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Isle of Man—Crown Dependency of the United Kingdom: 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 the Isle of Man 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 the Isle of Man's request for technical assistance. It is based on the information available at the time it was completed in October 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 the Isle of Man or the Executive Board of the IMF.

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ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR

Volume II: Review of Financial Sector Regulation and Supervision

Isle of Man

October 2003

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GLOSSARY

AML/CFT	Anti Money Laundering/Combating the Financing of Terrorism
ARM	Annual Review Meetings
BA	Banking Act (1998)
CIS	Collective Investment Schemes
CJA	Criminal Justice Act (1990)
CP	Core Principle
CSP	Corporate Service Provider
CTP	Common Trading Practices
FATF	Financial Action Task Force
FSA	Financial Supervision Act (1988)
FSAUK	U.K. Financial Services Authority
FSB	Fiduciary Services Bill
FSC	Financial Supervision Commission
FTE	Full-Time Equivalent
FX	Foreign Exchange
GAAP	Generally Accepted Accounting Principles
IAIS	International Association of Insurance Supervisors
ICAEW	Institute of Chartered Accountants of England and Wales
IFA	Independent Financial Advisor
IOSCO	International Organization of Securities Commissioners
IPA	Insurance and Pensions Authority
IBA	Investment Business Acts (1991–1993)
IOM	Isle of Man
KYC	Know Your Customer
LEG	Legal Department
MFD	Monetary and Financial Systems Department
MOU	Memorandum of Understanding
MLRO	Money Laundering Reporting Officer
NCCT	Non-Cooperative Countries and Territories
OECD	Organization for Economic Cooperation and Development
PEP	Politically Exposed Person
POTA	Prevention of Terrorism Act (1990)
SBA	Statutory Boards Act (1987)
SCE	Securities and Exchange Commission
SRO	Self-Regulatory Organization

*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. **This assessment of the current state of compliance by the Isle of Man ("the Island") with the Basel Core Principles for Effective Banking Supervision has been completed as part of the IMF Offshore Financial Center (OFC) assessment program**. Completion of a formal assessment serves several purposes. First, it benchmarks the current state of banking supervision, recognizing that there have been extensive changes in the last few years. Second, it suggests a number of further improvements or changes. Thus, this report provides a key input for the development of an action plan to move toward full compliance with the Core Principles. The assessment was conducted by Jack Heyes and Marcel Maes (both consultants of MFD). The team expresses its thanks to the staff of the Financial Supervision Commission (FSC), who cooperated in the completion of the assessment.

Information and methodology used for assessment

2. **This assessment of the effectiveness of banking supervision** was based on an examination of the legal framework, both generally and as specifically related to the financial sector, the self-assessment of the Core Principles, and extensive discussions with the staff of the FSC, external auditors, and the management of commercial banks.

Institutional and macroprudential setting, market structure overview

3. The Isle of Man has 59 licensed banks and 2 licensed building societies. The banks come from a variety of geographical areas, including Europe, Ireland, South Africa, United Kingdom, and the United States. Total bank deposits were £27.1billion. The majority of banks are engaged in providing private banking services to nonresidents. The services offered by banks are directed toward deposit taking with the funds on loan primarily in the international interbank markets. Some banks act as custodians and trustees to collective investment schemes, while others conduct trade, finance, and treasury operations.

4. The Financial Supervision Commission (FSC) was established in July 1983, under the Financial Supervision Commission Order, 1983, as a statutory board. It is governed by the Statutory Boards Act of 1987. The FSC originally regulated both deposit-taking institutions and insurance business and, later, investment business. In 1986, a separate insurance authority to supervise and regulate the insurance industry was established. This has since evolved into the Insurance and Pensions Authority (IPA), which is also constituted as a statutory board governed by the Statutory Boards Act of 1987.

5. As a statutory board, eight commissioners appointed by the treasury, subject to the approval of the parliament, Tynwald, oversee the FSC's work.

6. The Banking Act, 1998, regulates banking business, which may not be carried on in or from within the island without a license. The Act confers licensing power to the FSC. The Act provides substantial powers for supervisory, disciplinary, and enforcement purposes.

General condition for effective banking supervision

7. Taken collectively, the banking laws, orders, and guidance notes provided by the supervisor constitute a generally appropriate legal framework for banking supervision. The BA gives the FSC the power to grant and refuse licenses.

8. A range of sanctions is available to the FSC where a bank is noncompliant. The FSC can make recommendations and issue directions to a bank. The ultimate enforcement sanction is revocation of a license.

9. The FSC uses both off-site surveillance and on-site visits in its supervision of banking entities.

10. All banks must maintain a minimum risk-based capital ratio of not less than 10 percent. The components of capital and the methodology used are in accordance generally with the Basel Capital Accord.

11. All banks incorporated in the Isle of Man are required to draw up annual financial statements. These must be prepared in accordance with U.K. accounting standards adopted by the United Kingdom Accounting Standards Board or other accounting standards approved by the FSC.

12. The Financial Supervision Act, 1988, permits the disclosure by the FSC of confidential information to other governmental agencies within the Isle of Man and to external agencies with statutory functions corresponding to the FSC.

B. Detailed Assessment

Table 1. Detailed Assessment of Compliance with the Basel Core Principles for Effective Banking Supervision

Principle 1.	**Objectives, Autonomy, Powers, and Resources** An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to the authorization of banking establishments and their ongoing supervision; powers to address compliance with laws, as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Principle 1(1)	An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.
Description	The Financial Supervision Commission Order, 1983, established the FSC as the body responsible for the licensing and supervision of the finance sector (with the exception of insurance and pensions business) in the Isle of Man. The FSC's general functions are to take steps leading to the effective supervision of the private financial and commercial sector. The FSC is the sole agency with responsibility for banking supervision in the Isle of Man, and its detailed responsibilities and powers are outlined in the Banking Act 1998 (BA). This legislation, and regulations and codes made under the BA—in particular, the Banking (General Practice) Regulatory Code, 1999 ("the Code")[1] —provide the framework for the minimum prudential standards that banks must meet. The FSC's policy function is to ensure that its regulatory framework keeps up to date with international standards and best practices. Normal practice is that the FSC identifies the need for particular regulatory measures and proposes the necessary legislation and guidance to achieve the objective. In July 2001, the FSC conducted a detailed review of the compliance of the Isle of Man's law and supervisory practices with the Basel Core Principles for Effective Banking Supervision. Although the results were generally positive, the exercise was helpful in identifying areas where further work could be done to strengthen the supervisory approach. As a result of the new FATF recommendations and the report of the Basel Committee on Banking Supervision entitled, "Customer Due Diligence for Banks," the FSC revised its Anti-Money Laundering Guidance Notes in December 2001. As a general rule, the Isle of Man's banking laws are updated as necessary to ensure that they remain effective and relevant to changing industry and international regulatory practices. The FSC's overall objectives are set out in its mission statement[2] and its medium-term objectives are set out in its "medium-term plan." The FSC reviews annually its performance against that

[1] Made under Section 10 of the BA.

[2] To protect the public interest by providing effective regulation and supervision within the Island's financial services sector; to support a competitive environment in which quality products and services are promoted for the economic benefit of the Island; and to foster good working relationships within the business community.

	plan. The regulatory structure in the Isle of Man was also subject to a major review in 1998 by the U.K. Home Office ("Edwards Review"). As a medium-term project, the FSC is currently conducting a review of legislation governing the regulated activities of its license holders (banks, corporate service providers, investment companies, etc.). The underlying objective is the consolidation of the primary supervisory legislation administered by the FSC in one new Act. For this purpose, a working group is being formed with the industry to examine the Banking Act, 1998; the Investment Business Act, 1991; the Building Societies Act, 1986; the Financial Supervision Act, 1988; the Corporate Service Providers Act, 2000; and the Fiduciary Services Bill. The FSC also works closely with the other crown dependencies to achieve a consensus approach in the prevention of money laundering. The primary purpose is to ensure greater consistency, to address observations made previously by FATF, and to commit to the Basel document mentioned above. A draft position paper entitled, "Overriding Principles for a Revised "Know-Your-Customer Framework," was issued in February 2002, and is now being discussed with the industry prior to a redrafting of the relevant guidance notes and legislation.
Assessment	Compliant
Comments	The FSC has to be commended for its continuous proactive attitude towards enhancing the Isle of Man's regulatory and supervisory regime, and its endeavor to meet international standards. The FSC holds discussions with the industry on the contents of its proposed guidance notes to ensure that implementation will be practicable. The FSC has also identified the need to rationalize and clarify its existing supervisory powers. In this respect, and similar to the objective pursued in the United Kingdom by the Financial Services and Markets Acts 2000, a one-license system encompassing the various categories of regulated business will be explored. Current duplication and potential inconsistencies between the various Acts that have been developed piecemeal over the last sixteen years will be identified and addressed. The FSC's administrative workload should benefit considerably from the results of this exercise. However, the present legislative timetable is such that a consolidation bill cannot be introduced for another two to three years. This lengthy process may adversely affect the efficiency and comparative attraction of the Isle of Man's financial services sector. It is therefore recommended that the Isle of Man authorities explore the possibility of revisiting the existing time schedule.
Principle 1(2)	Each such agency should possess operational independence and adequate resources.
Description	The FSC is a statutory body established in 1983 by the Financial Supervision Order 1983 (Section 3). The members of the FSC direct its affairs. Section 3(2) of the Order provides that the FSC shall consist of no less than three persons appointed by the treasury, subject to the approval of Tynwald (the Isle of Man parliament). Currently, there are eight commissioners, seven of whom are non-executive. Members of the treasury and persons in receipt of a salary from the government or the FSC shall be eligible for appointment to the FSC (Section 3 (3)). Presently, eight commissioners direct[3] the FSC, seven of whom are non-executive. The chief executive is the only executive member. The chairman is a politician and a member of the

[3] The treasury, subject to the approval of Tynwald, appoints these. There must be a minimum of three commissioners. There is no requirement that they be politicians or members of the treasury.

	treasury. His tenure of office as FSC chairman, as well as the tenure of the other members, is determined by the Statutory Boards Act, 1987 (SBA). Following the issue of the Edwards Report, which questioned the policy of having a politician on the Board, the composition of the Board was considered and it was concluded that there was no reason to change. In appointing a new political chairman in December 2001, the treasury minister, confirmed that he was still considering whether it was appropriate to appoint a nonpolitical chairman. The commissioners as a group ("Board") meet formally monthly. According to Section 8 of the Financial Supervision Commission Act, 1984, the expenses of the FSC in performing its duties are defrayed out of money provided by Tynwald. According to the Isle of Man's business planning process, the council of ministers establish government aims, objectives, corporate indicators, and targets. These are provided to departments and the statutory boards, such as the FSC, together with their budget and resource allocation. During the year 2001, an internal audit was undertaken by the government's internal audit division; no major issues were identified. In its meeting on January 25, 2001, the FSC approved a code of conduct designed to assist the commissioners in identifying for themselves potential conflicts of interests and in being aware of the appropriate action to take. In practice, the FSC's costs are met from annual license fees and from charges related to the companies' registry functions. The FSC has discretion in the appointment of its staff within a headcount and a budget agreed with the treasury. The majority of its staff has significant experience in the regulatory field or private financial services firms (or both) and has a range of professional qualifications (mainly in accountancy and law). The FSC places a high priority on staff training. Every staff member discusses and agrees with his or her superior a training program for the year ahead. The quality of the staff is also acknowledged by the industry. During the period of 2001/2002, seven persons (out of 54.5)[4] left the FSC, some of them for senior compliance positions outside. The existing full employment situation and the predominance of the financial sector in the economy also contribute to staff turnover. In this context, and in order to restore or maintain a competitive pay structure, a job evaluation exercise has been held. As a result, existing pay bands have been adapted. The FSC has the ability to hire outside experts as the need arises. Until now this has occurred on one occasion only. The FSC's budget has allocations for the training of staff, the purchase of technological equipment, and for expenditure related to the conduct of on-site and off-site supervision.
Assessment	Materially noncompliant
Comments	Edwards Report, and concluded that there was no reason to make any changes. However, when appointing a new political chairman in December 2001, the treasury minister confirmed that he was still considering whether it was appropriate to appoint a nonpolitical chairman. Regarding the issue of the FSC's lack of independence mention must also be made of the following circumstances, most of which arise because the FSC is a "Board" governed by the provisions of the Statutory Boards Act 1987 (SBA):

[4] Three out of the seven staff members were part of the banking supervision team (on a total of 7.75).

	As mentioned above, the authorities considered the composition of the FSC in the wake of the • a member of the FSC may be removed from office by a resolution of Tynwald (Section 3 (4) of the SBA); • the council of ministers may, after consultation with the FSC, give to the FSC such directions as to the exercise of its functions in relation to any matter, which appears to the council of ministers to affect the public interest, and the FSC shall comply with any such directions (Section 12 (1) of the SBA); • the FSC shall supply to the chief minister such information, and render such other assistance, as the chief minister may from time to time require, and for that purpose shall permit any person appointed for the purpose by the chief minister to inspect and make copies of its accounts, books, documents and papers, and shall afford such explanation thereof as that person may reasonably require (Section 12(2) of the SBA); • the treasury may give the FSC such directions as it thinks fit with respect to the exercise or performance of its powers under sections 4 to 7[5] and 13(1) to (3)[6] of the BA or SBA whether generally or in any particular case and the FSC shall comply with such directions; • According to Section 8 of the Financial Supervision Commission Act 1984 the expenses of the FSC in performing its duties are defrayed out of money provided by Tynwald. According to the business planning process (mentioned above) the council of ministers establishes government aims, objectives and corporate indicators and targets. These are provided to departments and the statutory boards, such as the FSC, together with their budget and resource allocation. Although in the past the FSC has made the case for additional resources in order to deliver the planned program of work, the request has only been partially met. In practice, except for the limitations imposed on the financial and staffing resources of the FSC, there are no signs of government intervention in the FSC's regulatory decision making. However, the existence of several legal powers enabling the government to intervene in the FSC's operations represents a potential impediment to its autonomy. The budgetary restrictions imposed on the FSC prevent it from fully achieving its supervisory objectives. The FSC's annual report 2001/2002 draws attention to the growing workload and the limited resources. FSC Direct Costing of Supervisory Responsibilities (percent) Total Banking Inv. Bus CIS CSP 100 28 24 21 27 The case for additional resources would benefit from an in-depth analysis of the FSC's supervisory objectives and the means needed to achieve them. The ongoing review of the business process of prudential supervision should be continued in order to enhance its efficiency and an appropriate change process should be agreed in the near future. This would help take account of the growing iversity and complexity of financial

[5] Licensing criteria and conditions, granting and refusal of licenses, and revocation and alteration of banking licenses.

[6] On inspection and investigation.

	products. The Isle of Man will also need to continue to give due regard to other developments in international standards, arising from pronouncements by the international regulatory bodies or other international initiatives.
Principle 1(3)	A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Description	Section 6 of the BA gives the FSC the power to grant and refuse licenses. Section 7 gives the FSC the power to revoke licenses in certain circumstances. As stated above, section 30 confers on the treasury the right to give the FSC such directions as it thinks fit with respect to its licensing powers, whether generally or in any particular case. The FSC's licensing policy is based on the belief that the Isle of Man is too small and too vulnerable to shoulder high risk banking operations, including start-up operations. The FSC therefore encourages applications from banks incorporated outside the Isle of Man, which meet its criteria for the establishment of a branch, or locally incorporated subsidiary. These banks must be licensed in their principal place of business that must be in a jurisdiction, which, in the FSC's judgment, exercises proper licensing and supervision and subscribes to the principles of the International Concordat on Banking Supervision. The FSC has reviewed its licensing policy for banks, in the light of changing demands and the fact that an entry criterion based too narrowly on size can exclude other, smaller high quality institutions, which might wish to apply for a license. The FSC's policy was revised to emphasize the importance of the credit rating of the banking group concerned and the jurisdiction of its home regulator. Reference to the world's top 500 banks as an overriding criterion was removed. Section 10 of the BA gives the FSC the power to make prudential rules (in the form of Regulatory Codes) without the need for primary legislation. However, if Tynwald subsequently fails to approve them they cease to have effect. The prudential rules issued in this context, and approved by Tynwald, are contained in the Banking (General Practice) Regulatory Code 1999. They relate to a variety of issues (e.g. capital requirements, auditing standards, ownership, acquisitions, mergers, and management). Guidance notes appended to a Code give guidance to banks about how the FSC will operate in particular circumstances. The Notes are not part of the Code. As a rule extensive consultation is held with the industry in formulating policy guidance and best practice. Section 12 of the BA empowers the FSC to seek whatever information from banks that it requires for the performance of its functions. The form and frequency of the prudential banking returns are outlined in Section 2.3 of the Code. The FSC has a comprehensive system in assessing applications for bank licenses. Initially, the assessment is conducted at executive level and will include "fit and proper" enquiries and assessment of the ability of the applicant to meet the licensing criteria and the general prudential requirements on an ongoing basis. The application is then considered at a meeting of the chief executive's licensing committee, following which a recommendation is made to a Licensing Committee, which comprises members of the FSC's Board who have not been involved in the initial review of the application. The applicant receives a copy of the recommendation. The applicant has the opportunity to attend, be represented and make representations when the license application is formally considered. These procedures were introduced in order to ensure compliance with the Human Rights Act 2001 (although not yet in force). However no new banking license applications have been filed during the past few years. On August 1, 2000, the FSC issued a guidance note on the responsibilities and duties of

	directors under the Laws of the Isle of Man (Appendix N).
Assessment	Compliant
Comments	
Principle 1(4)	A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws, as well as safety and soundness concerns.
Description	Section 6 of the BA gives the FSC power to revoke licenses in certain circumstances. A range of sanctions is available to the FSC where a bank is noncompliant. Section 7 of the BA allows the FSC to impose conditions on a license at any time. The FSC can make recommendations and issue directions to a bank under Section 11. The ultimate enforcement sanction is revocation of a license under Section 7. As stated above Section 10 gives the FSC power to set prudential rules (in the form of Regulatory Codes) administratively. Guidance notes explain what the FSC considers to be best practice. Strictly speaking guidance notes are not legally binding but if needed, they provide elements which the Courts take into account. The notes do, however, provide a basis for regulatory action, including the imposition of conditions on banks. Section 12 of the Act allows the FSC to seek whatever information from banks that it requires for the performance of its functions. The form and frequency of the prudential banking returns are outlined in Section 2.3 of the Code. In the Isle of Man, two methods are used for collecting and assessing the information needed for making supervisory judgments: • off-site supervision - requiring information from banks and their auditors, assessing it and discussing it with management; and • on-site visits. Section 12 of the BA states that the FSC may request such information from a banking institution or former banking institution or a manager or past manager of a banking institution that it may reasonably require for the performance of its functions. The FSC may issue directions to any banking institution to secure that effect is given to any such request. The FSC is also proactively engaged in identifying illegal financial activities. The FSC has specific powers to enter premises and seize relevant documents where it has reasonable grounds to suspect that illegal activity is being performed. It can then apply to the High Court for the appointment of a provisional liquidator, deemed official receiver. This gives the FSC the ability to move quickly with the approval of the Court, to protect the interests of investors or depositors.
Assessment	Largely compliant
Comments	The range of sanctions available to the FSC is to be augmented by the power to impose penalties. During the past year, consideration was also given to developing the FSC's powers to appoint managers or administrators to problem license holders. It was agreed that such powers would be desirable and that the necessary legislative changes will be considered further. The need to obtain prior treasury agreement for the Regulatory Codes developed by the FSC might represent an impediment to the development of necessary secondary legislation. In addition, Tynwald has to approve the Regulatory Codes of the FSC after they are issued, although this has not caused problems in practice. However, the rigidity and workload of Tynwald procedures could at some point of time hamper the efficiency and required speed. The FSC has to apply to the High Court for the appointment of a temporary manager or administrator.

Principle 1(5)	A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	The FSC and its officers have statutory immunity from suit, under Section 15A of the Investment Business Act 1991 and Section 19 of the Corporate Service Providers Act 2000. They are protected from liability in damages for, or in respect of, acts done or omitted in conducting their statutory supervisory functions unless shown to be acting in bad faith. Additionally, the FSC's officers are indemnified for acts or omissions, under Schedule 2 (paragraph 11) to the Statutory Boards Act 1987, provided that they acted reasonably and honestly. The FSC has the discretion to indemnify officers for any damages or costs which they have been ordered to pay, provided that it is satisfied that the officers honestly believed that they had acted within the scope of their functions.
Assessment	Compliant
Comments	
Principle 1(6)	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	Section 24 of the Financial Supervision Act 1988 permits the disclosure by the FSC of confidential information to other governmental agencies within the Isle of Man and to external agencies with statutory functions corresponding to the FSC. The disclosure must be for the purpose of enabling those bodies to exercise their statutory functions. The legal provisions are drafted so that the disclosure of information by the FSC is permissive and not mandatory. When releasing information under this Section, the FSC specifies that the information must remain confidential to the receiving agency and must not be passed on without the FSC's written consent. The FSC has also signed and is in the process of completing a number of MOUs with foreign regulators. The disclosure of information about the affairs of individual customers is prohibited except in very limited circumstances (Section 24(6)). The FSC is addressing this issue and is proposing to government that this provision be dispensed with.
Assessment	Compliant
Comments	
Principle 2.	**Permissible Activities** The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.
Description	"Banking Business" is defined in Section 1 of the BA. This definition primarily covers the taking of deposits (from the public), while Section 2 makes it an offence to conduct such business without a banking license. Section 9 makes it an offence to use the word "bank" without the written consent of the FSC. The activities that banks can conduct, other than the taking of deposits or the receipt and payment of checks, are not explicitly specified in legislation, nor are they specified in the banking license. The approach to date has been to give a letter of consent to a bank for the conduct of additional activities, in accordance with the requirements of the Code.
Assessment	Largely compliant
Comments	The legislation is largely compliant with this principle. Expanding the definition of "banking business" to include other activities and altering banking licenses to state more specifically the activities that holders are allowed to conduct, will be considered in a future review of the banking law, possibly in conjunction with the proposal to have a composite financial services law. (However, the requirement to have a banking license will still be based on deposit

	taking). As the range of activities conducted by banks is rather limited for the moment, the absence of full transparency through a listing of the activities that can be conducted is not considered material.
Principle 3.	**Licensing Criteria** The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.
Description	The FSC's policy in assessing applicants for banking licenses is outlined in the *Regulatory Guide to Banking Business in the Isle of Man.* The policy is based on the belief that the Isle of Man is too small and too vulnerable to shoulder high-risk banking operations, including start-up operations. The FSC therefore encourages applications from banks incorporated outside the Isle of Man, which fulfill the FSC's criteria for the establishment of a branch, or an Isle of Man incorporated subsidiary. These banks must be licensed in their principal place of business that must be in a jurisdiction, which in the FSC's judgment, exercises proper licensing and supervision and subscribes to the Core Principles for Effective Banking Supervision. The basic licensing criteria are set out in Section 5 of the BA. The FSC cannot grant a license unless these criteria are met. Section 4 (2) of the Act allows the FSC to prescribe the form of a license application and to request whatever specific information and documentation it requires from the applicant in order to assess an application. The FSC has a formal application form, which sets out the detailed information that the FSC requires from applicants in support of an application. The Code outlines in greater detail the general regulatory requirements and, in particular, the minimum capital requirements (see also CP 6 para1). The FSC is also required to examine the operating plans, internal controls and proforma accounts of proposed banks. These include a "fit-and-proper" assessment of the applicant, its shareholders, directors and senior management, and the ability of the FSC to exercise effective supervision over the applicant. It is important to note that the fit and proper test is both an initial test at the time of granting a license and a continuing test in relation to the conduct of the business and the relationship with the FSC. Section 5 of the Code requires disclosure of all shareholders holding more than 5 percent of the applicant's shares. Section 4(2) of the Act allows the FSC to prescribe the form of a license application and to request whatever specific information and documentation it requires from the applicant in assessing an application. As a matter of policy the FSC prefers that banks operating in the Isle of Man are directly held, wholly owned subsidiaries of banks as this facilitates the communication and control necessary for proper parental oversight of Isle of Man operations. Nevertheless, there are occasions when an intermediate holding company, which is not a bank, is interposed between the Isle of Man bank and its banking parent. It is important that this does not complicate communication and control, or dilute responsibility by introducing a further jurisdiction into the ownership chain. In such cases, the FSC requires not only that the intermediate holding company has positive free resources but also that the parent bank provides a Letter of Comfort in terms acceptable to the FSC.

