1.</b>	<b>Objectives, Autonomy, Powers, and Resources</b> 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.
<b>Principle 1(1)</b>	An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.
Description	Both the government and the Financial Services Authority (FSA) are responsible for banking supervision. The government is responsible for granting, withdrawing, and revoking licenses. The FSA is responsible for the ongoing supervision of the banking system.  The legislative base for banking supervision is comprehensive, and it is based on the implementation of EU banking legislation as is required of Liechtenstein as a member of the EEA.
Assessment	Largely compliant
Comments	While the present system appears to have worked well, it would seem more desirable that supervision should be exercised by a single regulatory body which would have responsibility for all aspects of supervision, including licensing matters and ongoing supervision. Such a body would have a more cohesive approach to supervision. While it is understood that such a structure may create constitutional difficulties, and these are being considered at present, if possible, Liechtenstein should seriously consider establishing one.
<b>Principle 1(2)</b>	Each such agency should possess operational independence and adequate resources.
Description	Each agency has operation independence.  The banking supervision department (BSD), which is a department within the FSA, is staffed by two persons and a banking consultant. The head of the BSD, Mr. Melliger, is also head of the FSA and has been with the FSA for just one month. The second person is an administrative assistant.  The head of the FSA/BSD was appointed by open competition. He has no minimum term. He can only be dismissed on grounds applicable to all civil servants. There are no provisions for the public disclosure of the reasons for his dismissal should this occur. <sup>4</sup>

<sup>4</sup> According to the provisions of the Act on Civil Servants (Art 9k Para. 2), the decision of dismissal can be appealed through a complaint to the Administrative Court, and the decision can be disclosed to the public according to the appealing party’s intention.

Assessment	Materially non-compliant.
Comments	<p>The BSD is seriously understaffed. As will be seen throughout this assessment, the absence of suitably qualified staff raises difficulties in a number of areas, particularly, for instance, in having a thorough understanding of the banks and their operations and in reviewing and analyzing the operations and reports submitted by the banks. Also, the absence of continuity of staff has created a knowledge deficit.</p> <p>On the question of the terms of employment for the head of the FSA, it would be more desirable if the grounds for his dismissal could be more job specific. This is an issue that could be considered in the event of a single regulatory body being established.</p> <p>It is understood that the BSD is currently recruiting an analyst. It is felt that a second analyst is also required in the department. To attract the right people, it is essential that competitive salaries are paid.</p> <p>Following the mission, the government approved the establishment of two professional positions for auditors/financial analysts.</p>
<b>Principle 1(3)</b>	A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Description	A legal framework exists based on EU legislation. It allows the BSD to set prudential standards administratively and to collect information from banks in the form and frequency it deems necessary.
Assessment	Compliant
Comments	
<b>Principle 1(4)</b>	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	The BSD has wide powers with which to carry its function. It can apply qualitative judgment in forming opinions, has unfettered access to banks' files, and can take prompt remedial action.
Assessment	Compliant
Comments	Administrative sanctions should be spelled out in detail (see CP 22).
<b>Principle 1(5)</b>	A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	Under the law on Official Liability, 1966, all public employees (and consequently supervisory staff) are not held liable as long as they are not acting with willful negligence. There are no statutory provisions protecting supervisory staff from the costs of defending their actions.
Assessment	Compliant
Comments	The provisions of the 1966 Act appear adequate. However, it would be desirable to introduce certainty into whether supervisory staff are covered for costs in defending their actions.
<b>Principle 1(6)</b>	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	The sharing of information with foreign banking supervisory authorities is permitted under Article 36 of the banking act, provided that, inter alia "the public order, other essential interests of the country, and the banking secrecy are not violated thereby." Article 36 further states that this provision would not apply where international treaties dictate otherwise.
Assessment	Largely compliant

<p>Comments</p>	<p>The term “banking secrecy” is not defined within Article 36 of the banking act. In practice, however, the provisions of Article 36 are still creating difficulties. An instance was cited to the assessors concerning a query on possible market manipulation from an EU member state. (Both that member state and Liechtenstein are subject to the EEA Agreement i.e., an international treaty).</p> <p>Providing an answer to the query involved obtaining details of client transactions from a number of banks. While the FSA was willing to pass on the information, the banks in question refused to allow it to be passed on, as they wanted clarity in relation to the banking secrecy issue.</p> <p>The FSA issued an order requiring the banks to pass on the information. The banks, however, appealed the order to the government. In its decision of May 7, 2003, the supreme administrative court confirmed the government’s interpretation of banking secrecy provisions referred to in Article 36 of the banking act, which would allow the FSA to share client account information with foreign counterparts under certain prescribed conditions. The court ruled that sharing of client information would be permissible if the information was shared for supervisory purposes only; there are appropriate confidentiality provisions in place at the receiving supervisor; the information is kept confidential and used only for agreed supervisory purposes.</p> <p>The FSA intends to begin sharing information on this basis but is, nevertheless, also reviewing possible amendment to Article 36 of the banking act.</p> <p>Information received from overseas regulators is subject to Liechtenstein secrecy provisions and can only be used for the purpose of prudential supervision. Any impediment or lack of clarity in relation to the exchange of information must be regarded as a serious matter.</p>
<p><b>Principle 2.</b></p>	<p><b>Permissible Activities</b> 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.</p>
<p>Description</p>	<p>Banking activities that are listed in the BA (Article 3, Para. 3) include: acceptance of deposits, granting of loans, safe custody business, off-balance sheet banking transactions, and participation in securities and banking services. Banks are defined as entities that are allowed to conduct banking activities (BA, Article 3, Para. 1) on a professional basis. Whilst finance companies can perform some of them, only banks can take deposits. Other entities are prohibited from advertising such services in a way that could mislead the public (BO, Article 3). The BO (Article 1) defines more precisely the scope of the banking business which also encompasses: portfolio management, payment services, investment management, and services, including issuing securities.</p> <p>The BA (Article 16, Para. 1) stipulates that licensed banks only in designations of business or business advertising can use the word “bank.” The FSA makes sure that companies’ names are not misleading (BA, Article 16, Para. 4). The government may dissolve any non-licensed company which would conduct banking activities (BA, Article 28, Para. 4).</p>
<p>Assessment</p>	<p>Compliant</p>
<p>Comments</p>	<p>The Swiss Post Office operating in Liechtenstein conducts some banking activities. A law enacted in 1999 put these activities under FSA supervision. However, conventions between Switzerland and Liechtenstein, and the management of operations must be analyzed before appropriate supervision can be conducted by the FSA.</p>
<p><b>Principle 3.</b></p>	<p><b>Licensing Criteria</b> 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</p>

	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	<p>Conditions and procedures for a banking license’s granting, expiration, withdrawal, and revocation are specified in Articles 17 to 30 of the BA and in Articles 28 to 35 of the BO. Detailed information and forms required are listed in FSA internal guidelines. The BA indicates that economic needs of the market may not be taken into consideration (Article 15, Para. 3), meaning that the banking market in Liechtenstein is open to competition. Although the licensing authority is the government (BA, Article 15, Para. 1), the applications must be filed with the supervisory authority (FSA) which must ensure within 12 months that all the conditions are met. Proposals by the FSA are also submitted to the Banking Commission for consultation before being transmitted to the government.</p> <p>Criteria for issuing licenses are consistent with international practices, notably adequate ownership, statutes, internal organization and procedure, resources, and business plan. Specifically, banks must be organized with a board of non-executive directors of at least three persons, a management board of at least two persons, and internal auditors. The head office must be located in Liechtenstein. One member of each of the boards must be resident in the country and must have the power to represent the bank vis-à-vis the authorities. The tasks of the board of directors, who collectively are in charge of the direction of the management, supervision, and control are defined in the BA; the internal auditors report directly to the board of directors. Fit-and-proper tests (“guarantee of impeccable business operation from both, a professional and a personal point of view” BA, Article 19) apply to the members of the board of directors and of the management board, and to the head of the internal audit. In that regard, the FSA has access to domestic official records and may contact its foreign counterparts. Additional requirements can be set by the licensing authority in order to achieve the provisions of the BA. The minimum capital is CHF 10 million; however, since 2000, the FSA request all new banks to bring CHF 20 million minimum capital (finance companies must have a capital of CHF 2 million). Lastly, applicants must have an external auditor, chosen on a list of audit firms licensed by the FSA. Any change in the prerequisite for a bank’s license must be notified to, or approved by the supervisory authority.</p> <p>In addition to the general prerequisite, foreign banking groups must comply with specific requirements before opening a subsidiary in Liechtenstein: the home supervisory authorities conduct consolidated supervision and they do no object to the establishment of the subsidiary (BA, Article 15). Similar conditions are set for representative offices.</p> <p>Decisions on licenses must be notified within six months after the complete application is received, and grounds for refusal must be specified. Such a decision can be appealed to the administrative court. However, the FSA would make sure that all legal conditions are met before sending an application to the government, and no application has been denied in the recent years. If the legal prerequisites or the contractual obligations for a banking license are no longer met, the license shall be withdrawn (BA, Article 28, Para. 1).</p>
Assessment	Compliant
Comments	
<b>Principle 4.</b>	<b>Ownership</b>
Description	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	Shareholders holding a “qualified interest”, defined as 10 percent minimum of capital (BA, Article 3a, Para. h), shall ensure a solid and prudent management (BA, Article 24, Para. 3). Bearer shares are allowed, but disclosure of the beneficial owners is required, in accordance with the DDA, which requires the identification of contracting parties (article 4) and the establishment of the beneficial owner (Article 5). The FSA can prohibit the transaction or

	<p>suspend the voting rights.</p> <p>The BO (Article 27a) stipulates that the FSA must receive prior information from any individual or entity that intends to:</p> <ul style="list-style-type: none"> <li>• directly or indirectly hold or sell a qualified interest in a bank;</li> <li>• increase its participation in a bank so as to obtain 20, 33, or 50 percent of the voting rights or the control of the subsidiary.</li> </ul> <p>Subsequently, if such operation would endanger the sound and prudent management of the bank, the FSA can prohibit the acquisition within three months (BO, Article 27a, Para. 3) or impose a suspension of voting rights (BO, Article 27a, Para. 8).</p> <p>The BA (Article 26a, Para. 1) and the BO (Article 27a, Para. 4 and 6) also require banks to inform the FSA of any change of a qualified interest and to report personal information on these shareholders at least once a year.</p>
Assessment	Compliant
Comments	
<b>Principle 5.</b>	<b>Investment Criteria</b> 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	<p>Laws and regulations do not formally give the FSA power to review and approve banks' acquisitions and investments. However, they are required to submit a description of their sphere of business and of their organization with respect to these activities, to the supervisory authorities (BO, Article 31). At the licensing stage, the BA (Article 21) requires that statutes define precisely the factual and geographical banking and non-banking business circles of a bank. The original statutes and their amendments are to be approved by the FSA (BA, Article 35, Para. 3b) and any change must be reported before public announcement (BA, Article 26, Para. 2).</p> <p>More specifically, banks' investments in entities which are not banks or finance companies or do not conduct business related to banking activities, are limited to 15 percent of the capital of each entity (BO, Article 20a, Para. 1). The total of these holdings cannot exceed 60 percent of a bank's capital (BO, Article 20a, Para. 3). Limits do not apply to banks that cover such investments with capital (BO, Article 20a, Para. 5). This information must be regularly reported to the FSA and are reviewed through the onsite examination process.</p>
Assessment	Compliant
Comments	
<b>Principle 6.</b>	<b>Capital Adequacy</b> 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	<p>The BA requires banks' own funds to be in an appropriate proportion to their risks (Article 4). The definition of both, the own funds and the risk-weighted assets and off-balance sheet exposures, as defined in the BO (Articles 4 to 7), is consistent with the Basel Accord. The general minimum requirement is 8 percent of the own funds, and 4 percent of the tier one for market risks (BO, Article 4, Para. 2). The ratio is applied on both a solo (quarterly reporting) and a consolidated basis (semi-annual reporting). Should a bank fail to meet the norm, the FSA has the power to issue final decisions and orders. Ultimately, the supervisory authority would report to the government in order to withdraw the banking license (BA, Article 28).</p>

	Out of the 17 banks operating in Liechtenstein, 16 institutions had a ratio above 20 percent and 1 between 15 percent and 20 percent at the end of December 2001.
Assessment	Compliant
Comments	
<b>Principle 7.</b>	<b>Credit Policies</b> 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	The FSA has not issued detailed or specific regulations concerning credit risks. Banks are required to define sound credit policies and procedures. The external auditors are in charge of the onsite assessment of banks' credit practices and must give their views on the true and fair value of loans.
Assessment	Largely compliant
Comments	Banks' exposure to credit risk is limited in Liechtenstein. Most of the institutions have a small portfolio of Lombard credit, and only the three major banks provide mortgage loans.  However, the FSA has not defined any standard for loan portfolio review, and asset and off-balance sheet exposure classification and provisioning. It relies exclusively on external auditors that should refer to "international best practices" when assessing banks' internal rules and procedures. Such a system does ensure of a level-playing field across the industry. In the past months, three "letters of urgency," based on annual external audit reports, have been sent to banks for various weaknesses in loan procedures.
<b>Principle 8.</b>	<b>Loan Evaluation and Loan-Loss Provisioning</b> 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	Cf. Principle 7: the FSA has not published detailed or specific regulations concerning loan classification or loan provisioning with the exception of unpaid interest that should be cancelled after 90 days (BO, Annex 3). Banks are required to define their own asset classification and provisioning rules. The external auditors are in charge of the onsite assessment of the banks' portfolio quality.
Assessment	Largely compliant
Comments	See comments under Principle 7.
<b>Principle 9.</b>	<b>Large Exposure Limits</b> 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	The BA (Article 8) requests banks to limit their exposure to an individual client. Large exposures, which include on and off-balance sheet positions, are defined as exposures above 10 percent of the capital (BO, Article 19). They must be reported on a quarterly basis. Limits are 25 percent for a single exposure and 800 percent for all large exposures; the ten largest exposures are to be reported on a yearly basis. Definition of related borrowers ("associated counterparts") is in line with international rules. The BA gives the broader supervisory definition, and the Persons and Companies Act sets the rules for financial consolidation. The Bankers Associations developed a software program for the collection and reporting of these risks which is used by most of the banks.  Due to regulations restricting the transfer of personal data, some internationally active banks are limited in their ability to automatically consolidate their global exposures to a single client.
Assessment	Compliant

Comments	
<b>Principle 10.</b>	<b>Connected Lending</b> 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	Banks are required to follow the "generally acknowledged principles of the banking business" when granting loans to related persons. These are defined as the members of the "corporate bodies" (board of directors, management board, audit) and of the external audit firm, as well as qualified shareholders and persons or entities related to them (BA, Article 9 and BO, Annex 3, Para. 81). Bank's statutes must include provisions on transactions by corporate bodies and personnel (BO, Article 31, Para. 2c). In accordance with the BO (Annex 3, Para. 81), loans and commitments in favor of associated or related undertakings must also be reported to the FSA.
Assessment	Largely compliant
Comments	Regulations are not precise enough to ensure that such loans are identified and granted on an arm's length basis. The FSA relies exclusively on external auditors that should refer to some "generally acknowledged principles of the banking business." No regulatory reporting is in place with the exception of "particular transactions of corporate organs" mentioned in the layout of the external audit reports (BO, Annex 5).
<b>Principle 11.</b>	<b>Country Risk</b> 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	Pursuant to Article 21a of the BO, the FSA has defined specific guidelines regarding country risk (BO, Annex 4-1). Banks are requested to identify, measure, limit, and monitor their country exposure, as well as booking the provisions that they deemed to be necessary. Specific reporting has to be established on an annual basis by the largest banks (BO, Annex 3, Table J).
Assessment	Compliant
Comments	
<b>Principle 12.</b>	<b>Market Risks</b> 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	Market-risk measurement is defined in the BO (Article 6 and Annex 1, 4, 4-2). The three major banks only hold substantial market exposures and use the standard approach to calculate their global exposure. Other banks have to meet the norms which are applicable to their activities, essentially limits on foreign exchange positions.
Assessment	Compliant
Comments	
<b>Principle 13.</b>	<b>Other Risks</b> 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	The BO stipulates that banks must determine principles, organization and procedures of risk management. This includes market, counterpart, settlement, liquidity, image, operational and legal risks (Article 21a): <ul style="list-style-type: none"> <li>• The BO has detailed guidelines for interest risk assessment and monitoring, that include requirements for VaR and stress testing exposures (Annex 4).</li> </ul>

	<ul style="list-style-type: none"> <li>Banks in Liechtenstein hold large liquid assets which are invested on the Swiss money market; the BA requests banks to maintain sufficient liquidity (Article 5), and the BO defines a monthly cash liquidity ratio and a quarterly total liquidity ratio (Articles 8 to 16); banks must also report on one month term liability positions vis-à-vis a single counterpart that exceed 10 percent of the one month term total liabilities (Article 15).</li> <li>Specific provisions have been defined regarding outsourcing of “essential” services (BO, Article 27e); essential services relate to the assessment and monitoring of risks, especially, with regards to EDP, administration, and accounting (BO, Annex 6).</li> </ul>
Assessment	Materially non-compliant
Comments	In private banking, operational, legal, and reputation risks are major issues. Considering the lack of international published standards in that regard, the FSA should publish some guidelines to make sure that minimum requirements are met by all banks, and to ensure consistency within the industry.
<b>Principle 14.</b>	<p><b>Internal Control and Audit</b></p> <p>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.</p>
Description	<p>The BA (Article 22 and 23) has several provisions related to a bank’s governance; this includes minimum requirements regarding the number, functions, and qualifications of the directors, as well as of the members of the management board. The organizational structure of the bank must be submitted to the FSA, and any change must be reported.</p> <p>Similarly, banks are required to set up an internal audit function (BA, Article 22), and the BO defines the rights and duties of the internal audit (Article 34). The head of internal audit is subject on a permanent basis to the fit-and-proper requirements, as defined for the directors and senior managers. With the approval of the FSA, the internal audit can be outsourced. Internal auditors must report directly to the board of directors (BA, Article 22). They coordinate their activities with the external auditors and make their reports available to them (BA, Article 11).</p> <p>Bank’s accounts must be audited every year by an independent audit chosen on a list of firms licensed by the government (BA, Article 11). Criteria for licensing are based on independence, professional organization and management, and on financial soundness of the firm (BA, Article 37). The audit firms must verify that banks comply with the law and the statutes, that the prerequisites for licensing are met permanently, and that the banking business is conducted on a sound basis. Auditors must have access to all documents they deem necessary to fulfill their obligations; (BA, Article 11). Appropriate measures must be enforced when legal provisions are not met (BA, Article 39), and the FSA must be informed of the outcome of the actions. However, any serious infringement must be immediately reported to the supervisory authorities (Article 39). The scope of audit reviews is defined through the regulatory outline of audit reports (BO, Annex 5).</p>
Assessment	Compliant
Comments	
<b>Principle 15.</b>	<p><b>Money Laundering</b></p> <p>Banking supervisors must determine that banks have adequate policies, practices, and procedures in place, including strict “know-your-customer” rules that promote high ethical</p>

and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.	
Description	<p>Under the <i>Law on Professional Due Diligence in Financial Transactions</i> (the DDA), as amended in 2001, banks are required to have in place policies and procedures, and internal controls to prevent the bank from being used for money laundering, predicate crimes to money laundering, and organized crime. The Due Diligence Unit (DDU) has exclusive supervisory authority for ensuring compliance with due diligence and suspicious activity reporting. The FSA has no role in this area although the DDU does apprise the banking supervisor of issues of common interest such as internal controls and management.<sup>5</sup> The DDU has wide powers to exchange information with domestic and foreign competent authorities, although sharing of information with foreign supervisory authorities may still be subject to banking secrecy. However, the financial intelligence unit (FIU) has authority to share transaction-specific information with counterpart FIUs when indications of money laundering, predicate offenses or organized crime appear.</p> <p>The DDA requires banks to implement procedures for identification of customers, establishing beneficial ownership information, and repetition of these verifications if doubts arise about the customer or beneficial owner during the course of the business relationship. The DDA and the Executive Ordinance for Due Diligence, (DDEO) contain specific requirements for minimum customer-profile information, which should act as the back bone of the monitoring obligation for unusual activity. Banks are required to appoint both, a due diligence officer, who has the responsibility for implementation of internal control policies and a compliance officer with responsibility, respectively, for compliance with the due diligence measures and for receiving and coordinating suspicious activity reporting.</p> <p>Banks are required to monitor relationships and accounts on an ongoing basis and to monitor transactions for unusual or suspicious activity that indicates that there could be a connection to money laundering, predicate offense, or organized crime. Indicia of money laundering are provided by DDU guidelines, which banks are expected to follow and which require implementation of procedures for monitoring of relationships, preferably through use of IT systems, clarification of activities that raise doubts, and mandatory reporting of transactions and activities when doubts remain. Banks and employees are shielded from liability, including liability for banking and official secrecy when reporting suspicious activities in good faith. There are both penal and administrative sanctions that may apply for failure to comply with due diligence requirements.</p> <p>Compliance with due diligence is monitored on a yearly basis through external audits, which currently are conducted separately from the annual supervisory audits. External auditors are required to ensure that duties of due diligence are undertaken and that the files and documentation are adequately preserved and available.</p> <p>The detailed assessment for anti-money laundering and combating the financing of terrorism provides further discussion on the requirements and supervisory measures for anti-money laundering applicable to banks.</p>
Assessment	Compliant
Comments	

<sup>5</sup> The government is proceeding with its plan to consolidate the current functions of the FSA, the ISA, and the DDU into a single integrated financial supervisory authority, which will bring the AML function for banks back together with the banking supervision function. (See discussion in Volume 1—*Proposal to create an integrated financial supervisory authority*.)

<b>Principle 16.</b>	<b>Onsite and Offsite Supervision</b> An effective banking supervisory system should consist of some form of both onsite and offsite supervision.
Description	<p>The Banking Supervision Department (BSD) employs both, an onsite and offsite system of supervision.</p> <p>While the BSD has the power to carry out onsite inspections, in practice such inspections are carried out by external auditors on its behalf and are in addition to the statutory audit carried out by external auditors. Inspections are carried out at least once a year, and the external auditor is required to report to the BSD after each inspection. The banking ordinance sets out the issues which must be included in the report—these are fairly broad ranging.</p> <p>Offsite supervision is achieved by means of various reports which banks are required to submit to the BSD, either monthly, quarterly, half-yearly, or annually. These include liquidity reports (monthly), capital adequacy and large exposure reports (quarterly), half-yearly and annual accounts. In carrying out its inspection, the external auditor carries out random checks on the accuracy of these reports. It is the duty of the BSD to review and analyze these reports.</p>
Assessment	Materially non-compliant.
Comments	<p>While the principles involved in onsite and offsite supervision can be regarded as satisfactory, serious questions arise as to the ability of the BSD with its current staff levels and lack of expertise to carry out a meaningful analysis of either the inspection reports submitted by the external auditor or the periodic reports submitted by the banks.</p> <p>As recommended in BCP 1, additional staff are required in the Banking Supervision Department.</p>
<b>Principle 17.</b>	<b>Bank Management Contact</b> Banking supervisors must have regular contact with bank management and a thorough understanding of the institution’s operations.
Description	BSD is open to meetings with banks and currently meets them on an <i>ad-hoc</i> basis. It would also have an awareness of the banks’ activities from the reports provided by the external auditors and the reports submitted by the banks themselves. It also appears that the banks notify it of any substantive changes in their activities or any material adverse developments, including breaches of legal and prudential requirements.
Assessment	Materially non compliant
Comments	<p>A thorough understanding of the bank’s operations can only be achieved by the appointment of additional qualified staff. The current staff complement is two—Mr. Melliger, who has also overall responsibility for the FSA and who has been with the authority for just one month, and an administrative assistant. The department is also supported by a consultant banking expert. While Mr. Melliger proposes to meet each of the 17 banks in the coming period; at this point, the department’s knowledge of the banks is incomplete.</p> <p>The situation is somewhat mitigated by the fact that the banking community in Liechtenstein is small and relatively homogeneous (i.e., private banking) and onsite supervision is carried out by external auditors. Nonetheless for supervision to be truly effective, it is essential for the supervisor to have a detailed knowledge of the banks and their operations.</p> <p>This situation once again highlights the need for a more structured and better resourced banking supervision department.</p>
<b>Principle 18.</b>	<b>Offsite Supervision</b> 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	Both, the banking act and the banking ordinance provide for the timely receipt by the BSD of prudential and statistical information from banks on a solo and consolidated basis, including

	<p>data on- and off- balance assets and liabilities, profit and loss, capital adequacy, profitability, large exposures, etc.</p> <p>The accounting technique with regard to the preparation of solo and consolidated accounts is governed by EU banking and accounting law.</p> <p>All banks are required to report as at the same reporting date thereby providing for meaningful comparisons across banks.</p>
Assessment	Materially non-compliant
Comments	<p>The law providing for the BSD to receive whatever returns it deems necessary is adequate as is the range of returns received by it. However, the department currently lacks the resources to carry out a meaningful analysis of these reports.</p> <p>Once again, this area highlights the need for a properly resourced banking supervision department.</p>
<b>Principle 19.</b>	<p><b>Validation of Supervisory Information</b> Banking supervisors must have a means of independent validation of supervisory information either through onsite examinations or use of external auditors.</p>
Description	<p>External auditors are used to verify supervisory information. In addition to carrying out their statutory audit function, the external auditor must by law carry out a ‘banking’ audit, the terms of which are set by the BSD. These banking audits are carried out annually and cover the broad range of banking activity. A report on the outcome of each audit is presented to the BSD.</p> <p>Apart from the annual banking audit, the supervisor has the power to request the external auditor to carry out any further audits as it deems fit. (Banks are also subject to annual audits carried out at the instigation of the Due Diligence Unit. These audits concentrate on anti-money laundering issues, and the auditors in question must be different to those carrying out the banking audit).</p> <p>External auditors are required to inform the BSD immediately on becoming aware of any serious issues uncovered in a bank.</p> <p>The BSD must approve in advance the appointment of the external auditor. In practice the external auditors to the banks are the major international accountancy firms.</p> <p>The BSD has the power to meet with the external auditors and has met with them.</p> <p>Each bank is required to employ an internal auditor. In some instances, mainly in the case of small banks, the function is outsourced to a firm of external accountants.</p>
Assessment	Compliant.
Comments	
<b>Principle 20.</b>	<p><b>Consolidated Supervision</b> An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.</p>
Description	<p>The BSD is required to supervise its banks on a consolidated basis under Article 41a of the banking act which in turn is based on EU Directive 2000/12/EC. All banks are required to prepare accounts on a solo and consolidated basis, and all relevant ratios (e.g., capital adequacy, large exposures, etc.) must also be calculated on a consolidated basis.</p> <p>The external auditors in carrying out their banking audits review consolidated accounts.</p> <p>Banks are only allowed to establish operations in foreign jurisdictions where the rules of those jurisdictions allow for the free flow of information to facilitate effective consolidated</p>

	supervision.
Assessment	Compliant
Comments	While compliant in this area, the BSD would benefit from properly qualified staff to assess the consolidated accounts and particularly the consolidated returns submitted to the BSD (see CP18).
<b>Principle 21.</b>	<b>Accounting Standards</b> 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	In accordance with EU banking and accounting Directives which have been transposed into Liechtenstein law, all banks must maintain adequate records drawn up in accordance with consistent accounting standards. They must also meet accounting guidelines set by the Swiss regulatory authority and the Swiss Bankers' Association.  Banks are also subject to an annual audit by external auditors who are required to give an opinion as to whether the accounts give a true and fair view of the financial condition of the banks.  Banks are required to publish their annual and semi-annual accounts.  The Banking Association in conjunction with the Department of Statistics publish aggregate data on the Liechtenstein banking industry on a yearly basis.
Assessment	Compliant
Comments	
<b>Principle 22.</b>	<b>Remedial Measures</b> 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	Article 35 allows the BSD to take all necessary measures to remedy violations. Article 35.4 states "If the Financial Services Authority learns about any infringements of the law or about other grievances, it shall issue the orders required to achieve the regular situation and to eliminate the grievances."  The term "the orders" is not defined but is a term derived from the Public Administration Act which allows administrative bodies to issue sanctions. Under that act, the FSA may take any action which it deems appropriate to the circumstances; for instance, the removal of any officer of a bank, the suspension of business by a bank, recommending to the government that it withdraw a license, etc.  The Court of Justice can impose imprisonment and fines on banks and bank staff for various offences, including violating the obligations connected with a license, furnishing false information to the FSA, failure to keep proper books and records, etc.  The government can impose fines up to 50,000 Swiss francs for various offences including failure to produce annual accounts or communicate with the FSA.
Assessment	Compliant.
Comments	The remedial powers appear adequate; however, the actions which the FSA can take under the heading "the orders" should be detailed in some public documents.
<b>Principle 23.</b>	<b>Globally Consolidated Supervision</b>

	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	<p>All operations of Liechtenstein banks, both at home or in other jurisdictions, are included for the purposes of consolidated supervision. Banks proposing to establish operations in other jurisdictions must first obtain the permission of the BSD and must submit a business plan in respect of those operations. They must also satisfy the BSD that the rules of those other jurisdictions would not impede effective consolidated supervision.</p> <p>In carrying out their banking audit, the external auditor must also have regard to the consolidated position of banks. In particular, they must satisfy themselves as to the appropriateness of group organization and the enforcement of the management principles determined for the group.</p>
Assessment	Compliant
Comments	
<b>Principle 24.</b>	<p><b>Host Country Supervision</b> A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.</p>
Description	<p>Liechtenstein banks are permitted to establish overseas operations. The FSA will only permit its banks to establish in countries where it is satisfied with the local supervisory regime. It can prevent its banks from establishing in countries with secrecy laws or other regulations prohibiting flows of information deemed necessary for adequate supervision.</p> <p>Liechtenstein has not established MOUs with any foreign regulator (Germany has requested one on the grounds that a German bank is the ultimate parent of a Liechtenstein bank).</p> <p>In the past, the FSA has contacted the host supervisor of the overseas operations of Liechtenstein.</p>
Assessment	Largely compliant.
Comments	<p>The BSD relies on its general supervisory powers to oversee that banks observe the above requirements. It also interprets Article 30o, which deals with foreign banks proposing to establish branches in Liechtenstein, as applying to Liechtenstein banks proposing to establish abroad. Clearly it would be more desirable if there were specific legislation dealing with the matter.</p> <p>Liechtenstein should consider introducing legislation dealing specifically with the issue of Liechtenstein banks proposing to establish abroad.</p>
<b>Principle 25.</b>	<p><b>Supervision Over Foreign Banks' Establishments</b> 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.</p>
Description	<p>All subsidiaries (there are no branches) of foreign banks are subject to similar prudential, inspection, and regulatory reporting requirements as domestic banks.</p> <p>All home country supervisors (Switzerland, Austria, and France) practice consolidated global supervision.</p> <p>Article 36a of the banking act provides that the home country supervisor may verify information required by it about a subsidiary domiciled in Liechtenstein. This verification may be carried out by an onsite visit by the foreign regulator to the Liechtenstein subsidiary or by the</p>

	<p>foreign regulator requesting the FSA to do it. To date, no foreign regulator has requested verification.</p> <p>Article 36a also stipulates that such information is used exclusively for the purpose of consolidated supervision, and that the requesting authorities are bound by official or professional secrecy.</p> <p>The provisions of Article 36a, relating to the sharing of information for the purpose of consolidated supervision, do not make reference to banking secrecy unlike Article 36, which states “The furnishing of official information by the Financial Services Authority to foreign banking supervisory authorities” shall only be permitted if, inter alia the public order, other essential interests of the country, and the banking secrecy are not violated thereby,” see CP1(6).</p>
Assessment	Compliant
Comments	

Table 1.2 Summary Compliance of the Basel Core Principles

Core Principle	C <sup>1/</sup>	LC <sup>2/</sup>	MNC <sup>3/</sup>	NC <sup>4/</sup>	NA <sup>5/</sup>
1. Objectives, Autonomy, Powers, and Resources					
1.1 Objectives		x			
1.2 Independence			x		
1.3 Legal framework	x				
1.4 Enforcement powers	x				
1.5 Legal protection	x				
1.6 Information sharing		x			
2. Permissible Activities	x				
3. Licensing Criteria	x				
4. Ownership	x				
5. Investment Criteria	x				
6. Capital Adequacy	x				
7. Credit Policies		x			
8. Loan Evaluation and Loan-Loss Provisioning		x			
9. Large Exposure Limits	x				
10. Connected Lending		x			
11. Country Risk	x				
12. Market Risks	x				
13. Other Risks			x		
14. Internal Control and Audit	x				
15. Money Laundering	x				
16. Onsite and Offsite Supervision			x		
17. Bank Management Contact			x		
18. Offsite Supervision			x		
19. Validation of Supervisory Information	x				
20. Consolidated Supervision	x				
21. Accounting Standards	x				
22. Remedial Measures	x				
23. Globally Consolidated Supervision	x				
24. Host Country Supervision		x			
25. Supervision Over Foreign Banks' Establishments	x				

<sup>1/</sup> C: Compliant.

<sup>2/</sup> LC: Largely compliant.

<sup>3/</sup> MNC: Materially non-compliant.

<sup>4/</sup> NC: Non-compliant.

<sup>5/</sup> NA: Not applicable.

#### D. Recommended Action Plan and Authorities' Response to the Assessment

##### *Recommended Actions*

20. Three major issues that cut across several Core Principles must be corrected:
- Priority should be given to recruiting two qualified staff. Constrains in financial resources may not allow the FSA to appoint people with expertise, which would be

the most efficient way, both for quality and rapidity. The BSD has recently been in the process of recruiting two additional members of staff; one of these two vacancies was already filled in June 2003. Training with foreign supervisory authorities and the external auditors is essential.

- Meanwhile, in order to streamline the exchange of information process with foreign regulators, the scope of banking secrecy within Article 36 of the banking act must be clearly defined, and it would be useful that MOUs be signed with major home supervisors.
- Lastly, full compliance would be achieved if more clarification were brought into the supervisory standards and enforcement powers: in several areas, notably operational and credit risks, some of the external auditors commonly refer to Swiss rules or practices, although such norms have not been formally approved by the FSA; and remedial actions, in the form of undefined “orders,” should also be formulated into specific and gradual measures.

Table 1.3 Recommended Action Plan to Improve Compliance of the Basel Core Principles

Reference Principle	Recommended Action
Independence and resources (CP 1–2)	Recruit experienced staff and/or train new staff
Information sharing (CP 1–6)	Delimit banking secrecy with regard to supervisory concerns
Other risks (CP 13)	Determine applicable norms
Onsite and offsite supervision (CP 16)	Add resources for effective and comprehensive analysis of audit reports and bank reporting
Bank management contact (CP 17)	Add resources for effective and comprehensive understanding of banks’ operations
Offsite supervision (CP 18)	Add resources for effective and comprehensive understanding and analysis of audit and bank reports

### *Authorities’ response to the assessment*

#### **Introductory note on behalf of the authorities of the Principality of Liechtenstein**

21. First of all, the authorities of the Principality of Liechtenstein want to express their sincere gratitude to the assessors. The assessment was an enriching experience for the authorities. They appreciate the recommendations of the assessment team and will try their best to heed them. Even before the assessment, it was the declared aim of the Principality’s authorities to improve their regulation and supervision on the financial sector, but the assessment certainly encouraged these ambitions even more and provided useful, well-founded incitements. In respect of this aim and with regard to the recommended measures,

the authorities respond as follows to the assessment, focusing above all on the issues of the Recommended Action Plan.

### **Financial Services Authority**

#### **FSA's human resources and organization**

22. It has to be stressed that the FSA was in a transitional situation at the time of the assessment. Now the recruitment of two additional banking staff members has been assured to the FSA by governmental decision of December 3, 2002. The FSA has recently been in the process of recruiting two highly qualified auditors/financial analysts according to the job-descriptions assigned by the government. One of these two vacancies was filled in June 2003. Furthermore, the organization of the Financial Services Authority has been streamlined, and the responsibility of each staff member has been defined. The FSA is also introducing a short- and long-term (permanent) training and education program in 2003.

#### **Basel Core Principles—statistical analysis**

23. Out of 30 (100 percent) Principles, 25 (83 percent) are within the range of compliant/largely compliant. It is the FSA's aim to see 28 (93 percent) of the Principles in the range of compliant/largely compliant. In order to reach this goal, first measures have been taken in the field of human resources.