	In general, the positive free resources requirement for a nonbank holding company obliges a holding company to have sufficient equity (including convertible unsecured loan stock) to fund its assets and contingent liabilities without recourse to third parties for new resources. This is an ongoing minimum requirement designed to ensure that a future Isle of Man banking subsidiary cannot be imperiled by the actions of creditors of a nonbank holding company. Such actions may arise for a number of reasons, including breaches of covenants, etc. In the FSC's view, it is also desirable that the holding company of a bank should be a demonstrable source of strength to the bank it owns, thereby enhancing the confidence of depositors. In cases where the intermediate holding company is itself a bank, the FSC's requirements are influenced by the requirements of the home supervisor of that bank. If the intermediate holding company is owned directly by a bank which has also provided a satisfactory Letter of Comfort, the FSC may be prepared to relax its requirements with regard to the financing of the equity of the subsidiary, provided that it is satisfied that there is no danger to the Isle of Man subsidiary from third party creditors. Section 7 of the BA allows the FSC to revoke a license should it subsequently emerge that the applicant provided false information. The FSC consults with the home supervisor where an applicant is a foreign bank that proposes to establish a branch or subsidiary in the Isle of Man. Following the issue of a license, the FSC's on-site and off-site procedures ensure that compliance with the licensing criteria and other supervisory requirements are continuously met.
Assessment	Compliant
Comments	
Principle 4.	**Ownership** Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.
Description	Section 5 of the Code requires the prior written consent of the FSC for transfers of voting shares of 5 percent or more of a licensed bank's total voting shares, and for transfers of a lesser amount which would have a material effect on beneficial ownership or control. The disclosure—to the FSC—of the ultimate beneficial ownership of all shares in excess of 5 percent of the issued capital of a bank institution is required. (Section 5.2 of the Code). A bank whose shares are quoted on a recognized Stock Exchange, should inform the FSC—in writing—within seven days of the discovery of any transfer of 5 percent or more of its voting shares or any lesser transfer which has a material effect on its immediate or ultimate beneficial control (Section 5.2 of the Code). The FSC must also be informed in writing not less than 21 days in advance of any proposed change in the ownership structure between it and its ultimate parent company (Section 5.2 of the Code). The guidance note on this issue, attached to the Code, indicates further that in some instances, a change of the parental ownership structure may not involve any changes in immediate or ultimate parent companies. However, if any material changes are to be made to any of the other companies in the structure linking the banking institution to its ultimate parent, the FSC must be notified. This would include, for example, the ultimate parent selling part of its stake in a subsidiary which itself forms part of the link between it and the banking institution. Furthermore these changes are to be covered by the annual certificate from senior bank management. (see also CP 14 para.3) The FSC must be aware at all times of the identity of the owners of a banking institution. Connected parties are considered to be one shareholder in considering questions of control.

	In assessing a license application, the FSC must not only be satisfied that the owners are "fit and proper" but also that the ownership is both appropriate and suitable. In particular, the FSC must be satisfied that there will be no conflict between the other business interests of the owners and those of the banking institution and that the owners recognize a moral responsibility to support the bank and have the substance to do so, if required. The accuracy of the FSC's information on significant shareholders in banks is checked to the annual financial statements of license holders and their parents (where applicable). The FSC does not receive a periodic return on controllers/significant shareholders. Furthermore, as part of the annual review of the bank's operations, the supervision division verifies with the Company Registrar that there have been no material changes in ownership.
Assessment	Compliant
Comments	
Principle 5.	**Investment Criteria** Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Assessment	Compliant
Comments	
Principle 6.	**Capital Adequacy** **Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.**
Description	Section 2 of the Code specifies a minimum absolute paid-up capital of £1 million for all banks. Additionally, all banks must maintain a minimum risk asset ratio of not less than 10%. The components of capital and the methodology used are generally in accordance with the Basel Capital Accord (Section 2.2 of the Code). Risk weightings are applied to both on-balance-sheet and off-balance-sheet risks. Interest rate and foreign exchange mismatches are also included in the calculation of risk asset ratios (see CP12). Risk asset ratios are set individually for banks according to the FSC's perception of the risks attached to a particular bank's business and may be higher than the 10% minimum.. A higher minimum may be set where the FSC believes this to be appropriate due to the nature of a bank's business, and/or by reference to its peer group (Section 2.2 of the Code). In addition, the FSC takes into account such factors as the bank's parent (and its ability to provide additional capital if required), the risk asset ratio applied to the parent bank by its home supervisor and the quality of the bank's management. At present required risk asset ratios vary between 10 and 18 %. Out of a total of thirty-four bank subsidiaries, eight have to comply with a capital ratio that exceeds the 10 % minimum. The FSC also employs "trigger ratios", which are set higher than the required minimum risk asset ratios in order to draw attention to the approaching need for more capital. If a bank's actual risk asset ratio falls to the trigger level, it is expected to discuss its capital adequacy planning with the FSC to ensure that its minimum required ratio is not breached. The Code (Section 11.1) also requires a bank to notify the FSC immediately if it breaches its minimum risk asset ratio.. In calculating its capital adequacy (its risk asset ratio) a bank should observe the principle of prudence, particularly when evaluating the quality of its assets and accruing income. Required risk asset ratios must be maintained on a solo and – where applicable – on a

	consolidated basis. Although the risk asset ratio - and the large exposure limits (see CP9) are related to a bank's adjusted capital base, the FSC recognizes that current earnings represent the first line of defense against losses and that profitability also affects a bank's decisions on whether or not to expand its Isle of Man operation, whether to invest additional resources, and so on. Accordingly, the FSC pays close attention to a bank's reported earnings, size as well as source. It calculates a number of ratios designed to measure not just profitability but also the strength and source of earnings. These reveal not only the success or otherwise of the business but often also the role the bank is playing within the banking group of which it is a part. Because the results of the Isle of Man operation are often the consequence of decisions taken as part of a wider strategy, the ratios need to be carefully interpreted but they are considered to be a vital supervisory tool. The amount of profits paid out as dividends needs to be compatible with a continuing need to maintain adequate capital. The FSC has no explicit power to suspend payments by banks to their shareholders. However, the FSC can achieve the same effect by issuing a direction to suspend such payments under Section 11 of the BA. If the payment of a dividend results in a breach of a bank's risk asset ratio the FSC has the power to require that the breach be rectified immediately (such breaches must be reported under Section 11.1 of the Code). In practice, as most banks have risk asset ratios well above their required minimums this is not a significant issue. The banks submit detailed quarterly prudential returns to the FSC.
Assessment	Compliant
comments	
Principle 7.	**Credit Policies** **An essential part of any supervisory system is the independent evaluation of a bank's policies, practices, and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.**
Description	Section 8 of the Code (in particular the related Appendix D) requires that banks must have internal controls, policies and procedures relating to the assessment and granting of loans and the ongoing management of these risks. Paragraph 4 of Appendix D requires banks to establish and adhere to adequate policies and procedures for evaluating the quality of assets and the adequacy of loan-loss provisions and reserves. Assessment of compliance with these requirements may be covered in the FSC's future on-site programs in accordance with its powers in Section 13 of the Act. The FSC has also stated that consideration will be given to applying more prescriptive requirements in these areas if necessary. These might include more detailed reporting (such as quarterly reporting of loan classifications (gradings) and detailed arrears figures) and a requirement to have prescribed levels of specific provisions in respect of such arrears. The FSC's requirements in this area are general in nature, and not detailed prescriptions. To some extent the FSC has taken into consideration the fact that most banks are part of larger U.K. entities, which apply group policies to their Isle of Man operations. Also, the priority which the FSC has given to addressing AML issues has prevented it from assessing the specific areas to which the criteria relate (except in isolated cases) with on-site examinations. In the opinion of the FSC CPs 7–10 are also inter-linked. It therefore decided to address these issues/criteria as part of a review of the Code, which was already being carried out by the policy unit, in conjunction with the Supervision Division. This review of the Code had not been completed at the time of the IMF mission. However the FSC has acknowledged the need for such a review and has indicated that the review will be completed as priorities allow.
Assessment	Largely compliant

Comments	The FSC places emphasis on banks' own standards of corporate governance and their audited financial statements. The FSC does not, however, review the scope and quality of the work carried out by banks' external auditors in order to achieve reasonable assurance that the required independent evaluation of credit risk policies, credit quality and provisioning assessments is being carried out in a consistent manner. Up to now there has been no formal or ongoing program for the independent assessment of banks' credit risk policies, practices and procedures. It is acknowledged that between November 2000 and December 2001, three focused reviews to ensure compliance with internal bank credit risk policies were carried out. In addition, and for particular business reasons, Reporting Accountants were employed on one occasion to confirm a bank's compliance with its own credit risk policies. No guidance/guidelines covering generally accepted credit risk policies and procedures have been provided to the industry. The FSC has recognized the lack of guidance in this area and has indicated that this subject will be addressed as part of the review of the Code. The reinforcement of the need for sound credit risk practices, policies and procedures is a primary requirement of supervisors. To balance the FSC's belief in being able to rely on home jurisdictions' own assessments the FSC may want to consider the possibility of reinforcing the need for international credit risk "best practices" by providing a copy of the Basel Committee guidance on this subject to all licensees. A covering letter would likely be needed to indicate that the FSC supports the content of the guidance and will be seeking compliance with the guidance during its on-site visitation program. Addendum: Subsequent to the mission the FSC has taken a constructive step to reaffirm the need for banks to have sound credit risk practices, policies and procedures. A letter to the industry has been developed which focuses on amongst other issues the importance of having sound credit risk policies, procedures and practices. Reference in the proposed letter is also given to Basel Committee guidance to banks on Credit Risk "best practices." The FSC, plans to develop more industry specific guidance on Credit Risk in the future. The FSC also plans to extend their on-site visitation program to include an in-depth assessment of the credit risk policies, procedures and practices where appropriate.
Principle 8.	**Loan Evaluation and Loan-Loss Provisioning** Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan-loss provisions and reserves.
Description	See also comments outlined in CP 7—The FSC has not carried out a single independent review of asset quality in a bank nor appointed outside professionals to do this on its behalf.
Assessment	Largely compliant
Comments	The FSC has viewed compliance with this principle to be of lower risk. Historically, banks in the Isle of Man have been primarily "providers" of funds to their parent bank or affiliates of their parent. At the end of August 2002, total loans and advances represented only 18.6 percent of total assets. The FSC is currently the home supervisor for only two independent banks, one of which has a restricted license. Reliance for loan evaluation and loan-loss provisioning assessments for subsidiaries has been placed on the home supervisor. An additional degree of comfort to the FSC has been the "true and fair" opinion provided by external auditors on banks' annual audited financial statements. No independent assessment of credit quality and loan-loss provisioning has been carried out as part of the on-site visitation program. Over the past three years the on-site visitation program has

	primarily focused on AML/KYC assessments. For this reason, the FSC has been unable to assess credit risk techniques and practices including such features as the quality of the credit risk management, credit risk administration, valuation of collateral and the processes for classifying loans and ensuring adequate provisions. The FSC has the power to employ Reporting Accountants to carry out special purpose audits. In our review of the one occasion when Reporting Accountants were employed to assess credit risk, the opinion formulated was limited to providing confirmation of the application of the bank's own provisioning policies and compliance with its own lending practices. No opinion was provided on the overall asset quality or the adequacy of provisioning. No specific guidance has been provided to the industry covering the identification and recording of impaired assets or the valuation of collateral to reflect net realizable value. The FSC has not yet developed an in-depth on-site credit risk evaluation process. In developing appropriate on-site examination criteria the FSC may want to consider the following: Credit process: • Do credit risk policies and procedures reflect the risk appetite of the licensee, and have they been confirmed by the board of directors; • Are policies and procedures in place for all credit risk products, and are they reviewed at least annually to ensure they remain up to date and relevant; • Are credit risk exposure limits reasonable, considering the risk appetite and the ability of the licensee's resources; • Have clearly defined and articulated policies and procedures been established for reporting and monitoring out of order conditions; • Has a risk rating system been put in place to the management and the board of the licensee to monitor asset quality trends in a timely and anticipatory manner. Credit assessment/quality: Before the FSC can have a successful asset quality review process, it will be of paramount importance that the FSC ensures that its staff has sufficient knowledge and understanding of credit risk assessment processes. The FSC may want to establish its own credit risk rating system that can be applied on a consistent basis to all credit risk assessments. The FSC credit risk rating system could then be used to assess the integrity of a licensee's own credit risk rating system; and The FSC could select a sample of a bank's loans and review these in order to confirm the quality and application of the bank's own credit risk policies and lending activities, including its credit administration process, its ability to identify possible adverse trends and its processes for reporting out of order conditions and loans. Loan-loss provisioning: Independent credit reviews could also assess banks' existing processes for identifying deteriorating situations in a timely manner, so appropriate provisioning is applied not only to known loss positions but also to deteriorating situations in a performing portfolio. We recognize that in developing a more prescriptive approach to loan evaluation and provisioning due consideration has to be given to ensuring that the FSC has staff capable of carrying out this type of specialized review.

	Addendum: Refer to comments Addendum CP 8. The FSC has also requested banks to provide the FSC by December 31, 2002, with a copy of their "documented Credit, Loan Grading and Provisioning Policy Statement(s). We will then review the statement(s) and provide feedback by March 31, 2003." The action taken by the FSC is reflected in the assessment provided.
Principle 9.	**Large Exposure Limits** Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.
Description	Paragraph 3 of Appendix D to the Code requires that banks have management information systems to enable ongoing management of exposures, including the identification of concentrations. A "large exposure" is defined in the Code as an exposure of more than 10 percent of the bank's adjusted capital base. All large exposures must be reported to the FSC but only in the case of exposures of more than 25 percent of the adjusted capital base need the notification to be in advance of the granting of the facility. Also, banks may not incur large exposures, which in aggregate exceed 800 percent of the adjusted capital base. Large exposures are reported by banks as part of the quarterly reporting returns. Exposures to "connected counterparties" (defined in Paragraph 3 of the definitions to the Banking Return) must be aggregated. Concessions are granted to the large exposures limits in limited circumstances**,** e.g., in the case of exposures, which are covered by "take-out" agreements given by the bank's parent or other group company. However, it is recognized that the FSC's policy in granting concessions needs to be more formalized, particularly in the area of group "take-out" arrangements.
Assessment	Largely compliant
Comments	The FSC is cognizant of the concessions provided to the industry and has implemented procedures to monitor the approved concessions. The confirmation of the accuracy of the regulatory returns adds a further element of control. The FSC has acknowledged the need for bringing more clarity to the approval process particularly in the area of group "take-out" arrangements.
Principle 10.	**Connected Lending** In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.
Description	Paragraph 5 of Appendix D to the Code requires that banks lend to related parties (as defined in Paragraph 2 of the definitions to the Banking Return) on an arm's length basis only and that they have information systems to monitor such credits. In addition, the FSC imposes an additional 50 percent weighting for capital adequacy purposes to such credits or, alternatively, reserves the right to deduct the exposures from a bank's adjusted capital base. Related party exposures must be reported in the quarterly Banking Return. The large exposure limits referred to in Principle 9 apply also to related party transactions. Transactions with such parties must be assessed and conducted on nonconcessionary terms and monitored and reported by the banks' managements on a regular basis. However, to date the banks' internal procedures in this area have not been subject to on-site review. It is also a matter for consideration if the FSC should have more prescriptive limits for the amounts which banks may lend to related parties.

	See also comments CP 19 re independent reviews completed by external auditors.
Assessment	Compliant
Comments	The issuance of credit risk guidance would add additional clarity to the process
Principle 11.	**Country Risk** Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring, and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.
Description	Paragraph 6 of Appendix D of the Code requires banks to have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk and for maintaining adequate reserves against such risks. The FSC has not issued detailed requirements for provisions against these risks. However, the FSC imposes limits on a bank-by-bank basis on exposures to certain countries, e.g., as regards interbank or intercompany placements. The FSC believes that the adequacy of provisions made against such exposures, as well as their recoverability, would be assessed by banks' external auditors as part of the annual audit. As banks are not exposed to country and transfer risk to any significant extent, the FSC does not consider that more prescriptive requirements are necessary at present. The FSC deals with the issue on a case-by-case basis, through the imposition of conditions or directions, where the need arises.
Assessment	Compliant
Comments	
Principle 12.	**Market Risks** Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor, and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposure, if warranted.
Description	Paragraph 7 of Appendix D (Controls and Procedures) to the Code requires that banks have systems that accurately measure, monitor and control market risks. The FSC measures, monitors and discusses with banks their exposure to movements in both interest and exchange rates. These arrangements form part of the regular process of supervision and are included within the scope of prudential interviews. There are different arrangements for Isle of Man incorporated banks and for branches of foreign banks, although both participate in the same reporting system. In the opinion of the FSC the primary responsibility for the control of exposures arising from foreign currency operations, as for any other aspect of a bank's business, must rest with a bank's own management. However, in the discharge of supervisory responsibilities, the FSC needs to know the methods by which bank management control such exposures, the extent of each bank's exposure, and its relation to other risks and to its capital. Section 3.2 of the Code requires banks to submit to the FSC their written policies (approved by their boards) on liquidity, interest rate and foreign exchange risk (including limits for overall currency positions against reporting currency position and for individual currencies). The FX operations of banks must also be covered by appropriate systems and controls. In this respect reference must be made to the Regulatory Code which requires banks to have in place internal controls that are adequate for the nature and scale of their operations and the systems of internal control procedures and management information systems are required to be documented and approved by the board of directors.(see CP14). These requirements by the Code must be covered by an annual compliance certificate from each bank's "4 eyes" (see CP14). The external auditors are required to provide annually, reasonable assurance as to the accuracy of a regulatory return.