24. On the part of the assessment team some concerns have arisen repeatedly which the FSA is not able to share:

#### **FSA's mandate**

25. The FSA's mandate is set out in the respective legal provisions (Article 35 BA, Article 53 IUG, Ordinances delegating responsibilities regarding trustees and lawyers to the FSA, Article 9 Law on Prospectuses, etc.) which guarantees a transparent and fully accountable regulatory process.

#### **Information Sharing**

26. In its decision of May 7, 2003, the supreme administrative court reconfirmed in a ruling the decision of the government that banking secrecy provisions referred to in Article 36 banking act do not limit the FSA's ability to share client account information with foreign counterparts.

27. The supreme administrative court confirmed the legal view of the lower instances whereupon information can be shared with foreign regulators while the information provided is only used within the scope of supervisory duties as described in the request of the foreign authority. Within the foreign authority, access to the information provided has only to be granted to persons who are subject to official secrecy provisions. The information has to be

kept strictly confidential and may only be used in accordance with the agreed supervisory purpose. Any further disclosure of the information whether to other national authorities or to other foreign authorities is not allowed. In the case that according to the foreign legislation the information provided by the FSA has to be forwarded to other authorities, the regular mutual assistance procedure has to be duly complied with.

28. Information is shared by the FSA according to this decision of last resort. Nevertheless the government will evaluate whether it is advisable to amend Article 36 of the banking act accordingly.

### **Transparency measures**

29. The FSA issues a complete annual report available to the public upon request. Furthermore, an annual code of administrative practice is issued and available to the public.

## II. IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

### A. General

30. An assessment of observance of the IOSCO Objectives and Principles of Securities Regulation (the IOSCO Principles) was conducted as part of an offshore financial center assessment in the Principality of Liechtenstein.<sup>6</sup>

#### **Information and methodology used for assessment**

31. The assessment relied on the Fund/Bank Guidance Note for Assessing Implementation of IOSCO's Objectives and Principles of Securities Regulation. The limited nature of permitted securities activity in Liechtenstein was an important factor in assessing the IOSCO Principles. The financial sector is focused on private banking, and this is mirrored in the activity of market intermediaries which is limited to portfolio management, investment advice, management of collective investment schemes, and some brokerage activity. There are no active secondary markets, no underwriting activities, very few issuances of securities, and no direct trading on secondary markets.

32. The assessment was based on a review of the relevant legislation, questionnaires prepared by the authorities prior to the mission, detailed discussions with staff of the Financial Services Authority (FSA), the Due Diligence Unit (DDU), and presentations by and discussions with members of industry and industry associations. Staff of the FSA and DDU were very generous in making themselves available for discussions which were helpful, frank, and forthcoming. Assistance from industry representatives was also extremely helpful. The relevant laws, as well as sample disclosure and account documentation, were made available in English.

#### **Institutional and macroprudential setting, market structure**

33. Securities related activity in Liechtenstein is carried out by universal banks, licensed under the Law on Banking, investment undertakings (collective investment schemes) licensed under the Law on Investment Undertakings, and trustees acting as asset managers, licensed under the Law on Trustees. Banks are focused on private banking and asset management primarily for high net worth clients, the majority of whom are located outside of Liechtenstein (the largest number are in Switzerland, followed by other European jurisdictions). Two large banks also offer brokerage services—including the sale of mutual funds and securities—to small retail investors. Only banks can open customer accounts in this manner. Asset management is also carried out by trustees who manage customer assets and provide investment advice—customer assets must be in custody at a third-party bank (located in Liechtenstein or elsewhere). Investment undertakings are those entities that operate collective investment schemes—they may operate collective investment schemes

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<sup>6</sup> The assessment was conducted by Jennifer Elliott.

organized as trusts or as limited liability companies and may not directly distribute funds. Many collective investment schemes are eligible under the UCITS directive for sale in other European jurisdictions.

34. There are 17 banks licensed and operating in Liechtenstein, all of which carry out securities activities. There are 81 licensed investment undertakings with a total of CHF 5.2 billion assets under management. There are 355 licenses granted, but many entities operate with more than one license in Liechtenstein—the number of trustees carry on business as asset managers is unknown, although it is thought to be almost 35).

35. There are few public issuers in Liechtenstein. The Law on Prospectuses came into effect in 1997, and during the past two years only six prospectus filings have been made—all from the same issuer (a Liechtenstein bank) and mostly for the purpose of making amendments to the original offering prospectus.

### **Description of regulatory structure and practices**

36. Responsibility for oversight of banks and investment undertakings rests with the FSA, which is responsible for screening licensing applications, reviewing and approving prospectuses and disclosure documents, and carrying out supervision. Licenses are granted by the government (Cabinet); withdrawal of licenses and imposition of fines are also carried out by the government. The public prosecutor is responsible for enforcement activity. The Court of Justice can also issue fines or terms of imprisonment. The DDU is responsible for enforcement of compliance with anti money-laundering regulations for banks, investment undertakings and trustees; the details of the DDU's supervision are discussed under the AML/CFT Methodology. In the case of trustees, the FSA grants licenses to trustees but has only a limited on-going supervision responsibility. FSA decisions can be appealed to the government.

37. Relevant laws include the Law on Banking, the Law on Investment Undertakings, the Law on Trustees, and the Law on Prospectuses, as well as subordinate legislation under each law. The FSA also issues administrative guidelines. As a member of the EEA, Liechtenstein is obliged to implement the EU Directives. It has implemented the Investment Services Directive, the UCITS directive, and the prospectus directive.

38. The Liechtenstein system is a “dualistic” system of oversight which means that it relies to a large extent on the use of independent third party auditors to supervise regulated entities. These auditors are accounting and auditing firms that carry out both, the regular annual audit of a company and report to the FSA on compliance with relevant regulation. The FSA has a very small staff, with two permanent staff engaged in banking supervision (one of whom is the head of the authority), a consultant for banking supervision and two permanent and one temporary staff for oversight of collective investment schemes. One staff member is responsible for licensing of trustees, including those that act as asset managers. There are two staff members in the legal department responsible for legal support and implementation of EU Directives.

39. Industry associations in Liechtenstein do not have a formal role in regulation but are nonetheless an integral part of the regulatory environment. All three associations—the Banker’s Association, the Funds Association, and the Trustees Association appear to be very professional and quite proactive in their approach to regulation. The Funds Association, for example, has developed a system for publication of net asset valuations which allows members to fulfill publication requirements by electronically entering net asset value information daily, which is then posted on the website and forwarded to the Liechtenstein press for publication. The investor is therefore able to see, at a glance, the current value of every Liechtenstein fund, its performance over the last several years and any disclosure information that has been published. Those trustees that act as portfolio managers (only a small portion of the trustee population) have recently formed a separate industry association to deal with common interests. The industry associations are very active in the process formulation of policies and the development of codes of conduct, and they work closely with the FSA.

### **General preconditions for effective securities regulation**

40. The preconditions for effective securities regulation, including a sound legal, accounting and tax framework, appear to be in place in Liechtenstein.

### **Principle-by-principle assessment**

41. The IOSCO Principles were assessed in accordance with the criteria set out in the Guidance Note, taking into account the particular context of the Liechtenstein market. A summary of findings and recommendations is below, followed by a detailed table enumerating each Principle.

42. A Principle will be considered *implemented* whenever all assessment criteria are generally met without any material deficiencies. The Principles acknowledge that there are often several ways for countries to implement the Principles. A Principle will be considered to be *broadly implemented* whenever only minor shortcomings are found, which do not raise major concerns and when corrective actions to achieve full implementation with the Principle are scheduled and are realistically achievable within a short period of time. A Principle will be considered *partly implemented* whenever significant shortcomings are found, and the authorities have not implemented one or more assessment criteria. A Principle will be considered *not implemented* whenever major and material shortcomings are found in adhering with the assessment criteria. A Principle will be considered *not applicable* whenever it does not apply given the structural and institutional conditions.

43. **Regulator (Principles 1–5)**—The FSA’s mandate should be set out more clearly in the law—current provisions are sometimes vague, and there is no clear constitution of the agency itself. The FSA should operate more independently and should be granted authority to license and withdraw licenses (authority it has only with respect to trustees, lawyers, and auditors), levy penalties and other sanctions against regulated entities without approval from government. The FSA should have the ability to make legally binding rules. The FSA issues

a complete annual report available to the public upon request. Furthermore, an annual code of administrative practice is issued and available to the public. Additional transparencies should be introduced by setting up a website. This would assist the public in understanding its function and create a more accountable regulatory process.

44. **Self-regulatory organizations (Principles 6–7)**—The regulatory system in Liechtenstein incorporates the activities of industry associations. These resources are a complement to the stretched resources of the FSA. The FSA must be vigilant in maintaining resources and experience sufficient to benefit from the association’s work in the policy-making process but not be dominated by it. One industry association—the Trustees Association acts as a self-regulatory body since membership in the association, and compliance with its code of conduct is mandatory. The Trustee Association is unsupervised. The FSA should have a formal role in the association’s formulation of rules for asset management activities. The supervision of trustees is discussed in detail under market intermediaries (Principles 21–24).

45. **Inspections, investigations, and enforcement (Principles 8–10)**—The FSA has full inspection and investigations authority other than over trustees. The public prosecutor, responsible for enforcement, has sufficient authority over regulated entities. While the FSA has a licensing authority over trustees; it does not have inspection authority (although, these entities are subject to a DDU audit). Under the dualistic system, regular inspections of most regulated entities are carried out by third party auditors. These audits could be extended to trustees acting as asset managers. The FSA does not have sufficient resources to make credible use of the inspection system, however, and must be in a position to communicate specific instructions to the auditors and to properly analyze inspection results.

46. **Information sharing and cooperation (Principles 11–13)**—The FSA has the ability to share information with all domestic counterparts and does so in practice, particularly with the DDU. The Law on Banking grants the FSA the ability to share information with foreign regulators on banks and investment undertakings under certain conditions. There has been considerable debate regarding the scope of this ability—the FSA’s interpretation of the law was recently upheld by a court decision. On the strength of its support from the court, the FSA must now enhance its practice of sharing client information with foreign authorities. In the case of trustees, the FSA has no authority to share non-public information with foreign counterparts and is limited by its lack of ability to obtain information through inspections and lack of responsibility for on-going oversight.

47. The FSA is not a party to any information-sharing agreements with foreign counterparts. Although a lack of formal agreement is not necessarily an impediment to sharing information; it would create consistency and efficiency if such arrangements were in place since each request would not have to be evaluated individually. The FSA should consider such an arrangement with important jurisdictions, particularly with the Swiss authorities. The FSA should also consider appointing a designated person for the handling of all information requests, again to provide some consistency and efficiency.

48. **Issuers (Principles 14–16)**—The issuance of securities is subject to the Law on Prospectuses which implements the EU Prospectus Directive. Under the Law on Disclosure on Major Participation in Companies, those with 10 percent or greater of voting shares are required to disclose transactions. There are no other continuous disclosure requirements, corporate governance or take-over bid rules—however, an issuer must be listed on an exchange which would have such rules in place. There are very few issuers in Liechtenstein, and the six prospectuses that have been reviewed and approved during the past two years, all have been from the same issuer (mostly in the form of amendments). Accounting standards are a mixture of EU and Swiss accounting standards and, for banks, IAS standards. Auditors are held to EU standards.

49. **Collective investment schemes (Principles 17–20)**—A legislative framework governing collective investment funds (known as investment undertakings) is largely in place in Liechtenstein, which has implemented the EU UCITs directive. Investment undertakings are subject to detailed licensing requirements, are audited annually by third-party auditors with reports made to the FSA, and must publish disclosure documents in accordance with detailed rules. There is a need for conflicts-of-interest rules for collective investment schemes—these rules should, among other things, address related party transactions, borrowing and lending with affiliates, trading using a related party brokerage, employee conduct, and disclosure of conflicts of interest to clients. The FSA should not rely entirely on the Funds Association for development of these rules. Net-asset-valuation rules should be developed in more detail with a clearer definition of transferable security that imports an element of liquidity and detailed requirements for the valuation of illiquid securities.

50. **Market intermediaries (Principles 21–24)**—Market intermediaries in Liechtenstein are banks which offer brokerage and asset management services and trustees who may act as asset managers. Regulation of banks is discussed in detail under the Basel Core Principles assessment. Trustees acting as asset managers are largely unsupervised; although, they are subject to a licensing process and are inspected by the DDU. The extent of the asset management business carried on by trustees is unknown, and because they operate under a general license, there is no transparency to the public. The authorities should consider licensing these entities separately from other trustees and must implement periodic audits in order to monitor compliance with existing requirements. The need for more detailed rules (some of which should apply to trustees also) should be addressed in a global fashion with rules governing account documentation, representations made to clients, disclosure to clients (both risk and conflicts of interest), rules regarding related party transactions, and employee conduct. The new EU Directives on UCITS and market abuse will also necessitate work in this area.

## **Comments**

51. The weaknesses that pervade the Principles assessment are mostly related to the low level of staffing and resources at the regulator—particularly for the supervision of banks. Immediate attention should be given to increased staffing in order to use the existing inspection system effectively and improve the FSA’s ability to actively develop policy. Staff

time is currently devoted to licensing and implementation of EU Directives, leaving little time for supervision. Staff currently employed in supervision are highly qualified and diligent but are lacking in regulatory experience. Because the opportunities for training within Liechtenstein are limited, the authorities could consider working with outside authorities to provide additional training—either by employing experienced staff from other regulators on a short-term basis in Liechtenstein or by placing FSA staff with other regulators for short training periods.

52. The FSA should have its role in supervision set out more clearly in law, ideally in a single document. The planned restructuring of the regulator should address many of the issues related to independence, including lack of licensing authority, ability to levy fines or make legally enforceable rules represent some weakness in the system. Creation of a website and a more detailed annual report would improve transparency.

53. Trustees that act as asset managers are effectively investment advisors operating outside of securities regulatory rules (but they can only act through licensed banks, which are, however, subject to securities regulations). These asset managers should be licensed separately, subject to rules governing sales and business conduct and supervised through inspections.

54. While the authorities have worked very hard over the past few years to implement EU Directives and bring Liechtenstein law up to contemporary standards, some gaps remain, including an absence of rules addressing conflicts of interest for mutual funds and asset managers.

Table 2.1 Detailed Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation

**B. Detailed Assessment**

<b>Principles Relating to the Regulator</b>	
<b>Principle 1.</b>	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>The Financial Services Authority is a part of the state administration in Liechtenstein and does not have particular status as an independent agency. It is subject to the general laws of administration but does not have its own operating statute. Authority is delegated under each particular law—supervisory authority over investment undertakings is granted in the Law on Investment Undertakings, and supervisory authority over banks is granted in the Law on Banking. The FSA’s authority is clear in practice but sometimes difficult to locate in the law.</p> <p>Regulation of trustees is split between the FSA, which directly licenses trustees, the Trustee’s Association which enforces a code of conduct, and the government generally (the public prosecutor or the FSA could appeal to the Court of Appeals for withdrawal of license). There is no on-going supervision of the trustees other than through membership in the Trustee’s Association, except with respect to the area of due diligence.</p> <p>Responsibility for all areas of securities activity carried on in Liechtenstein is granted to the FSA—collective investment schemes, portfolio management, and brokerage activities. There is no division of responsibility; although, the DDU has an additional responsibility to monitor the compliance of these same entities with anti-money laundering law. Cooperation and information exchange between the FSA and DDU appears sound. Enforcement of securities law is carried out by the public prosecutor’s office which has a general responsibility to enforce the law. The public prosecutor’s enforcement powers are discussed under Principle 9.</p>
Assessment	Broadly implemented
Comments	The status of the FSA is somewhat unclear in law, although authority and responsibility are clearly established. In restructuring the regulator, the authorities should create a clearer legislative basis for the new regulator and set out its authority and responsibility broadly, in one law. Authority for the regulation of trustees is split between the government, the FSA, and the industry association—this structure is not transparent and could lead to confusion regarding responsibility for trustees.

<b>Principle 2.</b>	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	<p>The FSA is not an independent agency, rather it is a part of the government administration. It does operate with a degree of independence from the political process and from industry. The FSA is headed by a government appointee with the same civil servant status as FSA staff generally. There is no board of directors or management. The FSA's budget is part of the government general budget and funded from general revenue. The FSA takes in various fees—less than its operational costs—which are remitted to general revenue. The budget does provide a stable source of funding; although, there are significant resource issues (see Principle 3).</p> <p>The government does not appear to interfere in the day-to-day operations of the FSA. However, apart from lawyers, trustees, and auditors, the FSA does not have licensing power. Furthermore, the FSA does not have the power to refuse or withdraw licenses or the power to levy fines against regulated entities—rather it makes recommendations to Cabinet. While in practice the Cabinet accepts the FSA's recommendations, this is still a limitation on the FSA's ability to act independently.</p> <p>The FSA operates independently from industry, initiates and leads the various respective working groups to elaborate codes of conduct etc. Final approval of these rules lies with the FSA. Nevertheless, it does rely to a great degree on the industry associations to formulate its approach to policy and to draft codes of conduct etc. While the use of such organizations is an important element in policy formulation and a good relationship with industry will facilitate implementation of new policy, the FSA should consider a more independent approach to developing rules, particularly, the codes of conduct being undertaken by the industry. There are inherent conflicts of interest in industry that should be balanced with an objective assessment by the regulator.</p> <p>The procedure for appointment of the head of the FSA is not set out in the law although his/her status as a civil servant is subject to the provisions of the Law on Civil Servants. This law states that a state employee cannot be dismissed without just cause. However, the broad language of the provision leaves open the potential for a politically-motivated dismissal.</p> <p>As civil servants, the head of the FSA and FSA staff are protected from liability for discharge of their duties in good faith by the Law on Official Liability.</p> <p>The FSA reports to government and is accountable for its activities to Cabinet. There is an annual report of its activities included in a general government report, which is public. The FSA also publishes an annual report of new legislation and decisions made during the year. The FSA does not have a website and does not make information on licensing or supervision activities widely available to the public; although, some limited information is available to the public upon inquiry. The FSA does operate transparently vis-à-vis the industry through its very close cooperation with the industry associations.</p> <p>Decisions taken by the FSA as well as licensing decisions made by the Cabinet are subject to appeal. FSA decisions can be appealed to Cabinet and Cabinet decisions to the Administrative Court. Enforcement activities are undertaken by the public prosecutor. Lower court decisions made against regulated entities may be appealed to a higher court.</p>
Assessment	Partly implemented
Comments	<p>The FSA's status and authority to regulate should be established more clearly in the law—consideration should be given to establish its role and authority in a single law. The independence of the FSA could be improved by granting it licensing power not only to trustees, lawyers, and auditors, but with respect to all regulated entities and by granting the power to levy fines. The criteria for appointment and dismissal of the head of the FSA should be clearly stated in the law. The authorities should also consider, in restructuring the regulator, the establishment of a board of</p>

	<p>directors to be appointed for a term of office under clear criteria. The FSA should consider a more detailed, single, annual report covering all of its activities in that year including licenses granted and withdrawn, a summary of investigations or compliance activities, as well new rules and policies. This report should be made public and widely available.</p>
<b>Principle 3.</b>	<p>The regulator should have adequate powers, proper resources, and the capacity to perform its functions and exercise its powers.</p>
Description	<p>The FSA has been granted licensing and supervision power over banks and investment undertakings which include the right to obtain information, request reports, and inspect. The FSA evaluates licensing applications and makes recommendations to Cabinet for approval or refusal to approve, can recommend withdrawal of a license to Cabinet, and can recommend levying of fines to Cabinet. The FSA has the ability to share information with domestic and foreign counterparts (subject to limitations described in Principle 11). The FSA has licensing power over trustees but no authority to carry out supervision of trustees.</p> <p>The FSA does not have the ability to make binding rules, approve or refuse licenses, withdraw licenses, or levy penalties on regulated entities.</p> <p>The number of staff members is small relative to its responsibility for all financial services regulation. It is subject to budget and resource constraints—all additional funding and resources must be approved by the government. Although the government has been supportive of the FSA, it is clear that more resources and budget are required. The FSA has recruited staff from Switzerland, Austria, and Liechtenstein. Staff of the FSA are generally inexperienced; although, they possess excellent qualifications and are clearly very dedicated and professional.</p>
Assessment	Partly implemented
Comments	<p>The lack of resources and staffing is the predominant challenge to securities regulation in Liechtenstein, as is evident throughout this assessment. The FSA urgently requires additional experienced staff, both in the area of banking supervision and in the area of investment undertakings supervision. Training should be provided to existing staff.</p> <p>The FSA also lacks some necessary powers, including, the authority to supervise trustees' ability to make legally binding rules, and approve, withdraw, or refuse licenses for all regulated entities. These issues should be addressed during the restructuring of the regulator.</p>
<b>Principle 4.</b>	<p>The regulator should adopt clear and consistent regulatory processes.</p>
Description	<p>The FSA is subject to the general administrative law in the Principality and carries out its responsibilities in accordance with the law. The FSA does not issue licenses for banks or investment undertakings, which is the responsibility of the Cabinet on the recommendation of the FSA. In the case of trustees, however, the FSA does directly grant licenses. Written decisions regarding licensing are made available to the applicant. The FSA cannot levy fines—this is also done by recommendation to Cabinet. Licensing and sanctioning decisions are published in the official gazette and are therefore publicly available. New laws and regulations are similarly published by the government in the gazette.</p> <p>The various laws and ordinances regarding securities regulation are available to the public. The FSA does not have a website, which would greatly assist in its ability to communicate regulatory processes to the public. However, the industry associations have excellent websites and have made all legislation available electronically to the public.</p> <p>The FSA has issued various guidelines setting out contents of licensing and prospectus applications. Reporting requirements are contained in the laws and ordinances.</p>
Assessment	Broadly implemented
Comments	<p>The addition of a website would facilitate greater transparency—the FSA should make available to the public, via the website, all laws and ordinances, proposed laws and policies, an account of its various processes, and an annual report.</p>

<b>Principle 5.</b>	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	The staff of the FSA are subject to the Law on Civil Servants which sets out very strict confidentiality provisions governing the protection of information and the use of information obtained during employment. Staff are subject to penalty, including dismissal, for a breach of these provisions.  There is no conflicts of interest code at the FSA and no requirement that employees report trading activity or other relevant financial circumstances. However, some related provisions can be found in the Penal Code.
Assessment	Broadly implemented
Comments	The FSA could develop a conflicts-of-interest code of conduct for staff that would include a definition of conflict of interest and require staff to report on a periodic basis any trading activity.
<b>Principles of Self-Regulation</b>	
<b>Principle 6.</b>	The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate, to the size and complexity of the markets.
Description	The Bankers Association and the Funds Association, representing banks and investment undertakings respectively, are very active industry associations in Liechtenstein. They participate in policy formulation and also establish best practices for members but do not have a self-regulatory role. The Trustees Association, which represents all trustees in Liechtenstein, including those that carry on asset management activities, acts as a self-regulatory organization. The Law on Trustees establishes mandatory membership in the Association and requires compliance with the Association's Code of Conduct. Non compliance with the Code can be the basis for removal of the license by a court. Membership rules for the Association are the licensing requirements under the Law on Trustees.
Assessment	Implemented
Comments	
<b>Principle 7.</b>	SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	The Trustees Association is not subject to supervision or licensing by the FSA or any other government authority. Its Code of Conduct is not subject to review and approval by the FSA. There is, however, close cooperation between the Trustees Association and the FSA.
Assessment	Partly implemented
Comments	As discussed under Principles 21–24, there is a need to supervise trustees who carry out asset management activities with separate and distinguishable licensing, the right to carry out inspections, a periodic inspection program etc. If the Trustees Association continues to play a role in the regulation of these trustee/asset managers, it should also be supervised by the FSA. Such supervision should include a review and approval of its rules applicable to asset managers.

<b>Principles for the Enforcement of Securities Regulation</b>	
<b>Principle 8.</b>	The regulator should have comprehensive inspection, investigation, and surveillance powers.
Description	<p>In carrying out its regulatory responsibilities, the FSA has the authority under the Law on Banking, and the Law on Investment Undertakings to access books and records and request any data it deems necessary from banks or investment undertakings. It may carry out investigations or inspections on a routine or unscheduled basis. The FSA uses the services of third-party auditors for these purposes. These auditors are granted a concession from the FSA qualifying them to audit regulated entities. The auditors are obliged to file a report with the FSA on an annual basis and to otherwise notify the FSA of any evidence of non-compliance on the part of the regulated entity. The auditor's responsibility is general and is carried out in conjunction with its regular annual business audit of the entity. The FSA does not set any specific terms of the audit generally but has the power to do so. The FSA can also require the auditor to answer specific questions or examine specific issues at any time.</p> <p>The FSA does not have inspection authority over trustees acting as asset managers; however, they are subject to due diligence audits as an AML requirement. The public prosecutor would have the authority to request documents or oral testimony in the case of an official investigation by the court.</p> <p>The FSA is not responsible for enforcement, which is carried out by the public prosecutor's office. The public prosecutor has full power to demand documents and oral testimony from any person in the course of its investigation or action. An action can be taken against a company or individual. Pursuant to Article 35 of the Law on Banking, the FSA has the authority to bring civil actions against third parties acting without a license by making an application to the court.</p>
Assessment	Partly implemented
Comments	<p>The FSA and public prosecutor have full inspection, investigation, and enforcement powers with respect to banks and investment undertakings. However, there is no supervisor with authority to inspect trustees acting as asset manager. This authority should rest with the FSA.</p> <p>In many countries, regulator's seek the ability to bring enforcement actions themselves (without using the public prosecutor) because of the time delays involved in using the public prosecutor who is burdened by many other duties. In Liechtenstein this does not appear to be a problem since the jurisdiction is very small, and the public prosecutor is able to handle the few matters efficiently.</p>
<b>Principle 9.</b>	The regulator should have comprehensive enforcement powers.
Description	The public prosecutor has full authority to investigate and bring enforcement actions against individuals or companies in violation of the various laws governing financial services as part of its general mandate to enforce all laws. There are also a number of provisions of the Penal Code, including a provision on insider trading that can be prosecuted by the public prosecutor. The prosecutor has authority to obtain books and records and other relevant data, seek orders to ensure compliance with securities laws, and bring criminal actions.
Assessment	Implemented
Comments	The public prosecutor has sufficient enforcement authority; however, more flexibility might be added to the system by allowing the FSA some ability to impose fines and penalties of its own. Again, in such a small jurisdiction that deals with very few actions, such flexibility is not crucial. It would, however, allow the FSA to act more quickly and independently, particularly, in more minor breaches of the law.

<b>Principle 10.</b>	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	<p>A dualistic system of supervision exists in Liechtenstein whereby third party auditors (the auditors already employed by the regulated entity for a regular annual audit) assess compliance with regulation and file an annual report with the FSA. These auditors are screened by the FSA to ensure they are independent from direct conflicts of interest, but there are no particular qualifications vis-à-vis financial services regulation. The auditors appear to be well versed in their responsibilities, which have changed considerably in the past two years. These audits are required of banks and investment undertakings but not trustee/asset managers.</p> <p>Each entity, including trustees, is subject to an audit regarding its anti-money laundering procedures, and this report is made to the DDU. Banks are required to employ a second auditor separate from the FSA auditor for the purposes of the DDU audit. Investment undertakings may use their regular auditor.</p> <p>Regulated entities that do not have an internal audit function are subject to a second, interim unscheduled audit annually. In practice, this means that investment undertakings, which are too small to house internal audit functions, have a second audit annually. While the auditor is not required to make a formal report to the FSA at the conclusion of this audit, the auditor would include the results of its findings in the annual report and is at all times required to report any continued noncompliance to the FSA.</p> <p>In all cases the auditor is paid directly by the regulated entity.</p> <p>Audit reports are reviewed by FSA staff. Currently, there is one consultant at the FSA reviewing bank audit reports, and two staff at the FSA are reviewing audit reports for investment undertaking.</p>
Assessment	Partly implemented
Comments	<p>The use of the dualistic system is acceptable under the IOSCO Principles and is appropriate in the case of Liechtenstein where the number of staff is low. Furthermore the nature of securities related activities lends itself to third party audits since the greatest risks involved are misappropriation of customer funds and lack of internal controls—both of which would be dealt with in an annual audit. Third party audits would be less appropriate to assess underwriting or trading operations. The audits do not assess sales and business conduct of banks vis-à-vis customers however (see Principle 22). Trustees that carry out asset management activities should be subject to annual audits and stricter on-going supervision, in addition to the periodic due diligence audits.</p> <p>The central weakness in the inspection system is the lack of resources at the FSA to oversee and evaluate the results of audits. The FSA should be in a position to make more use of its ability to give audit instructions for specific institutions and to make a closer analysis of each audit carried out to assess in order to ensure quality of inspections, to achieve a working knowledge of the industry’s activities, to address issues of non-compliance, and to determine areas where policy work is required. The FSA does not currently have sufficient resources to do so. The FSA must, as a priority, recruit and retain experienced staff with the purpose of supervising the audit process.</p>

<b>Principles for Cooperation in Regulation</b>	
<b>Principle 11.</b>	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	<p>The Act on the Organization of State Administration grants domestic agencies the ability to share information between themselves and obliges them to share relevant information. In practice the FSA, as a small unified regulator, facilitates the sharing of information between investment undertaking, trustee, and banking supervisors. The FSA and DDU also in practice share information with the FIU.</p> <p>Article 36 of the Law on Banking grants the FSA or the government the ability to share information regarding a bank or an investment undertaking with a foreign supervisor, provided the information is being requested for a regulatory purpose and the confidentiality of the information will be protected. The FSA is able to share information on licensing and investigations. What constitutes bank secrecy within Article 36 banking act has been a matter of debate in Liechtenstein. Earlier in 2002, the FSA proposed to provide client identity and the particulars of client accounts to a number of securities regulators in response to requests from those authorities who were engaged in insider trading investigations. This action was protested by the banks concerned that providing such information is a violation of the Law on Banking. In keeping with the Liechtenstein administrative law, the matter was appealed to the Cabinet of the government.</p> <p>In its decision of May 7, 2003, the supreme administrative court confirmed the government’s interpretation of banking secrecy provisions referred to in Article 36 banking act, which would allow the FSA to share client account information with foreign counterparts under certain prescribed conditions. The court ruled that sharing of client information would be permissible if the information was shared for supervisory purposes only. There are appropriate confidentiality provisions in place at the receiving supervisor, and the information is kept confidential and used only for agreed supervisory purposes.</p> <p>The FSA intends to begin sharing information on this basis but is, nevertheless, also reviewing possible amendment to Article 36 of the banking act.</p> <p>The FSA has no legislative authority to share nonpublic information on trustees with foreign counterparts, and its ability is further limited by the FSA’s lack of inspection rights and lack of ability to obtain information from trustees other than in the licensing process.</p>
Assessment	Broadly implemented
Comments	The ability to provide client account details, including client identity, is a crucial element of compliance with this Principle. Client identity is a key piece of information in the investigation and enforcement of market abuse cases and is very important to effective cooperation with other securities regulatory authorities.
<b>Principle 12.</b>	Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.
Description	<p>The FSA has not entered into any memorandum of understanding with foreign supervisors; although, the Law on Banking clearly establishes the circumstances under which such information can be shared. Requests for information appear to be handled quickly and efficiently by FSA staff.</p> <p>Domestic information sharing is informal although the law requires agencies to cooperate with each other and the system appears to be effective—the FSA as a unified regulator with a tiny staff has an ability to quickly share information. The FSA and DDU also have very close ties and information is readily exchanged between the two. There are no legal impediments to sharing information with any government authority.</p>
Assessment	Broadly implemented
Comments	Although there are no formal mechanisms in place for the sharing of information, because of the size of the FSA and the small number of requests received, it is unlikely that requests will go

	<p>unnoticed or unaddressed. It would be preferable to establish a designated person to act as contact with all foreign supervisors and to be responsible for handling all requests. In addition, it is recommended that, given the special relationship with the Swiss authorities and the close ties between the industries in the two jurisdictions, a MOU with the Swiss authorities be negotiated. It is recognized that such an MOU must await a decision on the limitations of banking secrecy.</p>
<b>Principle 13.</b>	<p>The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.</p>
Description	<p>The FSA has the authority, under the Law on Banking, to obtain information from regulated entities and provide that information to foreign authorities. This information could include all public information related to regulated entities, licensing, and investigations information. There is no dual illegality limitation. The FSA cannot, however, as discussed under Principle 11, provide client-account information. The provision of this information must be in compliance with Article 36 of the Law on Banking, which requires that it be used for regulatory or supervisory purposes only and that confidentiality be protected.</p> <p>The FSA has no ability to obtain information from trustees on behalf of a foreign regulator.</p> <p>The FSA does not carry out enforcement activity—that is carried out by the prosecutor’s office but according to Article 25 Administrative Proceedings Law, the FSA is entitled to obtain information on oral testimony or documentation obtained in the course of the prosecutor’s investigation.</p>
Assessment	Broadly implemented.
Comments	The ability of the FSA to provide client account information to foreign supervisors should be improved.
<b>Principles for Issuers</b>	
<b>Principle 14.</b>	<p>There should be full, accurate and timely disclosure of financial results and other information that is material to investors’ decisions.</p>
Description	<p>The Law on Prospectuses implements the EU Prospectus Directive and requires issuers to disclose the nature of the ownership interest being conveyed, the terms of the instrument, the financial condition of the issuer (audited financial statements), business plan of the issuer, material risks to the issuer’s business, and details of management. Prospectuses are reviewed and approved by staff in the legal department of the FSA.</p> <p>There have been six prospectus filings since the law came into force in 1997 and all of those from one Liechtenstein bank (and mostly for the purpose of amending the original prospectus).</p>
Assessment	Implemented
Comments	
<b>Principle 15.</b>	<p>Holders of securities in a company should be treated in a fair and equitable manner.</p>
Description	<p>The Law on Prospectuses requires disclosure of ownership interest and voting rights. The Law on Disclosure of Major Participants in Companies requires those with 10 percent or greater of voting rights to disclosure transactions. There are no rules specifically applicable to minority shareholders (related party transactions, take over bid rules, or corporate governance rules).</p>
Assessment	Not applicable.
Comments	Since the market in Liechtenstein is almost nonexistent, it is not reasonable to expect a full set of rules applicable to issuers.
<b>Principle 16.</b>	<p>Accounting and auditing standards should be of a high and internationally acceptable quality.</p>
Description	<p>Accounting and auditing standards in Liechtenstein are a blend of IAS standards (applicable to banks), Swiss accounting rules and accounting standards, set out in EU Directives, all of which are of high and internationally acceptable quality. The only issuer is a bank and therefore uses IAS standards.</p>
Assessment	Implemented
Comments	

<b>Principles for Collective Investment Schemes</b>	
<b>Principle 17.</b>	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
Description	<p><b>Licensing:</b>            Under the Law on Investment Undertakings and Ordinance on Investment Undertakings, collective investment schemes are required to seek a license before operating in the jurisdiction. The investment undertaking is subject to a number of eligibility requirements. In the case of an investment undertaking in the form of a trust, the management company is subject to a minimum capital requirement of CHF 1 million and in the case of an investment undertaking in the form of a limited liability company to a minimum capital requirement of CHF 50,000. The undertaking must also demonstrate sufficient funding for the commencement of operations. Management of the undertaking must be acceptable to the FSA, which undertakes a fit-and-proper assessment of management and determines whether management has the capacity to carry out the undertaking. The undertaking’s application must appoint and have the approval of an auditor and a custodian (both of which have to be acceptable to the FSA). The applicant must submit investment policies and internal rules and disclosure documents of the scheme for approval. The undertaking must set out any proposed sub delegation of portfolio management to a third party portfolio manager for approval with the license. There are no restrictions on sub delegation. The terms of sale and redemption of the units and method of calculation of net asset valuation of units of the scheme must be set out in the application.</p> <p>There are three categories of license for investment undertakings: a UCIT eligible fund with general investments subject to regular concentration and risk limits; a broad second category of fund exempt from risk limitations but not eligible as a UCIT; and a third category of real estate funds.</p> <p>The FSA considers the licensing application and makes a recommendation to Cabinet for its approval or refusal. In practice, the licensing requirements are reviewed accurately at preliminary stage and informally denied if necessary; the FSA has never forwarded an application to Cabinet without endorsing its approval, and Cabinet has always approved these applications. A license may be subject to specific terms and conditions.</p> <p>Any material changes to the licensing conditions must be submitted to the FSA. The FSA is required to approve changes to the board of directors, custodian bank or auditors. The FSA is also required to approve any amendments to the investment regulations.</p> <p>Foreign investment undertakings must be licensed in order to offer units for sale in Liechtenstein. Eligible UCITs can market their funds in Liechtenstein but must notify the FSA and appoint a paying agent in Liechtenstein.</p> <p><b>Supervision:</b>            The Law and Ordinance on Investment Undertakings set out some requirements for record keeping, audit trail, and operation of collective investment schemes in line with those set out in the UCITs Directive. The FSA has the right to carry out scheduled and unscheduled audits but has not yet found it necessary to do so. All investment undertakings are required to have an annual audit by an approved auditor as well as an interim “unscheduled” audit carried out by the same auditor. Custodians are all Liechtenstein banks subject to annual audits. Custodians have an obligation to supervise compliance with NAV calculation rules and investment policies of the investment undertaking under Article 19 of the Law on Investment Undertakings, and the FSA would expect this to general obligation to result in reports of non-compliance to the FSA.</p>

	<p><b>Conduct:</b> There is a general provision in the Law on Investment Undertakings that the investment undertaking must put the interests of the client first; but, the FSA has not created rules on conflicts of interest including related party transactions, borrowing and lending with related parties, use of affiliate brokers or employee transactions. Recently, the FSA developed rules regarding the borrowing and lending of securities by an investment undertaking. The Funds Association in cooperation with the FSA is currently developing a code of conduct, which will be completed in time for the revised UCITs directive which will require such a code. This code will address market manipulation and other misconduct, best execution, treatment of NAV calculation, and other errors and omissions, and it is subject to approval by the FSA..</p>
Assessment	Broadly implemented
Comments	<p>The eligibility requirements are in depth and incorporate EU law. Licensing authority should be vested in the FSA to improve efficiency and independence. In addition, oversight of the audit process falls to a very small staff without a great deal of experience. Both increased staffing and training should be considered.</p> <p>Rules regarding conflicts of interest including related party transactions, commissions and fees, borrowing and lending with related parties, use of affiliated brokers and employee transactions should be developed. There should be a specific positive obligation for the custodian to report material non compliance with NAV or investment regulations to the FSA.</p>
<b>Principle 18.</b>	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	<p>There are two permissible legal forms of collective investment scheme—the first, an investment fund, is a structure wherein the collective investment scheme is in the form of a trust, managed by a separate management company (a limited liability company). Client assets are held in trust and clearly legally separate from the liabilities of the management company, which operates the fund. Client assets cannot, therefore, be affected by a bankruptcy of the management company.</p> <p>The second form, the investment company, is a limited liability company in which investors place asset in trust (by purchasing a unit of the investment fund and also purchase a share in the investment company. Client assets (units) are required to be separated and held in trust—however the client also has shares representing an ownership interest in the investment company. Client assets are, therefore, protected from liability or bankruptcy of the investment company. The terms of this structure must clearly be disclosed to clients in the prospectus.</p> <p>Both forms must have a separate custodian which must be a Liechtenstein. The law requires the custodian to be clearly separate from the management company for both structures. Custodian banks are subject to the supervision of the FSA and annual third party audits.</p>
Assessment	Implemented (subject to explanation of the legal requirement to separate assets in the investment company structure)
Comments	There is a clear and appropriate structure for collective investment schemes with appropriate segregation of client assets.
<b>Principle 19.</b>	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor’s interest in the scheme.
Description	<p>Article 8 of the Law on Investment Undertakings requires all investment undertakings to issue a prospectus containing all “necessary information for investors to be able to make a reasoned appraisal of the investments proposed to them.” The prospectus must be approved by the FSA. Investment undertakings must also publish annual and semi-annual reports updating the prospectus information.</p> <p>Detailed requirements for prospectus content are set out in Annex I to the Ordinance on Investment</p>

	<p>Undertakings. These include: designation of custodian and auditor, terms of redemption, terms of calculation of net asset value of the units, investment policies (type of investment, limits on investments, nature of markets traded on), terms of ownership interest, details of management of the fund, terms of sub delegation, and details of remuneration.</p> <p>Prospectuses are reviewed and approved by the FSA staff at the time of licensing. Amendments are also reviewed and approved.</p>
Assessment	Implemented
Comments	Prospectus requirements are in place, and there is effective review of their contents. Staff responsible do not have a great deal of experience in this area, which is complex and fast changing, and additional means of training should be considered.
<b>Principle 20.</b>	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>For UCIT eligible investment undertakings, units must be redeemable at a minimum of daily, for other investment undertakings a minimum of every 6 weeks ,or once a year for real estate funds. Changes to the terms of redemption must be published in the official gazette twice before coming into effect, and investors must be permitted to redeem funds prior to the change.</p> <p>The terms of net asset valuation must be set out in the application for license, the prospectus, and investment regulations of the investment undertakings. All listed securities must be valued on a mark-to-market basis on any day that units are for sale or are redeemable or at least every 14 days. UCITs are required to be valued daily. There are no rules for valuation of illiquid securities. NAV must be published each day units are available for sale or redemption (daily for UCITs) or a minimum of twice monthly. Foreign funds must publish NAV calculations every 14 days.</p> <p>Custodian banks, all located in Liechtenstein, have an obligation to calculate NAV in accordance with the FSA rules and the investment undertakings own investment rules.</p> <p>There are no specific rules regarding valuation of illiquid securities and no particular definition of liquidity—the definition of transferable securities is quite broad and could encompass securities that do not trade on a frequent basis (thus a general mark-to-market requirement may not be insufficient even for ‘transferable’ securities).</p>
Assessment	Broadly implemented
Comments	Increased resources at the FSA would ensure that staff are able to monitor audit reports with respect to both management companies and custodians in order to ensure that NAV calculations, redemptions, and errors are being handled appropriately. The FSA should consider developing rules on the valuation of illiquid securities and should also consider more detailed definitions of transferable securities under the Ordinance.

<b>Principles for Market Intermediaries</b>	
<b>Principle 21.</b>	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>There are two kinds of market intermediary in Liechtenstein: banks and trustees. Banks carry out portfolio management (both discretionary and non-discretionary), distribution of their own and third-party mutual funds, sale of securities, and custody of customer assets. Banks are subject to minimum entry standards including fit and proper assessment of owners, directors and officers, minimum capital, internal control, and capacity requirements, all of which are discussed under the Basel Core Principles 2–4.</p> <p>Trustees may act as asset managers (discretionary and non-discretionary) and are subject to the requirements under the Law on Trustees and regulated as trustees rather than as asset managers per se. Under the Law on Trustees, trustees can give investment advice and manage customer assets. Customer assets must be deposited into a trust account, a separate account is required for each account, and the bank must know the beneficial owner of each account. Monies can be moved through the trustee’s operating account. Co-mingling or pooling of customer assets is considered banking activity and is not permitted—this issue has been recently subject to legal challenge, and the court did interpret such activity as banking, requiring a banking license. Trustees are licensed directly by the FSA and must take a written examination which covers various aspects of financial planning and financial law, and trustees must undergo a three-year apprenticeship. There is no distinction between trustees that act as asset managers and those that do not. There is no information available regarding which trustees do in fact carry out this business.</p> <p>Trustees are required by the Law on Trustees to be members of the Trustees Federation, an industry association, and are subject to the Federation’s code of conduct. Non compliance with the code could result in the removal of a license. The code requires the trustee/asset manager generally to act in the client’s best interest and avoid conflicts of interest. However, there is no monitoring of compliance with the code. There are no other requirements application trustees and no on-going supervision of them. Trustee/asset managers are not subject to annual audits except for due diligence audits. If a trustee is a limited liability company, it is subject to a minimum capital requirement under the Law on Persons and Companies. If the trustee is an individual or partnership such as capital requirement according to Article 31 Act on Trustees, respectively the Law on Persons and Companies (PGR).</p> <p>As with collective investment schemes, applications for license as a bank or a trustee are made to the FSA which in turn makes a recommendation to Cabinet.</p>
Assessment	Partly implemented
Comments	<p>The authorities should strongly consider licensing of asset managers separately rather than as trustees generally. At a minimum, the asset management activities of trustees should be transparent in the terms of the trustee license so that the trustee’s permitted activities are known to regulators and the public. The terms and conditions of such licenses should be established clearly in the law and should include requirements for fit-and-proper management and ownership, management capacity, internal organization, etc. Some of these requirements exist in the current licensing requirements for trustees—which are rigorous but not particular to asset management. The FSA should review and approve such applications for license (also for banks) and should have the power to withdraw these licenses.</p> <p>See also Basel Core Principles 2–4.</p>
<b>Principle 22.</b>	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.

Description	<p>Banks are subject to initial and on-going capital requirements and other prudential requirements as detailed in Basel Core Principle 6.</p> <p>Trustee/asset managers are not subject to capital or other prudential requirements according to Article 31 Act on Trustees, respectively the Law on Persons and Companies (PGR). They are required to carry liability insurance.</p>
Assessment	Broadly implemented
Comments	<p>The on-going monitoring of the financial position of bank requires additional staff resources. See discussion of onsite and offsite reviews under Basel Core Principles.</p> <p>See also Basel Core Principle 6.</p>
<b>Principle 23.</b>	<p>Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.</p>
Description	<p>Banks are subject to internal control and operational requirements as set out in Basel Core Principle 14. These include a requirement for (i) an internal compliance function; (ii) to establish policies and procedures to ensure compliance with all legal and regulatory requirements; (iii) to identify and properly segregate client assets; (iv) to maintain proper books and records; and (v) to establish proper internal supervision. There are no rules regarding proprietary trading.</p> <p>Trustee/asset managers are not subject to internal control requirements.</p> <p>There is a general requirement for both banks and trustees to act in the best interest of the client. In addition, the Ordinance on Banking sets out general requirements for the securities related activities of banks requiring banks to maintain books and records sufficient to recreate a client transaction (audit trail requirements), and have in place policies and procedures dealing with custody and segregation of assets. Banks are also subject to conduct rules under the Ordinance including a requirement to seek information related to the client’s financial position and investment objectives, and a requirement to avoid conflicts of interest. These requirements are very general in nature, and it is not clear they would be audited to any degree of specificity in an annual audit. There are general rules regarding confidentiality of customer information under the Law on Banking and the Law on Trustees as well as under the Code of Conduct of the Liechtenstein Bankers’ Association.</p> <p>Trustee/asset managers are subject to the Trustees code of conduct, but this code is not legally enforceable and does not deal with account documentation or disclosure to clients. The Law on Trustees requires a separate trust account for client funds but does not give particulars. Asset managers are required to notify clients of investments made from these funds and to give annual client statements but there are no specific requirements for notifications or statements. Trustees/asset managers are required to cease activity that would create conflicts of interest; however, conflicts of interest are not defined.</p> <p>In practice, many of the banks and asset managers appear to have adopted international best practices in terms of account documentation and confidentiality and the monitoring of employee conflicts of interest.</p>
Assessment	Partly implemented
Comments	<p>The ability of the FSA to ensure that internal controls and conduct rules are in place in regulated entities is impeded by its lack of resources and therefore inability to adequately review and monitor the audit process, which is the chief supervision tool.</p> <p>The FSA should develop internal control standards for asset managers—because of the limited nature of the asset manager’s activities these would not be as detailed as those for banks and could be based on current best practices in the industry. The FSA should develop business conduct rules for all market intermediaries that include rules regarding account documentation (client contracts,</p>

	trade confirmations and account statements, etc.), information to be obtained from clients (know you client information—investment objectives, etc.), conflicts of interest disclosure, risk disclosure, and employee conduct (employee trading, etc.).  See also Basel Core Principle 14.
<b>Principle 24.</b>	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	Monitoring of the financial solvency of banks is discussed under Basel Core Principle 22.  In accordance with the Law on Trustees, the winding down of a trustee would be administered by the regular Courts. There is no monitoring of asset managers and no contingency plan in place for their failure. Asset managers are permitted to hold client funds, which must all be held in separate trust accounts, so there is little risk to client assets in the event of an insolvency.
Assessment	Implemented
Comments	See also Basel Core Principle 22.
<b>Principles for the Secondary Market</b>	
<b>Principle 25.</b>	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	There are no exchanges or trading system operating in Liechtenstein.
Assessment	Not applicable.
Comments	
<b>Principle 26.</b>	There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	There are no exchanges or trading systems operating in Liechtenstein.
Assessment	Not applicable.
Comments	
<b>Principle 27.</b>	Regulation should promote transparency of trading.
Description	There are no exchanges or trading systems operating in Liechtenstein.
Assessment	Not applicable.
Comments	
<b>Principle 28.</b>	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	There is no secondary market in Liechtenstein and therefore no requirement for surveillance of trading or detailed market abuse rules. Insider trading rules have been implemented and insider trading is a criminal offence under Article 122A of the Penal Code. Investigations and prosecutions are the responsibility of the public prosecutor.  The FSA can and does cooperate with the DDU and the Financial Intelligence Unit to share information regarding insider activities. Its ability to cooperate with foreign regulators is limited by bank secrecy requirements as discussed under Principles 11–13.
Assessment	Broadly implemented.
Comments	
<b>Principle 29.</b>	Regulation should aim to ensure the proper management of large exposures, default risk, and market disruption.
Description	Large exposure risks would be an issue for Liechtenstein banks only since only banks actively trade securities (and in practice this is a very limited activity). These issues are dealt with under Basel Core Principles.
Assessment	Not applicable.
Comments	
<b>Principle 30.</b>	Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective, and efficient, and that they reduce systemic risk.

Description	There are no clearing and settlement systems in Liechtenstein.
Assessment	Not applicable.
Comments	

Table 2.2 Summary Implementation of the IOSCO Objectives and Principles of Securities Regulation

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Implemented	7	P 6, 9, 14, 16, 18, 19, 24
Broadly Implemented	10	P 1, 4, 5, 11, 12, 13, 17, 20, 22, 28
Partly Implemented	7	P 2, 3, 7, 8, 10, 21, 23
Not Implemented		
Not applicable	6	P 15, 25, 26, 27, 29, 30

### C. Recommended Actions and Authorities' Response to the Assessment

#### *Recommended actions*

Table 2.3 Recommended Plan of Actions to Improve Implementation of the IOSCO Objectives and Principles of Securities Regulation

Reference Principle	Recommended Action
Principles Concerning the Regulator (P1-5)	<ul style="list-style-type: none"> <li>Increased staffing resources are urgently needed.</li> <li>Training of staff should be a priority, consider working with other jurisdictions.</li> <li>The FSA mandate should be clearer in law.</li> <li>The FSA should have authority to grant, refuse, and withdraw licenses for banks, investment undertakings, and asset managers.</li> <li>Criteria for selection and dismissal of the FSA head should be set out in a manner that is transparent and legally binding on the government.</li> <li>Greater transparency through a website should be introduced.</li> <li>The FSA should have the authority to make legally binding rules.</li> </ul>
Principles for the Enforcement of Securities Regulation (P 8–10)	<ul style="list-style-type: none"> <li>FSA should have the ability to withdraw licenses and levy fines.</li> <li>FSA should have authority to inspect and supervise trustees.</li> </ul>
Principles for Cooperation in Regulation (P 11–13)	<ul style="list-style-type: none"> <li>The FSA should adopt new policies and procedures to implement their authority to share client account information.</li> <li>FSA should enter into information sharing arrangements with key counterparts, specifically the Swiss.</li> </ul>

<p>Principles for Collective Investment Schemes (P 17–20)</p>	<ul style="list-style-type: none"> <li>• FSA should develop more detailed net-asset-valuation rules.</li> <li>• FSA should develop conflicts of interest rules for investment undertakings.</li> <li>• FSA should consider more detailed rules for duties of custodians.</li> <li>• FSA requires more resources/more experience for review of audits and prospectuses.</li> </ul>
<p>Principles for Market Intermediaries (P 21–24)</p>	<ul style="list-style-type: none"> <li>• Asset managers organized as trustees should be subject to a separate licensing procedure, which sets terms of their ability to carry out asset management business and makes this transparent to the public.</li> <li>• FSA should have licensing-, supervision-, and rule-making authority regarding asset managers.</li> <li>• Asset managers should be subject to an annual FSA audit.</li> <li>• FSA should develop more detailed rules regarding sales and business conduct of market intermediaries.</li> </ul>

*Authorities’ response to the assessment*

**Financial Services Authority**

55. The Authority appreciates the helpful suggestions made within the context of the assessment of Observance of the IOSCO Objectives and Principles. It will be the Authority’s aim to be responsive to the proposed recommendations as best as possible. Especially within the framework of the activities for the restructuring of financial supervision in the Principality of Liechtenstein it will comply with these suggestions. We want to point out particularly that the recommendation for a separate license for asset managers instead of the present general license as a trustee will be considered strongly.

56. We further want to refer to our statement in the Authority’s Response to the Assessment of the Basle Core Principles:

**FSA’s human resources and organization**

57. It has to be stressed that the FSA was in a transitional situation at the time of the assessment. Now the recruitment of two additional banking staff members has been assured to the FSA by governmental decision of December 3, 2002. The FSA has recently been in the process of recruiting two highly qualified auditors/financial analysts according to the job descriptions assigned by the government. One of these two vacancies was filled in June 2003. Furthermore, the organization of the Financial Services Authority has been streamlined, and the responsibility of each staff member has been defined as per attached organization chart and the respective job descriptions. In the meantime, a short- and long-term (permanent) training and education program has been installed to develop the potential of the staff in the direction of top professional qualification.

### **FSA's mandate**

58. The FSA's mandate is clearly set out in the respective legal provisions (Art 35 BA, Art 53 IUG, Ordinances delegating responsibilities regarding Trustees and Lawyers to the FSA, Art 9 Law on Prospectuses, etc.), which guarantees a transparent and fully accountable regulatory process.

### **Information sharing**

59. In its decision of May 7, 2003, the supreme administrative court reconfirmed in a ruling the decision of the government that banking secrecy provisions referred to in Article 36 banking act do not limit the FSA's ability to share client account information with foreign counterparts.

60. The supreme administrative court confirmed the legal view of the lower instances whereupon information can be shared with foreign regulators while the information provided is only used within the scope of supervisory duties as described in the request of the foreign authority. Within the foreign authority, access to the information provided has only to be granted to persons who are subject to official secrecy provisions. The information has to be kept strictly confidential and may only be used in accordance with the agreed supervisory purpose. Any further disclosure of the information, whether to other national authorities or to other foreign authorities, is not allowed. In the case that according to the foreign legislation the information provided by the FSA has to be forwarded to other authorities; the regular mutual assistance procedure has to be duly complied with.

61. Information is shared by the FSA according to this decision of last resort. Nevertheless the government will evaluate whether it is advisable to amend Article 36 of the banking act accordingly.

### **Transparency measures**

62. The FSA issues a complete annual report available to the public upon request. Furthermore an annual code of administrative practice is issued and available to the public.

63. Within the implementation of UCITS III (i.e., directives 2001/107/EC and 2001/108/EC) the FSA will apply for additional staff for the division of investment undertakings. As a result of this new legislation, investment undertakings will be committed to disclose information on suitability of funds for investors, initial and ongoing capital, proper risk-management, specific rules preventing conflict of interests, and there will be developed a Code of Conduct, which will be approved by the authority.

### III. DETAILED ASSESSMENT REPORT ON THE OBSERVANCE OF THE IAIS CORE PRINCIPLES

#### A. General

64. An assessment of observance of the IAIS Core Principles was conducted as part of an offshore financial center assessment in the Principality of Liechtenstein.<sup>7</sup> The assessment was based on discussions held with the staff of the Insurance Supervisory Authority (ISA), representatives of the Insurance Association of Liechtenstein and Insurance firms. The assessment considered several documents, including the review of applicable legislation and guidance for onsite inspections. Specific documents reviewed included:

- several laws and executive orders, especially, the Insurance Supervision Law of December 5, 1995;
- the Executive Order of December 17, 1996 on the supervision of insurance companies;
- the Executive Order of April 8, 1997 on the financing of insurance supervision;
- Liechtenstein—Switzerland agreement on direct insurance of December 19, 1996;
- Insurance Contract Act of 2001;
- note on onsite inspection of July 17, 2002 by the insurance supervisory authorities;
- note on insurance auditors and companies of May 21, 2002 by the insurance supervisory authority;
- EC directives on insurance: life insurance third directive 92/96 of November 10, 1992, non life insurance third directive 92/49 of June 8, 1992, and insurance accounting directive N°91/674 of December 19, 1991.

65. The assessment additionally considered the review of (i) the ISA circular letter on the use of assets in unit linked policies (November 30, 2000); (ii) a specific onsite inspection report; (iii) financial and structure information on insurance companies; and (iv) the draft financial report file to be sent by the companies to the supervisor starting 2003.

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<sup>7</sup> The assessment was conducted by Guillaume Leroy, JWA-Actuaires France.

### **Information and methodology used for the assessment**

66. This assessment of Liechtenstein's compliance with the IAIS Core Principles was conducted using the Core Principles methodology report adopted by the IAIS in October 2000. The assessment was based on discussions with the supervisory authority and cross checking of different sources of information from the supervisory authority, as well as neighboring supervisory authorities in the field of financial services and the opinion of some of the supervised companies, and the review of applicable legislation, rules, policies, guidelines, and other documentation.

### **Institutional and macroprudential setting, overview**

67. Liechtenstein insurance companies did not exist until 1995, as insurance services were previously provided by branches of Swiss companies. In 1995, Liechtenstein joined the EEA and implemented the third generation EU directives, which allowed Liechtenstein firms to market insurance products throughout the EEA under the provisions of freedom of services. In addition, based on a 1996 agreement, Liechtenstein companies are able to market insurance products in Switzerland.

68. Supervision of insurance activity in Liechtenstein is based on the Insurance Supervision Law of 1995, which formed the corner stone of the insurance regulatory system following Liechtenstein's membership in the EEA.<sup>8</sup> With a legal framework in place, the authorities established an institutional framework for insurance regulation. New companies were licensed starting in 1996; at end-2002, there were 12 life insurance companies, 4 nonlife companies and 5 reinsurance companies.

69. Although there is a local market for life insurance products, to a greater extent Liechtenstein companies market insurance products to the broader European Union and to Switzerland.

70. Reinsurance captive companies have grown for different reasons that include stability, geographic advantages, and the tax and legal framework for captives. Five reinsurers are licensed in Liechtenstein, with their basic activities comprised of captive reinsurance for foreign operators.

71. The Liechtenstein market consists of two basic parts. The first part is the local market, which is dominated by the branches of Swiss insurance companies with a premium income of about 197 million euros at end-2001. The second part is the life and reinsurance market, which have incorporated in Liechtenstein and carry out activities in the European Union, Switzerland, and other non EU countries. It amounted to as much as 319 million euros in 2001. As a consequence of Liechtenstein's EEA membership and its arrangement

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<sup>8</sup> The Executive Order on the Law on Supervision of Insurance Undertakings 1996 is also highly relevant, as it details the practical application of the 1995 Insurance Supervision Law.

with Switzerland, the ISA is charged with the protection of predominantly non Liechtenstein residents, whereas the Swiss Supervisory Authority has responsibility for the protection of Liechtenstein policyholders.

72. The assets held by the Liechtenstein companies amount to CHF 1.1 billion in the field of direct insurance (nearly all of it is made of assets-matching life-technical reserves) and CHF 0.78 billion for the reinsurance business, basically assets matching captives technical reserves.

73. As for the life business, it is increasingly made of unit linked policies (and to a certain extent, capital redemption operations) that amount to a large part of new business and approximately 65 percent of the total technical reserves of life insurance companies. From a systemic risk point of view, the asset risk in these products is borne by the policyholder, which should make the situation of the Liechtenstein companies less fragile in the case of a long lasting depression of asset values. Yet, some rules dealing with surrender values might make the situation slightly more difficult than expected.

74. As for captive insurance activity, a similar situation exists, whereby the substantial majority of the risk is borne by the captive parent companies, and the risk in the Liechtenstein market is very limited.

75. For the time being, little global market data is available. In the field of solvency, there is no aggregate data, which makes it difficult to have an accurate view of the market all the more, so as there is no annual report from the Insurance Supervisory Authority or the Insurance Association.

76. While some strengthening of supervision function over insurance firms is appropriate, the risks in the market appear small due to the lower risk profile of products sold. Moreover, a number of new legislative changes and improvements to the supervision process are to be implemented in 2003/2004. Some have already been adopted by the parliament and will come into force in 2003 (exchange of information with other supervisory authorities); others are to be implemented shortly (new financial statement files to be sent to the supervisory authority). The changes will allow for better monitoring of insurance-market risks, asset-liability management, and exchange of information, which are welcome changes given the expanding market.

77. Planning is underway to establish an integrated financial services supervisory authority that would bring together the oversight of banking, securities, and insurance activities. The creation of the new agency is now planned for early 2005, with legislative changes to be completed in mid 2004. This would be a major change that should create tighter links between the insurance supervisory authority and its banking and funds management counterparts.

## Conditions for effective supervision

78. The legislative framework for insurance supervision has been created over the last five to eight years and follows EU requirements consistent with Liechtenstein's status within the EEA. The legal framework is influenced by the EU directives, and also the Swiss legal system and, consequently, has much in common with the legal systems of other continental European countries. A general difference for Liechtenstein's system relative to other continental European countries is that legislation permits the presence of Trusts.

79. Since the creation of a Liechtenstein insurance market in 1995, insurance has been supervised by the Insurance Supervisory Authority, which is a department of the office of national economy. The ISA relies upon the activity of six trained people to achieve its tasks.

80. The Due Diligence Unit oversees anti-money laundering requirements in the insurance sector. The supervision of the insurance industry will significantly evolve in 2003; the ISA has the intention to carry out more frequent onsite inspections once the licensing process of the Liechtenstein incorporated companies has been finished.

81. Additionally, and due to the evolution of the EU as well as the enforcement of new legislation in Liechtenstein and the growing maturity of the market, a significant part of the existing legislation of Liechtenstein will be modified in the months ahead. After the setting up of the legal foundations of the market, the supervisory authority has considered and started improving the regular on-going supervision scheme. A new set of reforms is to change drastically the practical features of the supervision system. It should enhance the existing system and give a stronger hand to the insurance supervisory authority to have a clear control over the sector.

Table 3.1 Detailed Assessment of Compliance of the Insurance Core Principles

### B. Detailed Assessment

<b>Principle 1.</b>	<p><b>Organization of an Insurance Supervisor</b></p> <p>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:</p> <ul style="list-style-type: none"> <li>• be operationally independent and accountable in the exercise of its functions and powers;</li> <li>• have adequate powers, legal protection, and financial resources to perform its functions and exercise its powers;</li> <li>• adopt a clear, transparent, and consistent regulatory and supervisory process;</li> <li>• clearly define the responsibility for decision-making; and</li> <li>• hire, train, and maintain sufficient staff with high professional standards who follow the appropriate standards of confidentiality.</li> </ul>
Description	Article 60 of the insurance supervision law of December 6, 1995 defines the supervisory

	<p>authority to be the Liechtenstein government, which is in charge of the granting, revoking, and withdrawal of licenses to insurance companies, as well as reinsurance companies. The bulk of the supervisory activity is carried out through the ISA, which is a department within the office of national economy.</p> <p>An Executive Order of April, 8, 1997 provides the ISA with resources to carry out the supervision task in line with the article 46 of the insurance supervision law of December, 6, 1995. The ISA's actual costs exceed the charges levied on companies, which as a consequence, necessitates that the ISA receive additional funding from the global budget of the state to support its supervision activities.</p> <p>The ISA addresses the issue of insurance supervision with a team of six trained staff (out of which four are university graduates). But the staff has also to cope with social security issues (pension funds, health and sickness insurance, accident insurance). Therefore, it must be noted that the insurance sector has fewer actual supervisors than it could have according to the number of the staff that may work on its supervision.</p>
Assessment	Broadly observed
Comments	<p>An increase in the number of people devoted to the insurance supervision is needed, given the expanding insurance activities and continuing responsibility for social security. More resources are needed for effective insurance supervision, particularly, as onsite inspection capacities are developed. See assessment of CP13, which notes the need to increase capacity to conduct onsite inspections.</p>
<b>Principle 2.</b>	<p><b>Licensing</b></p> <p>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:</p> <ul style="list-style-type: none"> <li>• 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</li> <li>• 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.</li> </ul>
Description	<p>The licensing process in Liechtenstein is described in:</p> <ul style="list-style-type: none"> <li>• Articles 12 to 21 and 23 of the insurance supervision law of 1995 in global terms;</li> <li>• Articles 24 to 27 of the insurance supervision law for Liechtenstein companies which wish to work in other EEA countries;</li> <li>• Articles 28 to 30 for companies wishing to work in Liechtenstein from other EEA countries;</li> <li>• Articles 31 to 34 for non EEA countries wishing to work in Liechtenstein.</li> </ul> <p>Apart from this, there is a specific agreement between Switzerland and Liechtenstein that sets up the principle of home-country control, and that enables the Swiss companies to work in Liechtenstein like the companies from EEA countries and allows Liechtenstein companies to work in Switzerland, as they do in the EEA.</p> <p>Additionally, information is given in Articles 48 to 62 of the Executive Order of 1996. The reinsurance companies are licensed according to the same rules as direct insurance companies. Insurance companies, having their head office out of Liechtenstein and only carrying out reinsurance transactions in Liechtenstein, are exempted from licensing by the Article 5 of the insurance supervision law.</p> <p>Other requirements imposed by the ISA for local insurance companies include that (i) at least one of the directors of an insurance company must be a resident of Liechtenstein (Article 23 of the</p>

	<p>insurance supervision law); (ii) adequate experience in the field of insurance is required for the management of the company according to Article 7 of the 1996 Executive Order; and (iii) within the business plan, specific attention is paid to the head office, which has to be in Liechtenstein and cannot be moved.</p> <p>The ISA permits local companies to transfer or out source some back-office activities to other companies, including to the parent company. The transfer or outsource arrangements need to include contractual agreement that requires ISA approval..</p>
Assessment	Observed
Comments	<p>Most licensing rules stem from the EU directives and treaties. They are in line with the principle from a legal as well as from a practical point of view. One may notice, that, like in some other countries, Articles 2 and 6 of the insurance supervision law enable the ISA to exempt some companies from supervision. The prohibition of such possibilities stems from the application of the EU directives, not from internal law even though these articles were never applied.</p> <p>As for brokers and intermediaries, they are not supervised and fall under the provisions of general trade law. Article 22 of the insurance supervision law explains that they may not work with companies not licensed in Liechtenstein.</p>
<b>Principle 3.</b>	<p><b>Changes in Control</b></p> <p>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:</p> <ul style="list-style-type: none"> <li>• 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</li> <li>• establish criteria to assess the appropriateness of the change, which could include the assessment of the suitability of the new owners as well as any new directors and senior managers, and the soundness of any new business plan.</li> </ul>
Description	<p>According to Articles 36 and 43 of the Insurance Supervision Law, the insurance supervisory authority must be informed of any change in the business plan of an insurance company. This includes changes in control. Additional references to the change in control are listed in Articles 58 to 61 of the Executive Order of 1996.</p> <p>As far as the business plan is concerned, insurance companies must provide information on the list of members of the board of the insurance companies on outsourcing contracts as required by Article 13 of the Insurance Supervision Law.</p> <p>Apart from this, the Insurance Supervisory Law requires that at least one of the directors of the company is a Liechtenstein resident (Article 23-1 of Insurance Supervision Law) and has additional requirements in the field of insurance (Article 7 of 1996 of the Executive Order). Therefore, the Insurance Supervisory Authority has a number of tools to check the way the company deals with the fitness and properness of its directors, and, to a large extent, owners.</p> <p>The Insurance Supervisory Authority does rely on the size of the market and the close links that exist between the different participants in this market to be able to check the changes in control.</p>
Assessment	Observed
Comments	<p>Most Liechtenstein companies are wholly owned subsidiaries of major foreign companies. Therefore, there have been only seldom changes in control over the past few years.</p>

<p><b>Principle 4.</b></p>	<p><b>Corporate Governance</b>  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:</p> <ul style="list-style-type: none"> <li>• the roles and responsibilities of the board of directors;</li> <li>• reliance on other supervisors for companies licensed in another jurisdiction; and</li> <li>• the distinction between the standards to be met by companies incorporated in his jurisdiction and branch operations of companies incorporated in another jurisdiction.</li> </ul>
<p>Description</p>	<p>No specific regulation exists in the field of insurance law in terms of corporate governance. By the way, the corporate governance principles are defined in broad terms in the general corporate law. As in most written law countries, there are no specific mandatory rules on corporate governance or guidelines that could be applicable to this principle.</p>
<p>Assessment</p>	<p>Not applicable</p>
<p>Comments</p>	<p>The situation in Liechtenstein is in line with the one prevailing in many written-law countries where there are no specific notions of corporate governance.</p> <p>One must notice that on some occasions professional secrecy is required from the authorities (Article 44 of the Insurance Supervision Law). This might be on some occasions harmful to the prudential supervision and to the company corporate governance of the company when authorities discover an abnormal behavior from a prudential point of view.</p>
<p><b>Principle 5.</b></p>	<p><b>Internal Controls</b>  The insurance supervisor should be able to:</p> <ul style="list-style-type: none"> <li>• review the internal controls that the board of directors and management approve and apply, and request strengthening of the controls where necessary; and</li> <li>• 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.</li> </ul>
<p>Description</p>	<p>According to Article 57 of the Executive Order of 1996 and the onsite inspection report manual of 2002, the Insurance Supervisory Authority is entitled to have a look at the internal controls of insurance companies which they must set up. Yet, there are no specific guide lines from the government and/or from the Insurance Association, and the checking of the internal controls does rely to a large extent on the attitude of the mother companies of Liechtenstein companies. By the way, most Liechtenstein companies are small size companies, subsidiaries of big groups, and, therefore, it is quite logical not to see specific internal controls differing from the ones of the mother companies.</p> <p>Apart from this, the supervision of internal controls does rely on the work of external auditors or actuaries who have been chosen by the Insurance Supervisory Authority within a list of auditors having an adequate level of knowledge of the insurance standards according to the Article 69c of the Executive Order of 1996; this is another tool which has been made available to the Insurance Supervisory Authority to check the internal controls of insurance companies in Liechtenstein.</p>
<p>Assessment</p>	<p>Observed</p>
<p>Comments</p>	

<p><b>Principle 6.</b></p>	<p><b>Assets</b> 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:</p> <ul style="list-style-type: none"> <li>• diversification by type;</li> <li>• any limits, or restrictions, on the amount that may be held in financial instruments, property, and receivables;</li> <li>• the basis for valuing assets which are included in the financial reports;</li> <li>• the safekeeping of assets;</li> <li>• appropriate matching of assets and liabilities; and</li> <li>• liquidity.</li> </ul>
<p>Description</p>	<p>The list of assets that may be held by insurance companies in Liechtenstein is detailed in Articles 31, 33 to 37, 40, 41, 43 to 47 of the Executive Order of 1996. Additionally, information is provided in the appendices 2 to 4 of the same text.</p> <p>EU regulations on the holding of assets by insurance company also apply. The regulation is in line with the EC requirements, and nothing special is to be considered. Yet, 2 or 3 rules exist which need be explained:</p> <ul style="list-style-type: none"> <li>• Articles 35 and 44 of the Executive Order entitle the Insurance Supervisory Authority to allow the use of other assets than those listed as conforming in the EU directive.</li> <li>• There are no asset liability management requirements in Liechtenstein: due to the features of the market, this is probably not a major issue for the time being, yet, to a certain extent it might become one.</li> <li>• The list of assets that may be held for unit-linked life policies is very wide, and some of the assets might be not very liquid, especially unlisted securities.</li> </ul> <p>At the same time, Article 71 of the Insurance Contract Law of 2001 requires that a surrender value will be paid to the policyholder within four weeks following his demand. Therefore, this could lead to some liquidity risk for Liechtenstein insurance companies whose business is highly concentrated on unit-linked life insurance policies if policyholders make an improper use of this legal provision.</p> <p>Currency matching requirements are in line with the EU requirements.</p>
<p>Assessment</p>	<p>Broadly observed.</p>
<p>Comments</p>	<p>Additional information from companies on the features of assets held by companies in terms of maturity, quality, and yield is needed in order to improve the ISA's ability to monitor types of assets held and quality of asset liability management. The ISA will soon require these changes beginning 2003..</p>