	Interest rate and foreign exchange mismatch positions are reported in the quarterly Banking Return. Such mismatches attract risk weightings for capital adequacy purposes. The FSC requires banks' net open FX positions to be added to their risk-weighted assets when their risk-asset ratios are calculated. This means in effect that each individual bank has to maintain capital for FX risk in line with its risk-asset ratio – depending on its required risk-asset ratio the amount will be between 10 and 18 percent of its net open FX position. Only four banks demonstrate FX-exposures and interest rate exposures, which combined, exceeded 1 percent of their respective capital requirements (from 3.40 percent to 1.33 percent)].
Assessment	Compliant
Comments	
Principle 13.	**Other Risks** Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks.
Description	Refer to comments under CP 12. These comments outline the process the FSC has in place to address liquidity, interest rate and foreign exchange risk. A liquidity gap report is required as part of the quarterly prudential returns. Banks incorporated in the Isle of Man provide the FSC with a written statement, approved by the board of directors, detailing their policies for the management of liquidity. In these policy statements banks have to stipulate their cumulative maximum mismatches for each time band detailed on Form SR-3 of the Banking returns and for cumulative time bands (Section 3.1 of the Code). This statement must also include a bank's own internal limits for funds placed with other banks including those belonging to the same banking group. A bank incorporated outside the Isle of Man has to provide the FSC with a written statement detailing its policy for the management of the liquidity of its branch(es) in the Isle of Man. The relevant guidance note further indicates that in all cases the FSC wishes to ensure that a bank's liquidity policy is appropriate to the nature and scale of its business. The quality and availability of its assets are important factors in determining its ability to meet obligations as they fall due. The FSC recognizes that it is not always possible to lay down supervisory rules for the management of liquidity that are both comprehensive and relevant to every institution. The activities of banks in the Isle of Man vary widely and are, in many cases, dependent on the role and tasks allotted to them by their parent bank. Their need for and approach to liquidity, therefore, depends not only on the nature and scale of their business, but also in many cases on group policy. Nevertheless, the FSC believes that every bank operating in the Isle of Man should have a policy detailing its approach to the management of liquidity and that the supervisors should know and understand that policy. If necessary, the FSC proposes changes. This is normally the exception and is usually done with the knowledge and agreement of the home supervisor (under the terms of the International Concordat on banking supervision, responsibility for supervision of local liquidity is placed on the host supervisor) . In its assessment of liquidity the FSC concentrates on measuring the mismatch between maturing liabilities and assets in various time bands as revealed by the maturity analyses provided quarterly by the banks. It focuses its attention primarily on the short maturities, particularly the time bands up to one month. It has not so far attempted to establish any general overall limits for mismatching, preferring—if necessary to set any limits on a case by case basis. However, it may seek to do so, particularly if such limits were to be established in

	the major financial centers. In assessing the amount of any mismatch for an individual bank the FSC takes account of any marketable assets, which the bank may hold. The test of marketability is strict: the assets must be of a quality that they will be marketable in adverse market conditions at a price not far removed from book value. In practice, these are usually assets in which central banks are prepared to deal regularly. Many banks in the Isle of Man use the inter-bank market or their parent bank as the repository of their liquidity. The FSC examines inter-bank limits (where appropriate) to ensure that inter-bank risk is properly spread. It may also impose its own placement limits on individual banks (including limits on placements with parent banks) if it perceives a need to do so. Another source of liquidity is, of course, a bank's ability to buy funds from other banks through the inter-bank market, or to obtain standby or other borrowing facilities from them. Here again few banks in the Isle of Man are active takers of funds from the inter-bank market. A few are occasional takers but most are regular givers. Experience teaches that agreed standbys and similar facilities are not always available to a bank facing liquidity pressures. While the FSC is prepared to make allowance for standby and other borrowing facilities in its assessment of liquidity mismatches, it does so on the assumption that these are available in fair weather markets only, except where the facility is provided by a parent bank and the FSC is satisfied with the standing and financial condition of the parent bank. This regular desk analysis of liquidity management is part of off-site supervisory program Another part of the task is discussing with the management the results for the business as revealed by the returns. The returns provide a useful snapshot of the business at particular points in time and the financial magnitudes revealed are, of course, the consequence of management decisions. The FSC considers that its 'stand alone" policy of supervision is in the interests of the Isle of Man as a financial centre. The FSC further considers that a license holder should create independent liquidity by placing funds outside its own group. This is regarded as a logical and appropriate extension of the 'stand-alone' policy. For the time being the FSC has decided not to introduce an industry-wide requirement to create independent liquidity. The FSC and the industry have indicated that other than limited exposure to market risk the primary risk is reputation risk. To assess the possible exposure to this risk the FSC undertook a series of focused AML/KYC visitations during the past three years. Section 9.2 of the Code requires banks to seek the prior consent of the FSC before making any addition or material change to any of their services or products (including unregulated services or products). As part of the approval process the FSC considers banks' ability to introduce and sustain new products or services.
Assessment	Largely compliant
Comments	The introduction of a more in-depth visitation program will allow the FSC to confirm the existence and application of comprehensive risk management policies and procedures.

Principle 14.	**Internal Control and Audit** Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls, as well as applicable laws and regulations.
Description	Paragraph 2 of Appendix D of the Code requires that banks have in place internal controls that are adequate for the nature and scale of their businesses. Section 8.4 of the Code requires that the systems of internal control, procedures and management information are documented, approved by the board of directors, and are in accordance with the Code and any other relevant legislation. Section 8 of the Code also requires that the day-to-day operations of a bank are effectively controlled by at least two individuals (the "four-eye" principle) and that at least two of its directors are Isle of Man resident with at least one being non-executive. The FSC requires prior notification of the appointment of directors and senior officers in order to assess their fitness and properness. The appointment of certain officers, e.g., compliance officers and money laundering reporting officers is obligatory. Furthermore, banks incorporated in the Isle of Man must comply with the requirements of the Companies Acts. In assessing compliance with the requirements in this area, the FSC receives an annual compliance certificate from each bank's "4-eyes" that it has complied with the Code. The FSC also receives copies of external auditors' management letters and there is an obligation on external auditors (or reporting accountants), under Section 20 of the Act, to report matters, which come to their attention, during the course of their audit work, relevant to the FSC's statutory functions. The requirements of the general law, i.e., the Companies Acts (where applicable), the BA and the Code also place responsibility on the banks directors and senior management with respect to corporate governance. The FSC reviews the reports of Internal Audit and where appropriate meets with Internal Auditors to discuss issues of common interest. While no specific corporate governance guidance has been issued for banks, a guidance note on the responsibilities and duties of directors under the laws of the Isle of Man was issued by the FSC in August 2000. The guidance note describes amongst other issues—duties of Directors—Powers of Directors—Knowledge of the Legal Framework—Liabilities—Criminal and Civil and also provides a definition of "Good Corporate Governance." The FSC plans to implement a more extensive on-site visitation process during the fiscal year 2002–2003.
Assessment	Largely compliant
Comments	The introduction of expanded visitation techniques and practices will provide an additional level of confidence for supervisory purposes. Addendum: The FSC is to be commended for the development of comprehensive corporate governance guidance entitled, "Corporate Governance for Banking Institutions." This guideline was developed subsequent to the IMF mission and when in force will articulate the accountabilities and fiduciary responsibilities of senior management and the board of directors for ensuring that banks operate in a safe and sound manner. The current process to have an annual certificate completed by senior management will ensure that an appropriate acknowledgement of fiduciary responsibilities is provided to the FSC.

Principle 15.	**Money Laundering** Banking supervisors must determine that banks have adequate policies, practices, and procedures in place, including strict "know-your-customer" rules that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.
Descriiption	Section 12.5 of the Code requires that banks have adequate policies and procedures in place to ensure high ethical standards and to prevent their use by criminal elements. Banks are required to comply with anti-money laundering legislation in place. The main legislation in place is the Anti-Money Laundering Code 1998. To ensure that banks (and other licensed financial institutions) comply with the requirements of this law, the FSC has issued comprehensive anti-money laundering guidelines. These guidelines are kept under continuous review and the most recent guidance notes were issued in April 2003. These guidance notes link into the regulatory framework through Section 12.5 of the Code and Section 6.1 of the Financial Supervision (Conduct of Business) Regulatory Code issued under the Investment Business Act 1991, which both state: "A license-holder shall have adequate policies and procedures in place, including strict "know-your-customer" rules that promote high ethical standards in the financial sector and prevent the institution being used, intentionally or unintentionally, by criminal elements. These policies and procedures shall ensure compliance with the money laundering legislation in force at that time." As stated above, the guidance notes are designed to assist license holders in complying with the money laundering legislation by specifying best practice in this regard. The FSC recognizes that license holders may have systems and procedures in place which, whilst not identical to those outlined in these guidance notes, nevertheless impose controls and procedures which are at least equal to if not higher than to those contained in these guidance notes. The FSC will take this into account when assessing the adequacy of a license-holder's systems and controls. Banks are required by the FSC to appoint money laundering reporting officers and are obliged by the law to report suspicious transactions to a constable (which includes officers of both the Isle of Man Constabulary and Isle of Man Customs and Excise.) During the last three years the FSC has conducted on-site visits in all the banks specifically to test their KYC procedures and their compliance with the anti-money laundering legislation.
Assessment	Compliant
Comments	
Principle 16.	**On-Site and Off-Site Supervision** An effective banking supervisory system should consist of some form of both on-site and off-site supervision.
Description	Off-site supervision is focused on the submission by the banks of a detailed quarterly Banking Return. These returns are checked for compliance with the prudential supervisory requirements (see CP18 for a more detailed description of the off-site supervision process). Follow-up on noncompliance with prudential requirements or other unusual situations is performed. Historically, on-site supervision has consisted of annual meetings (ARMs or Annual Review Meetings) with the senior management of banks to review significant areas of their operations. These meetings are held to review with senior management, issues coming out of off-site supervision and other issues of supervisory interest. Over the last three years the FSC has given priority to carrying out assessments of AML/KYC techniques and practices coupled with selected ARM meetings whenever the risk profile indicated an ARM meeting was warranted. The FSC formulates an annual on-site program for the ARM visits. The focus of these visits is determined by an internal risk assessment (CAMELB.COM methodology). Issues coming out of

	the ARM meetings are monitored as part of the off-site-monitoring program.
Assessment	Largely compliant
Comments	The long-standing off-site supervisory process, coupled with the ARM process, has been effective. A standardized assessment and reporting process is in place for off-site reviews. It was encouraging to note that the FSC requires external auditors to provide reasonable assurance annually as to the accuracy of a regulatory return. In addition, the practice of obtaining an annual certificate from senior management of banks confirming their compliance with the Regulatory Code brings a further degree of accountability and possible liability to senior management should a distress situation occur. The FSC also obtains a letter from home supervisors confirming there were no issues of significant concern that would adversely impact the FSC as a host supervisor. The FSC is to be commended for the implementation of these control and accountability frameworks. The FSC has also made progress in its efforts to enhance the structure and approach to on and off-site supervision. Contributing factors to the enhanced supervisory process include: • An organizational structure will be introduced which when fully implemented and staffed will focus on a consolidated approach to supervision of FSC licensees; • A risk-rating system has been introduced for banks and is being applied on an ongoing basis; • A draft on-site methodology has been developed. The methodology developed parallels the risk-rating system (see comments re methodology below): • The existing technology platform provides for statistical comparisons. Unusual items are followed up. A more advanced technology platform was undergoing acceptance testing at the time of the mission; and, • Existing reporting formats are standardized and focused. Production of reports is timely. Copies of reports produced for supervisory purposes are also provided to boards of directors and parent banks, where appropriate. Three years ago, the FSC identified the need to ensure that licensed banks had an effective anti-money laundering regime in place. Over this period all banks have had a special focus on AML/KYC visitation. The on-site work was well documented. Industry representatives and auditing firms also confirmed that the focused visitations were effective. As a result of the focused AML/KYC visitation program, no full-scope safety and soundness visitations were carried out during this period. For example, while three visitations focused on credit-risk policies and procedures, the scope of the visitation did not assess credit quality or the reasonableness of loan-loss provisions. In addition, the effectiveness of the overall corporate governance regime in banks has yet to be subject to an independent assessment during visitations. In our opinion the on-site visitation program must be expanded. Significant risk areas should be assessed to confirm that an effective process of control exists throughout all areas of a bank's operations and that the corporate governance regime is reflective of the risk appetite and profile of the bank. The FSC has developed a draft methodology designed to provide for a more probing visitation program. Our review of the proposed methodology revealed that while the methodology is sound the format of the methodology will be difficult to implement. The FSC has acknowledged this weakness and has confirmed the methodology will be reformatted in a manner to support risk-based assessments.

	We are however concerned that the FSC may not be able to achieve their departmental objectives particularly in the area of on-site safety and soundness visitations. Central to our concerns is that it appears that while staff employed is well qualified and supportive of the directional statements being made, the Supervision Division has a resource deficit. Another concern is the dynamic knowledge gap that is occurring as a result of the accelerated changes that have and continue to occur within the industry. The FSC has established an on-site visitation program that is reflective of the risk profile of their banks. The visitation objective is designed to ensure that all banks are visited at least within three years. Extrapolating the numbers of person days for scheduled on and off-site supervision estimated by the Supervision Division suggests that there will be a significant shortfall. Other issues that will have an impact on the effectiveness of the Supervision Division include: • In general, the industry feedback concerning the quality of FSC staff was positive although some concerns were registered regarding the FSC's ability to assess in a detailed manner some of the new products and services and the required control practices being provided by the industry; • There are no prescribed quality control procedures being applied to support the on-site observations and judgments; and, • Turnover at the management level has occurred. Turnover within the Supervision Division for the year ending March31, 2002 was 17 percent. For the period ending September 30, 2002 turnover has been 7 percent. While recruited staff is well qualified they will need time and guidance to be able to assume their new accountabilities. To address the aforementioned issues the FSC would now benefit from adding a further degree of discipline to the on and off-site supervisory process. Examples of the types of additional discipline that would add value to the process include: • Accelerate the plan to finalize the on-site examination methodology. For example, refer to the comments and recommendations contained in CP8 for guidance on this particular subject; • Training programs focused on the expectations of the enhanced on-site methodology will be required; • The quality control or assurance process be formalized; and, • A time accounting process should be put in place that would provide quantitative and where appropriate qualitative data on how the division allocates it time. This type of reporting will become more important as the Supervision Division moves toward the implementation of a fully integrated on and off-site supervisory process. In general, we are concerned that unless the Supervision Division department is adequately resourced, the progress made to date will not be sustained.
Principle 17.	**Bank Management Contact** Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.
Description	The FSC has formal contact with senior management in banks through Annual Review Meetings (ARMs). Additionally, "ad hoc" meetings are held at the request of either the FSC or the bank. The rationale for these meetings and the on-site visits is to ensure that a good understanding of the bank's business is obtained. To date, the ARMs have focused on the results of the off-site surveillance activities and other issues of interest.

	Banks are required to notify the FSC of any significant changes in their operations (Section 9.2 of the Code). The FSC conducts an ongoing assessment of the quality of a bank's management as well as an assessment of its business operations and this is fed into the overall risk assessment of the institution as referred to in the assessment of compliance with CP16. Feedback obtained during visits with senior management from a selection of banks, the Association of Licensed Banks and the Society of Chartered Accountants confirmed the constructive dialogue that exists between the FSC and other interested stakeholders. There appears to be a common interest within the Isle of Man that is directed at encouraging the development and sustainability of a sound regulatory regime.
Assessment	Compliant
Comments	A more in-depth, on-site examination process that addresses safety and soundness issues, will allow the FSC to assess compliance with regulatory requirements and obtain evidential confirmation of its understanding of the quality of management.
Principle 18.	**Off-Site Supervision** Banking supervisors must have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.
Description	Section 2.3 of the Code requires banks to submit a quarterly Banking Return (calendar basis) in a format prescribed by the FSC. Where the bank's year-end is different from the calendar quarters a bank is required to provide a further return to take into consideration the period to the calendar year-end. The Banking Returns consist of 4 distinct sections—(1) Balance Sheet, (2) Profit and Loss, Related-Party Transactions and Capital, (3) Liquidity, and (4) Foreign Currency and Interest Rate Exposure (off-balance sheet data). A less detailed reporting regime is in place where a subsidiary or associate company exists or a branch operates in the jurisdiction. Where applicable, these returns must be on a consolidated and solo basis. The information provided is mainly prudential but is also partially statistical. Prudential returns must be signed by a recognized director or senior manager. Section 12 of the BA permits the FSC to seek information on entities related to the bank, if it so requires. The Banking Return must be submitted to the FSC no later than 21 calendar days after the quarter-end date. The reporting process is monitored to ensure returns are being received on a timely basis and to highlight anomalies and concerns in the information provided that may have implications for the effective management and operation of the bank. Where issues warrant further assessment queries are sent to banks and followed up. An internal procedures document has been developed to ensure consistency of assessment over regulatory returns. An internal data base of information has been developed to provide validation checks on specific reporting items. This data base is available to the banking team as well as other selected staff. An enhanced "Financial Reporting System" ("FRS") is currently undergoing acceptance testing. The development is being driven by the Operations Division, in conjunction with the Isle of Man government ISD Division. The development team includes representation from the Banking Team as well as two other representatives from the FSC knowledgeable about investment business and investment schemes. When implemented the technology platform is expected to allow the bank supervision team to expand their institution specific analysis to allow for more focus to be placed on broader trends and systemic issues.
Assessment	Largely Compliant
Comments	The relationship and ownership of the technology platform that exists between the FSC and the Isle of Man government ISD Division should be reassessed. Confirmation should be obtained from the government that the data provided by banks is "ring-fenced" from possible access by

	other government departments.
Principle 19.	**Validation of Supervisory Information** Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.
Description	Section 13 of the BA provides for the conduct by the FSC of inspections (on-site visits) on banks. The powers contained in this Section do not limit the scope of the inspection. In addition, the FSC may appoint external officers to conduct such inspections. Section 21 permits the FSC to appoint "Reporting Accountants" to report on any aspect of a bank's business. Banks are also required to have an annual audit by external auditors and there are obligations on such auditors (and also on Reporting Accountants), under Section 20, to report to the FSC if they become aware of facts during the course of their audits that they believe to be of material significance in relation to the FSC's functions under the BA. The requirements of the Act focus on what could be referred to as "dire straits"—likely to lead to a serious qualification or refusal of the certificate of audit—endanger the existence of the banking institution; or gravely impair its development—imperil the protection of customers of the institution—indicate that the principles of sound management have been seriously violated. The external auditor is also required to submit a letter to the FSC confirming that to the best of his knowledge and belief, the banking institution has complied with several sections of the Code: 4.2(b)—verification of banking returns, 4.5—accounting records in the Isle of Man, 4.6-records retention, 4.7—accounting records—written communications with the FSC, 7.1-creation of charges over assets, and 8.4—existence and application of internal controls, procedures, and management information. While the FSC is receiving the required letter sections 4.2(b), 4.5, 4.6, 4.7 and 7.1, external auditors have not agreed to provide an opinion relating to section 8.4e—existence and application of a sound process of control. This issue was discussed at length with the accounting profession following the introduction of the code in 1999. As no resolution was able to be achieved the issue has remained outstanding. Auditors are also required to verify the accuracy of a bank's supervisory returns with the underlying accounting records at least once per year and provide an opinion as to the accuracy of the information reported. The Isle of Man Society of Chartered Accountants has provided its members with an explanatory memorandum dated February 2000 entitled "Explanatory Memorandum for the Guidance of Auditors and Reporting Accountants of Regulated Financial Service Entities in The Isle of Man." Amongst other issues covered in this document is a reference to the Auditing Practices Board support for allowing auditors' to have the right and duty to report to regulators in the Financial Sector and the Isle of Man reporting requirements.
Assessment	Largely Compliant
Comments	The FSC is to be commended for obtaining reasonable assurance through independent audit opinions, which confirm the accuracy of regulatory reports. In addition, the letter required from external auditors indicating that nothing has come to their attention that would indicate noncompliance with sections of the Code adds further value to the supervisory process. However, a weakness in the process is that external auditors are not providing an opinion on internal controls as prescribed in section 8.4 of the Regulatory Code. This issue is under discussion with the FSC. An important degree of reliance is being placed on the work and opinions provided by external auditors. However, the FSC has not put in place a process to monitor the quality of work performed by external auditors in order to establish if reliance can be placed on it. The type of assurance sought could be achieved if the FSC was able to review the audit working

	papers supporting the prescribed regulatory returns or where appropriate the work undertaken as part of the Reporting Accountant process. In discussions with representatives of the Isle of Man Society of Chartered Accountants concerning the aforementioned subject, the representatives from the Society indicated that they understood the need for the FSC to obtain the necessary quality assurance. They also indicated that they were willing to work with the FSC to develop a methodology to achieve the desired results. The power of the FSC to conduct on-site safety and soundness examinations has not been exercised to any great extent. Nor has the FSC been active in using Reporting Accountants to complete special purpose or systemic reviews covering particular supervisory concerns. Refer also to comments CP 16 (On and Off-site supervision). Without a more in-depth on-site examination process that is designed to focus on a bank's process of control or reaching an agreement with the external auditors to fulfill the specific requirements of section 8.4 of the Code an element of a supervisor's responsibilities is not fulfilled.
Principle 20.	**Consolidated Supervision** An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.
Description	The FSC has the power, in Section 12 of the BA, to seek information on the activities of any member of a group of which a licensed bank is a part. The FSC therefore has the ability to monitor the activities of such groups on a consolidated basis. All of the prudential requirements apply to licensed banks and their subsidiaries (i.e., on a consolidated basis). There are no impediments to the direct and indirect supervision of affiliates and subsidiaries of licensed banks. A bank, or banking group, must seek the consent of the FSC, under Section 9 of the Code, for any expansion of its activities. Memoranda of Understandings (MOUs) have or are in the process of being put in place for nine jurisdictions. The MOUs referred to are associated with the more significant "home" jurisdictions. On an annual basis the FSC obtains a standardized confirmation from all "home" supervisors covering the operations of banks licensed on the Isle of Man. This annual request seeks confirmation that: • the parent bank is compliant with regulatory requirements; • there are no special conditions applied to the parent bank; • that the home supervisor has no objections to the continuation of the bank's operations on the isle of Man; • the home supervisor undertakes consolidated supervision; and, • there are no specific supervisory issues that could impact the bank's Isle of Man operations. Almost all banks regulated by the FSC would fall under the category of being within a host supervisory regime.
Assessment	Compliant
Comments	

Principle 21.	**Accounting Standards** Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.
Description	The requirements in relation to financial statements and accounting records are contained in Section 4 of the Code. These place the onus on banks' management for ensuring that the accounting records reflect accurately the financial position of their banks' business at any time. All banks incorporated in the Isle of Man are required to draw up annual financial statements. These must be prepared in accordance with U.K. Accounting Standards adopted by the United Kingdom Accounting Standards Board or other accounting standards approved by the FSC and must take account of the disclosure requirements specified in Appendix B to the Code and any additional disclosure requirements made by the FSC. The annual financial statements must be audited by a member of one of the accounting bodies mentioned in section 14(1)(a) of the Companies Act 1982. The auditor must have professional indemnity insurance, acceptable to the FSC, of at least £20 million. The audited accounts must be submitted to the FSC within four months of the end of the accounting period to which they relate and must be accompanied by a detailed profit and loss account, consolidated accounts, if appropriate, and a compliance certificate (see Appendix F of the Code). Branches of banks which are not incorporated in the Isle of Man are required to submit a copy of the audited annual accounts of the bank of which they are a part, together with a detailed profit and loss account relating to the activities of the Isle of Man branch, and a compliance certificate, within four months of the end of the period to which they relate. All banks, whether incorporated in the Isle of Man or not, must submit in computerized and hard copy a completed set of the FSC's Banking Returns (see Appendix A of the Code) as at the end of each calendar quarter date within 21 days of the date to which they relate. The FSC examines any significant differences between the figures reported to it and the figures in the audited accounts. As a further check on the integrity and efficiency of the reporting system to the FSC, license holders are required to arrange—on an annual basis—for their auditors to verify to the accounting books and records a set of quarterly returns chosen by the auditors (unless the FSC specifies a particular set of returns). The accounting records are tested, as part of the annual statutory audit of the bank (Section 4.2 of the Code), and the auditors must report that such books and records are properly kept. The FSC (under Sections 13 or 21 of the Act) can inspect, or commission reporting accountants to examine, such accounting records. Under Section 4.8 of the Code, banks are required to file their audited financial statements with the Registrar of Companies within four months of their financial year-end and to make available such statements at their registered offices and branches in the Isle of Man. There is no specific provision in the BA granting the FSC the power to revoke the appointment of an external auditor. However, in practice the FSC could request/direct (i.e., issue a direction to the bank under Section 11 of the BA) a bank to remove its auditor and such a motion could be submitted before a general meeting of the bank's shareholders. Where the auditor in the course of his work becomes aware of matters of material significance in relation to the work of the FSC he must report such matters to the Commission under

	Section 20 of the BA. Matters of material significance include facts which are likely to lead to a serious qualification or refusal of the certificate of audit, endanger the existence of the banking institution, imperil the protection of its customers or which indicate that the principles of sound management have been violated. Section 22 of the BA enables the auditor to communicate with the FSC without breaching any duty of confidentiality, which he may owe to his client. These circumstances will be exceptional. Guidance notes have been issued by the FSC in relation to such issues (Appendix M of the Code).
Assessment	Compliant
Comments	
Principle 22.	**Remedial Measures** Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.
Description	Section 11 of the BA empowers the FSC to make recommendations to a bank, such as the suspension or discontinuance of part or all of its operations. They extend also to a bank whose license has been revoked, lapsed or surrendered and to managers and past managers of banks. These powers are reinforced by the power to issue directions. Failure to comply with a direction is a criminal offence, which can render banks and their directors, managers and officers liable to fines and even imprisonment. The FSC's direction-making powers can be used to ensure compliance with its requirements in cases where appropriate measures cannot be agreed with the directors and management and where the FSC wishes to reinforce its supervisory concern. An alternative course of enforcement action is for the FSC to attach special conditions to a bank's license—breach of which would also be a criminal offence. However, license conditions (including special conditions) are open for public inspection, and so the FSC chooses this course only when it considers that the matter will not unjustifiably undermine public confidence in a bank. The issue of directions is not a matter of public record unless a bank fails to comply and a prosecution is to be brought. Because the FSC's direction-making powers are wide-ranging and backed by criminal sanctions there is a procedure in Section 24 of the BA for a bank, which is aggrieved by the issue of directions by the FSC. The bank can apply to the chief secretary who shall report the application to the council of ministers for a review of the decision to issue such directions. The council of ministers must appoint a Review Committee consisting of 3 persons who must be independent of both the FSC and the applicant. The Review Committee may confirm, vary, or revoke the direction appealed against, but until the Committee decides, the direction remains in force and the previous operation of the direction is unaffected by any decision the Review Committee may make. However, in cases of noncompliance with prudential requirements or other situations where depositor's funds may be threatened, the FSC would initially seek to have these issues addressed in an informal way, generally by verbal or written communication. If the matters are not rectified as a result of this moral suasion, the FSC has the statutory power to impose conditions on the bank's license (Section 7(3) of the BA). The FSC can also issue recommendations (Section 11(1) of the BA) or issue directions on the bank (Section 11(2) of the BA).

	Failure to comply with any of these enforcement actions entitles the FSC to revoke the license (Section 7 (1) of the BA/ Section 33(2) (Enforcement Action). Enforcement action can be applied to the bank itself or to any managers of the bank. Sections 25 to 29 of the BA also cover a number of other offences, which could lead to fines, custodial sentences, or revocations of licenses. The bank or any other person can appeal, under Section 24 of the Act, to the council of ministers' Review Committee for a review of the FSC's decision where a license has been revoked or a condition or direction is imposed. As stated above under CP 6 the FSC has no explicit power to suspend payments to shareholders. However, the FSC could issue a direction under Section 11 of the BA to suspend such payments. If the payment of a dividend resulted in a breach of the capital requirement of a bank, the FSC has the power to require that the breach be rectified immediately (such breaches must be reported under Section 11.1 of the Code). There is no specific provision in the BA granting the FSC the power to revoke the appointment of an external auditor (see CP 21). However, in practice the FSC could request/direct (i.e., issue a direction to the bank under Section 11 of the BA) a bank to remove its auditor and such a motion could submitted before a general meeting of the bank's shareholders.
Assessment	Compliant
Comments	Legal provisions are in place, which enable the FSC to take regulatory action against a noncompliant bank. The action required can apply to any or all elements of a bank's business. The FSC keeps a log of regulatory breaches by banks and the action taken to ensure corrective action. The powers available to the FSC are significant and wide-ranging and are in compliance with the principle. During the past year, the FSC made a policy decision to introduce fining, initially for administrative breaches. It was agreed to request whatever legislative amendments were necessary to grant this power. It was also agreed to publicly "name and shame" persons deemed not "fit and proper" under Section 16 of the Act.
Principle 23.	**Globally Consolidated Supervision** Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures, and subsidiaries.
Description	Banks in the Isle of Man could not be said to be internationally active, as they have limited overseas operations. However, the legal instruments are in place in order to supervise these operations on a consolidated basis (banking returns on both a solo and consolidated basis and, for some operations, individual branch or subsidiary returns). In the recent past one bank used to have subsidiaries outside the IOM Banks in the Isle of Man could not be said to be internationally active, as they have limited.
Assessment	Compliant
Comments	This principle currently has no application in the Isle of Man but is being complied with.
Principle 24.	**Host Country Supervision** A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.
Description	As per CP 23 above, the IOM licensed banks have presently no branches or subsidiaries in other jurisdictions so the FSC does not act in the role of home supervisor. The FSC has signed MOUs with a number of foreign regulators and is in the process of signing a number of others.
Assessment	Compliant
Comments	

Principle 25.	**Supervision Over Foreign Banks' Establishments** Banking supervisors must require the local operations of foreign banks to be conducted with the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.
Description	Local branches and subsidiaries of foreign banks that are licensed in the Isle of Man have to comply with the same prudential and regulatory requirements as domestic banks. As mentioned before many of the IOM-licensed banks are subsidiaries or branches of overseas operations. In the past the FSC has demonstrated close cooperation with other regulators. In licensing a foreign subsidiary or branch the FSC requires prior approval of the home supervisor. In these cases the FSC would also need to be satisfied that the home supervisor exercises global consolidated supervision. The FSC cooperates in the exchange of information with the home supervisors of these banks(formally at least annually). The FSC's powers to exchange confidential information with other regulators are contained in Section 24 of the Financial Supervision Act 1988. Visits by home supervisors to local subsidiaries and branches for supervisory purposes are permitted and take place. Home country supervisors are advised of regulatory action taken by the FSC in respect of local subsidiaries or branches of foreign banks and copies of reports on on-site inspection visits are sent to the home supervisors as a matter of course.
Assessment	Compliant
Comments	

Table 2. Summary Compliance with the Basel Core Principles

Core Principle	C[1/]	LC[2/]	MNC[3/]	NC[4/]	NA[5/]
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**				

Core Principle	C[1/]	LC[2/]	MNC[3/]	NC[4/]	NA[5/]
16. On-Site and Off-Site Supervision		**X**			
17. Bank Management Contact	**X**				
18. Off-Site 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**				

[1/] C: Compliant.
[2/] LC: Largely compliant.
[3/] MNC: Materially noncompliant.
[4/] NC: Noncompliant.
[5/] NA: Not applicable.

Table 3. Recommended Actions to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action
CP 1(2) - Operational independence and adequate resources	• The existing framework of government dependence and the lack of budgetary autonomy should be addressed. • Perform an in-depth analysis of the resources required to fulfill the supervisory objectives and as a consequence establish a change plan for the business process of banking supervision.
CP 16 - On-site and off-site supervision	• Prioritize the completion of the examination methodology for full scope examinations supplemented by formalized quality control procedures. • Explore increased synergies between FSC and external auditors

C. Authorities' Response to the Assessment

Reference Principle	Action Taken/To be Taken
CP 1 (2) – Operational independence and adequate resources	• The Isle of Man treasury is currently undertaking a full review of the Island's regulatory bodies (scheduled for completion by June 2004). This review will have full regard for independence, accountability and proposed changes to the legislative framework.
CP 16 – On-site and off-site supervision	• The examination methodology for full scope examinations has now been completed. • Formalized quality control procedures have been put in place. • Within the reorganization of Supervision Division there will be one senior individual assigned responsibility for consistency of approach and quality control for both on-site and off-site supervision. • There will be a validation panel, consisting of experienced supervisors, to validate / challenge risk assessments and supervisory programs for individual license holders.
	• Since the IMF visit, two meetings have taken place with the external auditors of banks. Each audit firm was represented at partner level at both meetings. The first meeting sought to identify synergies between the external auditors and the FSC. The second was to discuss industry wide current auditing and supervisory issues on a nonlicense holder-specific basis. It was agreed that formal half-yearly meetings will take place. In addition, the Commission and the auditors agreed to enhance cooperation with each other on specific issues and to consider more regular bilateral or trilateral meetings. The Commission will also consider making greater use of the Reporting Accountants regime.

II. FATF Recommendations For Anti-Money Laundering and Combating the Financing of Terrorism

A. General

Information and methodology used for the assessment

13. A detailed assessment of the anti-money laundering (AML) and combating the financing of terrorism (CFT) regime of the Isle of Man was prepared by a team of assessors that included staff of the International Monetary Fund (IMF) and an expert not under the supervision of IMF, who was selected from a roster of experts in the assessment of criminal law enforcement and nonprudentially regulated activities. The IMF staff 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. In addition, the IMF staff, reviewed the arrangements for trust and corporate service providers which were in a transitional phase towards full prudential regulation. The experts not under the supervision of IMF reviewed the capacity and implementation of criminal law enforcement systems.

14. The team consisted of Ian Carrington, (MFD) and Ross Delston, (Consulting Counsel, LEG) , with Washington-based assistance from Stuart Yikona, (Technical Assistance Officer, LEG). Messrs. Carrington and Delston were part of a Fund-led mission to Isle of Man during the period October 21–30, 2002. The independent law enforcement expert was Detective Chief Superintendent Felix McKenna of Ireland's Criminal Assets Bureau who visited Isle of Man during February 11–13, 2003.

15. This assessment is based in part on discussions on AML/CFT issues that were held with officers and other representatives of the following offices among others, all of whom were most helpful in the preparation of this assessment: the FSC; the IPA: the attorney general's chambers: the Isle of Man Police; Customs and Excise and the FCU. In addition, the assessors met with a number of financial sector parties, including banks, investment management companies, CSPs, insurance companies, lawyers, and associations representing these sectors.

16. Information used for the assessment was obtained from the Anti-Money Laundering Code 1998 as amended (the "Code"); Corporate Service Providers "(General Requirements) Regulatory Code 2000" "CSP Code"); the Banking (General Practice) Regulatory Code 1999 (the "Banking Code"); the Financial Supervision Commission Conduct of Business Regulatory Code (the "Conduct of Business Code"); the Criminal Justice Act 1990 as amended (the "CJA"); the Criminal Justice Act 1991 (the "CJA2"); the Drug Trafficking Act 1996 as amended (the "Drug Act"); the Banking Act 1998 (the "Banking Act"); the Insurance Act 1986 (the "IA"); the Insurance (Amendment) Bill (Draft 2) (the "IA Bill");[7] the Companies Acts 1931-1993 (the "Companies Acts") ; the Charities Registration Act 1989 (the "Charities Act"); the European Communities (Money Laundering Directive)(Application) Order 2002 (the "Directive"); the Corporate Service Providers Act 2000 (the "CSP Act"); the Extradition Act (the "Extradition Act"); the Anti-Money Laundering (Money Service Businesses) Regulations 2002 (the "Regulations"); the Anti-Money Laundering Guidance Notes (the "Notes")[8]; the Prevention of Terrorism Act

[7] Passage expected in the first half of 2003

[8] The Notes do not meet the definition of 'law' contained in the Methodology since they are not 'mandatory,' evidenced by the fact that the cover page of the Notes states "[whilst this publication has been prepared by the Financial Supervision Commission for general guidance, it is not a legal document and should not be relied upon in respect of points of law. Reference for that purpose should be made to the appropriate statutory provisions."] The

(continued)

1990 (the "POTA"); Terrorism (United Nations Measures) (Isle of Man) Order 2001 (the "UN Order"); Iraq (United Nations Sanctions) (Isle of Man) Order 2000 (the "UN Sanctions Order"); Al-Qa'ida and Taliban (United Nations Measures) (Isle of Man) Order 2002; Anti-Terrorism and Crime Bill (June 2002); Insurance (Amendment) Regulations 1998 (the "1998 Insurance Amendment"); Insurance and Pensions Authority Common Trading Practices for Isle of Man Insurers (Guidance Notes on the Prevention of Money Laundering, effective March 31, 2003)(the "CTP")[9]; Investment Business Acts 1991-1993 ("IBA"); the Financial Supervision Act 1988 (the "FSA"); the Finance Act 1958; the Interpretation Act 1976 ("the Interpretation Act"); Police Powers and Procedures Act 1998 (the "PPP Act"); the Customs and Excise Etc. (Amendment) Act 2001 (the "Customs Amendment Act"); the Off-shore Group of Banking Supervisors Mutual Evaluation Report on the Anti-Money Laundering System in the Isle of Man (1999); Position Paper: Overriding Principles for a Revised Know Your Customer Framework (February 2002), issued by the Guernsey Financial Services Commission, the Isle of Man Financial Supervision Commission and the Jersey Financial Services Commission,

17. For the purposes of this assessment, the term 'Financial Institutions' (FIs) means the following: banking business within the meaning of the BA; investment business within the meaning of the IBA; insurance business within the meaning of the IA; business carried on by a building society within the meaning of Section 7 of the Industrial and Building Societies Act; business carried by a society registered as a credit union within the meaning of the Credit Unions Act; business carried on by a society (other than a building society or credit union) registered under the Industrial and Building Societies Act; any activity carried on for the purpose of raising money authorized to be borrowed under the Isle of Man Loans Act; any activity carried on for the purpose of raising money by a local authority; the business of a bureau de change; the business of an estate agent within the meaning of the Estate Agents Act; the business of a bookmaker within the meaning of the Gaming, Betting and Lotteries Act; any activity permitted to be carried on by a license holder under a casino license granted

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attorney general agrees with this conclusion. Hence, the Notes are not included in the detailed assessment in any discussion of laws or legal requirements. In addition, there is no explicit legal basis for the issuance of the Notes by the FSC.

[9] The CTP constitute guidance notes and therefore do not meet the definition of 'law' since they are not 'mandatory,' evidenced by the fact that they are only enforceable by reference to a Directors' Certificate required to be filed by the 1998 Insurance Amendment. The attorney general agrees with this conclusion. Hence, the CTP are not included in the detailed assessment in any discussion of laws or legal requirements. In addition, with respect to the legal authority of the IPA to issue the CTP, section 24A of the IA provides that the IPA may publish information or give advice to insurance licensees.

under the Casino Act; the business of the Post Office in respect of any activity undertaken on behalf of the National Savings Bank; any activity involving money transmission services or check encashment; any activity in which money belonging to a client is held or managed by an advocate, a registered legal practitioner within the meaning of the Legal Practitioners Registration Act, and an accountant or a person who, in the course of business, provides accountancy services; the business of promoting or forming bodies corporate, acting as company secretary of bodies corporate, or providing registered offices for bodies corporate, or engaging in any regulated activity within the meaning of the CSP Act (i.e., the sale, transfer or disposal of companies; the provision of accommodations address facilities for a company; acting as director or alternate director of companies, or arranging for others to act as officers of corporate bodies; acting as or arranging for others to act as nominee shareholders of companies and the provision of company administration services); and the business of acting as trustee in return for payment, or providing or taking steps to provide persons to act as trustees in return for payment.

Overview of measures to prevent money laundering and terrorism financing

18. The attorney general for the Isle of Man is the central authority for the purposes of mutual assistance in criminal matters. The main institutions in the Isle of Man in the AML/CFT area are the Financial Crimes Unit (FCU), which is part of the Isle of Man Police and is the FIU for Isle of Man; the police and the customs and excise, which provide staff to the FCU and investigate criminal activities; the attorney general's chambers which prosecutes ML and FT, defends the Isle of Man authorities against suit, and advises the Tynwald (parliament) and the government on legal issues; and the FSC and IPA, which are the financial regulators for the Isle of Man and are responsible for monitoring compliance for FIs that are regulated by them.

Legal and institutional framework

19. The Isle of Man has a developed legal and institutional framework generally, particularly with respect to measures relating to confiscation of the proceeds of criminal conduct, information exchange and international cooperation. The broad regulation of the financial sector, including banking, investment companies and CSPs regulated by the FSC, and insurance business regulated by the IPA, is a strength. However, the Isle of Man's legal and institutional framework falls short in a number of areas outlined below.

Implementation of the legal and institutional framework and financial sector-specific issues

20. Discussions with the FSC, IPA and industry representatives suggest a high level of awareness of AML/CFT issues and that considerable effort has been undertaken to put appropriate practices into place. The oversight function employed by the two regulatory bodies is generally satisfactory. Both regulators employ a regime of on-site and off-site surveillance and have visited the majority of licensed institutions in the last two years. Most

of the institutions visited had comprehensive documentation on AML policies and procedures.

B. Detailed Assessment

21. 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. Detailed Assessment of Criminal Justice Measures and International Cooperation

I—Criminalization of ML and FT (compliance with criteria 1–6)
Description
1. The Isle of Man is a crown dependency and not a sovereign state and therefore the United Kingdom is responsible for its international affairs. The Isle of Man is not therefore in a position to sign or ratify international Conventions in a formal sense. Conventions are usually extended to the Isle of Man in accordance with the procedures set out in the Conventions. The following have been extended to the Isle of Man: UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention); Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime; and the European Convention on Mutual Assistance in Criminal Matters 1959 (Strasbourg) which operates as between Isle of Man and Austria, Denmark, Greece, Italy, Luxembourg, Spain, Netherlands and Sweden. Operation between other Council of Europe States and the Island has been requested and awaits confirmation by those States. (The Additional Protocol to the Strasbourg Convention does not apply but extension of the Second Additional Protocol has been requested of the Council of Europe states). UN Security Council Resolution 1373 is implemented by Article 10 of the UN Order. The UN Convention for the Suppression of the Financing of Terrorism, and the UN Convention Against Transnational Organized Crime (Palermo Convention) have not been extended to the Isle of Man. 2. Money laundering extends to proceeds of criminal conduct and appears to be generally consistent with the Vienna and Palermo conventions. The POTA and the UN Order contain provisions criminalizing the financing of terrorism. There is no specific provision requiring inference of an intentional element from objective factual circumstances in all cases. According to the authorities, under the Isle of Man legal system, knowledge, suspicion or grounds for suspicion are themselves normally ascertained by reference to objective factual circumstances. Certain of the ML and FT provisions specify reasonable grounds (or cause) for suspicion rather than specific knowledge (CJA Section 17(C)(2), Drug Act Section 45(2), POTA Sections 7, 8 and 9 and UN Order Articles 4 and 5). The offense of money laundering extends not only to those who have committed money laundering but also extends to persons who have committed both laundering and the predicate offense (Section 17C(1) of the CJA and Section 45(1) of the Drug Act). It is not necessary for a person to be convicted of a predicate offence to establish that assets were the proceeds of a predicate offence and to convict any person under Section 17A or 17B of the CJA of laundering such proceeds. The offence under Section 17C of the CJA is aimed at money laundering for the purpose of avoiding prosecution. The money laundering offences under the Drug Act relate to the proceeds of drug trafficking and do not require that a person be convicted of a predicate offence. Predicate offenses for money laundering extends to all serious crimes (criminal conduct) (Section 17A(7) of the CJA) and drug trafficking offences (Sections 45-47 of the Drug Act). The offence of money laundering extends to property that directly or indirectly represents the proceeds of crime (Sections 17A(2), 17B(1) and 17C(1) and (2) of CJA and Sections 45(1) and (2), 46(2) and 47(1) of the Drug Act). Predicate offenses include conduct which would constitute an offense if it had occurred in the Isle of Man (Section

17A(7)(b) of the CJA and Section 1 of the Drug Act). In addition, financing proscribed organizations (Section 8 of POTA) and terrorist acts (Section 7 of POTA are predicate offenses for the purposes of the money laundering offences under Section 9 of the POTA. Membership in a proscribed organization (Section 2 of POTA) is a predicate offence under the CJA (Sections 17A-D).

There is a gap in the POTA relating to acts of terrorism committed on the island, which are not covered in the POTA. Also, the definition of terrorism in Sec. 18 of the POTA does not include any reference to "the use or threat is made for the purpose of advancing a political, religious or ideological cause." However, the UN Order contains a broader definition of terrorism (Article 3(1) of the UN Order) that would include acts committed on the island and a reference to the use or threat provision referred to above. The operative provisions of the POTA and the UN Order will be consolidated in the Anti-Terrorism and Crime Act 2002 which has recently been enacted by the Tynwald (parliament), but will not be in force until later in 2003.

3. Sections 7-11 of the POTA and Articles 4-7 of the UN Order criminalize the financing of terrorism. The ability to ensure full implementation of the Convention will arise when the Anti-Terrorism and Crime Act is implemented.

4. The offences of money laundering in the CJA (Sections 17A-C), the Drug Act (Sections 45-47) and POTA (Sections 7-9) apply different tests of knowledge. 17B(1) and 17C(1) CJA and 45(1) and 47(1) of the Drug Act apply to persons that know that property is the proceeds of criminal conduct (drug trafficking or terrorist financing). Sections 17C(2) of CJA, 45(2) of the Drug Act and 7 of the POTA require knowledge or reasonable grounds to suspect. Sections17A (1) of CJA, 46(1) of the Drug Act and 8 and 9(1) of the POTA are silent on the point but it is a defense to prove that there was no knowledge or suspicion that the arrangement related to proceeds of crime (drug trafficking or terrorist financing). However, there is no specific provision regarding inference of an intentional element from objective factual circumstances in all cases but, according to the authorities, under the Isle of Man legal system knowledge, suspicion or grounds for suspicion are themselves normally ascertained by reference to objective factual circumstances.

Acts of Tynwald (parliament) are construed by reference to Section 3 of the Interpretation Act 1976 under, which references to "person" include a body corporate or incorporate. The offences therefore apply to bodies corporate as well as individuals.