<p><b>Principle 7.</b></p>	<p><b>Liabilities</b> 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:</p> <ul style="list-style-type: none"> <li>• 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;</li> <li>• the standards for establishing policy liabilities or technical provisions; and</li> <li>• the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collect ability.</li> </ul>
<p>Description</p>	<p>The principles on the constitution of insurance liabilities are explained in Articles 29 and 30 of the Executive Order of 1996. Some specific articles or appendices deal with credit insurance and health insurance (Appendix 3 of the Executive Order of 1996 and Article 38 of the Executive Order of 1996). There are no other specific rules in the field of non life insurance.</p> <p>In the field of life insurance, the Appendix 4, Article 13 explains that interest rates should be chosen for guaranteed interest-rate business according to a circular by the insurance supervisory authority. The authority refers to the figures used by the different supervisory authorities of the European Union.</p> <p>Simultaneously, an actuary must supervise technical reserves for life insurance companies (Executive Order of 1996, Article 9).</p> <p>As for reinsurance, the tax system is favorable since all technically justifiable reserves are tax deductible which has attracted some reinsurers.</p> <p>Credit is given to reinsurers according to their rating without specific technical protections (letters of credit, asset pledges).</p>
<p>Assessment</p>	<p>Observed</p>
<p>Comments</p>	
<p><b>Principle 8.</b></p>	<p><b>Capital Adequacy and Solvency</b> 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.</p>
<p>Description</p>	<p>The Articles 12 to 28 of the Executive Order of 1996 detail the solvency regulations in Liechtenstein. It is in line with the EC directives 73/239 and 79/267 on direct non-life and life insurance. The same regulation applies in Liechtenstein.</p> <p>As for reinsurance companies, the Liechtenstein authorities don't require any solvency margin, which is favorable to the settlement of captives and might change once a new EU regulation on reinsurers' solvency has been implemented.</p>
<p>Assessment</p>	<p>Observed</p>
<p>Comments</p>	<p>Nothing special is to be considered in this field; although, no global data is available on the market so as to see how solvent the companies actually are, which might help have a clearer view of the market situation.</p>

<p><b>Principle 9.</b></p>	<p><b>Derivatives and ‘Off-Balance Sheet’ Items</b>                  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:</p> <ul style="list-style-type: none"> <li>• restrictions in the use of derivatives and other off-balance sheet items;</li> <li>• disclosure requirements for derivatives and other off-balance sheet items; and</li> <li>• the establishment of adequate internal controls and monitoring of derivative positions.</li> </ul>
<p>Description</p>	<p>No specific regulation exists in the field of derivatives for Liechtenstein companies. The companies are not allowed to use derivatives to cover their liabilities towards policyholders. Yet, two Articles, 33 and 44, of the Executive Order of 1996 could enable the supervisory authority to allow the use this derivatives to cover their liabilities. Yet, these have never been used.</p> <p>Moreover, one specific point must be noted at this stage: the life insurance companies are allowed to use a very large list of funds including hedge funds and other alternative or derivative funds so as to match their liabilities for unit linked policies.</p> <p>Even though the capital risk on these policies is borne by the policyholder, this situation might prove to be considered as an issue to be addressed in terms of unexpected liquidity problems for non listed assets matching some unit-linked policies. Indeed, a four week only delay is available to pay back surrender values to policyholders according to the Insurance Contract Law (and the same kind of rule exists in the insurance contract law of many other counties where Liechtenstein companies sell their products), and this may prove to be insufficient to sell unlisted assets.</p>
<p>Assessment</p>	<p>Broadly observed</p>
<p>Comments</p>	<p>Further guidance for use of derivatives is needed.</p>
<p><b>Principle 10.</b></p>	<p><b>Reinsurance</b>                  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 reinsurers in determining an appropriate level of exposure to them.</p> <p>The insurance supervisor should set requirements with respect to reinsurance contracts or reinsurance companies addressing:</p> <ul style="list-style-type: none"> <li>• the amount of the credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collect ability of the reinsurance recoverable and may take into account the supervisory control over the reinsurer; and</li> <li>• the amount of reliance placed on the insurance supervisor of the reinsurance business of a company which is incorporated in another jurisdiction.</li> </ul>
<p>Description</p>	<p>The insurance companies in Liechtenstein disclose technical reserves net of reinsurance according to Appendix 4 of the Executive Order of 1996, which prevents external observers from directly viewing the reinsurance programs of Liechtenstein companies.</p> <p>Even though the non life market is a small one, there is no specific regulations in terms of credit given to reinsurance companies apart from information on its rating, that is to say the supervisor authority does rely on the rating of reinsurance companies by rating agencies as well as the global reinsurance program of mother companies to make sure that proper reinsurance choices have been made by the Liechtenstein companies.</p>

	<p>When companies change their reinsurer, they have to inform the supervisory authority according to the Articles 36 and 43 of the Insurance Supervision Law.</p> <p>As for reinsurers, they do not have to abide by the insurance contract law according to article 62 of the insurance contract law. Due to the current size and lower-risk profile of the market, reinsurance is not a material concern; therefore, no specific regulations are in place.</p>
Assessment	Observed
Comments	
<b>Principle 11.</b>	<p><b>Market Conduct</b></p> <p>Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills, and integrity in dealing with their customers.</p> <p>Insurers and intermediaries should:</p> <ul style="list-style-type: none"> <li>• at all times act honestly and in a straightforward manner;</li> <li>• act with due skill, care, and diligence in conducting their business activities;</li> <li>• conduct their business and organize their affairs with prudence;</li> <li>• pay due regard to the information needs of their customers and treat them fairly;</li> <li>• seek from their customers information which might reasonably be expected before giving advice or concluding a contract;</li> <li>• avoid conflicts of interest;</li> <li>• deal with their regulators in an open and cooperative way;</li> <li>• support a system of complaints handling, where applicable; and</li> <li>• organize and control their affairs effectively.</li> </ul>
Description	<p>Up to now, no specific rules have been enforced in terms of market conduct. For Liechtenstein, like in other EU countries, a part of these principles are provided for in general provisions of corporate law or consumer protection law. In addition, other issues are addressed in the insurance regulatory framework, especially in the field of policyholders' information.</p> <p>A new insurance-protection act has just been passed but is not yet implemented. The office of national economy is broadly responsible for consumer protection, including for insurance. Yet, no consumer association exists for the time being in the field of insurance and no ombudsman exists as well.</p> <p>The Insurance Association is not active in monitoring the conduct of its members.</p> <p>As a matter of fact, and in so far as the Liechtenstein market is a new market, few complaints have been registered up to now; therefore, specific formal procedures for dealing with consumer complaints have not been set up even though the ISA deals with complaints brought to its attention. In addition, insurance firms have not established procedures to handle customer complaints.</p>
Assessment	Not applicable
Comments	<p>Methods and processes for handling market conduct and consumer complaints are undeveloped; but, as the market remains very young, there have been few concerns expressed.</p> <p>The legal framework to support market conduct, including consumer protection, is to a large extent in place but is not largely implemented (no formal process). As the market expands, the ISA will need to strengthen its methods of monitoring market conduct, particularly given the cross-border activity.</p>

<p><b>Principle 12.</b></p>	<p><b>Financial Reporting</b></p> <p>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, onsite inspections, and communication with actuaries and external auditors.</p> <p>A process should be established for:</p> <ul style="list-style-type: none"> <li>• 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;</li> <li>• setting the accounting requirements for the preparation of financial reports in the jurisdiction;</li> <li>• ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and</li> <li>• setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction.</li> <li>• In so doing, a distinction may be made:             <ul style="list-style-type: none"> <li>• between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared for the insurance supervisor; and</li> <li>• between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in another jurisdiction.</li> </ul> </li> </ul>
<p>Description</p>	<p>The financial reporting requirements of the Supervisory Authority are listed in articles 39 to 42 of the Insurance Supervision Law and in article 64 and the appendix 4 of the Executive Order of 1996. The general provisions of company law also apply.</p> <p>In addition, the Insurance Supervisory Authority receives the annual report of insurance companies and a special report by the auditor of the companies and, for the life business, a certification report by the responsible actuary.</p> <p>However, there are few files sent to the Insurance Supervisory Authority by the companies, which might make a clearer distinction between what is being sent to the shareholders and what is being sent to the supervisor.</p> <p>The ISA has not implemented reporting requirements for financial-risk assessment, which is a major issue in most countries and for solvency measurement. As a consequence, the mission team observes that the information received by the Supervisory Authority is insufficient to determine on a timely basis the financial position of the companies. Instead, the ISA has to rely on (i) the report by the auditors which it chooses according to their knowledge of insurance activity and for whom it requires at least three mandates in the field of insurance; and (ii) on the life insurance assessment by the responsible actuary.</p>
<p>Assessment</p>	<p>Broadly observed</p>
<p>Comments</p>	<p>The Insurance Supervisory Authority has prepared a new set of reporting templates that firms are required to send to the Insurance Supervisory Authority beginning in 2003. The reporting will enhance the ISA's information regarding assets-liability management and solvency analysis. New systems will need to be developed to receive and analyze the reported information, hence, the</p>

	broadly observed rating.
<b>Principle 13.</b>	<p><b>Onsite Inspection</b> The insurance supervisor should be able to:</p> <ul style="list-style-type: none"> <li>• carry out onsite 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</li> <li>• 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.</li> </ul>
Description	<p>Onsite inspections of insurance firms are authorized by Article 42 of the Insurance Supervisory Law. The Insurance Supervisory Authority has also recently issued a report on its policy in the field of onsite inspection of the insurance companies. In so far as the Supervisory Authority doesn't rely on a dualistic approach of inspection, effective onsite inspection is necessary.</p> <p>The ISA has conducted a few limited-scope onsite inspections which focused on specific concerns; however, to date the onsite inspections have lacked comprehensive coverage. The ISA continues to be responsible for Social Security issues. Therefore, onsite inspection has remained very limited in Liechtenstein up to now.</p>
Assessment	Materially non-observed
Comments	Additional staff is needed for the ISA to conduct regular onsite inspection and monitor the financial position of insurance firms. Staffing will be needed given the present responsibilities of the ISA for the supervision of the social security system.
<b>Principle 14.</b>	<p><b>Sanctions</b> 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:</p> <ul style="list-style-type: none"> <li>• the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions;</li> <li>• 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</li> <li>• 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.</li> </ul>
Description	<p>The Insurance Supervisory Authority has the capability to sanction insurance companies. Criminal violations are dealt with by the Public Prosecutor through Article 64 of the Insurance Supervisory Law, which details the sanctions that may be taken against individuals exercising control over insurance companies.</p> <p>As for the prudential aspects, the refusal of authorization (Articles 19, 33 of the Insurance Supervision Law), the revocation of authorization (Articles 51, 55, of the same text) and the transfer of portfolio are available to the Insurance Supervisory Authority.</p> <p>As for the reinsurance companies, the same possibilities exist for the Supervisory Authority. As far as brokers and intermediaries are concerned, there are few texts, and they may only be sanctioned according to the general provisions of trade law.</p> <p>The present system enables the Supervisory Authority to sanction insurance companies.</p>
Assessment	Observed
Comments	

<p><b>Principle 15.</b></p>	<p><b>Cross-Border Business Operations</b>  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:</p> <ul style="list-style-type: none"> <li>• no foreign insurance establishment escapes supervision;</li> <li>• all insurance establishments of international insurance groups and international insurers are subject to effective supervision;</li> <li>• the creation of a cross-border insurance establishment is subject to consultation between host and home supervisors; and</li> <li>• foreign insurers providing insurance cover on a cross-border services basis are subject to effective supervision.</li> </ul>
<p>Description</p>	<p>The insurance companies of Liechtenstein get the bulk of their premium income in foreign countries. Therefore, the specific issue of cross-border operation is a major one for them. It is being dealt with:</p> <ul style="list-style-type: none"> <li>• Articles 24 to 27 of the insurance supervision law for Liechtenstein companies which wish to work in other EEA countries;</li> <li>• Articles 31 to 34 for non EEA countries wishing to work in Liechtenstein; and</li> <li>• by the agreement between Switzerland and Liechtenstein.</li> </ul> <p>In terms of relationship with other supervisory authorities of the EU countries, the ISA applies the Sienna Protocol. Information sharing with foreign authorities is also made possible through the provisions of Article 61 of the Insurance Supervision Law.</p> <p>At this stage, the Liechtenstein companies working outside of the EEA may face a slightly different situation, and, therefore, a new text has just been implemented to strengthen supervision.</p>
<p>Assessment</p>	<p>Observed</p>
<p>Comments</p>	<p>There is a substantial level of cross-border insurance activity between Liechtenstein, EEA countries, and Switzerland. As a consequence, the ISA will need to make a concerted effort to establish strong relationships with those foreign supervisors that oversee insurance firms with Liechtenstein activities. Consideration should be given to holding bi-lateral meetings with foreign supervisors to ensure comprehensive supervisory arrangements are in place.</p>

<p><b>Principle 16.</b></p>	<p><b>Coordination and Cooperation</b></p> <p>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.</p> <p>In order to share relevant information with other insurance supervisors, adequate and effective communication should be developed and maintained.</p> <p>In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor:</p> <ul style="list-style-type: none"> <li>• 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;</li> <li>• 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;</li> <li>• 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</li> <li>• is permitted to set out the types of information and the basis on which information obtained by the insurance supervisor may be shared.</li> </ul>
<p>Description</p>	<p>Liechtenstein belongs to a number of associations in terms of insurance supervision: IAIS, EFTA. It has an observer status in the EU, and there is a mix commission with Switzerland. It is informed of the major changes in insurance supervision both within Europe and globally.</p> <p>Article 61 of the Insurance Supervision Law entitles the Insurance Supervisory Authority to have information exchanges with foreign supervisors.</p> <p>The ISA with regard to other domestic supervisory agencies is obliged to share relevant information (Article 15 of the Act on the Organization of State Administration, LLG 1973 Nr. 41) and to grant assistance (Article 25 Administrative Proceedings Law, LLG 1922 Nr. 24). Furthermore, there are specific obligations in specific laws to cooperate very closely (Article 20 Due Diligence Act, LLG 1996 Nr. 116, Article 53 Code of Penal Procedure, LLG 1988 Nr. 62, 61 Para 1 VersAG).</p> <p>The issue of money laundering is being dealt with by the DDU; the DDU informs the Insurance Supervisory Authority of its specific investigations in this field.</p>
<p>Assessment</p>	<p>Observed</p>
<p>Comments</p>	
<p><b>Principle 17.</b></p>	<p><b>Confidentiality</b></p> <p>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 onsite inspections.</p> <p>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.</p> <p>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.</p>
<p>Description</p>	<p>The staff of the ISA must abide by the general civil service law, which considers that the breach</p>

	<p>of confidentiality is a criminal offence (Article 310 of the Penal Code). Confidentiality is clearly respected.</p> <p>Additional provisions in Article 44-2 of the Insurance Supervision Law have been implemented that protect secrecy towards people out of the ISA by transforming professional secrecy into official secrecy. In rare instances, the secrecy provisions may conflict with prudential-risk operations that could be considered an official secret under the provisions of Article 44-2.</p> <p>The communication of official information by the ISA in the context of collaboration with foreign authorities is regulated by Article 61 of the Insurance Supervision Law.</p>
Assessment	Observed
Comments	The restrictions imposed by professional secrecy requirements may affect some areas of prudential risk related to insurance products; e.g., guaranteed interest rates to policy holders in excess of the legal provisions, illiquid SPV as matching assets for insurance policies may exist and cannot be openly sold.

Table 3.2. Summary Observance of IAIS Insurance Core Principles

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Observed	10	CP 2, 3, 5, 7, 8, 10, 14, 15, 16, 17
Broadly observed	4	CP 1, 6, 9, 12
Materially non-observed	1	CP 13
Non-observed		
Not applicable	2	CP 4, 11

### C. Recommended Actions and Authorities' Response to the Assessment

#### Recommended actions

82. The insurance regulation has enabled development of Liechtenstein's insurance market over the past seven years. To date, there have been no significant problems, yet there are a number of areas where further developments of the regulation system are required for a mature market. In this regard, not all IAIS principles are observed and some strengthening is necessary. The Liechtenstein authorities are aware of this situation and have started implementing new rules and practices.

83. The mission observes that the authorities have introduced new legislation that will apply starting 2003, including as follows:

- more comprehensive supervision of the cross-border activities of Liechtenstein companies out of the EEA: new Article 27a of the insurance supervision law (see Principle 15);

- tighter links with supervisory authorities outside of the field of insurance: new Article 61 of the insurance supervisory law (see Principle 16).

84. The implementation of the new legislation will require more specific financial reporting to the supervisory authorities (see Principle 12) and greater capacity for onsite inspection (see Principle 13).

85. Several recommendations are proposed to improve the present supervisory system and the level of compliance with the IAIS core principles. Principles 1 and 13 assessments express concern regarding the staffing of the Insurance Supervisory Authority, which is stretched to carry out onsite supervision. In so far as a number of its staff have to deal with other issues, especially in the field of Social Security, the ISA should consider increasing the number of trained staff to face the increasing size of companies, risk profiles, and to be able to carry out onsite inspection on a regular and comprehensive basis. This will prove to be all the more useful as the processing of data and files sent by companies will become more comprehensive and complex.

86. The ISA could benefit from access to global insurance market information, and reporting of foreign insurance firms, which would allow for peer comparison between Liechtenstein firms and insurance firms in other markets. Similarly, market information would allow the ISA to have a better view of solvency and financial trends, claims payments, etc.

87. The ISA will require new reporting templates on types of assets to be filed by companies beginning in 2003. In addition, consideration should be given to a more comprehensive process of asset liability management (e.g., stress tests) for life insurance companies to guard against excessive asset-liability mismatching.

88. The regulatory framework should consider the fields of assets authorized for unit-linked policies (especially considering the surrender value issue in Liechtenstein but also in the countries where Liechtenstein products are sold) and to a larger extent asset-liability management. Inadequacies in asset-liability management proved to be a very significant issue in other countries (for instance Japan or Switzerland for guaranteed interest rate life liabilities, which were matched by inadequate assets in terms of liquidity, yield, and safety, over the last few years).

89. The liquidity risk on unit linked products also led some companies to severe losses in different countries. Therefore, the list of assets to be held for unit-linked policies should be considered from an insurance and not predominantly from a financial point of view. Specific regulation should be considered (see Principles 6 and 9). This has already been implemented in several other EU countries. Therefore, the ISA might add new rules in this field (see Principles 6, 7, and 9).

90. Some legal provisions to clarify the status of capital redemption operations would be very useful.

91. Additionally, a more sophisticated system to deal with customer claims out of the general consumer protection system, within the companies or through the adequate channel (ombudsman), might be useful to develop a satisfactory market conduct system (see Principle 11).

92. As mentioned in Principles 10, 13, and 15, the soundness and effectiveness of the supervision is dependent on a satisfactory international cooperation, especially in the field of reinsurance and life insurance where the bulk of the business is made in foreign countries. At this stage and up to the introduction of a new EU directive on this issue, intermediaries are not supervised as accurately as the insurance companies. This situation may create some problem for some Liechtenstein based life-insurance companies and to a lesser extent for reinsurance companies.

93. Stronger cooperation in the field of intermediaries should enhance the soundness of the Liechtenstein supervisory system. The newly adopted EU Directive should be used to deepen cooperation in the EU in this field.

Table 3.3 Recommended Action Plan to Improve Observance of IAIS Insurance Core Principles

Reference Principle	Recommended Action
<b>Organization of an Insurance Supervisor</b>	
CP 1	Increase in the staff number to supervise insurance companies (CP 1).
<b>Prudential Rules</b>	
CPs 6–10	Adapt the asset/liability management supervision (CP 6). Clarify the legal framework for unit linked products and capital-redemption operations (CP 6-9).
<b>Market Conduct</b>	
CP 11	A new insurance protection act has been passed, but it is not yet implemented. Processes for consumer protection will need to be developed.
<b>Monitoring, Inspection, and Sanctions</b>	
CPs 12–14	Develop systems for receiving reports sent to the ISA (CP 12). Increase in the number of staff devoted to supervision of insurance companies (CP 1 and 13).
<b>Cross-Border Operations, Supervisory Coordination and Cooperation, and Confidentiality</b>	
CPs 15–17	Build stronger relationships with those foreign supervisors that oversee firms that have material activities involving the Liechtenstein insurance market. Similarly, strengthen cooperation with foreign supervisors regarding the distribution of insurance products outside of Liechtenstein by brokers representing Liechtenstein firms (CP 15).

### **Authorities' response to the assessment**

94. The government of Liechtenstein acknowledges that there is a lack of resources and is fully committed to do its utmost to grant the essential staff resources to the supervisory authorities. The ISA plans to recruit two highly qualified persons (auditor, lawyer).

95. *Prudential rules, monitoring and inspection* The ISA has prepared a new set of reporting templates that companies are required to send to the ISA beginning in 2003. The reporting will enhance the information available to the ISA in the field of asset-liability management and solvency analysis. In this context, new systems will be developed to receive and analyze the reported information. The ISA shall develop new rules in the field of the assets authorized for unit linked products.

96. As mentioned above, the ISA intends for the year 2003 to perform systematically onsite inspections, depending of course on the available staff.

97. *Cross-Border Operations, Cooperation*—With the transposition of the new EU Directive on Insurance Intermediation there will be an effective supervision on insurance intermediaries. In this context, the cooperation with foreign authorities to supervise intermediaries will become more intensive.

## IV. ASSESSMENT OF ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

### A. General

#### Information and methodology used for the assessment

98. The mission reviewed the relevant AML/CFT laws and regulations and supervisory and regulatory systems in place to deter money laundering (ML) and financing of terrorism (FT) among prudentially regulated financial institutions, including banking, insurance, and securities firms.<sup>9</sup> In addition, the mission conducted a review of ML-preventive measures for trustees and trust companies providing trust and company services and conducting financial transactions; such trustees and trust companies are macro-relevant to the economy and pose a risk for money laundering. Aspects of implementation relating to criminal justice measures are assessed by the IAE and appear in *italicized text* throughout the report.<sup>10</sup>

99. The assessment was conducted using the methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism Standards, (AML/CFT Methodology), endorsed by the Financial Action Task Force (FATF) in October 2002 and by the IMF and World Bank Executive Boards in November 2002.

100. The assessment team reviewed relevant primary and secondary legislation including, the *Law on Professional Due Diligence in Financial Transactions* (including the *Law of November 16, 2001, Concerning the Amendment of the Due Diligence Law*) (collectively, the DDA), the Executive Order Concerning the Law on Professional Due Diligence (the DDEO), the Decree of October 15, 2001 Concerning the Due Diligence Unit, *the Law Concerning the Financial Intelligence Unit* (the FIU Act), the Executive Order of February 22, 2001 concerning the establishment of the FIU, *the Law on International Mutual Assistance in Criminal Matters* (MLA Law), relevant provisions of the Ordinance on Persons and Companies, the Criminal Code (StGB), and the Code of Criminal Procedures. In addition, the assessment team reviewed a Guideline 2002/1 Monitoring of business relationships, Directive 2001/2 on the Performance of Inspections in Accordance with the DDA and Instructions for the Conduct of Audits in Accordance with the Due Diligence Law in 2002 that were issued by the Due Diligence Unit (DDU).

101. The assessment team met with representatives from the DDU, the FIU, the Financial Services Authority (FSA), public prosecutor's office, the office of legal assistance in the

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<sup>9</sup> The AML/CFT assessment team was comprised of P. Moni SenGupta, IMF-LEG, Mr. Ron Ranochak, a private consultant, and Boudewijn Verhelst, Deputy Director of CTIF-CFI, the Belgian FIU, an independent AML/CFT expert who was not under the substantive supervision of Fund staff.

<sup>10</sup> Pursuant to the decisions of the IMF Executive Board (See SM/02/227), assessment of implementation of the criminal justice system and sectors that are either not macro relevant or having no significant AML/CFT vulnerability are not covered by Fund staff.

ministry of justice, the legal advisor to the government, commercial registrar, the national police authority, a judge of the Princely Court, the trustee's association, the lawyer's association, the auditor's association, and two Liechtenstein banks. In addition, the assessment team attended meetings with the prime minister and outside advisers to the government focused on restructuring of the supervisory system for financial services in Liechtenstein. The assessment team appreciates the time and high degree of cooperation of all participants, and particularly notes the substantial time devoted by the DDU, FIU, public prosecutor, and the legal adviser for mutual legal assistance in completing the detailed assessment.

### **General situation of money laundering and financing of terrorism**

102. Liechtenstein is a well-established offshore financial center that is highly dependent on its multiplicity of financial services, particularly banking and a thriving international business company (IBC) business involving the formation of legal entities, including, foundations (Stiftung) and trusts; the latter of which are an anomaly in civil law jurisdictions. Historically, these IBCs have been of concern in the context of money laundering because of the effectiveness of the disguising of beneficial ownership information through use of the foundations, trusts; and IBCs. The tradition of banking secrecy also has added to the vulnerability and misuse of Liechtenstein financial institutions to money laundering. Liechtenstein trustees conduct a robust business in the formation and management of IBCs that establish nominal addresses within Liechtenstein with an estimated 85,000 total entities enrolled on the commercial registry. This high level of offshore business, coupled with the Liechtenstein's tax policies, has resulted in large capital flows through the jurisdiction.

103. Very recently, the attractiveness of choosing Liechtenstein as a location to commit money laundering has diminished because of changes in the legal structure for increasingly more transparency insofar as providing access to information on beneficial ownership information for IBCs and in loosening of banking secrecy in criminal investigations and international cooperation. However, with respect to the described conditions—high rate of IBC business (coupled with tax policies)—the risk of misuse of Liechtenstein financial service providers cannot be disregarded.

### **Overview of measures to prevent money laundering and terrorism financing**

104. The Liechtenstein financial sector offers a wide range of services that include banking, trust, and other fiduciary services, investment management, and insurance to a global market with a majority of services provided to non-residents. There are 17 banks with over 200 thousand customer relationships, approximately 355 trustees and trust companies providing trust and company services for approximately 31 thousand incorporated entities, 51 thousand foundations, and 1,500 trusts with family purposes; 101 lawyers, many of whom are also trustees; 12 insurance companies engaged in direct life insurance; and 16 mutual fund management companies managing 81 investment funds.

105. The Liechtenstein authorities have implemented necessary legislative and supervisory measures in a manner designed to take into account the breadth of financial services within the country. Liechtenstein authorities have designed their main anti-money laundering measures, both legislative and supervisory, to regulate in a comprehensive manner the application of minimum due diligence measures in a broad range of financial transactions. In addition to enumerated financial intermediaries, the DDA has a broad catch-all provision capturing all persons, who, on a professional basis accept or keep in custody other person's assets or help to invest or transfer such assets.

106. The Liechtenstein authorities have devoted substantial attention and resources to improving the country's anti-money laundering legal and institutional framework and effective supervision of due diligence requirements since it was identified by the FATF as a non-cooperative country and territory in June 2000. FATF removed Liechtenstein from the NCCT list in June 2001, based in large measure on commitments for future affirmative action and improvements within specified deadlines. Moreover, the FATF decided in June 2002 to cease its monitoring, recognizing the improvements Liechtenstein had both implemented and committed to implement in the near future. Both the authorities and the financial sector are taking measurable steps to improve the quality of anti-money laundering measures to achieve conformity with the FATF 40 Recommendations. These measures are ongoing and now encompass the goal of achieving conformity with the FATF 8 Special Recommendations on Terrorist Financing. Specific weaknesses, previously identified, focused on the level of due diligence undertaken by Liechtenstein financial intermediaries and ineffective delivery of mutual legal assistance.

107. To address identified weaknesses, Liechtenstein has both enacted major legislation and enhanced existing laws. Primarily, the DDA, which was first passed in 1996, was substantially enhanced in 2001, and provides for minimum requirements for due diligence measures, including customer identification (know-your-customer), requires internal control procedures, training, and designation of compliance and due diligence officers for all financial intermediaries. In addition, the DDA contains specific requirements for ongoing monitoring of accounts and reporting of suspicious activities to the FIU, record keeping, audit requirements for due diligence and provides penal and administrative sanctions. The DDA overrides banking and official secrecy with respect to disclosures of AML/CFT intelligence to the DDU, FIU, and foreign competent authorities. Furthermore, the FIU Act sets forth the structure and functions of the FIU, which was initially established earlier in February 2001 by an Executive Ordinance of the government.

108. The MLA Law was enacted in 2000 to substantially reduce the procedural process for providing mutual legal assistance to ensure rapid and effective delivery of assistance and to reduce the number of appeals allowed. Previously, the process for mutual legal assistance could involve up to 12 steps and several offices and resulted in very ineffective delivery. Liechtenstein was severely criticized for its back log and slow response to mutual legal assistance steps. Since enactment of the MLA Law, the back log of older requests has been virtually eliminated, and the scope of assistance has been broadened and clarified. Moreover, the new MLA Law allows for broader participation of foreign investigators, prosecutors, and

judges in proceedings resulting from mutual legal assistance requests. The MLA Law also specifies that, as soon as a criminal investigation has started, banking and profession secrecy of trustees no longer applies and can not justify a refusal to testify or produce documents.

109. Enhancements to primary legislation further included amending the criminal provisions on money laundering to liberalize the intent requirement of the offense and to permit prosecution for self-laundering. As a result, investigations and criminal prosecutions for money laundering are being pursued regularly and without undue evidentiary impediments. Under Liechtenstein criminal law, the offense of participation in criminal organizations addresses the financing of terrorist organizations to a limited extent already, nevertheless, there are pending proposals to enhance the criminal code to have a separate offense for the financing of terrorism.

110. As a result of efforts over the last two years, several primary institutions have been empowered with responsibility for AML/CFT. The DDU was created in October 2001, to administer compliance with the DDA and DDEO for all financial intermediaries including banks and finance companies, lawyers, trustees, investment undertakings, insurance companies engaged in direct life insurance business, bureaux de change, and the Liechtenstein Post, as well as on a blanket basis, other persons who accept or keep in custody client assets.

111. The banking sector has apparently embraced the need for effective and thorough customer due diligence and ongoing monitoring of relationships and transactions. However, some sectors have not traditionally been subject to a compliance culture. The insurance and trustees sectors may require specialized attention in this regard. There is perhaps a need to educate trustees further to focus more on effective know-your-customer policies and ongoing monitoring of accounts and transactions rather than on formalistic application of the minimum due diligence requirements and papering the files.

112. The FIU, created in February 2001, is the responsible authority for the collection, analysis, and dissemination of financial intelligence and is a key gateway in the information exchange concerning ML and FT with foreign counterpart FIUs. The national police, through a special unit called EWOK, is responsible for investigations of white collar crime, including money laundering, predicate offenses, and organized crimes. The public prosecutor is primarily responsible for development and prosecution of ML offenses and criminal violation of the DDA and in execution of confiscation orders, both through the domestic criminal process, civil process, and those that are received from mutual legal assistance requests. The princely courts have authority in conducting all the criminal processes, confiscation matters, as well as the execution of mutual legal assistance requests. The main conduit for mutual legal assistance is the legal assistance unit of the ministry of justice.

113. The authorities work collaboratively to ensure the range of legal measures are fully implemented. The authorities commendably have designed their institutional mandates in an integrated fashion to capitalize on the different expertise. Accordingly, implementation of measures over the last two years has progressed quickly, due in large part to the dedication

and professionalism of the individual authorities, many of whom were brought in from neighboring Austria and Switzerland to enhance expertise. Analysis of suspicious activity reports, transmittal of information to investigative authorities, preparation or prosecutions, and provision of mutual legal assistance or information sharing with foreign authorities spontaneously have progressed considerably. The collaborative efforts appear to have been put to effective use; although, the methods of collaboration among domestic authorities remains somewhat informal in the absence of clearly established procedures to implement broad coordination now permitted under law.

114. Effective implementation of criminal justice measures, FIU processes, and execution of international cooperation under the new structures adopted appears to be progressing as well, despite the fact that the legal and institutional structure has been established only recently. The authorities are properly focusing now on ongoing monitoring of implementation efforts as a necessary step in achieving a true culture of compliance. The authorities seem aware of the need to ensure that the structure adopted be used to maximum effect, and that participants in the financial sector have ongoing obligations to comply. Nevertheless, the true test of the effectiveness is in the execution of the criminal laws, FIU operations and execution of international cooperation, which appear to be progressing and increasing as implementation is achieved.

115. While the efforts to date have allowed for broad compliance with the range of legal and institutional requirements of the FATF 40+8 Recommendations, the vulnerabilities to money laundering and financing of terrorism in Liechtenstein call for measures beyond the existing standard. *In particular, Liechtenstein should implement criminalization and international cooperation fully through the application of the Strasbourg Convention, the Second EU Directive on Money Laundering, Evolving trends in continental law limits concerning legal liability of entities and inclusion of fiscal related matters should be considered, particularly those that relate clearly to fiscal fraud matters. Similarly, evolving best practices and trends regarding FIU authority should prompt the government to consider that the FIU to have direct access to financial information from financial institutions rather than relying on indirect access from the DDU.*<sup>11</sup>

116. It is anticipated that a proposed criminal provision for an autonomous FT offense will enhance the structure further, and will fill the gaps that currently exist on measures to combat the financing of terrorism. Impediments to effective prosecutions, FIU operations and international cooperation that arise should be handled promptly through legal and institutional reform, including consideration of potential gaps in the legal certainty of the existing legal framework that while not currently posing problems, may be anticipated. Specific legal measures which should be monitored include the limitation in the criminal provision for ML that does not permit both prosecution for the predicate offense and money

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<sup>11</sup> Liechtenstein is a signatory to the Strasbourg Convention on money laundering. The convention has been in force in Liechtenstein since March 1, 2001 and is being applied by the courts. Therefore no further implementation is needed.

laundering, particularly if this is found to inhibit either confiscation of proceeds or the provision of mutual legal assistance. While this provision meets the FATF 40 Recommendations, the Strasbourg Convention to which Liechtenstein is a signatory, contemplates allowing for prosecution of both offenses. Authorities should consider whether such limitation in the legal system is an impediment to pursuing criminal actions. The same concern arises with the inability to prosecute legal entities under the ML and existing FT provisions. At the moment, it appears that the criminal provisions as written are not inhibiting the investigators and prosecutors from initiating investigations and prosecutions, but an eye towards filling potential gaps is suggested, although it is understood that these questions may not be addressable fully in a limited context of AML/CFT but rather as part of the evolution of the Austrian legal traditions, which Liechtenstein follows in its penal code measures.

117. With respect to combating terrorism and the financing of terrorism, the government has established a coordination task force headed by the FIU, which also includes DDU, national police, public prosecutor, judicial service, personal staff of the government (directly reporting to the prime minister), foreign ministry, and the press office. The Coordination Committee has responsibility for implementing the FATF 8 Special Recommendations on terrorist financing, as decided by the government on January 8, 2002. The government has committed to amending the legal framework and filling possible gaps to comply with the FATF 8 Special Recommendations. If needed, other offices and consultants may be brought in. The Coordination Task Force has responsibility for disseminating lists of suspected terrorists, terrorist organizations, and those who finance terrorism from the United States and the European Union for enhanced scrutiny. The lists from the United Nations are issued directly by Executive Order of the government and require immediate blocking and reporting of the relationship. Other lists, such as those issued by the United States, are disseminated by the DDU, and administrative blocking also applies. The Coordination Task Force has responsibility for completing and updating reports to the UN Counter Terrorism Committee, including United Nations Security Council Resolution (UNSCR) 1373, which was last updated in January 2003.

118. Liechtenstein's principle institutions for AML/CFT work closely together, and in fact, the DDU, FIU, and the public prosecutor are deliberately housed in the same building (along with the FSA, the main prudential supervisory authority) to ensure continuous and close cooperation. Moreover, the legal framework has been redesigned, particularly the DDA, to increase the coordination between the responsible institutions. There is currently a proposal under consideration to bring the DDU under the umbrella of an integrated financial services supervisor, which will promote more efficient integration of prudential and AML/CFT supervision. With the proposed change, the specific duties and expertise of the DDU should be sustainable and not be diminished to ensure continuous and effective AML/CFT measures are in place in the financial sectors.