5. With respect to criminal sanctions, persons (including corporations) found guilty of engaging in money laundering are liable on summary conviction to imprisonment for a term not exceeding six months or a fine not exceeding 5000 pounds, or on conviction on information to imprisonment for a term not exceeding fourteen years or a fine or both (Sections 17A(6), 17B(9) and 17C(4) of the CJA; Section 51(1) of the Drug Act and Section 11(1) of the POTA). In addition, under the Code, persons may be found liable for offenses that do not involve money laundering (Para. 3(2) of Code), on summary conviction the same as above, and on information, imprisonment of up to two years and/or an unlimited fine (Section 17 F of CJA). Section 42 of High Court Act of 1991, provides that the court may by order appoint a receiver in all cases in which it appears to be just and convenient to do so.

(For further discussion on sanctions see Section VIII, Criterion 64)

6. *The Isle of Man Authorities have the legal means and resources available to them to effectively implement Money Laundering and Financial Terrorism Laws. There is legislation in the Isle of Man statute to effectively combat, investigate and prosecute money laundering and the financing of terrorism. In the attorney general's chambers there is one dedicated legal officer, with responsibility for dealing with Mutual Assistance Requests, ML and FT. The Isle of Man authorities have and are currently carrying on a number of investigations into suspected Money Laundering, which involve millions of pounds in assets. The investigation structure in the Isle of Man is divided between Police and Customs and Excise. The Isle of Man Police Force consists of 248 Police Officers and there are 54 Customs and Excise Officers. Due to the heavy demands imposed on the attorney general's staff, the attorney general is currently reviewing his staffing levels with a view to recruiting an assistant to the dedicated legal officer. The Isle of Man authorities recognize the complexities involved in the investigation of ML/FT and regularly participate in joint investigations with other countries to successfully investigate and prosecute ML/FT.*

The resources available to the Isle of Man Financial Crime Unit (FCU) are as indicated below:

Authorized Personnel	*Current Personnel*
One Detective Inspector	*One Detective Inspector*
Three Detective Sergeants	*One Detective Sergeant*
Nine Detective Constables	*Eight Detective Constables*
Two Customs and Excise Officers (Part-time)	*Two Customs and Excise Officers (Part-time)*
One Analyst (Civilian)	*One Analyst (Civilian)*
One Administration Manager (Civilian)	*One Administration Manager (Civilian)*
One Administration Assistant (Civilian)	*One Administration Assistant (Civilian)*
One Accountant (Civilian)	*One Accountant (Civilian)*

The functions of the FCU are:

(i) The investigation of all serious financial crime involving the finance sector on the island;

(ii) The investigation of serious financial crime involving the Isle of Man but where jurisdiction is unclear;

(iii) The conduct of initial investigation into serious financial crime where jurisdiction lies outside the Isle of Man but where evidence needs to be secured or obtained on the Island.

The FCU also undertakes the following functions:

(i) The gathering of evidence for other jurisdictions on behalf of the attorney general in respect of financial aspects of crime involving fraud, drug trafficking, murder, extortion, corruption, theft, or any other serious crime;

(ii) The gathering of evidence under the Drug Trafficking Acts, Prevention of Terrorism Act and Criminal Justice Acts through police to police liaison;

(iii) The financial profiling of drug traffickers with a view to asset forfeiture;

(iv) The provision of expert skills, advice and assistance which can be drawn on and be utilized by uniform colleagues and other specialist police departments;

(v) The provision of awareness training on fraud and money laundering, advice and assistance to the financial sector;

(vi) Acting as the reception point for "Financial Disclosures" which are reported by the Isle of Man's finance sector via their statutory obligations under Money Laundering legislation. Dissemination of information from disclosures also falls within the responsibility of the FCU;

(vii) Undertaking international police investigations of a financial nature routed via the International Police Organization (Interpol);

(viii) The provision of a computer data recovery service, technical advice and guidance in relation to computer crime;

(ix) Assist Senior Investigating Officers in the investigation of serious criminal matters by considering and undertaking appropriate financial enquiries.

The functions outlined above are too widespread thus lessening the ability of the unit to focus on ML/FT. The investigation, prosecution and conviction of persons/companies requires specialist and dedicated skills and therefore the functions as outlined over-burden the FCU. Its workload has increased steadily over the last few years.

The resources dedicated to ML/FT in the Isle of Man Customs and Excise consists of six investigators with a further two intelligence officers working on a part-time basis with the FCU as outlined above. The set-up and structure of the FCU should be streamlined in that a particular number of personnel therein are wholly and fully engaged on ML/FT investigations.

The Isle of Man Customs and Excise have 6 investigators dedicated to the investigation of ML/FT. A further two intelligence officers work on a part-time basis with the FCU as outlined above.
Analysis of Effectiveness
The Isle of Man's framework for criminalizing money laundering is generally adequate. With respect to criminalizing the financing of terrorism, there is a gap relating to the limited scope of terrorist activities covered by the POTA and the inadequate definition of the financing of terrorism therein that will be remedied once the Anti-Terrorism and Crime Act has been implemented. The island needs to implement legislation to allow the UN Convention for the Suppression of the Financing of Terrorism, and the UN Convention Against Transnational Organized Crime (Palermo Convention) to be extended to the Isle of Man.
Recommendations and Comments
Implementing legislation, in particular the Anti-Terrorism and Crime Act, should be adopted or implemented by the Isle of Man so that the UN Convention for the Suppression of the Financing of Terrorism, and the UN Convention Against Transnational Organized Crime (Palermo Convention) may be extended to the Isle of Man. *The Isle of Man authorities should increase the staffing level in the FCU to its authorized strength. The authorities should also re-evaluate the organizational structure/functions of the FCU in order that resources are permanently dedicated to ML/FT operations/investigations , because their workload is too widespread i.e., they are required to investigate all financial related frauds etc. The appointment of an assistant to the dedicated legal officer in the attorney general's chambers should be pursued.*
Implications for compliance with FATF Recommendations 1, 4, 5, SR I, SR II
Full compliance will be achieved when implementing legislation for the UN Convention for the Suppression of the Financing of Terrorism is adopted and implemented and the Convention is extended to the Isle of Man.
II—Confiscation of proceeds of crime or property used to finance terrorism (compliance with criteria 7–16)
Description
7. Laws provide for the confiscation of assets upon conviction of a person. Provision is made for confiscation of proceeds of criminal conduct where a person is found guilty of an offense (Sections 1 and 2 of the CJA; Section 2 of Drug Act; Section 11 and Schedule 4 of the POTA). Provision is also made for the forfeiture of the instrumentalities of crime (Section 16 of the Criminal Law Act 1981 and section 32 of the CJA2). The attorney general may make an application for a Court order to restrain any person from dealing with realizable property held by a defendant, and where such an order is made, the police seize the property to prevent its removal from the Isle of Man (Section 7(1), 7(5) and 7(10) of the CJA). There are similar provisions under Section 26 of the Drug Act and Paragraph 3, Schedule 4 of the POTA. There is a provision that deals with the seizure and forfeiture of proceeds of criminal conduct with respect to imported or exported cash (Sections 23A and 23B of the CJA). There is a similar provision under Sections 39–44 of the Drug Act in respect of the import and export of drugs cash. In addition, Article 6 of the UN Order enables terrorist funds to be frozen on suspicion. Sections 8 and 11 and Schedule 4 of POTA enable the confiscation of funds of proscribed terrorist organizations. With respect to all crimes and drug crimes, the laws provide for the payment of a sum corresponding in value to the benefit to the defendant and are not limited to specific property. (Section 1 of CJA and Sections 2 and 4 of Drug Act). There is no direct equivalent in the POTA. Section 11 of the POTA is limited to forfeiture of money or property in the possession of a person convicted of an offence under sections 7–9 of POTA. Civil forfeiture currently applies in respect of import and export of drug proceeds cash (Section 39–44 of the Drug Act) and crime proceeds cash (Section 23A-23F of the CJA). The Anti-Terrorism and Crime Bill (Sec.17) will provide for the seizure and forfeiture of terrorist cash in the Isle of Man whether or not being imported or exported. According to the authorities, in civil cases, the Isle of Man High Court may grant a freezing injunction ("Mareva Order"), an injunction to prevent a defendant removing assets from the jurisdiction or from dealing with assets within the jurisdiction. Applications for such orders are normally made ex parte. Section 56A of the High Court Act 1991 (as amended by the Civil Jurisdiction Act 2001) allows for such an order to be obtained pending a civil trial or pending determination of an appeal where the High Court has jurisdiction to entertain the proceedings or

where civil proceedings are to be or have been commenced in a country or territory outside the Isle of Man.

8. Police and customs officers have the legal authority to obtain information about money laundering, which includes the power to identify and trace property suspected of being the proceeds of crime or used for FT. Sections 52-54A of the Drug Act provide powers to obtain information about drug trafficking (includes money laundering—see Sections 1(2) and (3)(f)). Those provisions also have effect in respect of all crimes money laundering under section 17J of the CJA. With respect to FT, Paragraph 2 of Schedule 7 of the POTA deals with orders for the production of material for the purposes of terrorist investigations (defined in section 15(1)) which includes FT offences under sections 7–9 of the POTA. Article 10 of the UN Order confers a power on the Isle of Man treasury to obtain information and documents to implement the Order or prevent evasion. Failure to comply with a treasury request for information is an offence.

9. Under section 7(7) of CJA, section 26(10) of Drug Act and paragraph 3(4) of Schedule 4 to the POTA, provision is made to safeguard the rights of third parties who may be affected by restraint orders. Under section 39(8) of the Drug Act and section 23A(8) of the CJA there is a right for any person to apply to the High Bailiff for the release of cash detained under section 39 or 23A (import/export of cash). Under section 6(1) of the Drug Act, obligations that have priority (e.g. a mortgage) are to be deducted from the value of the realizable property for confiscation. It is inherent in section 6(2) that property that has been acquired by a third party for full payment is not to be available for confiscation. (equivalent provisions in CJA are sections 4(1) and (3)).

The authorities have indicated that without prejudice to those specific provisions, the High Court has an inherent power to hear and determine competing claims in respect of property. If property is not frozen, seized or confiscated strictly in accordance with the statutory powers conferred on the appropriate authorities then the High Court can be asked to make an appropriate order (e.g. return of property, damages, etc.).

10. Although there is no explicit authority under Isle of Man law to void contracts or render them unenforceable where parties to the contract knew or should have known that as a result of the contract the authorities would be prejudiced in their ability to recover financial claims resulting from the operation of AML/CFT laws, the authorities have indicated that a contract to achieve an illegal purpose would be void under Isle of Man law.

11. *The Isle of Man authorities do record all statistics relating to amounts of property frozen, seized and confiscated relating to ML, the predicate offences and FT.*

12. *The Isle of Man FCU has a budget specifically for the training of their personnel. All members have undergone numerous courses relevant to the investigation of ML/FT e.g.: National Terrorist Financial Investigation Course organized by the London Metropolitan Police; Development Course for Financial Investigators organized by the London Metropolitan Police and the Assets Forfeiture/Money Laundering Course organized by the U.S. Drug Enforcement Administration . Custom and Excise Officers also receive financial investigation and intelligence training from HM Customs and Excise.*

There is also in-house training provided on an ongoing basis and external institutions provide seminars/courses to the members of the FCU about the industry in particular on the issues of constructive trust., trust funds, banking and on-line gaming.

The prosecutorial and judicial authorities of the Isle of Man are legal experts and regularly attend and participate in seminars and conferences both in the Isle of Man and in the United Kingdom covering the subjects of freezing, seizing and confiscation of assets.

13. Laws provide for freezing of funds or other property of terrorists, those who finance terrorism and terrorist organizations (Article 6 of the UN Order; Article 4 Iraq (United Nations Sanctions) (Isle of Man) Order 2000; Article 8 of Al-Qa'ida and Taliban (United Nations Measures) (Isle of Man) Order 2002).

13.1 *The Isle of Man authorities keep statistics of property frozen relating to FT and the number of individuals or identities, which have been examined by the evaluator.*

14. The authorities have the power to identify and freeze the property of suspected terrorists, those who finance terrorism and terrorist organizations, whose names may not appear on the list(s) maintained by the relevant committees of the U.N. Security Council. In the UN Order there is power to obtain information under Article 10

and a power to freeze funds under Article 6. 15. As an administrative matter, a fund (the Seized Assets Fund or SAF) administered by the Isle of Man treasury already exists and is used for the purposes of depositing confiscated property relating to all crimes. These assets are then used by Government for various AML and CFT initiatives in law enforcement, health, education or other appropriate purposes. 16. According to the authorities, there is statutory authority to provide for asset sharing. The ability to share exists both prior to (as part of a plea bargain after a seizure) and following confiscation of assets. The attorney general deals with letters of request seeking repatriation and sharing of assets within the jurisdiction and where possible voluntary repatriation/sharing is used. Assets confiscated that are the proceeds of drugs offences are paid into a seized assets fund which is dealt with administratively but whose assets may be shared and may be used in relation to law enforcement. Assets that are confiscated in the Isle of Man that are not the proceeds of drugs offences fall to General Revenue. Section 2 of the Finance Act 1958 allows moneys to be paid out of the General Revenue where voted or appropriated by resolution of Tynwald (parliament) with the concurrence of the treasury for the purposes of the Isle of Man Government. According to the authorities, the Isle of Man is currently seeking the extension of the Treaty between the government of the United Kingdom and the Government of the United States on Mutual Legal Assistance in Criminal Matters with Exchange of Notes, Treaty Series No. 14 (1997). Article 16 of the Treaty states that "[a] Requested Party in control of forfeited assets or the proceeds of their sale shall dispose of them according to its laws. Either Party may transfer forfeited assets or the proceeds of their sale to the other Party to the extent permitted by their respective laws, upon such terms as may be agreed." Pending the extension of the Treaty, the Isle of Man wishes to act consistently with the principles of law enforcement through cooperation and mutual legal assistance in criminal matters as exemplified by the Treaty and would intend to deal with net proceeds of confiscation in accordance with the provisions of Article 16 of the Treaty.
Analysis of Effectiveness
The framework for the confiscation of proceeds of crime or property used to finance terrorism is generally adequate. However the framework would be enhanced if relevant legislation provided for forfeiture of property of corresponding value in connection with terrorist activities and the authority to share assets other than drug assets with other jurisdictions. There is also some concern about the limited scope for civil forfeiture.
Recommendations and Comments
The relevant legislation should be amended to provide for forfeiture of property of corresponding value in connection with terrorist activities , in the event that property that is subject to confiscation is not available. In addition, consideration should be given to passage of a law establishing an asset forfeiture fund into which all or a portion of confiscated property will be deposited and will be used in the management of seized and confiscated property, as well as for law enforcement, health, education or other appropriate purposes. Finally, the relevant laws should be amended to explicitly provide for the authority to share assets other than drug assets with other jurisdictions along the lines of Section 63(4) of the Drug Act. Consideration should be given to the adoption of a civil forfeiture law for crimes other than FT.
Implications for compliance with FATF Recommendations 7, 38, SR III
Full compliance will be achieved when laws allow for the forfeiture of property of corresponding value.

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)
Description
17. The Isle of Man FCU is the FIU. However, under the relevant Acts and the Code, police and customs officers are the recipients of STRs and there is no reference in the relevant Acts and the Code to the FCU. Reporting parties are required by law to make their disclosures to "a constable," which includes a Customs Officer for the purposes of the relevant laws (Sec. 17J, CJA and Sec. 58, Drug Act, although not under POTA). In practice, all disclosures are made to the FCU though there is no law requiring this. The FSC and the IPA have issued guidelines for the identification of unusual transactions in the form of the Notes and the CTP, although the authority of the FSC to do so is unclear, and the authority of the IPA is pursuant to a provision not designed for that purpose—section 24A of the IA that was cited by the authorities as the basis of the issuance of the CTP provides that the IPA may publish information or give advice to insurance licensees. However, the authorities have provided a copy of the Insurance (Amendment) Bill, enactment of which would explicitly provide for authority to issue binding guidance notes with explicit sanctions for noncompliance. The Notes and the CTP provide guidelines for the identification of complex and unusual transactions or patterns of transactions, and suspicious patterns of behavior (Notes Sec. 6.01; CTP Sec. 8.4). There is no provision in law indicating the manner in which STRs are to be made. Although disclosure of suspicious transactions may be made on the Isle of Man Disclosure Form (Section 6.04 and Appendix H of the Notes, and Section 8.1 and Appendix 4 of the CTP), there is no legal requirement to do so. Further, the Notes and the CTP do not apply to all parties required to file STRs by the relevant laws. 18. The FCU is not authorized to obtain from reporting parties, either directly or through another competent authority, additional documentation needed to assist in its analysis of financial transactions. However, there are laws and procedures regarding the production of records by financial institutions and other persons, the search of persons and premises, seizure and obtaining of evidence for use in investigations and criminal proceedings (Sections 11—25 of the PPP Act; Sections 17J, 24 and 25 of the CJA; Section 15 of the POTA; Sections 52 and 53 of the Drug Act). In addition, under the FSA, the FSC has authority to disclose information "to any constable for the purpose of enabling or assisting the Isle of Man Constabulary to discharge its functions." (Section 24(1)(aa)). This would allow the FSC to provide information in its possession to the FCU, which is principally staffed by constables. With respect to insurance business, under the 'Agreement on the dissemination of information from suspicious transaction reports to the Insurance and Pensions Authority' between the FCU and the IPA, requests for information may be passed to the IPA from the FCU and, once information has been obtained from the licensee (Sections 21 and 22 of the IA), such information may then be passed to the FCU (Section 24 of the IA). In addition, the IA Bill will expand the powers of the IPA to include disclosure for certain additional purposes, including the following: any criminal proceedings on the island or elsewhere (new Section 24(1)(a)); facilitating a determination of whether any such investigation should be initiated (new Section 24(1)(c))[10]; and any criminal investigation (new Section 24(1)(d). The Customs Amendment Act creates legal gateways allowing the exchange of information between Customs and other Isle of Man Government bodies such as Income Tax, DHSS, FSC, IPA, Gambling Control, Office of Fair Trading and the Police as it relates to the discharge of their relevant functions. 19. The FCU has full direct access to the companies' registry and vehicle licensing database of the Isle of Man government main frame and the land records on an expedited basis. There is no legal authority for access to other government databases, such as social security, but information may be made available to the FCU on an expedited basis if the requirements of Section 27 of the Data Protection Act 1986 are fulfilled, i.e., that the

[10] This provision is interpreted by the authorities as including disclosures to the FCU.

request is for the prevention or detection of crime. In addition Customs officers attached to the FCU have access from Custom House to certain information from the VAT Office rates and voters roll and Income Tax as well as direct access to a variety of intelligence and accounting databases run by the United Kingdom's HM Customs and Excise.

20. Although the FCU is not authorized to order sanctions or penalties, the FSC and the IPA have broad authority to order administrative sanctions (Section 7 of the Banking Act; Section of 4 of the CSP Act; Sections 6 and 9 of the IA; Section 3 of the IBA). See generally, the response to criterion 5, above. Failure to report could lead to a breach of Paragraph 12 of the Code. An FI which fails to report, risks committing a money laundering offence under CJA or Drug Act if there are reasonable grounds for suspecting ML and the institution undertakes transactions.

21. Since the FCU is not a body created by statute, a police or customs officer is authorized to disseminate financial information and intelligence to domestic authorities for investigation (Section 17H of the CJA).

22. The sharing of information and intelligence is authorized under Section 17I(1) of the CJA. Under this section, information may be passed off the Island by the FCU of its own volition for the purposes of the prevention or detection of crime, or for the institution of or otherwise in connection with criminal proceedings. Where necessary the FCU has negotiated memoranda of understanding to facilitate the exchange of information, including the United Kingdom, and are in negotiations with, Australia, Belgium, Republic of Ireland and Thailand. The consent of the chief minister under Section 17I(2) of the CJA is required for the passing of information where the information is for purposes other than the investigation and prosecution of crime.

There are restrictions on the use of information disclosed by the police to domestic authorities (Section 17G(1) of the CJA). The FCU may impose conditions on the use of the information that is passed to foreign counterpart FIUs under Section 17I(1) of the CJA. In practice, these conditions are those accepted by the Egmont Group as part of the Egmont generic MOU.

23**.** *The Isle of Man FCU (FIU) and other competent authorities record statistics of all STRs received which include the number analyzed and disseminated. The number of STRs are as follows:*

1998	*1999*	*2000*	*2001*	*2002*
1,021	*1,214*	*1,012*	*1,642*	*1,836*

Records are kept relating to STRs resulting in investigation, prosecution or convictions (to date there are no ML convictions in the Isle of Man, however the Isle of Man authorities have assisted in numerous ML investigations with other jurisdictions that have resulted in prosecutions and convictions elsewhere).

Detailed records are kept in relation to the requests for assistance received by the FCU and other competent authorities from both foreign and domestic authorities as well as the number of responses provided to the requests received.

The Isle of Man spontaneously refers all STRs to NCIS and also following a preliminary evaluation of the STR they are referred to competent authorities both domestically and foreign.

Although there is no legal requirement to do so, it is normal practice for the Isle of Man financial institutions to make (STRs) on large currency transactions to the authorities and statistics are kept. It is generally speaking unusual for individuals to deal in large cash transactions and this therefore immediately raises suspicion.

24. The officer in charge is a Detective Inspector, who is appointed by the Chief Constable of the Isle of Man Police and is answerable to him on the activities of the FCU. The Isle of Man FCU operates with a number of personnel dedicated to Intelligence (statistics, analysis and dissemination), International Cooperation team and an Investigative Team who specialize in Fraud, ML and FT investigations. Investigations into ML and FT are also carried out by an Isle of Man Customs and Excise Team. The close relationship between the FCU and Customs and Excise avoids any conflict in relation to investigations being conducted by these two authorities.

The staffing levels are as outlined in Criteria No. 6 and the FCU is currently operating below capacity.

The FCU's funding is "ring fenced" and is under the control of the chief constable who specially allocates funds that do not impinge on the rest of the Isle of Man's Police Force budget.

The FCU's IT facilities although sufficient are being upgraded at present to facilitate the sharing of information with Customs and Excise.