119. As an overall approach, the regulations and guidelines defining the scope of the preventive measures for financial institutions address minimum requirements across all relevant financial sectors. Accordingly, the due diligence obligations in the DDA and DDEO

are broadly drawn. Nevertheless, many of the DDA and DDEO preventive measures satisfy the sector-specific criteria, particularly, those set forth by the Basel Committee for Banking Supervision in the Basel Core Principles (BCP) and the Customer Due Diligence Paper (CDD Paper). The general approach to providing clear, objective, and achievable preventive measures is commendable, given the need to bring financial sectors up the level of the FATF standards. However, as the implementation of the DDA and DDEO progresses, specific sector-specific issues are likely to arise that will require more tailored requirements to ensure compliance with the evolving sector specific standards.

120. At the moment, only the additional sector specific requirements for banks contained in the BCP and in the CDD Paper have been integrated into the framework for preventive measures. However, the authorities are cognizant of the need for developing guidance for insurance, investment undertakings and trustees. As a general matter, the supervisory framework of the DDU is designed to adequately monitor compliance with both core preventive measures and the sector specific requirements that are needed, especially through the use of mandatory guidelines for external auditors such as Instructions (February 2002) and Guideline 2002/1. Where needed, these instruments may be easily tailored to account for additional requirements applicable to banking, insurance, and securities to incorporate the BCP, IAIS, and IOSCO requirements. Liechtenstein largely relies on the system of dualistic or indirect supervision wherein routine DDU audits are conducted by external auditors rather than by the DDU. The DDU itself conducts a limited number of audits yearly, and its staff experience in auditing is progressing. Ongoing attention is required to ensure that the dualistic system is adequately functioning and continues to be appropriate given the structure of the Liechtenstein financial marketplace.

## B. Detailed Assessment

The following detailed assessment was conducted using the October 11, 2002 version of *Methodology for assessing compliance with the AML/CFT international standard, i.e., criteria issued by the Financial Action Task Force (FATF) 40+8 Recommendations* (the Methodology).

### Assessing criminal justice measures and international cooperation

Table 4.1 Detailed Assessment of Criminal Justice Measures and International Cooperation

<b>I—Criminalization of ML and FT</b>
<b>(compliance with criteria 1-6)</b>
Description
Liechtenstein has been a signatory to the Palermo Convention since 2000, the Convention on Laundering, Search, Seizure, and Confiscation (Strasbourg Convention) since 2000, and the International Convention for the Suppression of the Financing of Terrorism (Financing of Terrorism Convention) since 2001. Liechtenstein has not yet ratified the Financing of Terrorism Convention but has partly implemented provisions on FT because of pre-existing legislation in Article 278a of the StGB. Liechtenstein is not a signatory to the Vienna Convention because of issues concerning the scope of narcotics crimes required, but the specific provisions of the Vienna Convention relating to criminalization of money laundering are contained in Liechtenstein legislation,

specifically Article 165 of the StGB.

Liechtenstein has fully implemented provisions of UNSCRs 1267, 1269, 1333, 1373, and 1390 directly related to FT. Implementation of UNSCR 1333 has resulted in freezing of assets of two individuals for a combined total of CHF 182,000. The government, based on Article 3, Para. 1 of the *Law on Measures With Regard to Economic Exchange with Foreign Countries*, has issued ordinances to take measures against persons and organizations on the UNSCRs. Normally, the measures include the blocking of assets, prohibition of payments transactions on behalf of persons listed, and obligation to report to the government if somebody manages assets in possession of or controlled by persons listed.

Liechtenstein criminalizes the offense of money laundering in Section 165 of the Penal Code (StGB), which is modeled on the Austrian Penal Code. The offense of money laundering applies to a natural person, who hides parts of assets originating from a crime or specified misdemeanor, or conceals their origin, or provides false information in legal relations with regard to the true origin or nature of the assets, ownership or other rights. Predicate offenses for money laundering are all crimes punishable by 3 years in prison, or specified misdemeanors relating to official corruption and misconduct and misdemeanors of the Narcotics Act, including sale or procurement of narcotics, financing narcotic trafficking, or the procurement of financing of narcotics. FT, as defined in Article 278a StGB, is a predicate offense for a ML prosecution. Fiscal offenses are not predicate crimes for money laundering.

Article 165 StGB criminalizing ML was amended on December 19, 2000 to allow for prosecution of self laundering, although a person who has been punished for participation in the predicate offense may not also be punished on the grounds of money laundering, pursuant to Article 165, Para. 5 of the StGB. The offense of ML extends to any asset, whether money or property that directly or indirectly represents the proceeds of crime. Although the person being prosecuted for ML need not be directly involved in the predicate offense, law enforcement authorities advised that the minimum necessary proof of the predicate crime almost always requires a conviction of some person for the predicate crime, which take place outside of Liechtenstein, as is frequently the case.

In addition to the ML offense in Article 165 of the StGB, Article 15, DDA imposes criminal liability for failures to: identify a contracting party, establish the beneficial owner, repeat the identifications, undertake a particular clarification, i.e., failure to monitor unusual or suspicious activity, file a SAR, block and retain assets, tipping off, maintain required records, maintain proper internal controls, among other violations of requirements in the DDA. The criminal measures of the DDA apply to both natural and legal persons.

Financing of terrorist acts is criminalized in Article 278a of the StGB, which prohibits formation, becoming a member, or supporting financially an organization that has the purpose of repeated and planned perpetration of serious criminal offenses inter alia posing a threat to life, integrity, freedom, or assets, or serious offenses in the field of sexual exploitation of persons, conveyance or illegal trafficking of weapons, nuclear material and radioactive materials, dangerous waste, counterfeit money or narcotics to gain political or economic influence, and to corrupt or intimidate others. Terrorist acts need not take place in Liechtenstein to be punishable under this offense pursuant Article 64, Para. 1 (4) StGB.

The existing provision on financing of terrorism covers a specified list of organized crime, terrorist offenses, and criminal organizations but does not define terrorism as a broad concept. Therefore, a separate provision to address a financing of terrorism offense should be enacted. The government decided on January 8, 2002 to implement the FATF 8 Special Recommendations on terrorist financing and has begun to amend the legal framework to include additional criminal provisions directly addressing the financing and material support to terrorist organizations and to empower the FIU and law enforcement authorities with the additional powers necessary to comply with the Special 8 Recommendations. The proposal is expected to go to the parliament in April 2003.

Offenses of ML in Section 165 StGB and FT in 278a StGB extend to natural persons but not legal entities, which is based on the Austrian model, and follows a traditional limitation in the Continental system, although the

Strasbourg Convention to which Liechtenstein is a signatory, calls for imposing criminal liability to entities and other trends in civil law countries is to extend criminal liability to legal entities. Authorities are monitoring the progress in Austria to extend liability to legal entities and recognize that criminal liability of legal entities is of significant added value. Nevertheless, as it stands, there is a gap in the Liechtenstein ML offense concerning legal entities.

However, the effect of the current limitation on liability on legal entities is mitigated in two ways. First, legal entities are not exempted from criminal prosecution for ML related activities, as Article 18 DDA extends the criminal provisions of Article 15 DDA to legal entities, which will be jointly and severally liable for fines, penalties, and costs of violations for willful violations of the DDA, which largely encompassed ML-related activities. This provision mitigates the gap in Article 165 of the StGB to some degree. Second, although one purpose of the extension of legal liability to legal entities is to effectuate confiscation against legal entities resulting from conviction, i.e., confiscation as a penal sanction, Liechtenstein has an *in rem* confiscation process (described below in Section II) that effectively allows for confiscation from legal entities notwithstanding the conviction of the legal entity.

The intentional element of Article 165 of the StGB previously required that the person prosecuted for money laundering have actual knowledge of the underlying predicate offense. This requirement has been eliminated from the criminal provision, and, as a result, prosecutions for the offense are now more available and pursued. The standard of knowledge is now *dolus eventualis*, which establishes intent if the person should know that from the circumstances that the assets or funds derived from a predicate offense. This is equivalent to a willful disregard standard.

Article 165 of the StGB imposes imprisonment for terms between six months and five years, or fines of up to 360 daily rates (multiples of daily salary or income). Article 278a of the StGB provides for imprisonment from one to ten years. In addition to fines and imprisonment, Article 20 of the StGB mandates payment of the amount of money equal to the unlawful enrichment for a criminal offense. Further, Article 15 DDA imposes imprisonment of six months or fines up to 360 per diem units for willful violations of the obligations DDA.

*With respect to the administration of the criminal offenses, the responsible offices are the office of public prosecutor, the Princely Court and the white-collar crime unit of the national police (EWOK). In recent years, the government has devoted substantial resources to increasing staffing and improving the infrastructure of these bodies to specifically address the vulnerabilities to ML. In addition, these bodies work closely with the DDU and the FIU to ensure that appropriate investigative tools and necessary legal orders, such as search orders are available in a timely manner. There are now four judges assigned to handle investigations both for domestic cases and for international cooperation matters.*

*The national police, office of public prosecutor, and Princely Court are dependent in large part on experienced persons from neighboring countries, and in order to sustain the new levels of investigations and prosecutions, there should be ongoing efforts to recruit and fund training for needed personnel. Efforts should be in place to sustain the pool of qualified investigators, prosecutors and judges.*

#### Analysis of Effectiveness

ML has been criminalized in Liechtenstein since 1993, but since the 2000 amendment liberalizing money laundering so that the person charged no longer needs to have actual knowledge of the predicate offense in order to be prosecuted under Article 165 StGB has vastly improved the framework for pursuing prosecutions. Article 165 StGB, following the Austrian Penal Code, applies solely to natural persons, which is not in line with the evolving best practices in other civil law countries or with the Strasbourg Convention and should be analyzed to ensure that the current limitations are not inhibiting necessary actions. However, there are separate penal offenses for willful violations of the DDA that may apply to both natural persons and legal entities. Nevertheless, authorities should consider whether the limitation on the application of Article 165 StGB to natural persons has actual collateral effects of limiting mutual legal assistance (because of dual criminality) or in limiting confiscation.

<p>Currently, the financing of terrorism is addressed by Article 278a of the Penal Code (StGB), which covers financing of terrorist acts and criminal organizations, including known terrorist organizations. Authorities recognize there is a need for an autonomous FT offense that will both enhance its domestic artillery and allow for broader international cooperation.</p> <p><i>The public prosecutor has begun to implement the available offenses by developing a number of ongoing matters within Liechtenstein and has opened a number of investigations for criminal violations of Article 15f DDA. By the end of March 2003, these investigations have resulted in nine indictments, which led to four convictions, three acquittals, and two pending cases. The increased level of prosecutions and convictions is encouraging and indicates that the system is functioning relatively successfully, without undue legal impediments. The current staffing levels appear adequate to sustain the expected level of criminal prosecutions.</i></p>
<p><b>Recommendations and Comments</b></p> <p>A proposal has been made to add a separate offense for financing of terrorism in Article 278d StGB, to gather or keep ready assets in order to partly, or in whole, specified terrorist acts that have not been committed yet or are planned. This amendment reflects the changes that are also being considered in Austria and to account for the international agreements. The proposal is intended to criminalize broader acts including gathering and assembling material support for terrorist acts and organizations. Mere participation as a member of a terrorist group will be punishable. The additional criminal provision for financing of terrorism should be finalized to achieve full compliance with Special Recommendation I. A proposal has been made to add a separate offense for financing of terrorism in Article 278d StGB, to gather or keep ready assets in order to partly, or in whole, specified terrorist acts that have not been committed yet or are planned. This amendment reflects the changes that are also being considered in Austria and to account for the international agreements. The proposal is intended to criminalize broader acts including gathering and assembling material support for terrorist acts and organizations. The additional criminal provision for financing of terrorism should be finalized to achieve full compliance with Special Recommendation I.</p> <p>Two collateral criminal procedural amendments are also being proposed as part of the package for the separate FT offense: the first is an amendment to Article 98a of the Criminal Procedure Code to allow for broader access to bank records and to provide a prohibition against tipping off in the case of a person who receives a request for mutual legal assistance.</p> <p>Authorities should strongly consider extending Article 165 StGB to legal entities as is required under the Strasbourg Convention, and not to require that a predicate offense be prosecuted outside Liechtenstein in order to institute a ML prosecution.</p>
<p><b>Implications for compliance with FATF Recommendations 1, 4, 5, SR I, SR II</b></p>
<p>The criminal provisions are largely compliant with the criteria for FATF Recommendations 1, 4, and 5, including the requirements of the Palermo Convention, particularly since the intent requirements for ML offenses have been liberalized; although, legal entities are not subject to liability for ML offense. The provisions of FT are not fully addressed by current law, but the existing provisions on organized crime groups are broad enough to meet the FATF SR II definition in large measure.</p>
<p><b><i>II—Confiscation of proceeds of crime or property used to finance terrorism (compliance with criteria 7-16)</i></b></p>
<p><b>Description</b></p>
<p>Liechtenstein has broad confiscation and provisional measures available, including,, a civil <i>in rem</i> process.</p> <p>Confiscation arising out of conviction is widely used. Article 20 of the StGB provides that a person who has committed a punishable criminal offense and has gained a pecuniary benefit or has received a pecuniary benefit in exchange for the perpetration of a punishable criminal offense must forfeit an amount of money equal to the unlawful enrichment. If the scope of the enrichment cannot be determined readily, the court has discretion to fix the amount and may take into account continuous or repetitive crimes or the time frame of the crimes in determining the amount, as well as if the crime has been committed as part of the operations of a criminal</p>

organization. Article 31a (4) StGB allows for reduction of the unjust enrichment if circumstances of the defendant have changed substantially, and the fine is no longer appropriate.

Assets of criminal organizations may be confiscated. Article 20b of the StGB provides that any assets that are subject to the power of disposal of a criminal organization, as defined by Article 278a of the StGB, shall be forfeited. In addition, assets that come from a punishable act, i.e., are the proceeds, property, or instrumentalities of a criminal offense in another jurisdiction may be confiscated even if the offense is not punishable in Liechtenstein, so long as the offense is not a fiscal (tax) offense. The same provision provides for confiscation of all yields or income derived from property laundered. Article 97a of the Criminal Procedures Act (StPO) allows for freezing prior to conviction; although, this is not permanent until conviction when Article 20b allows for final and permanent confiscation. Article 20b of the StGB also allows for confiscation of assets in the hands of third parties. The public prosecutor has advised that in at least one actual case, the entire assets of a foundation were declared confiscated, even though, only one part of the foundation was the direct result of the criminal act, and the rest had accumulated from interest earned.

Liechtenstein has adapted its legislation to conform to the confiscation requirements of the Strasbourg Convention. Freezing and seizing and other provisional measures are available through an order by an investigative magistrate. Requests for such orders generally are made through the public prosecutor. The FIU, the DDU, and the public prosecutor closely coordinate requests for freezing and seizing, and due to the ongoing cooperation and the size of the country and efficiency of coordination among law enforcement authorities within the country allow for orders to be obtained quickly, sometimes within hours.

Article 9 DDA provides the FIU and the public prosecutor with up to ten days to take necessary measures on suspicious activities reported by requiring immediate blocking and freezing of assets in question until the FIU notifies the reporting party that the freezing or blocking is no longer needed. The ten-day period may be extended if required. The FIU advises that the blocking can be reduced or eliminated as necessary. The structure of the blocking provision in Article 9 DDA requires immediate attention by the FIU to determine whether the ten-day blocking is needed and to reduce the time if not. There is a real risk that the automatic ten-day blocking is not needed and will lead to suspects being tipped off that a suspicious activity is reported thereby prejudicing an investigation. In every SAR case, the FIU is called upon to make a determination on the blocking length when the more useful approach would be to eliminate the automatic blocking and to empower the FIU with discretionary authority to block when there is an indication that the assets may be moved or dissipated.

Other freezing and seizure actions require the involvement of the Princely Court pursuant to Article 97a of the Criminal Procedures Code (StPO), and this authority is widely used and can be executed in a matter of hours when necessary to prevent the dissipation of assets. The FIU, EWOK, and the public prosecutor have wide authority to identify and trace property that may become subject to confiscation or is suspected of being the proceeds of crime.

Article 20c of the StGB will exclude confiscation of assets if these are subject of legal claims of persons who are not involved in the criminal offense or criminal organization, or the purpose of the forfeiture may be fulfilled by taking other legal measures, in particular, as far as the unlawful enrichment is forfeited through foreign procedures and the foreign decision can be enforced in Liechtenstein. The legal provision allows for refraining from forfeiture if the remedy is disproportionate to the importance of the matter or procedural efforts.

Liechtenstein law provides for civil forfeiture in addition to criminal forfeiture. Art 353ff of the Criminal Procedures Code (StPO); there is a special procedure to permit confiscation in the absence of a criminal conviction for a forfeiture *in rem*. A civil forfeiture order or freezing order must be issued by an investigative magistrate at the request of the public prosecutor. Civil forfeiture orders may be obtained against individuals or entities.

*The FIU, public prosecutor, and the ministry of justice maintain statistics on assets forfeited through domestic proceedings and as a result of requests for mutual legal assistance, and, although some statistics are available on frozen funds, the exact amounts is not fully tracked. Because the seizure of bank accounts necessarily involves*

*the intervention by a judge but physical seizure can be executed by the Police in its operations, the total amounts seized are not available in a centralized manner. Nevertheless, since August 2000, the public prosecutor estimates that above SwF 500 million have been frozen or confiscated in aggregate.*

*Authorities undertake training concerning confiscation in a number of ways: generally, the authorities make use of available training provided by other neighboring countries. Specifically with respect to confiscation, two prosecutors attended a forfeiture program offered by the DEA in Munich, as well as generalized prosecutorial training in Barcelona, and the International Prosecutors Conference, both of which address confiscation. Within the Police, there are monthly information exchanges within the country on topical areas, including confiscation; members have attended financial crimes conferences held by INTERPOL and a yearly seminar in Stuttgart on ML. The Judges regularly attend seminars on criminal code and procedures offered in Austria.*

Article 20b specifically provides that assets that are subject to the power of disposal of a criminal organization, which includes terrorist organizations, are subject to forfeit.

Based on Article 3, Para 1 of the *Law on Measures with Regard to Economic Exchange with Foreign Counterparts*, the government of Liechtenstein has issued ordinances to take measures against certain persons or organizations, including names on UNSCRs. The names of the persons or organizations are in each case stated explicitly in the ordinance, and in most cases the measures prescribed include, blocking of assets, prohibition of payment transactions on behalf of persons or organizations named, and an obligation to report if somebody manages assets in possession of or controlled by persons listed. As a result, the DDU has issued directives to all financial intermediaries requiring them to search for names on UNSCRs 1267, 1269, 1333, 1390 and to freeze assets identified. Five accounts related to terrorist financing activity have been frozen (based upon a mutual legal assistance request from Switzerland), and two disclosures were sent to the FIU based on the government executive order on Taleban lists.

The DDU has issued directives to require financial intermediaries to identify, freeze, and report on assets associated with names of suspected terrorists, those who finance terrorism and terrorist organizations that appear on FBI and U.S. Department of Treasury, and U.S. Department of State designated terrorist organizations lists. The DDU also issues directives based on EU lists. The most recent such advisory was issued on October 28, 2001.

Article 97a of the Code of Criminal Procedures (StPO) allows the court upon application by the public prosecutor to freeze proceeds of crime or funds or other assets of terrorists and terrorist organizations, as well as those who finance terrorist acts or organizations. The freezing under the StPO is automatically discontinued after two years, but an extension is possible.

Liechtenstein does not have an asset forfeiture fund but provides for allocation of the amounts seized in accordance with the rights of other jurisdictions, as well as considering necessary restitution of victims, or the rights of bona fide third parties.

Article 253a of StPO authorizes entering into sharing agreements for forfeited assets. Liechtenstein has formal policies on asset sharing of confiscated or forfeited properties. Because the crimes are frequently occurring in other jurisdictions, but the assets may appear in Liechtenstein, the authorities have established policies by which to ensure that the amounts over the cost recovery for the investigation, prosecution, and court execution in Liechtenstein is properly allocated to both known victims of the crime and the countries where the underlying offense occurred. Asset sharing has been executed, most recently a case of assets located in Liechtenstein of approximately \$28 million was recovered and turned over to the United States, less a small percentage remaining inuring to the Liechtenstein government.

#### Analysis of Effectiveness

Liechtenstein has established a comprehensive framework for confiscation, freezing and seizing of assets, property, and funds associated with ML and FT. The legal provisions authorize forfeiture upon conviction, siphoning off of amounts equal to unjust enrichment, and authorize civil forfeiture, even in the absence of a

<p>criminal conviction. Orders to freeze assets do not require an ongoing criminal investigation, and the FIU has authority to extend mandatory blocking of assets frozen that are the subject of suspicious activity reports (SARs). Confiscation and freezing and seizing may be executed on behalf of foreign countries through receipt of a mutual legal assistance request. Liechtenstein forfeiture and confiscation proceedings take into account the rights of bona fide third parties and provide such persons with an opportunity to be heard.</p> <p><i>The legal framework for provisional measures and confiscation together with the adequately structured systems adopted by the ministry of justice, Judiciary and public prosecutor allow for a high level of compliance with FATF Recommendations 7 and 38. Much of the high level of compliance can be attributable to the efforts to fully integrate the Strasbourg Convention into the Liechtenstein legal and institutional framework. The implementation efforts for SR III have resulted in actual freezing and seizure of suspected terrorist-financing assets.</i></p>
<p><b>Recommendations and Comments</b></p> <p><i>Liechtenstein's civil in rem confiscation process goes a long way in cutting off the movement of ML and FT related funds and assets and should continue to be used to full effect and as a complement to criminal confiscation, particularly with respect to confiscation of assets or funds of legal entities. Authorities should analyze whether the limits of corporate criminal liability have an effect, in fact, in the exercise of confiscation in penal matters, and whether the in rem procedure is sufficient to accomplish the needed freezing, seizure, or confiscation.</i></p> <p><i>As stated below, the discretionary blocking powers of the FIU in the event of a SAR filing should be explicit and clarified in the DDU.</i></p> <p><i>Authorities may wish to consider developing more targeted statistics on frozen funds and confiscation, and making them available in a centralized manner in order to be able to more accurately measure the effectiveness of the confiscation regime..</i></p>
<p><b>Implications for compliance with FATF Recommendations 7, 38, SR III</b></p> <p>The measures for freezing, seizure, and confiscation are legally adequate and have been put to effective use by the Liechtenstein authorities, thus resulting in compliance with FATF Recommendations 7 and 38 regarding provisional measures and confiscation. In addition, the Liechtenstein government and authorities have moved quickly to fully implement the blocking requirements in FATF SR III, resulting in actual identification and blocking of accounts and extending its freezing, seizure, and confiscation authority to FT related assets.</p>
<p><b>III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels (compliance with criteria 17-24)</b></p>
<p><b>Description</b></p> <p>The FIU was established formally by an Executive Ordinance on February 22, 2001, on the basis of Article 22 DDA and was formally codified by the Law on Concerning the Financial Intelligence Unit on May 8, 2002 (FIU Law). The FIU Law sets forth the position, competencies, and responsibilities of the FIU. The authority of the FIU to collect and analyze information relating to FT is derived in part from Article 278a StGB, which is the organized crime offense that encompasses terrorist financing activities.</p> <p>The FIU is an independent agency reporting directly to the prime minister and is not subordinated to the FSA, other supervisory authorities, or the DDU. As a purely administrative agency, the FIU does not have any law-enforcement functions, The FIU is deliberately separate from the supervisory authorities to ensure that financial intermediaries have the possibility of filing suspicious activity reports (SARs) with a neutral body, which will perform the preliminary analysis to determine whether the information should be forwarded to law enforcement authorities. Nevertheless, close collaboration with the DDU and FSA appears to be successful, although, much of the effectiveness of these efforts is due to the individuals involved rather than the existence of a formalized channel of communications. Thus, ensuring future close collaboration may require implementation of systemic lines of communication that will continue as the FIU grows and more individuals are involved in the proper execution of the FIU's core functions. Similarly, additional demarcation of financial intelligence and transformation of intelligence to usable evidence for law enforcement would reinforce the structural and</p>

functional independence of the FIU and facilitate communications with law enforcement.

The FIU's main role is to act as the central agency for the collection and analysis of information needed to detect money laundering and predicate offenses leading to money laundering or organized crime. The analysis is conducted through obtaining information from within the public domain and from nonpublic sources of financial intelligence to which the FIU has direct access or may request access through other competent bodies, such as the national police, as well as information obtained from counterpart foreign FIUs.

*The independent structure of the FIU does not appear to have limited its operational ability to undertake pre-investigative analysis of financial intelligence. The structure of the FIU theoretically limits its direct access to financial information from financial intermediaries to information needed in support of an SAR but not to other financial intermediaries with relevant financial information. Nevertheless, the FIU believes it has sufficient access to financial information indirectly through the DDU, which may obtain bank records, including beneficial ownership information and share with the FIU. Moreover, the FIU maintains that, when necessary, it can contact relevant financial intermediaries and encourage the filing of SARs when additional information is needed.*

All SARs must be reported to the FIU in accordance with Article 9, Para. 2 and Article 9a, Para. 2 DDA. Article 4, Para. 1 of the FIU Act, and Article 9, Para. 4 and 6 requires reporting parties to take all necessary measures required by the FIU in connection with SARs filed. Article 9, Para. 2 DDA requires a financial intermediary to report to the FIU suspicions of a connection with money laundering and Article 9a, Para. 1, permits anyone who has suspicions that the transaction in question could be related to money laundering to report to the FIU prior to the establishment of a relationship. The filing requirements for SARs in Article 9 also permit the reporting party to simultaneously file a SAR directly with the public prosecutor, which may cause confusion among financial institutions. Given the relationship between the FIU and the public prosecutor, and the need for clarity, the legal provision permitting filing directly with the public prosecutor is unnecessary and may have unintended consequences.

The FIU relies to a great extent on the information provided in support of a SAR for its analysis. Article 23 DDEO prescribes minimum information requirements for SARs to contain all information necessary for the FIU to evaluate the situation. Pursuant to Article 23 DDEO, the FIU has formulated a SAR notification form that sets forth the minimum requirements for name, address, business relationship, and date, type, and nature of transaction being reported, its background and the origin of assets involved as well as the basis for the suspicion. For transparency, the SAR form and instructions should be disseminated widely, possibly through the FIU's website.

The FIU does not have the direct ability to issue guidelines for the identification of complex and unusual transactions, but pursuant to Article 3, Para. 2 DDEO, such authority is vested with the DDU, which is required to consult with the FIU in establishing guidelines for monitoring. A more formalized role for the FIU in this respect may be beneficial given the FIU's day-to-day experience with the evolving typologies of unusual and suspicious transactions. The DDU, in collaboration with the FIU, issued a specific Guideline 2002/1 *Monitoring of business relationships*, which applies to all financial intermediaries and sets forth principles for fulfilling clarification (i.e., "verification"), obligations, actions, once clarifications have been carried out, and obligations of auditing bodies to inspect for compliance. Guideline 2002/1 is based in large part on the guidelines for monitoring of Switzerland. Further, Guideline 2002/1 provides an illustrative list of indications of money laundering for which financial intermediaries should pay enhanced scrutiny. The guideline was approved by the government on December 18, 2001 and in force as of January 1, 2002. Financial intermediaries were required to revise internal procedures by March 31, 2002 to comply with the guideline.

The FIU has been a member of the Egmont Group since June 2001 and has access to the Egmont Group encrypted website (ESW) for information exchange with counterpart FIUs. The FIU is a member of the Training Working Group and Outreach Working Group of Egmont. The FIU is also entrusted with responsibility for strategic analysis for the government in ML, organized crime and FT.

In addition to its core functions, the FIU is the Secretariat for Liechtenstein's Coordination Task Force for Counter Terrorism, including FT. The task force was established in October 2001, and is comprised of the national police, prosecutor's office, DDU, the judicial service, personal staff of the government, foreign minister's office, and the press office. The task force is responsible for disseminating EU and US lists of suspected terrorists, terrorist organizations, and those who finance terrorists or terrorist organizations to public bodies, and subsequently the DDU is charged with disseminating these to the financial sector. The task force operates pursuant to Article 5(c) of the FIU Act, which entitles the FIU to obtain information on predicate offenses to ML, which includes Article 278a of the StGB criminalizing financing of terrorist organizations and organized crime. The task force is also responsible for the UN Counter Terrorism Committee Reports, including reports on FT developments.

Article 8 of the FIU Act authorizes the FIU to obtain, record, and process the information required for the exercise of responsibilities. Pursuant to Article 14, Para. 2 DDA, the DDU can demand any information and documents necessary to carry out its supervisory duties from reporting persons or from auditors and audit companies in charge of controls. Moreover, Article 23, Para. 2 DDEO requires that the information in an SAR contain all the information necessary for the FIU to evaluate the situation, and, after receipt of the notification, the FIU may demand further details, which are to be provided immediately.

The FIU has access to databases on a real time basis for vehicle registration and is attempting to ensure compatibility of IT systems for real time access to the police database. On request, the FIU can obtain information from the commercial register, tax administration, and registry of persons concerning marriage, divorce, births, deaths, foreign residents, etc. ("Zivilstandregister"). The FIU has access information from INTERPOL on request from the national police. In principle, the FIU has authority for real-time access to necessary information in databases maintained by other public bodies, such as the mutual legal assistance office and commercial registry; however, practically this has not been implemented because of the incompatibility of computer systems. However, the FIU reports that it does not experience delays in obtaining needed information.

The FIU does not have the direct authority to issue sanctions as it is not either a law enforcement or supervisory authority. Nevertheless, Article 15, Para. 1 DDA provides for criminal penalties of up to six months or a fine up to 360 per diem units for a person or entity who willfully fails to file an SAR in accordance with Article 9, Para. 2 of the DDU. In addition, Article 19 DDA provides that further measures in accordance with the banking act, the Law on Investment Undertakings, with the Insurance Supervision Act, as well as the Laws on Trustees and Lawyers may be reserved for failures to comply. Specifically, Article 35, Para. 4 of the banking act provides that any infringements of the law or about other grievances, the FSA shall issue the orders required to achieve the regular situation and to eliminate the grievances. The DDU is the body charged with ensuring compliance with the DDA but will consult closely with the FIU when the FIU becomes aware of failure to file SARs and will apprise the FSA of necessary supervisory measures. The DDU's role in this regard further emphasizes the need for consideration of formalizing the collaboration between the FIU and DDU to ensure that the information gleaned by the FIU on improper or non-filing of SARs is appropriately sanctioned and corrected. Accordingly, Article 14, Para. 1(d) DDA authorizes the DDU to ask appropriate authorities to take the corresponding disciplinary steps and they must be informed about the state of any such disciplinary measures. Article 14, Para. 1(c) authorizes the competent authority to prohibit the entering into any new business relations for a limited period of time for repeated and serious violations DDA.

Article 6 of the FIU Act requires the FIU to issue information required combating ML, predicate crimes, or organized crimes and to transmit documentation to other domestic authorities, in particular to the courts, state prosecutor's office, the national police, and the DDU.

Domestic cooperation is broadly authorized. Article 20 of the DDA (lex specialis to Article 25 Administrative Proceedings Law) requires the other competent authorities to cooperate with the FIU and any other government body involved in ML, FT, or organized crime. The FIU has a formal agreement with the national police since May 8, 2001 that governs information exchange between the two authorities that preceded Article 6 of FIU Act to have a clear understanding of the scope of exchange of information. Article 20, Para 1 contains a parallel obligation on all Liechtenstein authorities, in particular, the courts, public prosecutor's office, the DDU, the

national police, and the FIU, to provide each other any information and transmit any documents necessary to enforce the DDA. The structure of the FIU and its close working relationship with the DDU, FSA, and public prosecutor is enhanced by the fact that these three offices are located, by design, in the same building, and regular meetings ensure efficient cooperation. There are monthly meetings, and if needed, they can be held more frequently; however, formal internal procedures for collaboration with the DDU and public prosecutor are not in place.

The FIU is obliged to turn over SAR information and attendant pre-investigative analysis to the public prosecutor by law at a relatively low threshold of suspicion. Article 5, Para. 1 of the FIU Act vests the FIU with authority to order measures to be taken in accordance with Article 9, Para. 4 and 6 DDA, in particular, forwarding information to the public prosecutor's office if in light of the analysis carried out by the FIU; the SAR in question confirms the suspicion of money laundering, predicate crimes, or organized crime. Article 5, Para. 1 also requires the FIU to cooperate with the national police to obtain information required for the detection of ML; this provision permits involvement of the FIU in undercover operations on financial structures.

Article 7 of the FIU Act authorizes the FIU to share information obtained and analysis developed, including, nonpublic information, to foreign FIUs without violating banking or official secrecy if the sharing of information does not adversely affect public order, other essential interests, matters subject to confidentiality or fiscal interests, the information is in accordance with the FIU Law, reciprocity and that the information will only be used to combat ML, predicate offenses, and organized crime. Article 7 sets forth the parameters for use by foreign counterpart FIUs of information shared by the FIU, including, prior consent to pass the information beyond the counterpart FIU. Information contained in SARs can always be shared under the conditions for Article 7 of the FIU.

In practice, the FIU regularly shares account and transaction-specific information with foreign counterpart FIUs, although the conditions for Article 7, if read strictly, could pose a problem concerning banking secrecy. By operation of Article 9 of the DDA, information filed in an SAR overrides banking secrecy, and the further dissemination of such information by the FIU does not itself newly invoke banking secrecy, and therefore, the condition in Article 7 "without violating banking or official secrecy" is not applicable. Some caution is warranted concerning the effect of this condition, and revisions to the DDA should clarify that the scope of the FIU's sharing of financial information with foreign counterpart FIUs.

Article 9, Para. 3 of the DDA immunizes from liability, including breach of banking secrecy for information filed with the FIU. Because information obtained through SARs is not subject to confidentiality or profession secrecy, further dissemination with counterpart FIUs is not inhibited.

The FIU does not need to have Memorandums of Understanding (MOUs) in place before providing assistance but will enter into MOUs if required by the counterpart FIU. When counterparts require signed MOUs, the FIU's priority is to ensure that all necessary MOUs are established; these priorities are identified in part on the frequency and volume of transactions conducted between Liechtenstein and the other country. In 2001, one priority was Belgium. The neighboring countries are being addressed separately as well. There are MOUs in preparation with Italy, France, Germany, and Switzerland. Based on annual analysis of SAR activity, the FIU evaluates future priorities for MOUs, for example the United States, Russia, and Croatia.

*The FIU keeps statistics on SARs received by type of institution, by the basis for the SAR (whether as a result of a mutual legal assistance requests, Liechtenstein court actions, or generated by financial intermediaries), as well as the underlying predicate offenses involved. In 2001, of 158 SARs received, 81 were filed by banks, 64 were from fiduciaries (including trustees) and 13 were from lawyers. In addition, the FIU keeps statistics on the number of SARs that were forwarded on to the public prosecutor for investigation and prosecution. In 2001, of 158 SARs files, 121 were forwarded to the public prosecutor. In 2002, through the second quarter of 93 SARs file, 72 were forwarded to the public prosecutor. The figure of 121 out of 158 SARs sent to public prosecutors appears to be a high number, but as explained by the public prosecutor, the legal threshold for the FIU to send information is quite low, rather than an indication that the FIU is not adequately analyzing the SAR for indications of ML or a predicate offense. Further, the relatively heavy obligation on financial institutions to*

*analyze unusual transactions before filing a SAR appears to increase the percentage of SARs with usable indications requiring investigations also serves to explain the high level of SARs passed on to the public prosecutor. The depth of analysis conducted by the FIU appears adequate,*

*The FIU advised that there is a small increase in the numbers of SARs filed in 2002. There were 202 of which 96 were from banks, 95 from fiduciaries, six from lawyers, two from insurance companies, one from investment companies and two from the Liechtenstein Post. The FIU further reports that the quality of the SARs filed has clearly increased. Most of the SARs received year-to-date were related to ML or organized crime and very few related directly to FT. Data through June 2002 shows 93 SARs filed, 51 from banks, 29 from fiduciaries, 1 from lawyers, and two from the Liechtenstein Post. Of these 93, 72 were forwarded to the public prosecutor.*

*The FIU has six full time staff, of which one person provides administrative support. The Head of the FIU is responsible for overall operations and is an experienced white-collar crime investigator, and members of staff are separately responsible for strategic analysis, preliminary analysis and operational analysis and IT management. The IT system is a high secured, Oracle based system, which is cut off from administration LAN systems and runs a standardized analytical tool for SAR and financial intelligence analysis. The members of the FIU, as are all public servants in Liechtenstein, bound to keep secrecy pursuant to Art 106(2) of the Criminal Procedure Code, although it is conceivable for the FIU members to be called as witnesses in court. To testify or to reveal official secrets requires authorization from the prime minister.*

*For the fiscal year 2002, in addition to salaries, the FIU had an operational budget of CHF 220,000.*

*Article 5, Para. F gives the FIU responsibility for producing periodic, status, and strategy reports. The FIU has published an annual report for 2001 and expects to publish the annual report for 2002 in April 2003. In November 2002, the government approved the work plan for the FIU, job descriptions for FIU employees, and agreed to salary ranges for the staff. The work plan details the steps of collection and analysis of SARs as well as the development needed to ensure proper analysis is conducted, and there is sufficient supporting evidence and intelligence to pass on to law enforcement authorities.*

#### **Analysis of Effectiveness**

The FIU has been in operation since March 1, 2001, and to date has been sufficiently resourced, staffed, and trained to carry out the collection, analysis, and dissemination of financial intelligence and to take a lead role in combating ML and FT. The FIU has broad powers to execute its functions for AML/CFT, including obtaining the information needed to detect cases of money laundering, predicate offenses, and organized crime from a variety of sources. The FIU concentrates on intelligence analysis at the pre-investigative stage as well as on offering support to law enforcement officials for additional support to cases under investigation and prosecution.