The FCU is established as a unit within the Isle of Man Police Force, accountable to the chief constable who has delegated the responsibility of the investigation of ML/FT to it. The operational structure of the FCU enables it to operate with a limited independence and is generally free from unauthorized outside influence or interference. The practice on the Isle of Man is for the head of the FCU to have regular contact with the attorney general and other authorities.

On law enforcement operational matters the FCU in the Isle of Man is recognized as the venue for receipt of all STRs (notwithstanding the legislation which authorizes STRs to be made to any Constable in the Island). The operational system in place ensures that all information and intelligence is securely protected and disseminated according to the legislation of the Isle of Man.

The Isle of Man FCU submits statistics to enable the chief constable to prepare a publicly available Annual Report on the performance of the Isle of Man Constabulary. Quarterly statistics, trends and typologies are also produced at crown dependency meetings.

Public warnings in relation to trends and typologies are also sent to the FSC who in turn alert the financial industry by way of posting the warnings on their public website and also for more sensitive matters by way of direct email/post to the authorized industry contacts.

The FSC also arranges conferences and seminars attended by members of the financial sector and other Government agencies where they, the FCU and Customs and Excise lecture on Anti-Money Laundering issues thus allowing the Unit to play its part in educating the financial services sector on ML/FT. Conferences and seminars organized by the FSC and the industry are attended by members of the FCU and Customs and Excise as speakers thus enabling them to share information on the statistics, trends and typologies of their industry. The FCU and Customs and Excise attend and participate in the quarterly meetings of the Joint Anti-Money Laundering Advisory Group (JAMLAG) where the issues of ML/FT investigations are addressed with representatives of the financial associations.

Analysis of Effectiveness

Arrangements for receiving, analyzing, and disseminating financial information are generally adequate. The absence of a requirement for STRs to be submitted to the FCU is a potential weakness as is the inability of the FCU to access all government databases on a real-time basis.

Recommendations and Comments

Consideration should be given to amending the relevant laws to require that the report be made directly to the FCU, and that it be made in writing on a form to be issued by the FCU. Consideration should also be given to amending relevant laws to permit the FCU to require the submission of additional information by reporting parties, and to provide expeditious or real-time access to public and nonpublic databases without the need for a court order.

Consideration should be given to amending the relevant laws to provide explicit legal authority for the FSC to issue guidance notes. With respect to the IPA, consideration should be given to enactment of the Insurance (Amendment) Bill to explicitly provide for authority to issue binding guidance notes with explicit sanctions for noncompliance.

The operational structure of the Isle of Man FCU needs to be evaluated in order to prioritize and focus on the subject of ML/FT. The staffing levels should be increased to the authorized strength and in addition the financial investigation team of Customs and Excise could be amalgamated with the FCU in order to improve the effectiveness and streamlining of enquiries into ML/FT. The number of support staff working in the FCU should be increased in order that Law Enforcement personnel therein can dedicate themselves to the investigative process of ML/FT.

Implications for compliance with FATF Recommendations 14, 28, 32
Compliant
IV—Law enforcement and prosecution authorities, powers and duties (compliance with criteria 25–33)
Description
25. *The Isle of Man FCU and Customs and Excise have responsibility for ensuring that ML and FT offences are properly investigated. There are a number of ongoing ML and FT investigations in the Isle of Man and the authorities are taking all necessary steps to ensure that these investigations reach a successful conclusion. There is close liaison between the attorney general's chambers, the FCU and customs and excise in relation to ongoing investigations and chambers are available to give advice when required.* 26. There is no explicit legal basis for controlled delivery or undercover operations but they are not restricted by current law. Interception of communications is controlled by the Interception of Communications Act 1988. According to the authorities, there is included in the official Isle of Man legislative program ending in July 2003 a proposal for a bill to regulate the exercise of certain undercover techniques such as covert surveillance. It is anticipated that the provisions are likely to be passed to coincide with the coming into operation of the Human Rights Act 2001 in mid-2003 which contains certain protections relevant to the exercise of Police Powers. 26.1 *At present there is no legislation enacted in the Isle of Man permitting the use of such techniques, however the FCU and Customs and Excise Investigation Team, use the techniques of controlled delivery/undercover operations on a case by case basis in their pursuit of the investigation of ML and FT offences. The interception of telephone communications are authorized by the Chief Minister of the Isle of Man with the advice of the attorney general pursuant to the Interception of Communications Act 1998 as amended in 2001.* 27. Law enforcement authorities are able to compel production of bank account records, financial transaction records, and other records maintained by FIs by lawful process, including the production or seizure of information, documents or evidence, searches of financial institutions and other entities, taking of witnesses' statements. (Sections 52, 53, 54 and 54A of the Drug Act; Sections 6, 7 and 24 of the CJA; Section 20 of the CJA2; Section 15 and Schedule 7 to the POTA; and Sections 24 and 25 and Schedules 5 and 6 of the Anti-Terrorism Act). 28. *The Geographic nature of the Isle of Man creates a close working environment for Law Enforcement authorities (FCU, Customs and Excise, FSC and attorney general) tasked with combating ML/FT. On a case by case basis representatives of these agencies are assembled, information is shared and a coordinated approach is agreed amongst the agencies in order to investigate fully and expertly ML and FT, thus creating a "task force" approach to the issue of ML/FT.* 29. *The FCU structure, funding and staffing has been answered in Criterion 24. The FCU and the other investigation teams are provided with a reasonable standard of IT facilities which are in the process of being upgraded. The law enforcement and prosecution services of the Isle of Man take all reasonable steps to provide whatever resources are necessary to carry out their functions regarding the investigation and prosecution of ML and FT.* 30. *The FCU is the recognized authority with responsibility for keeping statistics on ML and FT. It keeps records and statistics of all investigations, prosecutions and convictions on its ML/FT cases and its statistics database enables it to identify investigations originated from STRs or from other sources. Its database contains the statistics on any criminal, civil or administrative sanctions. Such information is obtained through fora that promote frequent contact with regulators, law enforcement and other government officials. The Isle of Man Financial Institutions have frozen monies linked to suspected terrorist funding (sanctions).* *31. The FCU actively disseminates the above information to all persons/agencies concerned through the medium of seminars, conferences, FSC publications and by participating in the Joint Anti-Money Laundering Advisory Group and the crown dependencies meetings.* *32. As outlined previously in Criterion 12, the Isle of Man Law Enforcement, Prosecutorial and Judicial authorities have taken all reasonable actions to ensure that the personnel tasked with the responsibilities as*

outlined above receive adequate training i.e.: participation in training courses, seminars and conferences. *32.1 The Isle of Man has provided special training/certification for the FCU and Customs and Excise investigators, enabling them to achieve the recommended standard of excellence required to conduct their investigations of ML, FT and the predicate offences.* *33. The Isle of Man Law Enforcement agencies are making reasonable efforts to meet their demands in order to successfully investigate, prosecute, convict, freeze, seize and confiscate the proceeds of crime or property to be used to finance terrorism. The FCU and Customs and Excise have a number of personnel working closely with the American and U.K. authorities on this matter. Any legal issues encountered are addressed by the attorney general's office and the chief constable. Due to the complexities involved in the investigation of ML/FT the prosecutorial authorities of the Isle of Man, when necessary, do engage the services of recognized experts in order to successfully investigate ML/FT.*
Analysis of Effectiveness
The framework for powers and duties of law enforcement and prosecution authorities is generally adequate. The framework would however be enhanced if there were an explicit legal basis for the use of controlled delivery and other undercover operations.
Recommendations and Comments
Consideration should be given to passage of the existing bill to regulate undercover techniques in order to provide an explicit legal basis for controlled delivery and other undercover operations.
Implications for compliance with the FATF Recommendation 37
Compliant
V—International Cooperation (compliance with criteria 34–42)
Description
34. There are laws and procedures for mutual legal assistance in relation to money laundering, drug trafficking, the prevention of terrorism and other crimes regarding the use of compulsory measures including the production of records by financial institutions and other persons, the search of persons and premises, seizure and obtaining of evidence for use in investigations and criminal proceedings and in related actions in foreign jurisdictions (Sections 17J, 24 and 25 of the CJA; Sections 21 and 22 of the CJA2; Section 15 of the POTA; Sections 52 and 53 of the Drug Act and Sections 11–25 of the Police Powers and Procedures Act 1998). There are appropriate laws and procedures to provide mutual legal assistance in the production or seizure of information, documents or evidence, searches of financial institutions and other entities, taking of witnesses' statements and identification and freezing of assets, seizing of cash at borders and enforcement of external forfeiture/confiscation orders (See legislation referred to in the first paragraph above and see Sections 25-26, 35-37 and 39–40 of the Drug Act and the Orders made thereunder; Sections 6–7, 23A-F and 18-20 of the CJA and the Orders made thereunder; Section 32 of the CJA2 (and the Orders made thereunder), and Schedule 4 to the POTA as well as the UN Order.) Assistance is provided in both investigations and proceedings where persons have committed both laundering and the predicate offence as well as in investigations and proceedings where persons have committed laundering only (see citations above). 35. *The Isle of Man requires that requests for assistance from foreign jurisdictions be processed through mutual legal assistance as its laws and procedures require.* *35.1 In the Isle of Man there is no prerequisite of dual criminality to affect its ability to provide mutual legal assistance other than in relation to fiscal offences. In practice this does not prevent assistance being given as invariably the conduct in the requesting jurisdiction constitutes the same or a similar offence in the Isle of Man. All requests for Mutual Assistance are evaluated in the attorney general's chambers, which transmits them to the relevant investigative authorities for execution.* *35.2 The Isle of Man has successful structures in place to facilitate timely and effective follow up to requests for mutual legal assistance.* *35.3 Detailed statistics are kept on all requests, made or received, for mutual legal assistance relative to ML/FT and the predicate offences. The records include details of the date, source, nature and outcome of the request.*

36. While there are a small number of bilateral agreements which extend to the Isle of Man concerning the investigation of crime and the restraint and confiscation of the proceeds and instrumentalities of crime or drug trafficking, the agreements do not affect the giving of assistance or the level of assistance given. The Isle of Man has mutual legal assistance treaties with the Bahamas, Saudi Arabia, Spain, Sweden, Ukraine, and the United States.

With respect to informal mechanisms, the Isle of Man is a member of the European Judicial Network and the legal officer (Financial Crime) is a contact point for the Network, regularly attending the Network meetings. The attorney general's chambers are also a member of the International Association of Prosecutors, set up largely to facilitate international cooperation amongst prosecutors. The legal officer (Financial Crime), officers from the FCU Unit, and officers from Customs and Excise attend a variety of national and international conferences and meetings to advise how assistance may be obtained from the Isle of Man.

37. Section 17I of the CJA allows for the provision of information to overseas authorities for the prevention or detection of crime or for the institution or other use in criminal proceedings. The FCU has also negotiated memoranda of understanding to facilitate the exchange of information where necessary. Information is exchanged either directly or through Interpol where the information refers to the subjects of investigations in other jurisdictions. In addition, the Customs Amendment Act provides for the disclosure of information or documents held for the purposes of, or in relation to, any Customs and Excise assigned matter to any agency for the purposes of any criminal investigation or proceedings, or for the purposes of initiating or bringing to an end such matters (section 174B(2)). Also, due to the Island's special relationship with the EU and Customs membership of the Customs Union, many of the EC Regulations governing exchange of information on customs, excise and VAT fraud are applicable in the Isle of Man along with other Conventions such as the Nairobi Convention, the 1998 Vienna Convention, the Naples II Convention and the CIS Convention.

The Drug Act contains restrictions on disclosure of information (section 50). This is limited to restrictions on publishing or broadcasting details in relation to STRs and restrictions on compelling witnesses in civil or criminal proceedings to give evidence in relation to the existence of an STR or the identity of the disclosing person. The POTA does not contain any restrictions on disclosure.

38. There is no explicit legal basis for controlled delivery or undercover operations, but current Isle of Man law does not restrict them. Interception of communications is controlled by the Interception of Communications Act 1988. There is included in the official Isle of Man legislative program ending in July 2003 a proposal for a bill to regulate the exercise of certain undercover techniques such as covert surveillance. It is anticipated that the provisions are likely to be passed to coincide with the coming into operation of the Human Rights Act 2001 in mid-2003. Isle of Man Customs has the option to carry out investigations where controlled deliveries of money, monetary instruments, restricted or prohibitive goods would take place. Such operations have to be authorized by treasury line management at the appropriate level, and voluntarily the UK's Regulation of Investigatory Powers Act authorization is also completed, if the modus operandi requires it, to ensure that any operation is Human Rights compliant in terms of being proportional, legal, authorized and necessary. There is no requirement or provision for judicial authorization. In unusual cases it is standard practice to seek legal advice from H.M. attorney general's chambers.

39. *The Isle of Man has no objections to the issue of asset sharing and each case is dealt with on an individual basis. The Isle of Man regularly participates in the investigation of cases where an international dimension or aspect is identified and by agreement and co-ordination simulated actions can be taken to ensure the seizure and forfeiture of ML/FT assets. Some problems related to asset sharing are discussed under criterion 16.*

40. There are procedures to extradite individuals charged with money laundering, drug trafficking and terrorism offences (Sections 7–15 of the Extradition Act 1989 (Act of Parliament)

41. The Isle of Man ensures that the Island is not a safe haven for individuals charged with FT. Extradition procedures are in place with other jurisdictions so that persons sought on charges relating to ML/FT can be extradited. The FCU and Police Special Branch and Officers of the Customs and Excise regularly liaise with the U.K. and U.S. authorities on the identity and movement of suspected terrorists. The geographic location of the Isle of Man would not be conducive to a "safe-haven" for terrorists.

42. The Isle of Man authorities generally provide adequate funding to ensure that the FCU is staffed properly supported by technical resources. The investigation of ML/FT is overseen by a Detective Inspector who is subject to advice from the attorney general. There is a current resource issue that could be resolved by the allocation of additional personnel as identified in Criterion No.6. *Mutual Assistance Requests from International Law Enforcement Agencies to the FCU/Customs and Excise account for approximately 60% of their workload. These requests are processed, the evidence uplifted and responses given in a prompt manner.*
Analysis of Effectiveness
The framework for international cooperation is considered to be adequate.
Recommendations and Comments
Implications for compliance with FATF Recommendations 3, 32, 33, 34, 37, 38, 40, SR I, SR V
Largely Compliant

Assessing preventive measures for financial institutions

22. In order to assess compliance with the following criteria assessors must verify that: (a) the legal and institutional framework is in place and (b) there are effective supervisory/regulatory measures in force that ensure that those criteria are being properly and effectively implemented by all financial institutions. Both aspects are of equal importance.

Table 5. Detailed Assessment of the Legal and Institutional Framework for Financial Institutions and its Effective Implementation

I—General Framework **(compliance with criteria 43 and 44)**
Description
43. Disclosure of information related to a suspicious transaction does not constitute a breach of any restriction imposed by statute or common law (Sections 17A(3)(a), 17B(5)(a) and 21 of the CJA, Sections 46(3)(a), 47(5)(a) and 48(4) of the Drug Act and Sections 10(1) and 16A(4) of POTA). 44. Although neither the laws nor any Isle of Man governmental authority designates a supervisor/regulator to ensure effective implementation of AML/CFT policies consistent with the FATF 40+8 Recommendations by all financial institutions, in practice, the function is allocated administratively, the FSC taking responsibility for the FIs regulated by it, the IPA taking responsibility for the FIs regulated by it. However, the FSC does not currently have the authority to regulate (except to the extent that a regulated FI engages in such activities) or to monitor compliance of businesses that engage in activities such as bureaux de change, check cashing and money transmission services ("MSBs"). Such regulation and monitoring is done by Customs and Excise under the Anti-Money Laundering (Money Services Businesses) Regulations 2002.
Analysis of Effectiveness
Although the framework is generally effective, the FSC does not have the statutory authority to regulate or monitor compliance for MSBs, which is the responsibility of Customs and Excise. This is considered to be a potential weakness.
Recommendations and Comments
Consideration should be given to rationalizing the existing regulatory arrangements for MSBs by enacting legislation under which the statutory responsibilities of Customs and Excise with respect to MSBs would be transferred to the FSC.
Implications for compliance with FATF Recommendation 2
Compliant

II—Customer identification (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)
Description
45. The Code requires FIs to establish and maintain procedures for customer identification (Article 3). However, the Code contains no explicit requirement that such procedures be followed by FIs, although such a requirement is clearly implied from the language of the Code. Section 3.1 of the CTP requires that verification of identity be undertaken on each applicant for a policy. There is no provision for an exception to this requirement. Section 3.02 of the Notes states that license holders must satisfy themselves as to the identity of their customers. It goes on to list the identity information required. 46. FIs are required to put in place procedures to seek satisfactory evidence of identity of a prospective customer, either occasional or usual, when establishing business relations or conducting one-off transactions (Sections 4(1) and 5(1) of the Code). However, the Code does not specify what may or may not represent satisfactory evidence of identity. Notwithstanding the absence of explicit requirements in the Code, the Notes do provide that in order to establish an individual's identity the information should include, his/her name and all other names used and reason for any aliases, the address at which he/she can be located and the date of birth, nationality, purpose of account, or in the case of a CSP, the reason for establishing the client company or trust, valid passport, driving license, government issued National Identity Card (Section 3.02(a) and (b) of the Notes). There is no requirement to renew identification when doubts appear as to the identity of a customer in the course of the business relationship. There is a requirement to record the identity of all customers (Section 7 of the Code). However, there are exemptions from the identification procedure under Sections 4 and 5 of the Code. No steps are required to be taken to obtain evidence of any person's identity: where there are reasonable grounds for believing that the potential FI is a regulated person, or covered by the EU Money Laundering Directive, or an authorized credit or financial institution in a country which is a member of FATF and which has anti-money laundering requirements approved by FATF, or a registered legal practitioner or an accountant, where the relevant person is satisfied that the rules of the applicant's professional body embody requirements of the Code (Sections 4(2), 4(3), 5(2) and 5(3) of the Code). Under Paragraph 4 of the CSP Code, a CSP must (a) "identify its client" and (b) "identify the beneficial owner of each of its companies (if not the same person as the client)." This is not limited to the point at which new business is accepted, but rather is an ongoing obligation. Paragraph 12.5 of the Banking Code 1999 requires that banks know their customers and that they comply with the anti-money laundering legislation in force. Paragraph 6.1 of the Conduct of Business Code requires that investment business license holders know their customers and that they comply with the anti-money laundering legislation in force. The Notes require FIs, in the case of corporate customers, to take particular care to verify among others, the evidence of identity of all beneficial owners and persons, the legal existence of a company, details of the nature of the applicant's business including sources of funds, satisfactory evidence of the identity of each of the beneficial owners, account signatories and those who are able to issue instructions relating to the operations of the applicant, and, in the case of a CSP, evidence of identity of at least two directors and a Board Resolution authorizing the opening of the account or establishment of the client company (Sections 3.03(a) and (b) of the Notes). There is no explicit prohibition of numbered accounts, nor is there any exemption from customer identification requirements for numbered accounts. b) Implementation Section 4.1.2 of the CTP requires that insurers receive the following documents as proof of identity for individual applicants—Passport or a National Identity Card (carrying a photograph of the individual) This should be accompanied by documents to confirm their address. Where it is not possible to obtain either a passport or national ID card an insurance business can accept two other formal documents carrying appropriate personal details which show verifiable reference numbers.

Section 8.3 of the CTP details that if, for any reason, at any stage of the life of a policy, the Insurance Business becomes aware of any doubts as to the identity of a Client (or any other party to a policy) this must be reported to the Money Laundering Reporting Officer using the normal reporting procedure for suspicious transactions. The Money Laundering Reporting Officer may take whatever steps they consider appropriate to satisfy the Insurance Business as to the identity of the Client (or other party) and if they consider there is a suspicion they should report as detailed in Section 8.2 which may include reporting to the FCU.

Section 5.1 of the CTP which addresses the issue of retrospective reviews indicates that relationships which are not yet being reviewed on a risk basis should be reviewed for any deficiency in verification documentation following the occurrence of a "trigger" event. Examples of trigger events are given as: a subsequent business transaction on the policy; or a surrender or redemption request.

Section 3.02 (a) of the Notes indicates information and documentation should be obtained and retained to support, or give evidence to, the details provided by the applicant for business. Acceptable identification documents include:

(i) current valid "full" passport;
(ii) Armed Forces ID card;
(iii) known employer ID card bearing the photograph and signature of the applicant; or
(iv) provisional or full driving license bearing the photograph and signature of the applicant, or
(v) government-issued National Identity Card bearing the photograph and signature of the applicant.

Identification documents which do not bear photographs or signatures, or are easy to obtain, are not appropriate as sole evidence of identity, e.g. birth certificate, credit cards, NHS cards, non-Isle of Man provisional driving license, student union cards.

Section 3.06 of the Notes describes exempt one-off transactions as follows:

Less than Euros 3,000 (or the equivalent thereof) in the case of a transaction or series of linked transactions entered into in the course of bookmaking or casino businesses;

Less than Euros 15,000 (or the equivalent thereof) in any other case.

Verification of identity is required for all other one-off transactions.

Section 3.03 of the Notes suggests that license holders should conduct periodic checks to ensure that corporate information they hold is correct and up to date. There are no provisions re reverification in respect of personal customers. This issue is however addressed in the Overriding Principles Paper.

The Isle of Man has a regime for introduced business. Introducers are broadly categorized as eligible or non-eligible. Eligible introducers are broadly speaking persons licensed under the Banking Act 1998, the Investment Business Act 1991, the Industrial and Building Societies Act 1892, the Corporate Service Providers Act 2000, the Insurance Act 1986, an authorized credit or financial institution in the European Economic Area which is covered by the Money Laundering Directive, an authorized credit or financial institution in a country which is a member of FATF and which has AML requirements which have been approved by FATF, an advocate, a registered legal practitioner within the meaning of the Legal Practitioners Registration Act or an accountant , where the license holder is satisfied that the rules of the introducer's professional body embody requirements equivalent to the Anti-Money Laundering Code 1998.