*The FIU works in close collaboration with the DDU, public prosecutor, and princely courts to ensure effective detection and prevention of ML and FT. In addition, the FIU has direct and close working relations with the FSA concerning matters that may affect prudential supervision. The FIU has broad information sharing capabilities that allow for effective communication with both domestic competent authorities and with foreign counterpart FIUs with minimal risk of violation of banking and official secrecy; although, Art 7 of the FIU Act could pose some impediments if read strictly, especially, in the context of a non-SAR related foreign request.*

The FIU has given priority to proper implementation of SAR reporting by the financial services sectors, and its overall stated goal for 2002 is to create a solid foundation for the reporting procedures to be followed by financial intermediaries. The FIU has prescribed a SAR form, minimum content requirements for SARs, and has focused on deepening the awareness of the financial intermediaries about ML and FT. The SAR form is not required for submission of a SAR, but, nevertheless, the SAR form and minimum contents instructions should be more widely disseminated, including placement on the FIU's website.

The FIU has current and updated information technology systems (IT) that have been specifically tailored to its needs.

<p><b>Recommendations and Comments</b></p>
<p><i>The FIU has found it effective to operate as an independent unit, which is not subordinated or linked to the supervisory authorities or law enforcement. It appears that a proper balance between operational independence and the need for coordination of the functions with the FSA, DDU, and the law-enforcement bodies has been achieved. Ongoing monitoring is advisable to ensure that the legal and institutional structure of the FIU in relation to the FSA and DDU, in particular, is sound enough to maintain the balance. As the FIU develops and evaluates the most effective methods of ensuring both that needed information and intelligence is disseminated but also that reporting lines are clear, some thought should be given to formalizing the procedures. Currently, the strength of the coordination rests with the individuals heading the FIU, law enforcement, and supervisors. However, there is, perhaps, a need for the structure of the reporting lines to be formalized so that the high level of coordination survives future changes of personnel. Formalizing the FIU's relationship with the FSA and DDU may be especially timely in light of the proposed restructuring of the supervisory authorities. In the short term, continuing the independence of the FIU, which has been recognized and maintained by the government, should be sustained given the FIU's need for neutrality and flexibility.</i></p>
<p><b>Implications for compliance with FATF Recommendations 14, 28, 32</b></p>
<p>The FIU has a strong legal framework, and in its relatively short existence it has developed a strong institutional structure and procedures to effectively assure detection of suspicious transactions, meaningful reporting of SARs, and high levels of dissemination and exchange of financial intelligence both with domestic law enforcement bodies and with the FIU's foreign counterparts, including exchange of account and transaction specific information.</p>
<p><b><i>IV—Law enforcement and prosecution authorities, powers and duties (compliance with criteria 25-33)</i></b></p>
<p><b>Description</b></p>
<p><i>The national police, specifically EWOK, a special unit focusing on white collar crime, is charged with investigating ML and FT, among other financial crimes. The public prosecutor is responsible for prosecution of ML and FT crimes, and the princely courts, specifically four investigative magistrates, are responsible for the necessary legal orders and search orders for ML and FT. The national police has undertaken a program to substantially increase the staffing for EWOK, which currently has seven investigators and is recruiting three additional investigators from neighboring Switzerland and Austria. Hiring of new officers has been completed and the full complement of ten officers will be in place by July 2003. The Police Act was recently amended to permit hiring of non-nationals as fully qualified police officers.</i></p> <p><i>Since 2000, the Public Prosecutor's efforts have focused on increasing resources, ML, and financial crimes cases on responding to requests for mutual legal assistance. Previously, the public prosecutor had two prosecutors of financial crimes and mutual legal assistance and one prosecutor assigned to misdemeanors. Under the revised structure, the public prosecutor has recruited experienced prosecutors from Austria, and the staff now includes six qualified prosecutors.</i></p> <p>There are no legal impediments to the use of a wide range of investigative techniques such as wire tapping and surveillance; although, sting operations are not permitted. Controlled delivery is available but not used in practice, except in drug cases. For example, Article 27 of the Drug Law protects police officers from liability for participation in undercover operations for, example, for controlled delivery of drugs. Article 103 of StPO allows for telephone tapping or obtaining phone logs with the permission of the President of the Court of Appeals (Obergericht). Article 9 of the Code on Criminal Procedure prohibits the use of the so called "agent provocateur" or sting operations. This article is identical to Article 25 of the Austrian Code of Criminal Procedure. However, the courts have ruled that this article does not prohibit investigative techniques such as wire tapping, surveillance-controlled delivery, and undercover operations. Liechtenstein law-enforcement authorities are awaiting changes in the Austrian procedural code. These planned changes are aimed to make the present legal situation clearer. <i>The Police treaty with Austria and Switzerland allows for mixed investigating teams.</i></p> <p><i>The Police report that there are currently no backlogs in ongoing investigations, and that the staffing of ten officers will allow for the handling of cases on an ongoing basis. In 2002, fifty cases were investigated based on</i></p>

*mutual legal assistance, 49 requests were received from foreign police authorities; 37 FIU requests and 113 domestic cases were initiated (either by court or prosecution orders). The EWOK unit of the national police, established in March 2000, has intensified training of police staff with respect to methods used for detection of money laundering and has focused on intensified national and international cooperation. An amendment has been made to the Liechtenstein Police Act that allows for recruitment of foreign investigators onto the police force. The design of the EWOK teams of two officers now consists of one foreign officer and one Liechtenstein officer with financial experience.*

Law enforcement authorities have adequate authority to compel production of bank account records, financial transactions records, and other records as needed. Article 96 of StPO allows for obtaining documents from banks, similar to a subpoena process that allows for production of electronic and paper records without the need for a physical seizure of original documents. In addition, Article 92 of StPO allows for searches of homes, businesses, and vehicles. Such orders are regularly sought and granted in relation to ML and FT investigations. In addition, the documents demanded by the DDU and the FIU under the DDA and FIU Act may be passed on to law-enforcement investigators after a criminal case has been opened.

*The government has formed a specific Coordination Task Force, which is headed by the FIUs, to address all matters relating to terrorism, terrorist organizations, and the financing of terrorism. The task force is comprised of the public prosecutor, DDU, police, and ministry of justice. But, as a general matter, task forces are assembled only for larger cases that require enhanced coordination rather than on a general basis. The close collaboration existing among law enforcement and the small number of officials involved, obviate the need for ongoing task forces to ensure adequate cooperation and information sharing. Legally, Article 20 DDA authorizes the widest range of cooperation required.*

*Funding and resources have been substantially increased for the national police, public prosecutor, princely courts, and the office of legal assistance. The public prosecutor has been expanded from three to six prosecutors and significant additional support staff. The cases encompass both domestic criminal proceedings and mutual legal assistance proceedings.*

*Four judges of the princely court are now available to handle domestic criminal investigations and prosecutions and requests for mutual legal assistance. The Princely Court, along with the office of the legal advisor in the ministry of justice and the public prosecutor, has instituted a system of assigning related cases to one judge and one prosecutor, to ensure consistency and coverage of matters.*

*In 2001, EWOK investigated 218 financial cases, including 45 requests from foreign police authorities, 18 requests from the FIU, 78 based on court orders, 25 based on prosecution orders and 52 of its own initiative. EWOK made 15 requests to foreign police authorities through INTERPOL. Of the 218 cases, approximately 74 appeared to be related to money laundering. Members of EWOK have attended a number of training programs and conferences related to ML and FT.*

*In 2002, the public prosecutor received 93 matters for investigation from SARs (the number of SARs is different than the number reported by the FIU because of consolidation of related matters for investigation) of which 59 concerned matters were already known to the public prosecutor's office (mainly from foreign mutual legal assistance request). Altogether in 64 cases a new investigation was opened. In five cases, foreign judicial authorities were requested to take over the prosecution of foreign suspects. Two investigations have led to formal forfeiture charges in rem. In one case, a suspect was indicted and sentenced to four years imprisonment. The defendant is serving the prison term in Austria at the moment. 51 investigations are still pending.*

*EWOK collaborates with neighboring countries of Austria and Switzerland based on the trilateral treaty on Collaboration of Police and Customs Authorities Across the National Border, effective in July 2001.*

*Previous back logs of mutual legal assistance requests for ML and financial crimes have been addressed, and the legal assistance office in the ministry of justice is the central competent authority to handle mutual legal assistance requests*

Analysis of Effectiveness
The DDA, Criminal Code (StGB), Code of Criminal Procedure (StPO), the FIU Act, and the MLA Law intersect to provide Liechtenstein authorities with an adequate range of available law enforcement and prosecutorial powers, which appear to be fully utilized by the relevant bodies, except in the case of fiscal offenses.
Recommendations and Comments
Law enforcement and prosecution authorities have received substantial resources for enhancements over the last few years and are now at the stage of completing implementation. These efforts must be ongoing and sustainable. Authorities advise that enhanced powers to obtain bank records through court orders are being proposed to allow for access to bank records which are not specifically tied to the name or transaction being investigated. The amendment is motivated by a court denial of an order for bank records that was not clearly related to the ongoing investigation. The new authority is expected to permit access to bank records that are suspected of being related to a criminal activity, even if the account is not in the name of the suspect or clearly related to the transaction.
Implications for compliance with the FATF Recommendation 37
The wide range of domestic tools for investigation and developing prosecutions is equally available in support of mutual legal assistance in criminal matters (see Ch. V, below) and allows for generally adequate means of obtaining evidence and materials in support of ML investigations and prosecutions. Enhancements to the investigative tools following the proposed changes in Austrian law should help to achieve full compliance with this criterion. The authorities should ensure that the “fiscal” excuse does not inhibit the full use of investigative techniques where there are indications of other activity such as fraud or bankruptcy.
<i>V—International Co-operation</i> <b>(compliance with criteria 34-42)</b>
Description
<p>Liechtenstein was severely criticized in the past for ineffective and overly bureaucratic processes for mutual legal assistance, and for using the limitation on disclosure of fiscal information as a means to deny most requests, even if such requests contained elements of non-fiscal offenses. This situation has changed dramatically for the better.</p> <p>On November 6, 2000, the new Law on International Mutual Legal Assistance in Criminal Matters (MLA Law) came into force. The MLA Law serves two basic purposes: first, to provide rapid and effective mutual legal assistance by reducing the necessary steps and appeals for execution, and to provide a specified procedure for implementing the measures requested. The MLA Law has been implemented by allocating more investigating resources and quicker involvement of judges, sufficient staff to handle the requests at the ministry of justice, new premises, new EDP databases for administration of files and modifications to the Criminal Code (StGB), and the Criminal Procedures Code. There has been additional focus placed on tri-lateral cooperation among the Princely Court, prosecutor, and office of legal assistance in the ministry of justice. The MLA Law allows for a clearer separation of responsibility between the administrative authority and the judiciary under the procedure for granting legal assistance. There are approximately 10 cases left from the previous back log (under the old MLA Law) that are still active.</p> <p>Article 64 of the MLA Law allows for complete and expeditious confiscation based on mutual legal decisions. In order to execute, the judgment should be final, the person subject to the confiscation must be heard, and the government must give considerations to the costs pursuant to Article 253a of StPO.</p> <p>A large part of the implementation efforts have been directed at reducing the number of long-pending requests that were back-logged prior to the enactment of the MLA Law. This involved assigning the ministry of justice as the competent authority and to reduce the number of steps and appeals at each stage of the request: evaluation of admissibility, substantive legal assistance, and delivery.</p> <p>The MLA Law allows for a streamlined process for executing requests by assigning four judges directly to investigation and mutual legal assistance proceedings, and all the same matters or crime are handled by the same judge and prosecutors. This practice is referred to as “one man, one case.” Pursuant to the MLA Law, once a letter of request is received by the office of legal assistance in the ministry of justice or by the court, the information is disseminated to the other, and a copy is sent to the FIU. The file is then sent to the public</p>

prosecutor and the involved judge will send a "Best Practice Form," which is a letter faxed to the foreign requesting party to apprise of who is handling the request and the file number. *The use of the Best Practices Form allows for efficient management of MLA requests.*

The MLA Law authorizes implementation of measures requested, including search and seizure of banking documents, blocking of assets, tapping of telephones, and interrogation of witnesses. Further, law enforcement officials from the requesting state may participate in the legal proceedings needed to execute the mutual legal assistance.

The major topics for requests received are fraud, money laundering, embezzlement, traffic violations, theft, forgery, receiving of stolen goods, and other financial crimes.

The range of mutual legal assistance executed under the MLA Law include implementation of measures requested such as search and seizure of banking documents, blocking of assets, tapping of telephones, and interrogation of witnesses. The MLA Law allows for officers from the requesting state to participate in the proceedings in Liechtenstein.

*Since the passage of the MLA Law, the back log of older mutual legal assistance requests has been largely cleared, and there are currently specific procedures in place to carry out the requirements of the MLA Act. Although fiscal offenses are not subject to mutual legal assistance requests, if there are other crimes under investigation by the foreign authority, the mutual legal assistance request will be granted if the information requested is equally applicable to the non-fiscal offense.*

*In 2000, Liechtenstein received 301 requests and made 188 requests to foreign authorities. Thirteen of the received requests were rejected because of various reasons (8 cases concerned requests in fiscal matters; in 2 cases there was no double criminality at the time of the incident, in 1 case Liechtenstein received no supplementation of the request in appropriate time, in 1 case Liechtenstein denied the "transferal of prosecution," and in 1 case the delivery of documents was impossible because of a false address. With respect to money laundering requests that were rejected in 2000, the public prosecutor advises that these were evaluated in light of the previous Liechtenstein criminal provision for ML that required a suspicion that the accused had knowledge of the underlying predicate crime.*

*In 2001, the legal assistance unit of the ministry of justice advised that there were 385 requests received, 300 issued; 13 of the requests received were rejected. In 2002, 304 requests were received, 472 were sent, approximately 10 requests received were rejected. Four of the rejected requests were for trafficking offenses, and the larger portion was rejected because it pertains to fiscal matters. Ninety-seven percent of requests to Liechtenstein originate from countries who have signed the European Convention on Mutual Legal Assistance. It is not a practice in Liechtenstein to reject requests because there are no bilateral or multilateral treaties or agreements with the requesting state.*

*The length of time in providing MLA has also declined dramatically. For non-coercive measures and without appeals, a Liechtenstein judge can get a witness statement in fourteen days to three weeks; the same is true with search warrants. One month for simple requests without appeals is a realistic turn around. Most requests are now resolved in under six months. For urgent matters, MLA can be executed on an expedited basis and has been. When urgent, MLA requests can be received directly from INTERPOL or from foreign courts.*

*Grounds for appeal are whether the request is fiscally motivated or the account sought is unrelated to the case abroad. The Judges decide for sufficiency of the requests and will check dual criminality. For non-coercive actions requested by signatories to the European Convention on MLA, dual criminality is not required to execute. Outside of the signatories, dual criminality is required for all requests. Although it is theoretically possible that the limitation on prosecution for the predicate offense and ML would allow for denial of a MLA request from abroad, authorities report that for all practical purposes, the MLA will be granted unless the facts are clearly indicative that both the ML investigation and predicate offense were the same. Moreover, because of the in rem civil forfeiture authority, a domestic case can be opened based on a very low threshold of suspicion of*

*involvement of a Liechtenstein person or entity, and the account or assets can be blocked.*

*Further, at the investigative stages, the need to specifically identify the underlying predicate crime because of the Liechtenstein serious crimes approach for predicate offenses, is less problematic and MLA will be granted in most cases. For example, MLA requests for an investigation at the very preliminary stages, where there is no economical value to the transaction, will likely warrant assistance, so long as the request does not appear to be solely fiscally motivated.*

*The breadth of interpretation of fiscal related matters may inhibit the assistance provided. Where a MLA matter relates to fiscal and other crimes, the request will be granted with the reservation that the information not be made available for the fiscal offense. The process in determining the fiscal nature is a review of the facts underlying the request, and if facts do not support a suspicion of a non-fiscal offense, the request will not proceed. The interpretation of what constitutes a fiscal offense should be reviewed. Currently, the Judges report that VAT carousel offenses are considered to be fiscal and MLA cannot be granted; although, there appears to be at least one case in the last 20 years where extradition was granted on a VAT carousel matter. The fiscal determination on VAT carousel stands despite the frequent circumstance of false invoicing and fraud that are attendant to the offense. However, if the request also supports false invoicing, fraud, or bankruptcy separately, MLA can and has been granted.*

Mutual legal assistance is supported through the use of conventions, treaties, and other agreements, including the European Convention on Mutual Legal Assistance to which Liechtenstein became a party in 1970. The legal assistance unit of the ministry of justice described generally the connection between the MLA Law and the international law and also the wording of Article 1 MLA Law (“Article 1, Priority of International Agreements: The provisions of this law shall apply unless otherwise provided for in international agreements”). Therefore, international agreements may override the MLA Law and its provisions. The latest example for such an international agreement is the bilateral treaty between Liechtenstein and the United States, which was signed on July 8, 2002.

To further increase the responsiveness to international requests, agreements have been finalized with Austria and Germany that allow for direct submission of mutual legal assistance requests such as letters rogatory through the courts without the need for direct involvement of the ministry of justice, although they receive copies. An agreement with Switzerland is pending.

In addition to the exchange of information through execution of mutual legal assistance, the FIU is widely empowered to exchange information with foreign counterparts. The national police participates in exchange of information through INTERPOL and bilaterally, particularly, with the competent authorities of neighboring countries. Under Article 15, Para 5 of the European Convention, there is the authority to send requests directly through INTERPOL.

Cooperative investigations, including controlled delivery are authorized under the Code of Criminal Procedure and the MLA Law. Controlled delivery for financial transactions and tracing of the movement of funds has been employed regularly by Liechtenstein authorities.

*Article 64 to 67 of the MLA Law and Article 13 to 17 of the Strasbourg Convention allow for enforcement of foreign forfeiture orders, provided at Article 6 of the European Human Rights Convention are met, there is dual criminality and mutuality that these do not relate to fiscal or political offenses (pursuant to Articles 14 and 15 of the MLA Law), that there is no ongoing domestic proceeding addressing the same assets, and that the concerned person is heard after forfeiture is executed. As a general matter, the money, assets, and objects forfeited or confiscated within Liechtenstein, as a result of international cooperation requests, devolve upon the state; however, sharing agreements are possible under Article 253a of the Code of Criminal Procedure if the conditions with state where the crime was committed, there is agreement on possible use and the ministry of justice is involved. Equivalent value seizure is permitted in the international cooperation context pursuant to Art 64(4) of the MLA Law.*

*The enforcement of foreign forfeiture orders has been used in several cases. The public prosecutor advised of three series of forfeitures executed under mutual legal assistance requests that ranged in amount from CHF 64,000 to £200,000.*

Extradition is authorized under Articles 10 through 41 of the MLA Law; although, extradition of nationals is not generally permissible, without their consent.

When extradition is not possible, the MLA Law Art 60 of the MLA Law authorizes “passive” transferal of prosecution, i.e., transfer of foreign prosecutions to Liechtenstein if there is mutuality (reciprocity), there is jurisdiction for the offense in Liechtenstein, and there is criminality in Liechtenstein. Article 74 of the MLA Law authorizes “active” transferal, i.e., transfer of prosecution of offenses committed in Liechtenstein to a foreign prosecutor where there is mutuality, jurisdiction in a foreign state, and extradition is not possible, reasonable, or in the interest of ascertaining the truth or proceedings performed with that person being present.

*The public prosecutor advises that this has been a very effective method of information exchange and to ensure prosecutions where extradition may not be possible. This authority has led to several convictions in other countries. In 2001, there were 51 active cases of transferal and 5 passive cases.*

Extradition and transferal of prosecution are designed in part to ensure that Liechtenstein is not perceived as a safe haven for criminals. In addition to the provisions of Article 60 MLA Law that authorize transferal of prosecution when nationals are not extradited, Article 65, Para. 1 (1) of the Penal Code allows for prosecution of offenses committed abroad. Inclusion of an autonomous offense of FT will also allow for wider extradition.

Article 64 of the Penal Code, provides that if extradition is not possible, for nationals, the public prosecutor has the competence to prosecute these individuals for participation in criminal organizations, including terrorist organizations or organizations for financing of terrorism, that are committed abroad.

#### Analysis of Effectiveness

International Cooperation has been substantially enhanced since the enactment of the MLA Law and the addition of a number of resources to handle a previous back-log of requests from foreign countries. The MLA Law was designed to expedite delivery of mutual legal assistance by truncating the procedures required to execute measures such as search, seizure, and subpoenas for bank documents, interrogation of witnesses, and extradition, to reduce the number of offices involved in reviewing the sufficiency of the requests received, and to reduce the appeals available for interested parties or subjects of requests. Previous back logs of mutual legal assistance requests for ML and financial crimes have been addressed and the legal assistance office in the ministry of justice is the central competent authority to handle mutual legal assistance requests. *These steps are fundamental in an effective MLA system. The processes themselves appear to be adequate, and the results of the new MLA Law demonstrate its efficacy. However, some questions remain whether on a substantive basis the MLA provided is limited because the dual criminality requires consideration of both the Liechtenstein serious crimes approach and prohibition of punishment for both the predicate offense and ML. Limitations on MLA on a fiscal basis may continue to limit the substantive delivery of MLA.*

Liechtenstein is increasing its efforts to establish additional bilateral and multilateral agreements that further expedite delivery of assistance and address aspects of assistance that are not generally authorized by the MLA Law. In particular, the former shortcomings in the enforcement of the law and the length of time required to conduct mutual legal assistance requests, appear to have been alleviated. The MLA Law attempts to harmonize the provisions applicable to mutual legal assistance with the Criminal Code and Code of Criminal Procedures to ensure the widest possible scope of assistance. With respect to fiscal offenses, assistance is not available under the MLA Act, but information that is equally applicable to fiscal offenses and another offense will be provided, so long as the evidence is not used to prosecute the fiscal offense. Despite the limitation in the MLA Law with respect to fiscal offenses, Liechtenstein authorities may enter into superceding bilateral agreements on taxation matters. A major improvement is the possibility of foreign investigators participating in a limited capacity to the execution of some proceedings, such as video conferencing of witness interrogations.

#### Recommendations and Comments

<p>It appears that implementation of the MLA Law has largely addressed the major shortcomings under the previous system by reducing the number of stages from a possible 12 to 4 and to expedite the means of legal redress and appeals. The scope of implementation will continue to require monitoring to ensure that the quality of the assistance provided is of substantive use to foreign law enforcement bodies and courts. Additional bilateral and multilateral agreements should be pursued to ensure coverage.</p>
<p>Implications for compliance with FATF Recommendations 3, 32, 33, 34, 37, 38, 40, SR I, SR V</p>

## Assessing preventive measures for financial institutions

Table 4.2 Detailed Assessment of the Legal and Institutional Framework for Financial Institutions and its Effective Implementation

<b>I—General Framework (compliance with criteria 43 and 44)</b>
Description
<p>The DDA and the DDEO are the main instruments that establish the legal and institutional obligations of financial intermediaries with respect to AML/CFT. The DDA and DDEO are intended to regulate in a comprehensive manner the application of due diligence measures in financial relationships and transactions in order to combat money laundering and organized crime, specifically, Article 2. Para. 1 DDA, subjects banks and finance companies, lawyers, trustees, investment undertakings, insurance companies (with respect to direct life insurance business), bureaux de change, and the Liechtenstein Post (collectively “financial intermediaries”). In addition, Article 2, Para. 2 DDA contains a blanket clause to covering all other persons who, on a professional basis, accept or keep in custody other person’s assets or help to invest or transfer them to the obligations of professional due diligence in financial transactions. Pursuant to Article 2 Para 1 DDA, the provisions of the DDA apply also to branches in Liechtenstein of foreign banks and finance companies and branches in Liechtenstein of foreign investment firms.</p> <p>The DDA and DDEO mandates due diligence, ongoing monitoring of customers and transactions, suspicious activity reporting, development and maintenance of internal procedures for compliance, audit and record keeping. Further, the DDA and DDEO establish the supervision and authority of the DDU, including cooperation with supervisors, and provides for administrative and penal sanctions for noncompliance. The DDA vests complete supervisory authority for preventive measures of financial institutions and intermediaries with respect to money laundering with the DDU. As a result, the licensing authorities, either the FSA or the ISA, do not have a major role in supervising compliance with AML/CFT laws and regulations. The FSA and ISA each has a limited role insofar as its enforcement authority may be invoked for violations of the DDA but does not participate in ongoing monitoring. Nevertheless, there are established gateways for communication between the DDU and the FSA/ISA on matters that affect both prudential supervision and due diligence; although, these are not formalized.</p> <p>The scope of covered persons and entities of the DDA and DDEO is quite extensive and the obligations encompassed by the DDA and DDEO are specified in great detail. Compliance is closely monitored through the use of external auditors as well as direct on-site and off-site monitoring by the DDU.</p> <p>Under the DDA, information required to be obtained to fulfill professional due diligence requirements and to be made available to the DDU and the FIU cannot be withheld on the basis of banking and official secrecy and confidentiality provisions. There is an open question about whether the DDU, like the FSA, may share transaction specific information with foreign counterpart supervisors (see discussion in BCP assessment). The concern for the exchange of ML and FT related information is somewhat less than when prudential information is sought because the FIU has authority to share transaction specific financial information and intelligence to counterpart FIUs without violating banking and official secrecy.</p>

Article 4 DDA establishes the requirement to identify all customers by use of supporting evidence when entering into business relationships. Article 5 DDA requires establishing the ultimate beneficial owner of the assets. The information obtained by financial intermediaries under these provisions must be available to external auditors and the DDU and all records must be stored and available in the Principality of Liechtenstein, pursuant to Article 12 DDA. Further, Article 5 of the DDEO requires maintenance of due diligence files for each contracting party.

Article 14, Para. 2 DDA provides that the DDU can demand any information and documents necessary to carry out its duties from reporting parties as well as from auditors and audit companies. Thus, the combination of obligations to obtain due diligence information and to make these available to the DDU, external auditors, and, if necessary, to the FIU, overrides the application of banking and official secrecy.

The DDU is the designated body to carry out supervision of compliance with the DDA, the DDEO, for banks and finance companies, trustees, lawyers, investment undertakings, insurance companies, and bureaux de change. On October 15, 2000, the government issued a decree establishing the DDU, and designating it as the competent office within the meaning of Article 21 (2) DDA and to issue directives. The decree further designates the DDU with all responsibilities relating to liaison with the international organizations, bodies and working groups concerned with ML, in particular, the FATF. The DDU has exclusive supervisory authority with respect to the DDA for all regulated financial intermediaries. Prior to its establishment, due diligence responsibilities resided with the FSA.

Pursuant to Article 14 DDA, the DDU monitors compliance with the law and takes necessary measures, including affirmative orders, to exercise formal or material control over business relationships, ordering or carrying out of extended and repeated examinations if necessary, prohibiting the financial intermediary from entering into any new business for a limited time, or asking the appropriate authorities to take corresponding disciplinary steps. The DDU can demand any information needed to carry out its supervisory duties in accordance with Article 14, Para. 2 DDA.

The DDU relies on external auditors to conduct onsite audits to assure compliance with the DDA and the DDEO. Banks, insurance firms, and investment companies are audited annually and trustees and lawyers at least once every three years. In addition to the work of the external auditors, the DDU conducted 11 direct onsite audits of trustees in 2001.

Based on the external audits, the DDU is able to validate that financial intermediaries have implemented policies and procedures to ensure compliance with respect to customer identification for new relationships.

Anti-money laundering measures are a major priority in Liechtenstein and the DDU, an independent entity reporting directly to the head of government as the Minister in charge of Finance, is adequately funded and staffed.

#### Analysis of Effectiveness

The establishment of the DDU as a separate body with complete responsibility for ensuring compliance among financial sectors has proven to be an effective mechanism to increase compliance levels in a relatively short time period.

Implementation of customer identification requirements appears to have been achieved across most sectors, with some questions arising about the completeness of records that were previously held exclusively by trustees. This situation is improving, and the requirement for due diligence audits every three years for trustees is a major tool in assuring compliance. The first round of audits of trustees and trust companies under the new amendments to the DDA will be completed in 2003, and systemic weaknesses appearing from this first round should inform additional sector specific guidance, if necessary.

The DDU appears to be adequately staffed at the present time to fulfill its enforcement mandate, given that it depends on the dualistic system of monitoring compliance. There is some concern that if a crisis arises and more

<p>direct supervision is required by the DDU, the staffing numbers would not support this need. Nevertheless, it is encouraging that the DDU staff continues to develop its expertise through active participation in onsite audits of the entities it supervises with regard to DDA and DDEO compliance.</p>
<p><b>Recommendations and Comments</b></p>
<p>The significant efforts and enhancements achieved need to be sustainable. The DDU should continue to play an active role in the supervision of compliance and maintain its depth of supervision and enforcement, even after the proposed merger of the FSA and DDU is completed. The DDU and FSA will both benefit from coordinated supervision and audits, which will help to sustain consistency.</p>
<p><b>Implications for compliance with FATF Recommendation 2</b></p>
<p>The DDA and establishment of the DDU have been major breakthroughs in establishing a system that is not unduly limited by banking and professional secrecy. Supervision for preventive measures is not limited by banking secrecy, so authorities have achieved compliance with FATF Recommendation 2.</p>
<p><b><i>II—Customer identification</i></b>  <b>(compliance with criteria 45-48 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 68-83 for the banking sector, criteria 101-104 for the insurance sector and criterion 111 for the securities sector)</b></p>
<p><b>Description</b></p>
<p>The minimum requirements for customer due diligence are set forth in significant detail in the DDA and the DDEO. Both instruments are mandatory and violations for either are subject to sanctions, both administrative and, in some cases, criminal. The implementation of such customer due diligence requirements are enforced by audits of banks, insurance, securities, trustees, and other financial institutions conducted primarily by external auditors under specific guidance and instructions from the DDU, and in part directly by the DDU, which is increasing the number of audits it conducts directly. At the time of the assessment, the DDU inspections were focused on the trustee sector, where implementation requires greater changes in operating practices.</p> <p>Anonymous accounts are not legally permissible in Liechtenstein because the DDA imposes affirmative obligations to establish identity and beneficial ownership of all contracting parties, including, the directors or controlling persons of legal entities. There is authority to open numbered accounts; however, customer identification and beneficial ownership information about these accounts must be maintained as with all other accounts. The only operative difference is that within the bank, a fewer number of employees have access to the customer information. This limitation on the availability of customer identification information does not apply to compliance officers, due diligence officers, or external auditors. All parties responsible for ongoing monitoring within the financial intermediary must have access to the customer information. The provisions for customer identification in Article 4 DDA and beneficial ownership in Article 5 DDA apply to numbered accounts. Some caution is warranted on the part of compliance officers and external auditors to ensure that the numbered accounts are not being used <i>de facto</i> as anonymous accounts and are held to the same level of customer due diligence.</p> <p>Minimum customer identification requirements in the DDA are clear and applicable to all financial institutions. Article 4 DDA requires that all financial intermediaries establish the identity of the contracting party through official documentation, and Article 5 DDA requires establishment of the ultimate beneficial owner. Before 2001, banks could delegate the duty to establish customer identification and beneficial ownership information to trustees and were not required to know or to have documentation concerning the beneficial owner information in the bank files. Since 2001, the DDA was amended to require that the banks obtain, verify, and maintain the customer identification information directly, pursuant to Article 5, Para. 1(d) DDA. The DDA requires financial intermediaries to identify customers when entering into business relationships and to repeat the identification if there are any doubts about the identity of the contracting person (or individual representing a legal entity that is a contracting party) or about the beneficial owner during the course of the business relationship (Article 7 DDA).</p> <p>Based on the external audits, the DDU is able to confirm implementation that the opening of new accounts and historical accounts have been brought into compliance with the exception of 423 accounts that are now blocked as of October 23, 2002, until such time as required customer identification details can be obtained. Efforts to qualify these blocked accounts continue.</p>

For natural persons, the supporting evidence consists of passports and identity cards. If the person is not able to obtain either from his/her home country, then he or she must provide a confirmation of identity issued by the authority competent for his or her place of residence, pursuant to Article 15 DDEO. In all cases, a copy of the document is to be kept on record. Art 16 DDEO requires legal persons and trusts to be identified by extract from a public register, or equivalent; an official confirmation issued by a national authority, the statutes, foundation files, or charter of a confirmation by a special law appointed auditor or an official authorization to carry out the relevant professional activity. Article 17 DDEO requires additional information for “non face-to-face” business relations that include obtaining certified copies of passports or identity cards of natural persons and for legal entities, certified copies of the minimum documentation required for all legal persons set forth in Article 16 DDEO. For legal persons or trusteeships, Article 16 of the DDEO requires identification by means of an extract from a public register or an extract from an equivalent register. Originals or certified copies must be submitted and kept on record.

Reliance on third parties to undertake KYC is provided for in the DDA and DDEO. Article 24, Para. 2 and 3 of the DDEO establishes requirements for assistance provided by third parties for identification of customers and beneficial owners, and continuous monitoring of business relationships may be performed by third parties as long as the implementation is guaranteed. The third party is obligated to provide all information collected is transmitted to financial intermediaries; however, neither the external auditor nor the DDU has direct access to the third party’s offices or records.

As an added tool, Article 19a DDA prohibits financial intermediaries which conduct accounts or deposits for which no business relationship profile has been established, from permitting withdrawal of assets so long as the business relationship information is not complete.

Separate provisions directly address beneficial ownership information. These provisions were designed to remediate the previous impediments in understanding who or what was behind an account or transaction. The impediments were bolstered by banking and professional secrecy and the previous posture of allowing agents or intermediaries maintain the beneficial ownership information on behalf of the financial institutions. At the outset, Article 5 DDA specifically requires establishment of the ultimate beneficial owner if there are doubts whether the contracting party is the beneficial owner; a cash transaction or insurance business is conducted in excess of thresholds in the DDA; business relations are entered into written correspondence, i.e., “non face-to-face,” or the customer is a legal person or trusteeship that does not engage in commercial activities or trade within the jurisdiction. With respect to collective accounts or collective deposits, the customer must provide a complete list of beneficial owners and report any changes in short intervals.

Beneficial owner means the ultimate beneficial owner, which can only be a natural person. The DDU advises that there is a legal presumption that the contracting party is the beneficial owner of the account; however, the circumstances of the relationship must be evaluated in their totality at their outset, and, if there are grounds for questioning the relationship, beneficial ownership information should be established. Article 18 of the DDEO requires the customer to declare name, date of birth, address, country of residence, and nationality of natural persons, and company name, registered office, country in which the company is registered, date of foundation, and place and date of entry into the public register (if available) for legal entities. The process for establishing the beneficial owner must be documented and the accuracy to be confirmed through the signature or qualified digital certificate of the customer.