The Notes indicate that an eligible introducer is allowed to retain identity verification documents where it undertakes, among other things, to supply the license holder forthwith upon request evidence of the verification of identity of any customer, to give the license holder the right to undertake compliance checks and /or visits to the introducer's premises when deemed appropriate and to supply the license holder all identity verification documents in the event that the introducer's relationship with the original applicant is terminated.

The CTP provides that under the Terms of Business between an insurance business and an introducer, the introducer shall undertake to provide to the insurance business original or suitably certified copy documents which verify the identity of all applicants.

The Overriding Principles Paper envisages that under a revised framework for introduced business a license holder will always hold either originals or copies of identity verification documents.

The existing framework for introduced business creates some weaknesses in relation to the verification of customer identity as license holders do not at all times necessarily have immediate access to verification documents. There is even greater concern where introducers are persons such as accountants and attorneys who are not subject to prudential regulation.

47. There is no legal requirement for FIs to verify the identity of a person on whose behalf an applicant may be acting.

Section 3.03 of the Notes indicates that satisfactory evidence of the identity of each of the beneficial owners of an applicant and any persons or persons on whose instruction the signatories are to act or may act.

Section 3.05 of the Notes indicates that in the case of all types of trust, if practical, license holders should obtain and verify the identity of any principal beneficiaries. The Notes also provide that where an applicant for a business is a "trustee or a person acting in a fiduciary capacity in relation to a third party . . . the Commission expects license holders to obtain satisfactory evidence of the nature of his trustee or fiduciary capacity or duties, satisfactory evidence of the identity of the settlor, protector and any controller or similar person who has the power to remove the trustees and evidence as to the source or origin of the assets under his control or which he holds as trustee.

Section 3.05 of the Notes indicates that where the applicant for business is a trustee, or a person acting in a fiduciary capacity in relation to a third party and is a regulated financial institution in the Isle of Man, the EEA or from a FATF member country with AML requirements which have been approved by FATF, the Commission expects license holders to obtain:

(i) satisfactory evidence of the nature of his trustee or fiduciary capacity or duties;

(ii) satisfactory evidence of identity of the settlor (and the person providing the funds where not the settlor), protector, and any controller or similar person who has power to appoint or remove the trustee.

The Notes go on to indicate that the license holder may wish to obtain copies of satisfactory evidence from the trustee or fiduciary showing the verification of identity of any and every party (including where relevant discretionary and contingent beneficiaries) for whom he is acting.

Section 4.4 of the CTP indicates that where the applicant is a trustee that the insurance business must satisfy itself

that the Trustees have been identified in accordance with the appropriate verification requirements for corporate applicants or individuals. Where there is more than one Trustee, appropriate identification must be obtained for each. Then "provided that the trustees have been identified to the satisfaction of the Insurance Business and satisfactory evidence of proper appointment of the Trustees has been received e.g. extracts of the Deed of Trust; the nature and purpose of the trust is known; the source or origin of the assets under the trust is known and the Insurance Business considers it satisfactory; the persons from whom the Insurance Business is to take instructions have been identified and specimen signatures have been obtained (although their identity need not be verified); the trustees may then provide details of the parties to the trust at the time the application is being made."

These parties will be:

the settlor(s), whose details should include the full name(s), date(s) of birth and, if they are still living, the current addresses of any individuals. If the settlor is no longer living, the date of death should be included. If the settlor has been other than an individual, or individuals, the trustee should provide sufficient information for the Insurance Business to identify the settlor(s) should they wish to do so;

any protector(s), whose details should include the full name(s), date(s) of birth and the current addresses of any individuals; all beneficiaries (as and when defined).

Section 4.5 of the CTP indicates that where the applicant is a nominee the insurance business must satisfy itself

that the Nominees have been identified in accordance with the appropriate verification requirements for corporate or individual clients and that satisfactory evidence of the appointment of the Nominees has been received; The persons from whom the Insurance Business is to take instructions have been identified and specimen signatures obtained (although their identity need not be verified); and provided that the Nominees have been identified to the satisfaction of the Insurance Business, the Nominees may then provide details of the parties to the arrangement. These will be the beneficial owner of the assets; and the 'settlor' or original source of the assets under the nominee arrangement. The Notes do not specifically address the issue of nominee shareholders as such persons are usually company or trust service providers who are regulated by the FSC. This approach does not however address instances in which where nominees are resident outside of the jurisdiction. 48. There is no legal requirement for FIs to include accurate and meaningful originator information and related messages on funds transfers that should remain with the transfer through the payment chain. Section 6.3 and 6.4 of the CTP indicates that where the Insurance Business does not receive complete originator information from the remitting bank the Insurance Business must review the information provided and consider whether additional information should be sought. A risk-based approach may be used in deciding whether to seek additional information. Further, where the monies are being remitted from several accounts the Insurance Business should understand the reasons for this and be satisfied in each case. Section 6.2 of the CTP requires that the Insurance Business must establish how payments are to be made, from where and by whom, and that where the monies are being remitted from accounts other than in the name of the Applicant the Insurance Business must be satisfied that the reasons for the account remitting the monies not being in the name of the Applicant are understood, and where considered necessary, the identity of the holder of the account from which remittance has been made should be verified. In the absence of being so satisfied, insurance businesses are required to terminate the application process. The CTP does not clearly indicate what criteria should be applied in the "risk based approach" to be used in determining when additional originator information is required. This issue is not specifically addressed by the Notes. Institutions visited generally had good customer identification requirements in place. They generally employed more onerous requirements for customers in categories considered to be higher risk. There was less consistency across institutions in relation to the issues addressed in the Overriding Principles Paper; principally in relation to to the holding of identity documents by introducers and the status of the Progressive Program.
Analysis of Effectiveness
Arrangements for customer identification are generally adequate. There are however some concerns about requirements related to satisfactory evidence of identity, the identity requirements for legal entities and reverification of existing customers.
Recommendations and Comments
The relevant laws should be amended to explicitly require that customer identification procedures be followed by reporting parties. Consideration should be given to the imposition of a requirement for the re-verification of existing customers. Consideration should be given to amending the relevant laws to limit the availability of the AML exemption to those entities regulated in EU States rather than to entities covered under the EU AML Directive. The Notes should be amended to require licensees to exercise care in initiating transactions with companies that have nominee shareholders. The FSC has already undertaken considerable work to direct FSBs towards the customer identification standards proposed by the Position Paper. It is nevertheless recommended that these efforts be redoubled to ensure a greater degree of consistency in the approach adopted by licensees.

Implications for compliance with FATF Recommendations 10, 11, SR VII
Full compliance will be achieved when the relevant laws are amended to explicitly require that customer identification procedures be followed and financial institutions have timely access to all customer identification records under the regime for introduced business.
III—Ongoing monitoring of accounts and transactions (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)
Description
49. There is no legal requirement for FIs to scrutinize all complex or unusual transactions and complex or unusual patterns of transactions that have no apparent or visible economic or lawful purpose, to examine as far as possible the background and purpose of such transactions. However, paragraph 4(4) of the Code requires that FIs establish procedures to verify the evidence of identity of the applicant for business where a transaction is undertaken that is significantly different from the normal pattern of previous business. This, linked to the requirement to file STRs under paragraph 12 of the Code, makes it implicit that FIs must monitor business relationships for such transactions. Section 6.01 of the Notes indicates that where a transaction is inconsistent in amount, origin, destination, or type with a customer's known, legitimate business or personal activities, the transaction must be considered unusual, and the license holder put "on enquiry." Such enquiries may lead to a suspicion being formed and may result in the filing of an STR. Appendix G provides examples of suspicious transactions. Section 8.4 of the CTP requires that all complex or unusual transactions and complex or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose, must be scrutinized by the Insurance Business and the background and purpose of such transactions ascertained so that the Insurance Business is satisfied as to why the transaction is being structured in this way. In the absence of being so satisfied the Insurance Business must not proceed with the transaction and report the suspicion in the normal way. Full details of any information obtained, and decisions made, should be recorded on the file. Under section 8.3 0f CTP which deals with suspicious transaction reporting suspicions should be aroused where there are unexplained changes in a client's investment pattern or sudden changes in intermediary transaction patterns. While the CTP requires findings to be recorded, the Notes contain no such requirement. However, both require the reporting of suspicious transactions. 50. There is no legal requirement to scrutinize transactions with persons in jurisdictions that do not have adequate systems in place to prevent or deter ML or FT. There is no legal requirement for FIs to provide effective measures to ensure that financial institutions are advised of concerns about weaknesses in the AML or CFT systems of other countries. The Notes only address this issue in relation to correspondent banking. Section 3.13 of the Notes provides as follows with respect to correspondent banking: In particular, banks should refuse to enter into or continue a correspondent banking relationship with a bank incorporated in a jurisdiction in which it has no physical presence and which is unaffiliated with a regulated financial group (i.e., shell banks). Banks should pay particular attention when continuing relationships with respondent banks located in jurisdictions that have poor KYC standards or have been identified as being "noncooperative" in the fight against money laundering. Banks should establish that their respondent banks have due diligence standards of at least an equal standard to their own, and employ enhanced due diligence procedures with respect to transactions carried out through the correspondent accounts. Appendix D of the Notes lists NCCT countries as well as other countries that have been subject to advisories and indicates that FIs must treat business from these countries as requiring further scrutiny. Section 3.17 of the CTP requires that the Insurance Business must have procedures in place to examine those Applicants who have connections with any country appearing on the list of FATF Non Cooperative Countries.

The Insurance Business should consider whether any additional verification of identity or source of funds is necessary in these cases.

Appendix D of the Notes list countries that appear on the FATF NCCT list and countries subject to money laundering related advisories.

51. There is no legal requirement for FIs to include accurate and meaningful originator information and related messages on funds transfers that should remain with the transfer through the payment chain.

Section 6.3 of the CTP indicates that where the Insurance Business does not receive complete originator information from the remitting bank the Insurance Business must review the information provided and consider whether additional information should be sought. A risk based approach may be used in deciding whether to seek additional information.

The Notes do not specifically address this issue.

Discussion with institutions as well as a review of documented procedures indicated that staff of financial institutions would be generally alert to unusual patterns of client activity. Most of the documented procedures adopted by the institutions visited, list NCCT jurisdictions and other countries over which there is some level of concern about AML/CFT standards. In general a higher level of due diligence in required when dealing with business associated with these countries.

Analysis of Effectiveness

Arrangements for the ongoing monitoring of accounts and transactions are generally adequate. The overall framework would be strengthened if the Notes broadened the focus of its guidance in respect of business relationships and transactions with persons from countries with inadequate AML/CFT systems. There are also concerns with respect to enhanced scrutiny to wire transfers and reporting of unusual or complex transactions.

Recommendations and Comments

Within the two-year period referred to by FATF, the relevant laws should be amended to require that accurate and meaningful originator information on funds transfers remain with the transfer through the payment chain, and that FIs give enhanced scrutiny to wire transfers that do not contain complete originator information.

The Notes should be expanded to require financial institutions to give special attention to business relationships and transactions with persons from countries that do not have adequate systems to prevent money laundering, in circumstances other than those related to correspondent banking.

Implications for compliance with FATF Recommendations 14, 21, 28, SR VII

Compliant

IV—Record keeping
(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)

Description

52. FIs are required to maintain records of a person's identity (Para. 7 of the Code) which indicate the nature of the evidence and comprises a copy of the evidence, for a period of five years commencing from the date when all activities relating to a one-off transaction or a series of linked transactions were completed, or the business relationship was formally ended, or if the business relationship was not formally ended, when the last transaction was carried out (Paras. 7, 8 and 9 of the Code) and these documents are available to a competent authority to inspect. With respect to FT, Section 15(2) of the POTA requires full auditable records in relation to any suspicion reported to be retained in perpetuity.

CTP Section 9.1 indicates that the records prepared and maintained by an Insurance Business on its Client relationships and transactions should be such that: competent third parties will be able to assess the Insurance Business' observance of money laundering policies and procedures; any transactions effected via the Insurance Business can be reconstructed; and the Insurance Business can satisfy, within a reasonable time, any enquiries or court orders from the appropriate authorities as to disclosure of information.

Further, under the CTP all documentary items relevant to Client identity and transaction history must be maintained and be capable of being retrieved efficiently.

The Required Period for the purposes of the CTP is at least six years from the date when all activities relating to a one-off transaction or a series of linked transactions were completed; or the business relationship was formally ended; or if the business relationship was not formally ended, when the last transaction was carried out. Where a report has been made to the FCU, or the Insurance Business knows or believes that a matter is under investigation, the Insurance Business shall retain all relevant records for as long as required by the FCU.

Section 7.01 of the Notes refers to the provisions of the Code requiring records to be maintained in respect of identification and verification and transactions. The notes indicate that records in respect of identification, verification and transactions should be retained for the period of the business relationship with the client plus five years.

53. FIs are required to maintain a record containing details relating to all transactions carried out by their customers and to keep the record for a period of five years commencing from the date when all activities relating to a one-off transaction or a series of linked transactions were completed, or the business relationship was formally ended, or if the business relationship was not formally ended, when the last transaction was carried out (Sections 8 and 9(1) of the Code; see also Section 7.01 and 7.02 of the Notes) and these documents are available to a competent authority to inspect the documents. With respect to banking and investment business, transaction records are required to be kept for five years (section 4(5) of the Banking Code and section 8(6) of the Conduct of Business Code). With respect to FT, Section 15(2) of the POTA requires full auditable records in relation to any suspicion reported to be retained in perpetuity. Records are required to be sufficient to identify the source and recipient of payments from which investigating authorities are able to compile an audit trail for suspected money laundering (Section 8 of the Code).

Section 7.01 of the Notes recommends that records of the following information be maintained :

- Volume, origin and destination of funds;
- The form in which the funds were offered or withdrawn and the identity of the person undertaking the transaction;
- The form of instruction and authority received and the name and address (or identification code) of the counterparty;
- The security dealt in, including price and size;
- The account details from which the funds were paid
- The form and destination of payment made by the business to the customer; and
- Whether the investments were held in safe custody by the business or sent to the customer or to his/her order and, if so, to what name and address.

Sections 9.1 and 9.4 of the CTP cover transactions records.

54. There are laws and procedures regarding the production of records by financial institutions and other persons, the search of persons and premises, seizure and obtaining of evidence for use in investigations and criminal proceedings (Sections; Secs. 11 - 25 of the PPP Act; Sections 17J, 24 and 25 of the CJA; Section 15 of the POTA; Sections 52 and 53 of the Drug Act; Section 24 of the CJA2 enables information to be obtained for external authorities).

With respect to insurance business, under section 22 of the IA, the IPA has the power to investigate the transactions and inspect the books, accounts and other documents of any authorized insurer.

Section 13 of the Banking Act provides that the FSC may inspect the books accounts and documents and investigate transactions of a banking institution a former banking institution or any other person who, acts or has acted as the manager of any banking business. The section also gives the Commission the power of entry and access to books, accounts and documents.

Section 8 of the IBA provides that the FSC may inspect the books, accounts and documents and investigate the transactions of a permitted person. The section also gives the FSC the power of entry and access to books, accounts and documents. Section 10 of the CSP Act provides that the FSC may inspect the books, accounts and documents and investigate transactions of a CSP or a former CSP. The section also gives the FSC the power of entry and access to books, accounts and documents. Visits to financial institutions indicated that procedures are maintained requiring that records be maintained for a period of six years after the termination of a business relationship.
Analysis of Effectiveness
The overall framework in respect of record keeping is generally adequate.
Recommendations and Comments
Implications for compliance with FATF Recommendation 12
Compliant
V—Suspicious transactions reporting **(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)**
Description
55. Where an FI has reason to suspect that assets are derived from criminal activity, it is an offence not to disclose the information to a constable (Section 17J of the CJA; Sec. 48 of DTA; Sec. 16A of POTA). With respect to FT, the Terrorism (United Nations Measures)(Isle of Man) Order 2001 permits financial sanctions to be imposed against named individuals and entities notified by the relevant authority (treasury in the IoM, Bank of England in the United Kingdom), rather than having to have them named in the Order. For example FIs must freeze any assets they identify as connected to either the individuals or organizations named post-9/11 by the FBI and make a disclosure to Customs and Excise which in practice goes via or is copied to the FCU. Section 16A of the POTA requires that suspicions of FT be reported to a constable and makes it an offence to fail to disclose information. In addition, Section 14 of the Anti-terrorism and Crime Bill requires the reporting of suspicions of terrorism. Section 48 of the Drug Act deals with the disclosure of information relating to drug trafficking proceeds. FIs are required to put procedures in place to identify an "appropriate person" to whom a suspicious report can be made (Section 12(1)(c) of the Code). The FSC has issued guidelines for the identification of unusual transactions, but there is no explicit legal basis for doing so. It should be noted, however, that the Code makes reference to the court taking into account compliance with the Notes and the CTP (Section 3(3)(a) of the Code). The IPA has issued such guidelines in the form of the CTP although the authority of the IPA is pursuant to a provision not designed for that purpose—section 24A of the IA was cited by the authorities as the basis of the issuance of the CTP provides that the IPA may publish information or give advice to insurance licensees. Section 8.2 of the CTP requires that a senior officer of the Insurance Business, resident on the Isle of Man, must be appointed by the Board of the Insurance Business as Money Laundering Reporting Officer and that the name of the Money Laundering Reporting Officer must be notified to the Insurance and Pensions Authority within 28 days of appointment. Section 8.5 of the CTP addresses the issue of suspicious transaction reporting. It provides examples of suspicious activity, and details on the reporting procedure. It also provides guidelines for reporting to the FCU. Section 5. of the Notes requires the appointment of an MLRO. Section 6 addresses the issue of identifying and reporting suspicious transactions. Appendix G provides a list of suspicious transactions. 56. Disclosure of information related to a suspicious transaction does not constitute a breach of any restriction imposed by statute or common law (Section 17A(3)(a) of the CJA). Similar provisions are in place in section 48(6) of the Drug Act and section 16A(6) of POTA. 57. FIs including their staff are prohibited from tipping off their customers when information relating to them is reported to authorized government officials (Section 17D(1) of the CJA). Similar provisions are in place in section 49 of the Drug Act and section 15(2) of POTA. There is no explicit requirement in law that provides

legal authority for the FIS or any other competent authority to give instructions to FIs or to require FIs to observe those instructions. Tipping off is addressed in 6.01 and Appendix N of the Notes and Section 8.7 of the CTP. All institutions visited have internal procedures for reporting of suspicious transactions usually to the person designated as MLRO. In one instance no reference was made to the MLRO and reports were required to be sent initially to the supervisor, manager or director. The institutions also had guidelines addressing the issue of the tipping-off offence.
Analysis of Effectiveness
The framework in respect of the reporting of suspicious transactions is generally adequate.
Recommendations and Comments
Consideration should be given to providing the FCU with the authority to give instructions to reporting entities and to require FIs to observe instructions of the FCU.
Implications for compliance with FATF Recommendations 15, 16, 17, 28
Compliant
VI—Internal controls, Compliance and Audit **(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)**
Description
58. Regulated FIs are required to establish procedures of internal control and communication as may be appropriate for the purposes of forestalling and preventing money laundering (Section 3(1)(a)(iv) of the Code; the Code applies to terrorist financing as well, see definition of "money laundering requirements" in Paragraph 2(1) of the Code). Financial institutions are required to take appropriate measures for purposes of making employees aware of the FI's anti-money laundering procedures and enactments relating to money laundering (Section 13 of the Code). In addition, FIs are required to provide employees with training in the recognition and handling of transactions carried out by or on behalf of any person who is or appears to be engaged in money laundering (Sections 3(1)(b), 3(1)(c) and 14 of the Code). The Notes cover internal procedures and policies and training. The CTP cover internal procedures and policies and training. The issue of an audit function for AML/CFT systems is not specifically addressed. The IPA however requires the auditors of licensees to provide annual certification of compliance with regulations made under Insurance Act. This includes compliance with CTP. Under the IA and the Insurance regulations it is a requirement that all insurance companies appoint external auditors. Section 10.1 of the CTP indicates that the Insurance Business shall provide, or shall arrange to be provided, education and training for all staff to ensure that they are, as a minimum, aware of: • their personal obligations under the anti-money laundering requirements; • their personal liability for failure to report information or suspicions in accordance with the anti-money laundering requirements; • the internal procedures for reporting suspicious transactions within the Insurance Business; and • the identity of the Money Laundering Reporting Officer and Deputy Money Laundering Reporting Officer. Additionally, the Insurance Business shall provide training to assist all staff: • in the recognition and handling of transactions carried out by or on behalf of, any person who is, or appears to be, engaged in money laundering; • in dealing with customers where such transactions occur; and

- in procedures to be adopted where transactions have been reported to the FCU

Section 10.2 of the CTP details the additional training required for senior, specific and key staff on the basis of the job performed. Section 10.4 requires all new employees to undergo training as soon as reasonably practicable.

59. While FIs are required to put procedures in place to identify an "appropriate person" to whom an STR may be made (Section 12(1)(c) of the Code), except for banks, there is no explicit requirement in law to appoint or designate such person, although such a requirement is clearly implied from the language of the Code. With respect to banks only, Section 11.12 of the Banking (General Practice) Regulatory Code 1999 requires the appointment of a senior executive as the MLRO, and the notification of the appointment of such officer and any change to the FSC within 14 days.

With respect to banks, fund and investment management businesses and CSPs, section 5.01 of the Notes states that the Code requires the designation of an MLRO such person (although not technically correct, see above). The Notes then state that the Commission would generally expect the MLRO to be a senior member of the staff.

Section 8.2 of the CTP indicates that a senior officer of the Insurance Business, resident on the Isle of Man, must be appointed by the Board of the Insurance Business as Money Laundering Reporting Officer to oversee relevant policies and procedures; receive reports of suspicions from employees; determine whether the information gives rise to a suspicion; investigate that suspicion; decide whether to report or not; record his action (which may involve further disclosure to the Financial Crime Unit) and act as the central co-ordination point. The name of the Money Laundering Reporting Officer must be notified to the Insurance and Pensions Authority within 28 days of appointment.

Neither the Notes nor the CTP specifically require the appointment of a compliance officer. The CTP's description of the functions to be undertaken by the MLRO includes oversight of relevant policies and procedures.

60. There is no requirement in law, Notes or CTP that FIs should be required to put in place adequate screening procedures to ensure high standards when hiring employees. There is an industry standard for the insurance sector which requires that references be taken for all employees.