The Law of November 16, 2001, contained a transitional provision that required all financial intermediaries to provide to other financial intermediaries that are involved in the business activity of the beneficial owner, comprised primarily of banks, beneficial ownership information concerning existing business relationships by December 31, 2001. As of December 2001, banks advised the DDU that only 2.5 percent of the relationships where formerly the beneficial ownership information was with the trustee had missing or incomplete beneficial ownership information. An audit of all 17 banks in April and May 2002, found that 3.8 percent of beneficial ownership information of relationships reviewed (2,196) was either missing (0.93 percent) or insufficient (2.57 percent). The quote mainly results from minor formal deficiencies (e.g., the date of birth of the beneficial

owner is not kept in record). The DDU conducted 11 direct audits on trustees in October and November 2001, and found that 6 percent had formal and other deficiencies in the beneficial ownership information. In 2002, deficiencies in beneficial ownership information in trustees audited stood at approximately 8 percent, which consisted mostly of minor deficiencies such as date of birth or other information and approximately 0.59 percent of audited business relationships showed that the beneficial ownership information was unknown.

Based on the external audits, the DDU is able to confirm implementation that the opening of new accounts and historical accounts have been brought into compliance with customer identification requirements. The exception are 420 historical accounts that are now blocked as of October 20, 2002 until such time as required customer identification details can be obtained. Efforts to qualify these blocked accounts continue.

Financial intermediaries, including money remitters, are not yet required to specifically include originator information on funds transfers or related messages. The authorities are awaiting the finalization on the FATF Interpretive Note for Special Recommendation VII before imposing specific requirements. Only the banks and the post office conduct wire and funds transfers, and the banks generally must adhere to the originator information requirements imposed by SWIFT. Until the FATF interpretive note is finalized, implementation of this cannot proceed.

### **Customer due diligence implementation**

With respect to implementation in the banking, insurance, securities, and trustee sectors, the DDU has begun inspections to ensure that financial intermediaries monitor business relationships as appropriate in view of the risk. These risk factors essentially require a graduated customer-acceptance policy for high-risk customers. Risk factors to be considered are (i) domicile of the contractual partner; (ii) the beneficiary or authorized representatives; (iii) the frequency and volume of transactions and the frequency and volume of cash transactions. Financial institutions must also take into account information, which is in the public domain concerning the contractual partner, the beneficiaries and other persons involved in the business relationship. Although guidance prepared by the DDU does not make specific reference to the handling of banking relationships with *politically exposed persons* (PEPs), the risk factors considered in the banks' systems include information on PEPs.

The DDU both conducts its own inspections to ensure compliance in a limited number of inspections per year, and primarily relies on external auditors to follow a series of detailed instructions on audits for customer due diligence. The audits may serve as a basis for remedial actions. Presently, all banks have undergone audits for compliance with the enhanced DDA requirements adopted in 2000 and 2001. In addition, insurance entities and mutual fund entities have also undergone inspections. With respect to the trustees, inspections are carried out once every three years, and the DDU expects that all trustees will be audited by year-end 2003 under the enhanced requirements.

The implementation tools are designed to ensure that customer identification information is required to be obtained for all individuals and legal entities—including numbered accounts, trusts, and corporate vehicles—in advance of establishing an account relationship. Existing numbered account relationships are subject to review at the time of audit to ensure that information required on customer identity, and beneficial ownership has been obtained.

Financial institutions are required under the DDA to identify all contracting parties by means of supporting evidence and to establish beneficial ownership recording pertinent details if:

- there are doubts whether the contracting party is the beneficial owner; or
- the transaction is in cash, and the amount is in excess of CHF 25,000; or
- the transaction was initiated by way of written correspondence from a natural person; or
- the transaction was initiated on behalf of a client by a legal person or trusteeship that does not operate a trading company, a production site, or any other trade operated in commercial terms in the state of

domicile.

Third party introductions, historically, have been a factor in new business development for banks. The DDU enforces the requirement that all new account openings involving third-party referral be supported by: (i) The same level of detailed documentation regarding customer identity required for all new accounts, including those directly opened by the banks; (ii) that official copies of relevant documentation be maintained within the bank; and (iii) that customer files contain confirmation of legal status and contact details for the introducer.

The KYC obligations are applicable throughout the life of the customer relationship. Banks are also obligated to review all existing relationships, including those referred by third parties to ensure that they are in compliance with the new regulations, and that evidence of this review is placed in a file accessible to authorized authorities. Moreover, Guideline 2002/1 requires financial institutions to terminate business relationships when significant doubts arise.

Correspondent banking is not specified as a unique relationship in the DDA; however, it is covered by requirements contained in the DDA and DDEO, including due diligence requirements for identification, and for beneficial ownership. One aspect is not addressed, insofar as there are no special provisions prohibiting the establishment of correspondent relationships with shell banks. The DDA, DDEO, or other guidance does not require specific treatment of correspondent relationships with banks incorporated in jurisdictions in which the banks do not have a physical presence (i.e., meaningful mind and management), and which is unaffiliated with a regulated financial group (i.e., shell banks) (see Basel Customer Due Diligence requirements Paras 50 and 52).

Trustees and trust companies, which act as professional intermediaries, are subject to the same DDA & DDEO requirements with respect to beneficial ownership as is required for all financial intermediaries. When collective accounts or collective deposits are employed the trustee is required under Article 5 of the DDA to provide the bank with a complete list of addresses of the beneficial owners and also report any changes.<sup>12</sup>

Investment undertakings do not distribute funds directly to clients, and therefore do not have customers or customer accounts.

#### Analysis of Effectiveness

The DDA does not permit opening of anonymous accounts because of the affirmative obligations to establish identity and beneficial ownership of all contracting parties, including the directors or controlling persons of legal entities. There is the authority to open numbered accounts; however, customer identification and beneficial ownership information about these accounts must be maintained as with all other accounts. The only operative difference is that within the bank, a fewer number of employees have access to the customer information. This limitation on the availability of customer identification information does not apply to compliance officers, due diligence officer, or external auditors. All parties responsible for ongoing monitoring within the financial intermediary must have access to the customer information. The provisions for customer identification in Article 4 DDA and beneficial ownership in Article 5 DDA apply to numbered accounts.

Article 4 DDA requires that all financial intermediaries establish the identity of the contracting party through official documentation and Article 5 DDA requires establishment of the ultimate beneficial owner. Before 2001, banks could delegate the duty to establish customer identification and beneficial ownership information to

<sup>12</sup> As far as investment undertakings are concerned, these requirements have to be fulfilled by the custodian banks. Branches of foreign investment firms in Liechtenstein are subject to DDA requirements according to Article 2 Para 1 lit. g.

<p>trustees and were not required to know or have documentation concerning the beneficial owner information in the bank files. Since 2001, the DDA was amended to require that the banks obtain, verify, and maintain the customer identification information directly, pursuant to Article 5, Para. 1(d) DDA.</p> <p>Based on the external audits, the DDU is able to confirm implementation that the opening of new accounts and of historical accounts has been brought into compliance with the exception of 423 accounts (as of October 23, 2002) that are now blocked until such time as required customer identification details can be obtained. Efforts to qualify these blocked accounts continue.</p>
<p><b>Recommendations and Comments</b></p>
<p>The DDA requires identification of the contracting party at the beginning of a business relationship and requires all clients be identified by a valid official document. The exceptions to this requirement are one-off cash transactions not in excess of CHF 25000 and insurance premiums not exceeding CHF 1500 p.a., or a single premium not exceeding CHF 4000, or if less than CHF 4000 is paid into a premium deposit.</p> <p>All beneficial owners must be established by all financial intermediaries and beneficial owner means the ultimate beneficial owners. The only exception for the application of due diligence measures is for publicly listed companies and for banks which are subject to EU Directive 91/308/EEC or any equivalent regulation.</p> <p>The amendments to the DDA in 2001 mandated that existing accounts for which beneficial ownership was not obtained by banks because of delegation of KYC authority to trustees under the previous law were to be obtained and updated by December 31, 2001. These amendments also authorized blocking of accounts for which the beneficial ownership information was not obtained by December 31, 2001. As of January 2002, beneficial ownership information was not available or incomplete for 1,139 accounts, and these accounts have been blocked, representing 2.5 percent of all relationships with banks where formerly the beneficial ownership information was with the trustees. As of October 23, 2002, there were 420 blocked accounts remaining, representing 99.87 percent of relationships in banks that beneficial ownership information is still not available.</p> <p>The mission recommends that the FSA/DDU issue guidance that restricts the level of correspondent activities of local financial institutions with Shell banks.</p>
<p><b>Implications for compliance with FATF Recommendations 10, 11, SR VII</b></p>
<p>The legal requirements for customer identification are sufficient for compliance with FATF Recommendations 10 and 11; although, full implementation in all sectors has not yet been verified. After the first round of external audits for trustees is completed at year-end 2003, the DDU will have a fuller picture on the implementation efforts and whether enhancements are required.</p>
<p><b><i>III—Ongoing monitoring of accounts and transactions</i></b> <b>(compliance with Criteria 49-51 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 84-87 for the banking sector, and criterion 104 for the insurance sector)</b></p>
<p><b>Description</b></p>
<p>Ongoing monitoring of accounts and transactions is addressed in detail by the DDA, DDEO, and in the tools for auditing implementation, instructions (February 2002). Specifically, to ensure implementation, the instructions (February 2002) require that auditors carry out substantive checks to ensure that the financial intermediaries exercise due diligence in monitoring business relationships in conformity with Guideline 2002/1 and whether a report has been sent to the FIU, in accordance with article 9, Para 2 of the DDA if the grounds for suspicion could not be removed.</p> <p>Guideline 2002/1 Para. 3 requires monitoring based on possible risk factors, including the domicile of the contractual partner, the beneficiary or representatives, among other factors. Financial intermediaries must also take into account information, which is in the public domain concerning the contractual partner, the beneficiaries, and other persons involved in the business relationship.</p>

Article 9 DDA imposes a duty to clarify the economic background and purpose of a transaction as well as the origin of the assets whenever a suspicion arises that there could be a connection with ML, a predicate offense, or organized crime. If the suspicions cannot be eliminated by the clarification process, a SAR must be filed. The scope of the clarifications needed is set forth in Article 22 of the DDEO whenever the nature and circumstances of a transaction do not correspond to the known economic background, or the usual business activity of the client or beneficial owner, or the business relations or transaction requested do not seem plausible, retraceable, or useful given the profile of the relationship. Details giving rise to or eliminating suspicion are to be collected and documented. Guideline 2002/1 Para 4.1 provides further details on the scope of clarifications, requiring financial intermediaries to obtain information which enables adequate assessment of the background of the transaction, including the purpose and nature of the transaction, the financial circumstances of the client or beneficiary, the professional or business activity, and the origin of the assets. To comply with these requirements, Guideline 2002/1 expressly permits financial intermediaries to seek supporting information from third parties.

Instructions (February 2002) for the conduct of audits in accordance with the DDEO require that auditors carry out substantive checks to ensure that the financial intermediaries exercise due diligence in monitoring business relationships in conformity with Guideline 2002/1 and whether a report has been sent to the FIU in accordance with Article 9, Para 2, of the DDA if the grounds for suspicion could not be removed.

In addition to the overall scrutiny requirements, the Annex to Guideline 2002/1 contains specific indicators of ML that require financial intermediaries to pay special attention. Among the factors are large and/or frequent transfers to or from drug-producing countries of from or to countries named on the FATF NCCT list.

The DDU, in cooperation with the FIU, provides circulars that advise on ongoing advisories, on new typologies and trends, as well as on the weaknesses or concerns about other jurisdiction's AML/CFT measures. These circulars are based on US lists, EU lists, as well as on other information known to the DDU. Financial intermediaries are expected to apply ongoing monitoring for these names. In particular, the FIU was given responsibility for the coordination of the fight against terrorism by a governmental decision of October 31, 2001, which has increased the number of advisories on typologies over the last year.

Guideline 2002/1 Annex, items A17 and A18 require financial intermediaries to give enhanced scrutiny to wire transfers that do not contain complete originator information. A17 applies to transfers to another bank without the recipient being identified, and A18 applies to acceptance of money transfers from other banks without the name or account number of the beneficiary being stated.

Compliance officers and external auditors should ensure that wire transfers are consistently scrutinized for originator information.

To ensure monitoring, financial intermediaries are required to establish and maintain a customer profile, which serves to distinguish usual from unusual transactions. Article 6, Para 2 DDEO sets forth the minimum information requirements for the customer profile, including the name of the contracting party and beneficial owner, authorized persons, economic background and origin of the assets, profession and business activity of the beneficial owner, and purpose of use of the assets. All anomalies relating to the profile and actual activities are subject to identification and enhanced monitoring by the bank. The Annex to the Guideline 2002/1, *Monitoring of business relationships*, identifies 32 indicators to be monitored by banks, which may be indication of higher risk.

Further, Guideline 2002/1 details the monitoring to be undertaken, strongly encouraging the development and use of IT systems to facilitate the monitoring. Guideline 2002/1 Para 3 states "[t]he intensity of the monitoring of the business relationship is governed by the nature of the business activity actually carried out" and further provides "[i]t is recommended that the business relationship be monitored as appropriate in view of the risk which the business relationship represents." Guideline 2002/1 Para. 6 requires auditors conducting DDA audits to ensure that the guideline has been adhered to. In the banking sector, monitoring of accounts and transactions is based in large measure on use of sophisticated computer software tailored to the requirements of the DDA and DDEO monitoring requirements. These requirements are elaborated in the Annex to the Guideline 2002/1, which identifies several indicators to be monitored by banks, includes A20 that provides that large and/or frequent

transfers to or from drug-producing countries or from or to countries named on the FATF list of uncooperative jurisdictions. Representatives of individual banks stated that a risk factor was whether a contracting party or beneficiary had association with a FATF-listed country. The systems in banks allow for them to be able to aggregate and monitor significant balances and activity in customer accounts on global basis. External auditors are required by the banking act to check on a consolidated basis significant exposure and other concentration risks in banks and their subsidiaries, both domestic and abroad. Discussions with auditors confirm that this is part of the scope of their audits.

The monitoring requirements are not easily adapted to the insurance sector. There are no specific provisions that would require insurance companies to monitor purchase and sale of second hand endowment policies or single premium unit-linked policies. Most internal controls are determined by parent companies administered outside of Liechtenstein. Guidelines for AML/CFT should include specific requirements for insurance entities to be alert to the implications of financial flows and transaction patterns of existing policy holders and should be extra vigilant to the particular risks form the practice of buying and selling second hand endowment policies and single premium life.<sup>13</sup> Reinsurance or retrocession should be reviewed regularly to ensure that monies are paid to bona fide reinsurance entities at rates commensurate with the risks underwritten.

Implementation in the trustee sector is not at as high a level as in banking, and the use of software systems appears more limited. The customer profile does not appear to play as important a role in this sector; although, it is similarly required by the DDA. In this regard, more use should be made of the customer profiles as a tool to ensure that the customer transactions are consistent with the known background of the customer. Nor does the trustee sector appear to be consistently exercising the level of qualitative judgment needed in analyzing customer transaction information, as demonstrated in recent cases concerning the misuse of Liechtenstein entities in the Iraqi oil-for-food program. The authorities are actively engaged in pushing for cultural changes in the trustee sector and are using the tools to audit the level of ongoing monitoring to identify weaknesses and to require remedial actions.

#### Analysis of Effectiveness

The DDA, DDEO, and the instructions and guidelines issued by the DDU require substantive and in depth ongoing monitoring obligations for financial institutions. These documents require development of expertise and judgment required to ensure that the implementation is being carried out, and is premised largely on the KYC profile built by each financial institution. By requiring a detailed customer profile and imposing a requirement in Article 6, Para. 1 DDEO to ensure that their business activities with their contracting parties are monitored, the legal framework provides a sufficient mechanism for monitoring. The implementation of the mechanism is also dependent on the technological resources and skills of personnel with responsibility for monitoring.

Implementation of ongoing monitoring is progressing in the banks, which have implemented IT systems to enhance their monitoring bases. Implementation in trust companies, particularly large trust companies and trustee's offices with large volumes, should also incorporate IT systems to enhance compliance. Implementation of systems in insurance entities and securities/mutual fund entities is not fully known, but appears to be less developed than in the banks.

The authorities have expressed some concern about whether the ongoing monitoring systems, used to flag problems, are fully supported by the exercise of judgment by trained internal control personnel. The authorities are attempting to promote a culture of looking behind the documentation whereby the financial institutions

<sup>13</sup> The AVB (General Insurance Conditions) of insurance companies contain the clause that a change of ownership of policies is only effective if duly reported. A change of ownership requires the same DDA procedures as the original purchase of a policy.

<p>exercise judgment to determine whether the activities are consistent with the type of activity expected of a particular client. Specifically, the FIU has advised that when reviewing SARs filed in response to international requests, some of the files of the financial institutions, while technically complete in terms of the documentation needed, did not raise questions with the financial institution or, in some cases, the external auditor that would have alerted them earlier to a need to file a SAR. Additional training of financial institutions and external auditors in this regard is advisable, particularly for trustees and insurance entities.</p>
<p><b>Recommendations and Comments</b></p>
<p>Compliance officers and external auditors should ensure wire transfers are consistently scrutinized for originator information.</p>
<p><b>Implications for compliance with FATF Recommendations 14, 21, 28, SR VIII</b></p>
<p>Legal requirements for ongoing monitoring are sufficiently clear to require financial institutions to undertake a systematic process to detect unusual transactions, complex or large transactions activities inconsistent with the known business of the client, and activities that do not appear to have a legitimate economic purpose. Implementation efforts in the banking sector show clear evidence of the exercise of scrutiny described in Recommendations 14 and 21. The level of scrutiny exercised by the trustee sector and insurance appears to be less meaningful, although authorities advise that the efforts are improving rapidly, and meaningful understanding of the risks is increasing. Guidelines provided are pragmatically drawn and consistent with Recommendation 28.</p>
<p><b><i>IV—Record keeping</i></b>  <b>(compliance with Criteria 52-54 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criterion 88 for the banking sector, criteria 106 and 107 for the insurance sector, and criterion 112 for the securities sector)</b></p>
<p><b>Description</b></p>
<p>Article 10 DDA requires financial intermediaries to retain documents and references to customer relations, including customer identification records, beneficial ownership information, reverification of customer information, information about false information submitted by customers, and information about suspicious activities for a period of ten years after the relationship with the customer has ended or following the execution of a transaction. Other record-keeping provisions necessary for the safekeeping of business records also continue to apply. Customer and account activity details must be regularly updated and retained for a period of ten years after the relationship has ceased.</p> <p>In addition, Article 32 of the DDEO requires that auditor work papers be retained.</p> <p>Implementation of the requirements is reviewed as part of the Substantive Checks phase of the external audit examination. It may be advisable for the DDU to review the Substantive Checks of record keeping to identify systemic weaknesses in compliance or weaknesses that arise within a particular type of financial institution for which greater attention is required. As experience accumulates with external audits, further refinements may optimize the desire for reconstruction of transactions.</p> <p>The DDA does not contain a specific provision for maintenance of all customer transaction records but rather requires that documents relating to suspicions and clarifications of transactions be subject to the same record keeping requirement as the customer profile and beneficial ownership information, pursuant to Article 10 DDA. The general record keeping requirements for books of accounts, business papers, and receipts is found in Article 5 of the Ordinance on the Persons and Companies Act, which requires anyone who is obliged to keep books of accounts to record these, business papers and receipts and keep all of them safe for a period of ten years. Article 8 of the Ordinance on Persons and Companies Act requires business papers to be recorded systematically and without gaps and to correspond to the accounting system used for books and records.</p> <p>Article 14, Para. 2 authorizes the DDU to demand any information and documents necessary to carry out its supervisory functions from reporting persons and auditors. Article 5 DDEO requires documents and files originally used or re-used to verify customer identity, the profile of the business relationship, any report on special clarifications or suspicious factors be retained within the country in a way to allow the statutory duties of due diligence to be complied with at any one time, and to ensure that requests from the competent national authorities (including the DDU and FIU) or auditors can be fully complied with within a reasonable period of</p>

<p>time.</p> <p>Banks as a financial intermediary are required to maintain files containing customer-identification details and customer profile details maintained in Liechtenstein for every client. Customer and account-activity details must be regularly updated and retained for a period of ten years after the relationship has ceased. In instances where a third-party intermediary was used, information regarding the legal status and contact details of that intermediary must also be maintained by the financial institution. Client files, and all information contained in them regarding customer identification, beneficial ownership, and client profile are available for inspection by the DDU and/or external auditors.</p> <p>Based on the external audits, the DDU validates that financial intermediaries have implemented policies and procedures to ensure compliance with customer identification. Verification is required according to instructions issued to auditors by the DDU for the conduct of external audits.</p>
<p><b>Analysis of Effectiveness</b></p> <p>There are clear provisions in the DDA and DDEO that mandate record keeping requirements for ten years for client identification, beneficial ownership, suspicious activity clarification, and reporting information; the applicable provisions require that the records be made available to competent authorities and auditors to ensure compliance with due diligence requirements and to the FIU for use in determining ML activities. The authorities advise that the requirements in the DDA and DDEO have allowed for sufficient records that can be used to reconstruct transactions and to provide a sufficient trail to trace assets and facilitate investigations. Of particular importance to the authorities is the requirement that all client identification records be kept in Liechtenstein. The general record-keeping requirement for business transactions, accounts, and books is found in the Ordinance for Persons and Companies Act and also requires retention for ten years. The business transaction records are to be similarly available for inspection by competent authorities without difficulty over the safekeeping period of ten years. Articles 5 through 10 of the Ordinance for Persons and Companies Act requires that transaction records of the business relationships be recorded systematically and without gaps.</p> <p>In addition to the requirements in Article 5 DDEO, Article 23 DDEO authorizes the FIU to obtain all information necessary to evaluate SARs and demand further details, which must be provided immediately.</p> <p>The DDU has unrestricted direct and indirect access through auditors to customer and transaction records and information for AML/CFT investigations and prosecutions. Implementation of the requirements are reviewed as part of the Substantive Checks phase of external audits examination. There is perhaps a need for additional clarity of the differences in the access to records available to the DDU and the FIU and a need to determine whether these parallel provisions are unnecessarily duplicative. Again, formalizing the coordination between the DDU and FIU may provide additional transparency in this regard.</p>
<p><b>Recommendations and Comments</b></p> <p>Additional elaboration of the requirement in the Ordinance for Persons and Companies Act that the records be available without difficulty would allow for more intelligence and information gathering for the DDU, FIU, and law enforcement.</p>
<p><b>Implications for compliance with FATF Recommendation 12</b></p> <p>Record keeping and record recovery is adequate, particularly in light of the 2001 amendments requiring all financial institutions to obtain and update KYC information, to maintain these records directly, and to keep these records within Liechtenstein.</p>
<p><i>V—Suspicious transactions reporting</i> <b>(compliance with Criteria 55-57 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 101-104 for the insurance sector)</b></p>
<p><b>Description</b></p> <p>Liechtenstein law imposes mandatory suspicious activity reporting for specific indicia and allows for voluntary reporting as well. Specifically, Article 9, Para. 2 DDA requires that after entering into a business relation and following the clarification of all details of unusual or suspicious activities and suspicious factors could not be</p>

eliminated, and suspicion remains that there is a connection with ML, a predicate offense, or organized crime, the financial intermediary must immediately report the transaction to the FIU. The reporting party may also directly notify the public prosecutor's office at the same time. However, the parallel reporting to the public prosecutor should not be the norm, only when criminal activity is obvious. The integrity of reporting systems for financial intelligence and the protection from liability for disclosure of bank secrecy information afforded by filing a SAR may not cover direct communications to the public prosecutor. The value of the FIU as the central unit for collection of financial intelligence is an important component to AML/CFT efforts. Accordingly, FIU is better placed than the reporting persons to determine whether financial intelligence is to be handed over to law enforcement to develop into usable evidence. There is also a significant added value to the analysis conducted by the FIU that streamlines and focuses the law enforcement bodies' efforts. Such analysis should not be side stepped by allowing for regular parallel filings. Given the efficiency in collaboration between the FIU and the public prosecutor, clarification of the primacy of the FIU is warranted. The exceptions for direct notification to the public prosecutor should be narrowly drawn through regulations or guidelines.

Article 9a DDA permits anyone who has suspicions with regard to contacts concerning the entering into business relations, irrespective of the actual conclusion of the transaction that the transactions could relate to ML, a predicate offense or organized crime to report to the FIU, before a relationship has been established. Therefore, the SAR reporting allows for reporting even in the absence of establishing a customer relationship.

Article 23, Para. 3 DDEO authorizes the FIU to issue a standardized notification form. Article 4, Para. B DDEO requires financial intermediaries to have internal guidelines for what steps personnel have to take in the case of suspicious transactions reporting to the person responsible for due diligence and reporting to the FIU. Through Guideline 2002/1 Annex, the DDU and FIU have established indications of money laundering for which financial intermediaries should pay special attention. The meaning of the indication is "to raise awareness among financial intermediaries" and serve as an aid to detecting suspicious transactions, but the list is not meant to be exhaustive or "to become the basis of routine actions to the exclusion of basic common sense." (Guideline 2002/1, p. 7).

The DDU issues guidance regularly to assist financial institutions in detecting patterns of suspicious financial activity. Guidance includes guidelines that have the force of law, newsletters that provide information on current developments, and clarification on matters of interpretation.

Instructions (February 2002) for the conduct of audits in accordance with the DDEO require that auditors carry out substantive checks to ensure that the financial intermediaries exercise due diligence in monitoring business relationships in conformity with Guideline 2002/1, and whether a report has been sent to the FIU in accordance with article 9, Para 2 of the DDA if the grounds for suspicion could not be removed.

Guideline 2001/2: inspection in accordance with the DDA includes among inspections measures that financial intermediaries have appointed a due diligence officer that is responsible for internal organization, internal guidelines, staff training, and providing advice related to due diligence requirements. When evaluating the internal guidelines, the external auditor must check to see that there are requirements for employees in the event of suspicious transactions are encountered.

Persons filing of SARs under either mandatory or voluntary filing provisions in the DDA are protected from liability arising from the disclosure. Specifically, Article 9, Para. 3 DDA and Article 9a, Para. 3 provide that anyone who reports to the FIU or to the public prosecutor's office in accordance with the mandatory reporting requirement in Article 9 and the discretionary reporting authority in Article 9a, and it is found that such reporting was unjustified, is exempt from any liability, provided that he/she has acted neither intentionally or with gross negligence. Moreover, the action of reporting is not illegal within the meaning of the criminal law, specifically with respect to disclosure of banking or official secrets, provided the person had no intention of communicating false information.

Liechtenstein has a somewhat unusual provision concerning tipping off. Article 9, Para. 5 provides that until the reporting party receives a notice from the FIU, or until the ten working days have elapsed, for which the FIU has the opportunity to order necessary measures to be taken, and the assets will be blocked, the reporting party may

not inform the customer or any third party that a SAR has been filed with the FIU, or that an investigation is underway. After the period of time prescribed for blocking has expired, the prohibition on tipping off no longer applies unless specifically requested by the FIU.

Instructions (February 2002) for the conduct of audits in accordance with the DDEO require that auditors carry out substantive checks to ensure that the financial intermediaries exercise due diligence in monitoring business relationships in conformity with Guideline 2002/1 and whether a report has been sent to the FIU, in accordance with article 9, Para 2 of the DDA if the grounds for suspicion could not be removed.

Awareness and implementation of suspicious activities by banks is fairly high; however, with fiduciaries and the insurance sector, the awareness and understanding of the need for ongoing monitoring of activities is progressing more slowly.

No industry specific guidance exists for the insurance sector to identify activities vulnerable to money laundering.

#### Analysis of Effectiveness

Generally, the framework for suspicious activities is sufficient because it requires all financial intermediaries to report activities and transactions for which a clarification within the financial intermediary does not dispel doubts raised. However, the two step-process for recognizing suspicious activity through ongoing monitoring and then mandating the financial intermediary clarify the transaction to dispel or confirm doubts may slow down the reporting process; although, evidence to date does not suggest that SAR filings have been delayed. The benefit of the two-step process is that it generally improves the quality of reporting and discourages “defensive” reporting that could clog the system. Nevertheless, the FIU may wish to analyze in its annual report review, whether the two-step process delays necessarily SAR filings. In this regard, the immunity from liability for filing a SAR is an important feature in protecting the integrity of the suspicious activity reporting process and encouraging proper analysis and filing by financial institutions. Further examination is warranted, and guidance may be considered to clarify when SARs can or should be filed directly with the public prosecutor, in addition to the FIU. In addition, the FIU and others read Article 9 as reducing the reporting requirement from a previous threshold of strong suspicion to a mere suspicion, and the evidence of SAR filings to date bear this out. Nevertheless, some analysis should be undertaken to ensure that the two-step process for analysis by financial institutions is not raising the threshold inadvertently. In practice, this does not appear to pose a problem, nor does the FIU see the “serious crimes” approach for predicate offenses to ML as an inhibition to widespread reporting.

Of some concern is the construct of the tipping off provision, and whether, in effect, tipping off is more frequently a live issue because of the operation of the automatic ten-day blocking when filing a SAR. Additionally, the effect of the automatic blocking on inhibiting filing of SARs may warrant study. There is no specific administrative fine for violations of the tipping off prohibition, which should be considered.

On other issue for legal clarity is the immunity for filing which exempts from immunity, intentional false filing, and gross negligence. The aspect of gross negligence may theoretically introduce some uncertainty in the scope of application of immunity and inhibit filing; although, in practice, it has not been an issue. Future revisions to the DDA should consider amending the exception from immunity to intentional conduct and bad faith, the prevailing international trend.

Authorities advise that awareness of ML and FT and ongoing monitoring of accounts and transactions is increasing, and as a result, the filing of SARs and the quality of reports filed is improving.

<p>Recommendations and Comments</p>
<p>Prohibitions against tipping off of customers and third parties should be extended to beyond the mandatory ten-day blocking period for suspicious transactions. Two changes need to be made to accomplish this goal. Specifically, Article 9, Para. 3 should be amended to eliminate mandatory blocking upon the filing of a SAR and, rather allow the FIU to impose a blocking an initial period of 48 hours, to determine whether a further blocking is necessary. If blocking is not ordered or the FIU advises that it is no longer needed, the financial intermediary may execute the transaction. Consequently, the prohibition against tipping off should be extended to completely ban any information to the account holder, subject of an SAR, or third party (except law enforcement and supervisors as required by law), without placing financial intermediaries in an untenable situation as currently is the case, when asked questions about why accounts and transactions have been blocked. It would also be advisable to have a specific administrative fine for violations of the prohibition against tipping off in addition to the criminal sanctions. The discretionary blocking should be extendable by ex parte application for a court order after the prescribed time frame has expired.</p> <p>The implementation off the blocking and tipping of requirements has raised questions of whether the ten-day blocking is necessary and whether the scope of the tipping off provision is sufficient. There is no specific administrative fine for violations of the tipping off prohibition, which should be implemented to further minimize the risk of tipping off.</p> <p>Guidelines for monitoring of accounts should be amended to require special attention to single premium life and buying and selling second hand endowments.</p>
<p>Implications for compliance with FATF Recommendations 15, 16, 17, 28</p>
<p>Generally, the suspicious transaction reporting system appears to be effective, and largely compliant with the FATF Recommendations. Aspects of tipping off and blocking require attention to achieve full compliance.</p>
<p><i>VI—Internal controls, Compliance and Audit</i>  <b>(compliance with Criteria 58-61 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 89-92 for the banking sector, criteria 109 and 110 for the insurance sector, and criterion 113 for the securities sector)</b></p>
<p>Description</p>
<p>Article 12 DDA designates the DDU with the responsibility to take controls, i.e., make inspections to ensure that financial intermediaries put into place formal controls, meaning internal-controls policies that address the due diligence requirements. Article 12, Para. 3 requires that audits of banks and finance companies, investment undertakings, and insurance companies be made for adherence to the DDA requirements by auditors qualified to conduct audits for each such entity under their respective laws on supervision. The audits for other financial intermediaries are to be conducted directly by the DDU or by auditors qualified by the government. Article 13 DDA requires the auditors appointed to conduct DDA audits to report their results to the DDU. The DDU and FSA have compiled a pre-selected list of auditors licensed by the FSA, which are qualified to conduct due diligence audits for banks and trustees.</p> <p>Article 4 DDEO requires financial intermediaries to establish and maintain internal guidelines for compliance with the due diligence requirements, in particular to set forth the definite measures to be taken to comply with the DDA and DDEO. These internal guidelines should address the content and record keeping of due diligence files and of records associated with the monitoring of accounts and reporting of suspicious transactions. Article 7 of the DDEO provides that a person may hold several functions.</p> <p>Article 11 DDEO requires financial intermediaries to ensure adequate up-to-date education and training of personnel for AML/CFT. Training focuses on conveying knowledge with regard to the legal requirements to prevent and combat ML, predicate offenses, and organized crime, including the specific customer identification requirements, monitoring of accounts and transactions, and suspicious activity reporting. In addition, training is to cover the applicable provision of criminal legislation.</p>

The DDU relies on external auditors to conduct onsite audits to assure compliance with the DDA and the DDEO. Banks, insurance firms, and investment companies are audited annually and trustees and lawyers at least once every three years. Auditor are required to ensure that all staff, in particular those with client contact, are sufficiently trained in the exercise of due diligence obligations.

At this stage of implementation, it is not practicable for the DDU to have come to any conclusions about the effectiveness of the work performed by the external auditors. Nevertheless, as the DDU efforts evolve from establishing the system to monitoring and ensuring its effectiveness, particular attention is required verifying the level of completeness of the external auditors' product and the quality of the analysis. A first step in this process could include face-to-face discussions with the auditors within a certain period after a report is completed, such as 90 days, to test the validity of findings. On an aggregate basis, the DDU should consider methods to evaluate the length and depth of audits performed in each type of financial institution.

Article 8 DDEO requires each financial intermediary to appoint a responsible contact with the DDU. Article 9 DDEO requires designation of a responsible person for due diligence who will be responsible for internal organization in accordance with the DDA, elaboration of internal guidelines to combat ML, education and training of employees, and advising on issues arising with regard to compliance with due diligence duties. Art 10 DDEO requires each financial intermediary to appoint a person responsible for internal control to ensure that the DDA and DDEO and internal procedures are complied with and perform internal examinations on the level of compliance. The internal control officer has specific responsibility for ensuring that due diligence documents are maintained and that duties to report have been complied with. The DDU advises that if serious concerns arose with respect to either the due diligence officer or the compliance officer, the DDU would have the authority to require removal or replacement of such a person, although the basis of this authority is not clear.

*Directive 2001/2: inspection in accordance with the DDA* require that the external auditor check for and comment on whether financial intermediary has appointed (i) a contact person to interact with the competent authority, and that there is regular contact; (ii) a due diligence officer responsible for internal organization, internal guidelines, analysis, and staff training; and (iii) an internal control officer responsible for internal audits to test compliance with DDA, DDEO, and other guidance.

The *Directive 2001/2: inspection in accordance with the DDA* includes, among inspections measures that financial intermediaries have appointed, a due diligence officer that is responsible for internal organization, internal guidelines, staff training, and for providing advice related to due diligence requirements. When evaluating the internal guidelines, the external auditor must check to see that there are requirements for employees in the event that suspicious transactions are encountered.

Article 12 (b) Para. 2 DDA requires auditors to examine for whether impeccable conduct of business is conducted, which includes review of the supervisory requirements for impeccable management found the applicable supervisory laws. For banking, the fit-and-proper test is in Article 19 of the banking act for senior managers and major shareholders (see discussion in BCP assessment). For investment companies and undertakings, the initial licensing requirement includes providing an extract of the register from criminal records in accordance with Articles 42 and 43 on the Executive Ordinance on the Law on Investment Undertakings (see IOSCO assessment). With respect to trustees, Article 1, Para. 2, clause b and Articles 3 and 4 of the Act on Trustees, initial licensing also requires providing an extract of the register for criminal records prior to issuance of a license. All financial intermediaries are subject to ongoing obligations to ensure impeccable management and have to be fulfilled permanently. These provisions apply only to management and are not applicable to employees in general. Consideration should be given to financial institutions establishing minimum requirements for employee screening.

*Directive 2001/2: inspection in accordance with the DDA* require that the external auditor check for and comment on whether the members of the supervisory board and the executive management, as well as the persons responsible for due diligence functions, have an impeccable reputation and, due to their professional and personal qualifications, ensure that due diligence duties are complied with.

Banks with foreign subsidiaries undergo audits for KYC standards as part of the regular external audit checks. According to the banking act, auditors must satisfy themselves as to the appropriateness of group organization and the enforcement of the management principles determined for the group (see BCP 23).

For insurance, there are no specific internal controls requirements other than those in the DDA. Most internal controls are determined by parent companies administered outside of Liechtenstein. No specific guidelines exist for insurance and reinsurance companies to foster close working relationships between underwriters and claims investigators. Instances of market abuse or fraud have not been a factor. In addition to the audit requirements in the DDA, Article 57 of the Ordinance on the Supervision of Insurance Companies, the ISA has the right to carry out inspections; but, there are no specific audit guidelines. They rely on both external auditors and their own internal staff for conducting audits. The ISA has created its own on-site inspection in 2002.

The Law and Ordinance on Investment Undertakings sets out requirements for record keeping, audit trail, and operation of collective investment schemes in line with those set out in the UCITs Directive. The FSA has the right to carry out scheduled and unscheduled audits but does not in practice do so. All investment undertakings are required to have an annual audit by an approved FSA auditor as well as an interim “unscheduled” audit carried out by the same auditor. Custodians are all Liechtenstein banks subject to annual audits. Custodians have an obligation to supervise compliance with NAV calculation rules and investment policies of the investment undertaking under Article 9 of the Law on Investment Undertakings, and the FSA would expect this general obligation to result in reports of non-compliance to the FSA.

#### Analysis of Effectiveness

The DDA requires financial intermediaries to adopt and maintain detailed and substantial internal controls policies, practices, and internal audit compliance. In addition, the requirement for external audit conducted for compliance with the DDA appears to be on solid foundation. All financial intermediaries are required to appoint due diligence and compliance officers to ensure compliance with due diligence requirements, and internal processes are designed to detect gaps in the system for customer identification, beneficial ownership information and suspicious activity reporting. Training is required for all employees; in banks this training is updated yearly.

The level of implementation in banks is generally adequate. With respect to trustees and insurance, the implementation is still progressing and may need to be refined. Additional training and outreach for these sectors are needed. In particular, trustees do not appear to have formalized procedures to ensure that their operations outside of Liechtenstein are complying with the due diligence requirements in the DDA.<sup>14</sup> There should be efforts to focus on developing understanding in these sectors on the indications of suspicious or unusual transactions, rather than focusing on formalistic or check lists for minimum documentation. The internal controls policies may need refinement in this regard.

At this stage of implementation, it is not clear how external auditors are judging compliance by financial institutions’ overseas operations. Additional guidance in this regard from the DDU is warranted. The FATF has recommended that the DDA audits be conducted separately from, and by separate audit companies or individual auditors from their general FSA audits, for adherence to supervision requirements. While this separation has some basis, the requirement in the banking act (see Basel Core Principles assessment) that the normal bank auditor be legally independent should be sufficient to ensure the necessary level of independence and will allow the auditor to evaluate compliance with the DDA within the framework of the bank’s general condition and internal controls. Some financial institutions are currently subject to three separate audits; financial, supervisory, and due diligence.

<sup>14</sup> The DDA is generally applicable for every operation of a trustee outside of Liechtenstein. As far as a Liechtenstein trustee is acting as an organ of a legal person that does not operate a trading company, a production plant or any other trade operated in commercial terms in the country of domicile, the DDA explicitly applies subject to Article 1 Para 1 DDEO. Compliance with the DDA is part of the periodic due diligence audits and therefore it is ensured that his operations outside of Liechtenstein are complying with the DDA.

Consistency in these audits will allow for quicker recognition of system weaknesses that affect both prudential and due diligence compliance. Such coordination will be beneficial to identifying systemic or pervasive problems in management, policies and procedures, or systems of internal controls that affect both due diligence compliance and supervisory matters. To ensure that combining audit functions does not compromise independence, the DDU will need to establish specific procedures for scrutiny of the independence of the external auditor and more in-depth verification that the external auditors are fulfilling their duties required.

Guideline 2002/1 Para. 2 advises financial intermediaries to ensure that their foreign branches and foreign associated companies not be misused to circumvent this due diligence guidelines. They are to ensure that the FATF recommendations are adhered to in associated companies and branches in countries, which are not members of the FATF, except insofar as local regulations prevent their doing so. This language in the guidance and the requirement that all records related to Liechtenstein accounts and relationships be maintained within the country under Article 12, Para. 6 DDA, enables external auditors to ensure that foreign branches of Liechtenstein financial intermediaries are subject to all the provisions of the DDA.

#### Recommendations and Comments

The FATF has recommended that the DDA audits be conducted separately from and by separate audit companies or individual auditors from their general FSA audits, for adherence to supervision requirements. While this separation has some basis, the requirement in the banking act (see Basel Core Principles assessment) that the normal bank auditor be legally independent should be sufficient to ensure the necessary level of independence and will allow the auditor to evaluate compliance with the DDA within the framework of the bank's general conditions and internal controls. Some financial institutions are currently subject to three separate audits: financial, supervisory, and due diligence. Consistency in these audits will allow for quicker recognition of system weaknesses that affect both prudential and due diligence compliance. Such coordination will be beneficial to identifying systemic or pervasive problems in management, policies and procedures, or systems of internal controls that affect both due diligence compliance and supervisory matters. To ensure that combining audit functions does not compromise independence, the DDU will need to establish specific procedures for scrutiny of the independence of the external auditor and more in depth verification that the external auditors are fulfilling their duties required.

As experience accumulates, and the first round of trustee audits is completed by year-end 2003, the DDU should consider differentiating the guidelines and instructions to external audits for different types of financial institutions. Currently, the Directive 2001/2 is targeted towards banking operations. Variances in business models of the range of financial institutions covered by the DDA should be reflected in the scope and depth of external audits. In this regard, proposed integration of the FSA, ISA, and DDU may foster greater understanding of the particular vulnerabilities in each sector.

Consideration should be given to providing guidance on employee screening procedures for criminal background-checks for those with access to customer funds or assets, who have criminal records, particularly if these relate to ML, FT, fraud, or other breach of trust involving financial relationships.

Future work for the DDU should envision qualitative reviews of the work of external auditors, and the results should be incorporated into analysis and revision of the list of qualified external auditors for DDU audits, particularly, as the DDU has advised that the quality of "material controls" undertaken by the external auditors to date has not been fully satisfactory and additional training is needed..

Insurance sector-specific guidelines for AML/CFT should include specific requirements for insurance entities to be alert to the implications of financial flows and transaction patterns of existing policy holders and should be extra vigilant to the particular risks form the practice of buying and selling second-hand endowment policies and single premium life. Reinsurance or retrocession should be reviewed regularly to ensure that monies are paid to bona fide reinsurance entities at rates commensurate with the risks underwritten.

Implications for compliance with the FATF Recommendations 19, 20
<i>VII—Integrity standards</i> <b>(compliance with Criteria 62 and 63 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criterion 14 for the securities sector)</b>
Description
<p>The DDU and the FSA (and ISA for insurance) have overlapping responsibility for ensuring impeccable management of financial intermediaries. The audits conducted for FSA review the application of the requirements for impeccable management.</p> <p>Article 12a, Para. 2 DDA requires that the auditors ensure through their material control of the proper professional activity as well as impeccable conduct of business. The DDU must advise the supervisory authorities of information concerning impeccable management and must specifically advise of any adverse information about the fit-and-proper information.</p> <p>At least one of the directors of an insurance company out of five must be a resident of Liechtenstein (Article 23 of the insurance supervision law). Adequate experience in the field of insurance is required for the management of the company according to Article 7 of the 1996 Executive Order. Within the business plan, specific attention is paid to the head office which has to be in Liechtenstein and cannot be moved (see IAIS CP 2-Licensing). However, with respect to trustees, the ongoing supervision of licensing is limited, and the requirement in the Act on Trustees on impeccable business operations is not directly monitored by the FSA. The Association of Trustees has some disciplinary role, but the system would benefit from more ongoing monitoring with fit-and-proper requirements for trustees directly by the FSA.</p> <p>Under the Law on Investment Undertakings and Ordinance on Investment Undertakings, collective investment schemes are required to seek a license before operating in the jurisdiction. The investment undertaking is subject to a number of eligibility requirements. Management of the undertaking must be acceptable to the FSA, which undertakes a fit-and-proper assessment of management (including a criminal background check) and determines whether management has the capacity to carry out the undertaking. The FSA considers the licensing application and makes a recommendation to Cabinet for its approval or refusal. In practice, the licensing requirements are reviewed substantively at a preliminary stage; the FSA has never forwarded an application to Cabinet without endorsing its approval and Cabinet has always approved these applications. A licensee may be subject to specific terms and conditions, and any material changes to the licensing conditions must be submitted to the FSA.</p> <p><i>Directive 2001/2: inspection in accordance with the DDA</i> require that the external auditor check for and comment on whether the members of the supervisory board and the executive management as well as the persons responsible for due diligence functions have an impeccable reputation and, due to their professional and personal qualifications, ensure that due diligence duties are complied with.</p> <p>One vulnerability that the Liechtenstein authorities continue to confront is the misuse of Liechtenstein foundations, trusts, and companies. Historically, these entities have been one of the most significant methods of hiding assets or obfuscating the ownership of bank accounts. The trustee sector is essentially dedicated to offering and setting up these vehicles.</p> <p>At the government level, the Commercial Register administers the Persons and Companies Act, which requires either registration of incorporated companies, foundations, limited liability companies, or depositing of instruments, which apply mainly to trusts and foundations. As a general rule, only family foundations and trusts have the option to choose whether to register or deposit their documents. The Commercial Register reviews the deposited document for sufficiency of information, but the information is not publicly available. Substantive oversight is not provided for in Liechtenstein law, which inhibits a full understanding of the types of activities undertaken by the foundations and trusts in particular. The FIU estimates that approximately 80 percent of foundations and trusts are used for tax planning purposes. The anonymity offered by foundations and trusts is</p>

recognized as the most vulnerable to misuse. The approach in recent years has been to place the onus on trustees to obtain and maintain identification information about the persons and entities behind these vehicles. As noted earlier in this report, the requirement for obtaining beneficial ownership information is designed as the cornerstone in understanding the activities of trustee administered entities.

While the authorities are satisfied that the vast majority of accounts for which beneficial ownership information is needed has been obtained, there is less confidence that the trustees analyze such information to prevent misuse of foundations, trusts, or corporate vehicles. Recent matters that have come to the attention of the FIU and law enforcement revealed weaknesses in either the understanding or willingness of trustees to question the information obtained. The FIU also advises that difficulty in detecting misuse of corporate vehicles is compounded by the fact that, frequently, the entity is housed in Liechtenstein but financial transactions are executed in other locations such as London, New York or in Swiss banks.

There are approximately 31,000 incorporated entities registered, including companies and foundations. Of these approximately 2,900 have commercial purposes, including authority to engage in financial transactions. The basis of determining whether the registered companies have commercial purposes or authority to engage in financial transactions is not clear. The procedures for verification of filings lacks transparency. The Commercial Register is clearly diligent in ensuring that the formal requirements are undertaken, but the ability to substantiate information provided by the filer appears limited. The resources of the police, FIU, or other governmental sources are not regularly available, although access to property and other records are accessible.

Some information in the registration is publicly available, such as the entity name and other identifying information. The Commercial Register is obliged to review the registration information for compliance with the Persons and Companies Act before registration or changing of dates. There is a requirement for updating of the correctness of boards, and if these are not fulfilled, the government, pursuant to Article 239 of the Persons and Companies Act, may begin liquidation. Article 1130 of Persons and Companies Act requires review of the incoming balance sheets and declarations, and if these obligations are not fulfilled, the government can impose fines.

There are approximately 51,000 foundations and 1,500 trusts with family purposes that are deposited rather than registered. Unlike other civil law jurisdictions, Liechtenstein recognizes trusts. The Commercial Register advises that all offshore companies registered in Liechtenstein are required to have a Liechtenstein trustee; although, the method of verification of such information is not formalized. The basis for determining the sufficiency of information of deposited documents is not clear.

Failure to file required papers may be fined and false confirmations discovered can be referred to the public prosecutor for criminal fines and imprisonment. Although this authority exists, the commercial register is not aware of criminal cases that have been pursued.

Currently, the commercial registry is not electronically available; but, this is planned for the near future. The FIU and law enforcement authorities advise that requests for information from the Commercial Register are carried out efficiently and timely.

There are a number of practical problems in exercising the authority to oversee the commercial registry. At minimum, without authority to substantively affirmatively confirm and verify the contents of documents registered or deposited, the checks performed by the Commercial Registrar are flawed.

#### Analysis of Effectiveness

The DDA requires external audits to examine for adherence to standards for impeccable management, which exist in the specific laws on licensing and supervision of each financial sector. The banking industry has the most robust requirement that includes ongoing adherence to fit-and-proper tests, and the FSA has authority to recommend withdrawal of a license when adverse information is discovered. Investment undertakings, insurance, and trustees are required to represent that there is no criminal record in order to procure a license, and they are

subject to ongoing obligations to ensure impeccable management, which have to be fulfilled permanently; however, the ongoing monitoring is more limited with respect to trustees.
Recommendations and Comments
The FSA should have a more active role in the ongoing monitoring of fit-and-proper requirement for trustees and to rely on information obtained from due diligence audits of trustees to evaluate the management integrity of trustees and trust companies.
Implications for compliance with FATF Recommendation 29
<i>VIII—Enforcement powers and sanctions</i> <b>(compliance with Criteria 64 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 93-96 for the banking sector and criteria 115-117 for the securities sector)</b>
Description
<p>Article 15 DDA contains criminal sanctions, including imprisonment for up to six months and fines of up to 360 per diem units for willful violations of the DDA. Willful violations of the obligations for customer identification, beneficial ownership verification, prohibitions against tipping off, failure to block assets, failure to report suspicious transactions, or to take required measures ordered by the DDU or FIU with respect to suspicious transactions, or record keeping are subject to these criminal sanctions. Other criminal violations may be simultaneously subject to punishment in addition, pursuant to Article 16 DDA. The DDU’s enforcement actions are separate from the FSA and ISA powers, which might result in conflicts in executing separate powers, duplication or insufficient integration of the various enforcement tools in a manner designed to maximize remedial efforts. Although to date, the different and co-extensive enforcement tools have not posed any real conflict, and the close coordination between the FSA and DDU has minimized problems, integration of the DDU and the FSA will allow for more functional use of both sets of enforcement authority.</p> <p>The government may also impose fines up to CHF 100,000 for refusal to give information, making untrue statements or concealing important facts from the DDU, or where applicable, the FIU, or an auditor. The same fines may be imposed for: failure to comply with a demand to establish the legal state of affairs or any other order issued by the DDU; or for permitting assets to be withdrawn from accounts or deposits for which no business profile has been established in violation of Article 19a DDA.</p> <p>The DDA, Article 15 and 16 provide the DDU with adequate powers of enforcement and sanction against financial institutions, and their directors or senior management. The government can withdraw a license for a financial intermediary on the recommendation of the FSA and ISA. The FSA under Article 35.4 of the banking act has the power to issue orders necessary to achieve the regular situation and to eliminate grievances. The powers under the banking act are broad and could include the withdrawal of a license. The action to close a foreign subsidiary has never been taken. The FSA has acted using this broad authority to close down companies found to be carrying out a banking business without a proper license.</p> <p>There are several cases where the FSA has taken remedial actions against financial intermediaries using its broad authority under Article 35.4 of the banking act to issue orders to “achieve the regular situation and to eliminate the grievances.” The remedial powers appear adequate; however, the actions which the supervisory agency can take should be clearly defined in legislation.</p> <p>The FSA has the right to require any information from investment undertakings and carry out scheduled or unscheduled inspection. The public prosecutor, responsible for enforcement, has the authority to compel documents and testimony from investment undertakings or relevant third parties. The FSA does not have sanctioning authority but may recommend fines for some instances of non-compliance to the Cabinet. The prosecutor has a range of sanctions available (see DDU assessment).</p>
Analysis of Effectiveness

Recommendations and Comments
<p>The DDU and FSA enforcement tools should be coordinated, and procedures should be implemented as the need for enforcement actions arises to ensure the available enforcement tools are used appropriately. As a next step to ensuring effective implementation, the DDU and FSA should review globally the available enforcement tools and develop guidelines for deciding which is the appropriate tool for a given violation.</p>
<p><b><i>IX—Cooperation between supervisors and other competent authorities</i></b> <b>(compliance with Criteria 65-67 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 97-100 for the banking sector and criteria 118-120 for the securities sector)</b></p>
Description
<p>The DDU has been fully staffed as of October 2002 with five full-time members, including administrative support, with sufficient IT, and with other resources. In 2001, the DDU itself undertook a number of inspections for compliance with the DDA, focused exclusively on inspections of trust companies and trustees. The DDU appears to have the resources and personnel to review and thoroughly analyze the external audit reports and to identify systemic deficiencies that might arise. The DDU has some overlapping responsibility with the FSA with respect to impeccable management, and there is a continuous exchange of information with the FSA. The DDU shares due diligence audits with the FSA and the ISA, and letters regarding follow-up measures are signed jointly, if needed.</p> <p>Currently, the DDU is an independent unit and has the direct authority to issue directives and guidelines. In 2001, the DDU ordered 80 due diligence audits and in 2002 about 330 audits. The DDU can impose measures with respect to non-compliance, including requiring remedial measures within a prescribed time frame and may prohibit a financial intermediary from entering into any new business for a limited period of time.</p> <p>As part of its functions, the DDU regularly issues newsletters advising the financial intermediaries of issues and requirements. The DDU is in the process of integrating the new EU Guideline against Money Laundering into national law and is formulating proposals for necessary amendments to the DDA identified.</p> <p>Article 20 DDA requires cooperation among all national authorities involved with due diligence, money laundering, and predicate offenses. Banking and official secrecy are not an impediment to disclosures of transaction or account specific information. The DDU, FSA, FIU, and public prosecutor are all subject to this requirement; however, the ISA is not. Implementation of this requirement is largely based on regular meetings among these authorities and open channels of communication.</p> <p>Article 20a DDA authorizes sharing of information with foreign authorities for money laundering if public order and other important national interests, secrecy, and fiscal interests are not violated, the information complies with the purpose of this law, reciprocity, the information is to be used exclusively for due diligence or money laundering, professional secrecy applies to the employees of the foreign supervisor, and the MLA Law is not applied. Liechtenstein is host to banking subsidiaries from Switzerland, Austria, and France. All of these countries practice consolidated supervision. Article 36a of the banking act provides that the home country supervisor may verify information required by the foreign regulator requesting the FSA provide the information. Use of information regarding individual accounts obtained through co-operative arrangements is subject to strict official secrecy requirements to ensure and facilitate its exclusive use for lawful supervisory purposes. The supervisor is only obliged to give confidential information to the court as well as to the ministry involved and according to explicit legal provision (e.g., Art 20 DDA).</p> <p>There is an open issue as to whether banking secrecy can affect the authority of supervisory authorities such as the DDU to provide account, customer, or transaction-specific information through international cooperation requirements. However, the limitations on the DDU to share transaction specific information under Article 20a DDA is offset considerably by the clear gateway for the international exchange of information on ML, predicate offenses, and organized crime available to the FIU.</p>

<p>The impediment to the sharing of supervisory information with foreign regulatory agencies relates to the term ‘banking secrecy’ being included in the relevant information-sharing legislation. While the FSA’s own legal interpretation is that the term has no effect and that its secrecy provisions are in line with EU law, a recent request for information showed that there are impediments to the flow of supervisory information. The FSA’s legal interpretation is firmed up by a government decision stating that the banking secrecy provisions referred to in Article 36 banking act do not limit the FSA’s ability to share client account information with foreign counterparts. This decision has been reconfirmed on May 7, 2003 by a ruling of the supreme administrative court.<sup>15</sup> However, foreign authorities pursuing criminal investigations would be entitled to seek client account information through the FIU or through requests for mutual legal assistance.</p>
<p>Analysis of Effectiveness</p>
<p>The DDA provides for broader information sharing by the DDU than is generally available to the other supervisory authorities in Liechtenstein. The DDU has apparent unfettered authority to share relevant information about ML and FT with domestic competent authorities. There is an open question as to the level of transaction specific information the DDU may share with foreign supervisory authorities. The language in Article 20 DDA is substantially the same as the provisions applicable to sharing of information by the FSA in the banking act, Article 36a. There are fewer concerns about sharing of information with foreign supervisors under these provisions because of the broad authority of the FIU to share transaction-specific information concerning ML, predicate offenses, and organized crime obtained from SARs. The provision on banking secrecy in Liechtenstein is based in large measure on Austrian law. An evaluation of the Liechtenstein law has resulted in a preliminary conclusion that such information can be shared with foreign authorities. The question currently before the government is whether the supervisory authorities may directly share transaction specific information.</p>
<p>Recommendations and Comments</p>
<p>Clarification of the limits on banking and professional secrecy on information exchange by the DDU should be resolved.</p>
<p>Implications for compliance with FATF Recommendation 26</p>

### **Description of the controls and monitoring of cash and cross-border transactions**

This section, based on FATF 22–23, is designed to collect information on any measures that may exist to control or monitor large cash transactions, and cross border movements of currency, monetary instruments, or wire transfers. The section is included in the detailed assessment report to gain a broader understanding of the AML/CFT system. The questions include general financial conditions that influence the use of cash and any particular factors that have resulted in increase or decrease in the use of cash in transactions (e.g., existence of financial transaction taxes, use of credit or debit cards; limitations on size denomination of bank notes; confidence in the banking system, etc.).

Table 4.3 Description of the Controls and Monitoring of Cash and Cross Border Transactions

What has the jurisdiction done in response to the following FATF Recommendations?

<sup>15</sup> The FSA issued several decisions providing assistance to foreign supervisors with respect to market abuse. According to Liechtenstein administrative law, these decisions can be appealed by all parties involved. At the moment three cases are pending.

<b>FATF Recommendation 22:</b>	
Description	<p>Liechtenstein entered into a customs and economic union with Switzerland in 1924, and Switzerland is charged with all customs controls for Liechtenstein. There is an open border between the two countries, such that cash controls, other than through reporting of large suspicious transactions in Liechtenstein financial institutions, is not feasible.</p> <p>With respect to bearer instruments, of greatest significance in Liechtenstein is the movement of bearer shares of companies and foundations. Implementation of the DDA, particularly the requirements for beneficial ownership disclosure, appear to require lodging or deposit of bearer shares with the trustees, or others who must verify beneficial ownership before a transaction can be executed. Effectively, the auditors and financial intermediaries, specifically the banks, almost routinely require lodging and immobilization of bearer shares.</p>
<b>FATF Recommendation 23:</b>	
Description	<p>Guideline 2002/1 Para. 4.1 requires filing of SARs for cash transactions that are suspicious or unusually large. As a general matter, foreign currency exchange transactions, which occur in banks and in two bureaux de change, for amounts in excess of CHF 25,000 are recorded, and these records are maintained and available to domestic competent authorities.</p>
<b>Interpretative Note to FATF Recommendation 22:</b>	
Description	Not applicable

**Ratings of compliance with FATF Recommendations, summary of effectiveness of AML/CFT efforts, recommended action plan and authorities' response to the assessment**

Table 1. Ratings of Compliance with FATF Recommendations Requiring Specific Action

<b>FATF Recommendation</b>	<b>Based on Criteria Rating</b>	<b>Rating</b>
1 – Ratification and implementation of the Vienna Convention	1	Largely compliant
2 – Secrecy laws consistent with the 40 Recommendations	43	Largely compliant
3 – Multilateral cooperation and mutual legal assistance in combating ML	34, 36, 38, 40	Largely Compliant
4 – ML a criminal offense (Vienna Convention) based on drug ML and other serious offenses.	2	Compliant
5 – Knowing ML activity a criminal offense (Vienna Convention)	4	Compliant
7 – Legal and administrative conditions for provisional measures, such as freezing, seizing, and confiscation (Vienna Convention)	7, 7.3, 8, 9, 10, 11	Compliant
8 – FATF Recommendations 10 to 29 applied to non-bank financial institutions; (e.g., foreign exchange houses)		See answers to 10 to 29
10 – Prohibition of anonymous accounts and implementation of customer identification policies	45, 46, 46.1	Compliant
11 – Obligation to take reasonable measures to obtain information about customer identity	46.1, 47	Compliant
12 – Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer	52, 53, 54	Compliant

identification documents		
14 – Detection and analysis of unusual large or otherwise suspicious transactions	17.2, 49	Compliant
15 –If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the FIU	55	Largely Compliant
16 – Legal protection for financial institutions, their directors, and staff if they report their suspicions in good faith to the FIU	56	Compliant
17 – Directors, officers, and employees, should not warn customers when information relating to them is reported to the FIU	57	Largely compliant
18 – Compliance with instructions for suspicious transactions reporting	57	Largely compliant
19 – Internal policies, procedures, controls, audit, and training programs	58, 58.1, 59, 60	Compliant
20 – AML rules and procedures applied to branches and subsidiaries located abroad	61	Largely compliant
21 – Special attention given to transactions with higher-risk countries	50, 50.1	Compliant
26 – Adequate AML programs in supervised banks, financial institutions, or intermediaries; authority to cooperate with judicial and law enforcement	66	Compliant
28 – Guidelines for suspicious transactions’ detection	17.2, 50.1, 55.2	Compliant
29 – Preventing control of, or significant participation in financial institutions by criminals	62	Largely compliant
32 – International exchange of information relating to suspicious transactions and to persons or corporations involved	22, 22.1, 34	Largely compliant
33 – Bilateral or multilateral agreement on information exchange when legal standards are different should not affect willingness to provide mutual assistance	34.2, 35.1	Compliant
34 – Bilateral and multilateral agreements and arrangements for widest possible range of mutual assistance	34, 34.1, 36, 37	Compliant
37 – Existence of procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution	27, 34, 34.1, 35.2	Largely compliant
38 – Authority to take expeditious actions in response to foreign countries’ requests to identify, freeze, seize, and confiscate proceeds or other property	11, 15, 16, 34, 34.1, 35.2, 39	Compliant
40 – ML an extraditable offense	34, 40	Compliant
SR I – Take steps to ratify and implement relevant United Nations instruments	1, 34	Compliant
SR II – Criminalize the FT and terrorist organizations	2.3, 3, 3.1	Largely compliant
SR III – Freeze and confiscate terrorist assets	7, 7.3, 8, 13	Largely compliant
SR IV – Report suspicious transactions linked to terrorism	55	Compliant
SR V – provide assistance to other countries’ FT investigations	34, 34.1, 37, 40, 41	Compliant
SR VI – impose AML requirements on alternative remittance systems	45, 46, 46.1, 47, 49, 50, 50.1, 52, 53, 54, 55, 56,	Not applicable

	57, 58, 58.1, 59, 60, 61, 62	
SR VII – Strengthen customer identification measures for wire transfers	48, 51	Largely compliant

Table 2. Summary of AML/CFT Effectiveness

Heading	Assessment of Effectiveness
<b>Criminal Justice Measures and International Cooperation</b>	
I—Criminalization of ML and FT	Criminalization of ML is largely consistent with international standards; although, legal entities are not subject to punishment for ML. The criminal provisions for the DDA allow for imposition of criminal penalties to legal entities, which alleviates some limits. At present, the criminalization of FT through Article 278a of the StGB is sufficient to address financing of terrorist acts and certain organizations. However, a separate criminal provision directly addressing terrorist financing (to broadly include terrorism and terrorist organizations) is needed to ensure wide coverage of the FT provisions in the FATF Special Recommendations.
II—Confiscation of proceeds of crime or property used to finance terrorism	Confiscation is comprehensive, effective, and efficient. Sustainability of the system should be a priority.
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels	The FIU is an effective body in the arsenal for preventing ML and the disguising of the proceeds of crime. The FIU should continue to maintain its independence, which has allowed it to maintain a significant role in the AML/CFT policy formation of Liechtenstein.
IV—Law enforcement and prosecution authorities, powers and duties	The recent enhancements to the Police EWOK unit are a necessary component of a now strong investigative arm, and its efforts should be sustainable. The public prosecutor appears to have succeeded in changing the culture and process of the Prosecutor’s office, such, that it is effectively carrying out its dual role of bringing prosecutions and directing substantive responses to foreign jurisdictions’ requests for mutual legal assistance in prosecutorial matters. The public prosecutor’s office now demonstrates a high level of skill and professionalism in its activities.
V—International cooperation	Mutual legal assistance measures have undergone one of the most significant transformations in Liechtenstein. Where previously international cooperation was stymied because of excessive review layers, professional secrecy, and differing standards of proof, the current process is

	diametrically different.
<b>Legal and Institutional Framework for All Financial Institutions</b>	
I—General framework	The general framework is adequate to ensure that covered financial institutions are adhering to the preventive measures.
II—Customer identification	Customer identification requirements are substantive and comprehensive. Implementation in banking has moved forward quickly; however, some implementation issues remain in the insurance and trustee sectors.
III—Ongoing monitoring of accounts and transactions	Ongoing monitoring is largely in line with the international requirements, and the awareness of each financial institution sector appears to be increasing, with banks the most advanced.
IV—Record keeping	Record keeping is largely adequate to allow for necessary recoverability of records sufficient to reconstruct necessary transactions and customer information. The DDA requirement that copies of all records be maintained within the jurisdiction has substantially enhanced the usefulness of records maintained.
V—Suspicious transactions reporting	The legal framework for suspicious transaction reporting is largely adequate; however, there are some concerns about the effect of the current tipping off provision, which only prohibits tipping off during an automatic ten-day blocking upon the filing of a SAR. The ten-day blocking in itself increases the risk of tipping off and does not appear to be as efficient as a discretionary blocking for a shorter time period by the FIU or other competent authority when a SAR is filed.
VI—Internal controls, compliance and audit	At present, the reliance on external auditors to carry out due diligence audits appears to be adequate for ensuring that internal controls and compliance levels are observed. As the system develops, the DDU should be prepared to assume greater direct-audit responsibility for DDU audits across sectors.
VII—Integrity standards	The most significant concern of vulnerability to misuse continues to be with corporations, foundations, and trusts, which are marketed and administered by the trustee sector. This is also where the controls in the law and supervision are the weakest. The law does not vest the Company Registrar with strong powers to verify or investigate the underlying information filed in the instruments for foundations, companies or trusts. As a result, the most effective tool available is the DDA application to the trustees and lawyers, for which implementation should be strengthened.
VIII—Enforcement powers and sanctions	
IX—Co-operation between supervisors and other	There continue to be limitations on the direct

competent authorities	exchange of account and transaction specific information between prudential supervisors. In the AML/CFT context, this limitation is mitigated somewhat by the availability of exchange of account and transaction-specific information by the FIU; nevertheless, this involves additional steps that may hinder efficient exchange.

Table 3: Recommended Action Plan to Improve the Legal and Institutional Framework and to Strengthen the Implementation of AML/CFT Measures in Banking, Insurance and Securities Sectors.

<b>Criminal Justice Measures and International Cooperation</b>	<b>Heading</b>	<b>Recommended Action</b>
Criminalization of ML and FT	I	Complete criminalization of a separate offense for financing of terrorism  Extend legal liability to legal entities
Confiscation of proceeds of crime or property used to finance terrorism	II	
The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels	III	Ensure continued independence of the FIU.  Provide clearer guidance on processes for domestic information sharing.
Law enforcement and prosecution authorities, powers and duties	IV	
International cooperation	V	Ensure that additional multilateral and bilateral agreements needed to ensure coverage are pursued.  Ensure that requests that have non-fiscal aspects are not rejected on the basis of fiscal grounds.
<b>Legal and Institutional Framework for All Financial Institutions and its Effective Implementation</b>		
General framework	I	Ensure that the effective supervision by the DDU continues after the proposed merger of the DDU with the FSA, into a single regulator.
Customer identification	II	Implementation by trustees and trust companies may need additional attention.
Ongoing monitoring of accounts and transactions	III	Implementation of monitoring obligations for trustees and trust companies may need additional attention.
Record keeping	IV	

Suspicious transactions reporting	V	Abolish the provision on automatic ten-day blocking of assets and accounts when filing SARs and replace with authority of the FIU to order blocking upon receipt of a SAR, and reduce the amount of time for blocking to a shorter time period, with extensions to ten days.  Amend the law to impose a permanent prohibition against tipping off.  Provide for a specific administrative sanction for violations of the tipping-off prohibition.
Internal controls, compliance and audit	VI	Due diligence audits and supervisory audits should be conducted by the same auditor or audit firm and should be conducted together, insofar as possible.
Integrity standards	VII	Additional monitoring directly by the FSA is warranted regarding the fit-and-proper requirements and impeccable management of trustees and trust companies.
Enforcement powers and sanctions	VIII	
Co-operation between supervisors and other competent authorities	IX	Clarification of the information-sharing authority of the DDU is needed. The DDU should be empowered to share account or transaction information related to ML or FT with foreign supervisory authorities.
Insurance Sector Specific Measures		
Ongoing monitoring of accounts and transactions		Guidelines should require insurance entities to be alert to the implications of financial flows and transaction patterns of existing policy holders and should be extra vigilant to the particular risks from the practice of buying and selling second hand endowment policies and single premium life.

### C. Authorities' Response to the Assessment

#### Due Diligence Unit

##### General Situation of ML and FT

121. It is stated that the attractiveness of choosing Liechtenstein as a location to commit money laundering has diminished due to structural changes and due to “loosening of banking secrecy in criminal investigations and international cooperation.” It must be said, however, that banking secrecy never applied in domestic criminal investigations or in mutual legal assistance proceedings. Hence, banking secrecy was not loosened. What has changed, however, is the enforcement of the law.

### **Measures to prevent ML and FT**

122. The report suggests application of the Strasbourg Convention by Liechtenstein. Against this background, it has to be stressed that Liechtenstein is a signatory to the Strasbourg Convention on money laundering. The convention has been in force in Liechtenstein since March 1, 2001, and is being applied by the courts. Therefore, no further implementation is needed.

### **Criminalization of ML and FT**

123. The government commissioned a draft which shall amend the existing legal framework and fill possible gaps in Liechtenstein legislation. On the basis of this draft, the government has recommended the following legislative measures:

- definition of the new crime “Terrorist Association” (Article 278 b StGB);
- definition of the new crime “Terrorist Financing” (Article 278 d StGB);
- collective designation of terrorist crimes (Article 278 c StGB);
- extension of the definition of gang to “Criminal Association” (Article 278 StGB).

124. In accordance with the normal legislative process, the proposed legislative amendments will be circulated for consultation and will then be discussed by the parliament on the basis of a draft law presented by the government.

125. The Liechtenstein Penal Code is modeled on the Austrian Penal Code. The 2002 Draft Act on Amendment of the Penal Code, currently under discussion in Austria, will also, to the extent possible, be incorporated into Liechtenstein law in order to maintain conformity of the two legal systems.

126. In addition to the definition of new crimes, the modification and extension of existing definitions of crimes are recommended as follows:

- taking terrorist associations into account with regard to the confiscation of proceeds of crime and forfeiture (Article 20 and 20 b StGB);
- extension of domestic jurisdiction according to Article 64 StGB to terrorist associations and terrorist financing;
- extension of the definition of money laundering (by expanding the list of predicate crimes and through the new Article 278 d StGB).

127. Furthermore, in the area of substantive criminal law in Article 320 StGB (“Support of a Party in a Foreign Armed Conflict”), the crime of “Arms Brokering” shall be included.

128. The objective of the proposed legislative measures is to improve the legal framework for combating terrorism in accordance, especially, with Security Council resolution 1373, as well as to implement the United Nations Convention against Transnational Organized Crime. Resulting amendments of organizational offenses are Article 278 StGB (Criminal Association), Article 278 a StGB (Criminal Organization), and Article 278 b StGB (Terrorist Association). Terrorist crimes are defined in Article 278 c StGB. Article 278 d StGB punishes the intentional provision or collection of financial assets for committing terrorist acts.

### **Customer identification and ongoing monitoring of accounts and transactions**

129. In the future, the DDU will give additional attention to the implementation of due diligence by trustees, trust companies, and insurances. Therefore, specific provisions for trustees, trust companies and insurances will be taken into consideration in the context of the planned revision of DDA and DDEO.

### **Internal controls, compliance, and audit**

130. The FSA and the DDU will conduct both types of audits—the supervisory audit and the due diligence audit—by the same auditor and, if possible, together in the near future.