61. The law and Notes are silent on the following: FIs should ensure that their foreign branches and subsidiaries observe appropriate AML/CFT measures consistent with the home jurisdiction requirements; FIs should inform their home jurisdiction supervisor/regulator when a foreign branch or subsidiary is unable to observe appropriate AML/CFT measures of the home jurisdiction; and where the minimum AML/CFT requirements of the home and host jurisdictions differ, branches and subsidiaries in host jurisdictions should be required to apply the higher standard.

With respect to insurance business, section 1 of the CTP states that where such business has branches or subsidiaries in other jurisdictions, practices and procedures, consistent with the CTP, must be operated throughout all parts of the organization. The section also indicates that where the requirements of the local jurisdiction differ from those required by the CTP the higher of the requirements must be applied.

Section 8.2 of the CTP allows that where Insurance Businesses have associated operations in other jurisdictions, a local officer may be appointed to deal with suspicion reports raised in those operations. In normal circumstances that local officer will be responsible for co-coordinating suspicion reports with the local authorities and for co-coordinating their activities with the senior officer responsible. At all times the Money Laundering Reporting Officer should be aware of any suspicion reports raised in these offices and should include details within the records and reports maintained in the Isle of Man under these Standards. This applies to both reports made by the Insurance Business and enquiries made by Financial Crime Unit. Where a local officer is not appointed, the Money Laundering Reporting Officer is responsible for ensuring that both local and Isle of Man obligations are met by the branch.

All but one of the institutions visited have substantive training programs in place for staff. There appears to be

active collaboration between the industry and the regulators on the issue of training. With one exception the institutions visited have appointed MLROs. In general AML/CFT compliance came under the main compliance function. The institutions visited generally assess a prospective employee's suitability on the basis of a CV and references (usually two) provided by the applicant. Apart from this approach there was in general no specific mechanism for investigating any past criminal activity on the part of prospective employees. This is to some extent influenced by the relatively small size of the jurisdiction.
Analysis of Effectiveness
The framework for internal controls, compliance and audit is generally adequate but would be strengthened by a requirement in the Notes for institutions to test the compliance of AML/CFT systems against home and host country standards. There are also concerns about requirements for the designation of an MLRO and the application of AML/CFT standards to foreign braches and subsidiaries and the adequacy of screening of employees.
Recommendations and Comments
Consideration should be given to the imposition of a requirement that all Isle of Man FIs apply Isle of Man legal and regulatory requirements in respect of AML/CFT to their branches and subsidiaries outside of Isle of Man. Consideration should also be given to ensuring that institutions test compliance of AML/CFT systems against home and host country standards. Consideration should be given to the imposition of a requirement to appoint or designate an MLRO for FIs other than banks. However, the authorities have indicated that the Code will be amended to require such appointment. Consideration should also be given to amending the appropriate laws to require banks and insurance companies to report any change in such position to the FSC and IPA, as is already required for trust and investment company businesses. Consideration should be given to amending the relevant laws to require all FIs to put in place adequate screening procedures to ensure high standards when hiring employees.
Implications for compliance with the FATF Recommendations 19, 20
Full compliance will be achieved when the AML/CFT framework ensures that all FIs apply Isle of Man standards to branches and subsidiaries in other jurisdictions.
VII—Integrity standards **(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 criterion114 for the securities sector)**
Description
62. There are laws that require that FIs be licensed and that controllers and certain officials of regulated FIs be fit and proper on their entry into a licensee and on a continuing basis, but do not define what fit and proper means (Sections 4(1) and 16 of the Banking Act; Sections 3(3) and 10 of the IBA; Section 20 of the IA; Sections 3(3) and 9 of the CSP). In addition, with respect to banking, any person who wishes to hold more than 5% of the share capital of an FSC-regulated FI must receive the prior consent of the FSC (Para. 11.5 of the Banking Code). With respect to CSPs, see also the definition of "controller" in section 27(1) of CSP Act and requirement for Controllers to be fit and proper under section 3(3). The laws cited do not explicitly address the matter of criminals being prohibited from involvement in FIs. What is covered is the failure to meet the fit and proper criteria or some other reason as the basis for refusing to permit a person from controlling or continuing to control an FI or to serve as a director or officer. This issue is not addressed in either the CTP or the Notes. 63. Under the Charities Act, an institution which holds itself out as a charity is guilty of an offence unless it is registered (Section 1 of the Charities Act). Under the Charities Act, "Institution' means any institution (wherever established) whether corporate or not and includes any trust or undertaking" (Section 15(1)). The chief registrar may refuse registration if satisfied that the institution is not established for charitable purposes or does not have a substantial and genuine connection with the Island. According to the authorities, in practice, the Registrar can and does take advice from the attorney general if in doubt. Any person who is a trustee, director, manager or other similar officer or agent of an institution which does not register while holding itself out as a

charity is himself guilty of an offence. A company which wishes to establish itself for charitable purposes may apply under the Companies Act 1931 (Section 18) to the attorney general for a license so that it can carry on business without using the word "limited" in its name. The attorney general will not grant such a license unless satisfied that the company is formed for promoting commerce, art, science, religion, charity or some other useful object, that the company will apply its profits, if any, or other income in promoting its objects and prohibits the payment of dividends to its members (Section 18 of the Companies Act). With respect to shell corporations, incorporated charities or other incorporated entities, the Code requires that CSPs put procedures in place to identify customers (Paras. 4, 5 and 6 of the Code). In addition, under Paragraph 4 of the CSP (General Requirements) Code, a CSP must identify its client and identify the beneficial owner of each of its companies. In addition, with respect to licensees of the FSC and the IPA, there is a requirement that such businesses conduct client due diligence of all customers, including shell companies and incorporated and unincorporated charities and other businesses (Section 3 of Notes and Section 4 of CTP). 3.03 (a) (ii) of the Notes which relates to private companies indicates that the Commission expects all license holders to obtain details of the nature of the applicant's business, the reason for the account or client company being established, an indication of the expected turnover of the account or the client company and its anticipated usage, the source of funds and source of wealth, and a copy of the last available accounts of the applicant where appropriate. Section 3.14 of the Notes requires license holders to undertake extra due diligence on nonprofit organizations and foundations. License holders are required to be especially vigilant for unusual transaction patterns or sizeable transactions and to ascertain geographical activity and business partners of such organizations. Section 4.11 of the CTP requires that where an application is received in the name of a charity the insurance business must satisfy itself that: (i) The charity exists and the investment is legitimately made on behalf of the charity; and (ii) The application is being made with the knowledge of the charity. The following information is received: (i) evidence of the registered office of the charity; (ii) a list of all directors and where the charity is not on an acceptable register of charities, verification of the identity of at least two directors; and (iii) a list of the officers from whom the insurance business is to take instructions. In the case of a foundation the insurance business must satisfy itself that The foundation Council has been identified in accordance with the appropriate verification requirements The following information has been received: (i) a certified extract from the public registry showing the protocolization of the public deed; (ii) satisfactory evidence of the appointment of the Foundation Council; (iii) The nature and the purpose of the foundation is known; (iv) The source of origin of the assets under the foundation is known; and (v) the persons from whom the insurance business is to take instructions is known. Section 4.2 and 4.3 of the CTP sets out identification requirements for corporate clients.
Analysis of Effectiveness
The legal framework is generally adequate except in respect of the need to expand the definition of "fit and proper" to include conviction for a serious crime.
Recommendations and Comments
Consideration should be given to amending the Code to explicitly prohibit involvement of criminals in FIs and to define minimum standards for 'fit and proper,' in a manner consistent with Isle of Man human rights and other relevant legislation.
Implications for compliance with FATF Recommendation 29
Compliant

VIII—Enforcement powers and sanctions (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)
Description
64. With respect to explicit statutory authority to impose administrative sanctions, the FSC and IPA have the following powers relating to banks, investment business, CSPs and insurance business: (i) issuance of a written directive or order (Sections 11 of Banking Act; 9 and 9A of IBA, 6 of FSA; 7 of CSP Act; 24A of IA); (ii) issuance of a public notice or statement (Section 17 of Banking Act; 12 of IBA, 22 of FSA, 14 of CSP Act; 5.7 of IA Bill); (iii) placing conditions on the license with respect to specified lines of business or activities (Sections 6 of Banking Act; 3 of IBA; 3 of FSA, 3 of CSP Act; 6 and Schedule 4(6)) of the IA; (iv) suspension or removal of directors, officers and controllers (Sections 16 of Banking Act; 10 of IBA; 18(1) of FSA; 9 of CSP Act; 7(3) of the IA Bill); (v) removal and disqualification of external auditor (6(2) of FSA (provides for the issuance of regulations by FSC to do so); (vi) appointment of a special auditor or reporting accountant at expense of licensee (Sections 21 of Banking Act; 8 of IBA; 19 of FSA (on application of FSC to High Court); 25 of CSP Act;); (vii) appointment for a defined period of a provisional or temporary administrator or conservator is only explicitly provided for CSPs (Section 16 of CSP Act (with petition by FSC to High Court), however, the High Court has authority by order to appoint a receiver in all cases in which it appears to be 'just and convenient' to do so (Section 42 of High Court Act 1991); (viii) with respect to investment business and CSPs only, imposition of civil money penalties (administrative fines) on licensees, i.e., legal persons and not individuals except with respect to sole traders (proprietors) and partnerships (Sections 6A of IBA and 8 of CSP Act; 5.9 of the Insurance Bill); (ix) revocation of license (Sections 7 of Banking Act, 3(6) of IBA, 4 and 14 of FSA; 4 of CSP Act; 9 of the IA); (x) the FSC may petition a court to wind up a company in the public interest (Sections 162(6) and 164(d)of the Companies Act 1931); and (xi) the FSC and through it the IPA may petition the High Court to disqualify a person from acting as a director or manager (Section 26 of Companies Act 1992). In addition, with respect to the regulatory laws governing FIs, any person who violates any provision of the Banking Act is liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding 5000 pounds, or to both, or on conviction on information to imprisonment for a term not exceeding three years or to a fine or to both, or have a banking license revoked upon conviction (Section 29 of the Banking Act); Any insurer violating any provision of the IA is liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding 5000 pounds, or to both, or on conviction on information to imprisonment for a term not exceeding two years or to a fine or to both (Section 31 of the IA); Any CSP violating any provision of the CSP Act is liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding 5000 pounds, or to both, or on conviction on information to imprisonment for a term not exceeding two years or to a fine or to both (Section 21(1) of the CSP). However, where there is a contravention of an order of the Financial Supervision Commission relating to the appointment of an individual who is not a fit and proper person, a CSP is liable on summary conviction to a fine not exceeding 5000 pounds (Section 21(2) of the CSP). With respect to insurance business, under Section 1 of the CTP, companies are warned that in addition to possible sanctions under Sections 12 and 31 of the IA, failure to comply with the CTP will also result in the IPA examining the fitness and propriety of the company. With respect to investment business, Section 19 of the IB Act provides that any person who violates any provision of the Act is liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding 5000 pounds, or to both, or on conviction on information to imprisonment for a term not exceeding three years or to a fine or to both.

With respect to the power to remove or disqualify an auditor (see para. v above) for malfeasance or criminal conduct, this power is available only with respect to collective investment schemes under the FSA, and, since the FSC has not issued regulations, it is not an operative provision. This power is also not available under current law to the IPA. The relevant laws should be amended to provide for this power with respect to all businesses supervised by the FSC and IPA. With respect to the power to appoint a provisional or temporary administrator (see para. (vii) above), the relevant laws should be amended to provide this authority to the FSC and IPA, with court approval if necessary under the legal framework in the Isle of Man, with respect to banks, investment business and insurance business. With respect to civil money penalties (para. (viii) above), there are a number of concerns: First, under current law, none of the available powers under the IBA and CSP Act have been implemented through secondary legislation; second, that under such Acts there is no ability to impose penalties against individuals, such as directors, officers and controllers; third, that the Banking Act does not have any comparable provision; and finally, that the range of penalties has not been set forth in secondary legislation, but should be sufficiently large so as to discourage wrongdoers from continuing their actions. While the authorities have indicated that the Trust Service Providers Bill will allow the imposition of such penalties on banks, investment business and CSPs, the Bill will incorporate the same weaknesses as under current law. Hence, the relevant provisions of the Bill should be revisited in light of these recommendations.
Analysis of Effectiveness
With respect to administrative sanctions that the FSC may impose, there are a number of gaps in coverage and uniformity as identified in the above-referenced description. The effectiveness of the existing framework would also be enhanced by expanding statutory enforcement sanctions available to the FSC and IPA.
Recommendations and Comments
With respect to explicit statutory enforcement sanctions available to the FSC and IPA, consideration should be given to adding the following to the legal framework: the power to remove or disqualify an auditor should be expanded to apply to all regulated FIs and not just collective investment schemes, and the regulations for such schemes should be issued by the FSC; the power to appoint a provisional or temporary administrator, with court approval if necessary; and the power to impose civil money penalties or administrative fines against individuals, such as directors, officers, and controllers; as well as legal persons. Consideration should also be given to empowering the FSC and the IPA to disqualify principal persons from regulated activities. In addition, the grounds for imposition of these sanctions should explicitly refer to ML and FT. Finally, the sanctions should be uniform across all financial sectors, so that the same rules apply to every FI.
IX—Cooperation between supervisors and other competent authorities (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)
Description
65. While no members of the IPA staff are employed full time on AML/CFT, 2 members of staff spend a significant proportion of their time on AML/CFT matters, and have the ability to call upon the assistance of other staff of the IPA whenever required. All members of the supervisory staff have some experience of AML/CFT matters, and refresher training is undertaken. It is the intention of the IPA that all life assurance companies will be visited at least once in every two years, with follow-up and additional visits if appropriate. Over the last two years, all but one of the insurance companies have been visited. An enforcement officer at the FSC devotes the vast majority of his time to AML/CFT issues and is able to call upon the assistance of other FSC staff as required. All staff attends training on AML/CFT annually. Over the last three years the FSC has visited most licensed banks and fund and investment managers and 27 CSPs. AML/CFT reviews are also undertaken through off-site surveillance. The reviews undertaken by both regulators appear to be thorough and in a number of cases licensees were required to undertake remedial action to meet required standards. In some instances concerns arising from on-site reviews were referred to the attorney general to determine if specific action should be taken against the institutions in question. While both the FSC and the IPA have undertaken a good level of surveillance of licensed institutions in relation to AML/CFT over the last three and two years respectively, this may have impacted on resources

available to cover other categories of risk.

66. Under the FSA, the FSC has authority to disclose information "to any constable for the purpose of enabling or assisting the Isle of Man Constabulary to discharge its functions." (Section 24(1)(aa)). The FSC also has authority under that Act to disclose information "with a view to the institution of or otherwise for the purposes of criminal proceedings whether in the island or elsewhere." (Section 24(1)(a).

Under the IA, according to the Isle of Man authorities, there is no statutory prohibition applying to the IPA to prevent it from disclosing information gained from on-site inspections and reports submitted by licensees to other domestic competent authorities. In addition, the IPA has explicit statutory authority to disclose certain other categories of information to the FSC (Section 24(2)(bb) of the IA) and "with a view to the institution of, or otherwise for the purposes of, any criminal proceedings, whether under this Act [the IA] or otherwise" (Section 24(2)(d)).

With respect to the Customs Service, there is similar authority to disclose information in aid of criminal investigations, domestic and foreign (Section 174B of Customs Amendment Act) and allows the financial regulators to disclose information to Customs (Section 174C).

According to the authorities, there is close cooperation with other domestic competent authorities including the lending of expertise with respect to AML/CFT analysis, investigations, and prosecutions between the financial supervisors, the FSC and IPA, and the FCU, Police and Customs. An example of this level of cooperation is the existence of a task force made up of enforcement and banking officials of the FSC, FCU officers, and an official from the attorney general's chambers relating to a specific ML investigation on the island.

With respect to insurance, under the IA, according to the Isle of Man authorities, there is no statutory prohibition preventing the IPA from disclosing information gained from on-site inspections and reports submitted by licensees to other foreign authorities. In addition, the IPA may disclose certain other categories of information the authorities the IPA may disclose information "to authorities which appear to the Supervisor [IPA] to exercise in a country or territory outside of the Island functions corresponding to those of the Authority and the Supervisor." The IA Bill will substantially expand this section to include disclosure for certain additional purposes.

The FSC has entered into MOUs with the United Kingdom, Ireland, Jersey, Guernsey, and South Africa. Negotiations are currently ongoing with the Cayman Islands.

Foreign supervisors have undertaken on-site visits to FSC regulated financial institutions in the Isle of Man and have had access to information at the institutions visited. The FSC and the IPA cooperate with other regulators outside the Isle of Man.

There is strong coordination amongst the FSC, IPA Customs, the FCU and the attorney general's chambers.

67. With respect to banking, investment business and CSPs, the FSC may disclose information for a range of purposes, including with respect to criminal proceedings in other countries (Section 24(1)(a)), for the purpose of discharging its functions under the laws administered by it (Section 24(1)(e), and for the purpose of assisting an authority in other countries to exercise functions that correspond to the FSC's functions (Section 24(5)(b)). In relation to the disclosure of information about an individual customer, the chief minister must provide written concurrence that the disclosure is in the public interest and that it is likely to be of substantial value to the authority to which it is made (Section 24(6)).

With respect to insurance, under the IA, according to the Isle of Man authorities, there is no statutory prohibition preventing the IPA from disclosing information gained from on-site inspections and reports submitted by licensees to other foreign authorities. In addition, the IPA may disclose certain other categories of information the authorities the IPA may disclose information "to authorities which appear to the Supervisor [IPA] to exercise in a country or territory outside of the island, functions corresponding to those of the Authority and the Supervisor" (Section 24(2) of the IA). The IA Bill will expand this section to include disclosure for certain additional purposes, including the following: any criminal proceedings on the island or

elsewhere (new Section 24(1)(a)); facilitating a determination of whether any such investigation should be initiated (new Section 24(1)(c))11; any criminal investigation (new Section 24(1)(d)); all financial regulators, as well as those exercising functions similar to the IPA (new Section 24(2)(b)); and to assist any foreign or domestic public authority specified in a treasury order to be issued (new Section 24(4)).
Analysis of Effectiveness
The framework for cooperation with supervisory authorities is generally adequate. The FSC does not however appear to have an adequate level of resources to cover AML/CFT as well as all other areas of risk.
Recommendations and Comments
The level of resources in the FSC's Supervisory Division should be increased to ensure that all areas of risk related to the operation of licensed institutions are adequately covered.
Implications for compliance with FATF Recommendation 26
Compliant

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

Table 6. Description of the Controls and Monitoring of Cash and Cross-Border Transactions

FATF Recommendation 22
Description
Powers exist to enable law enforcement authorities to carry out either intelligence-led or structured risk testing examinations at ports and airports. Purely random checks, however are not provided for in law as authorities need to have reasonable grounds for carrying out such searches. Customs and Police share facilities at the ports and maintain close links with port security personnel responsible for examining and searching passengers and their baggage prior to embarking aircraft and ships. In addition to law enforcement's own checks, systems are in place that enable security personnel to notify customs/police of any detection of significant sums of currency or negotiable instruments. Unaccompanied baggage is also subject to examination, either intelligence led or under structured risk testing at ports and airports. During 1999 a national exercise involving the United Kingdom and Isle of Man Customs Services was conducted to test the extent of physical cross border movements of cash and bearer negotiable instruments between the United Kingdom and the Isle of Man. Subsequently, for several months in 2001, customs officers were involved in examining all movements of persons and goods into the Island. On neither of these occasions was any cash or negotiable instrument found to be either the proceeds of or intended for use in drugs, crime or terrorism. Notwithstanding the fact that no relevant detections have been made, there exists extensive intelligence networks with agencies outside the Isle of Man to ensure any information relating to smuggling in any form reaches the appropriate competent authority. The Island's recent introduction of a registration regime for money service businesses has further enhanced our ability to gather intelligence on persons who may be or may become involved in the transportation of currency."

[11] This provision is interpreted by the authorities as including disclosures to the FCU.

FATF Recommendation 23
Description
The reporting system on the Isle of Man is suspicion based. There is therefore no requirement to report transactions in cash or otherwise purely in relation to a certain threshold. The Isle of Man authorities are of the view that methodologies such as electronic funds transfers pose a greater threat than cash transactions but nevertheless require institutions to pay an appropriate level of attention to cash transfers. The authorities consider that their suspicion based approach to reporting provides a focused and efficient means of monitoring and identifying transactions relating to crime.
Interpretative Note to FATF Recommendation 22
Description
a) See response to 23 b) Movements of all goods into and out of the EU including high value goods such as gold or diamonds transported commercially or privately must be declared to customs. Powers under the Customs and Excise Management Act 1986 enable examination of all such movements.

Ratings of Compliance with FATF Recommendations, Summary of Effectiveness of AML/CFT Efforts, Recommended Action Plan and Authorities' Response to the Assessment

Table 7. Ratings of Compliance with FATF Recommendations Requiring Specific Action

FATF Recommendation	Based on Criteria Rating	Rating
1 – Ratification and implementation of the Vienna Convention	1	Compliant
2 – Secrecy laws consistent with the 40 Recommendations	43	Compliant
3 – Multilateral cooperation and mutual legal assistance in combating ML	34, 36, 38, 40	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 nonbank financial institutions; (e.g., foreign exchange houses)		See answers to 10 to 29 Largely compliant
10 – Prohibition of anonymous accounts and implementation of customer identification policies	45, 46, 46.1	Largely compliant
11 – Obligation to take reasonable measures to obtain information about customer identity	46.1, 47	Largely compliant
12 – Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer identification documents	52, 53, 54	Compliant
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	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	Compliant
18 – Compliance with instructions for suspicious transactions reporting	57	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	Compliant
32 – International exchange of information relating to suspicious transactions, and to persons or corporations involved	22, 22.1, 34	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	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	Largely Compliant
40 – ML an extraditable offense	34, 40	Compliant
SR I – Take steps to ratify and implement relevant United Nations instruments	1, 34	Largely 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	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, 57, 58, 58.1, 59, 60, 61, 62	Not Rated
SR VII – Strengthen customer identification measures for wire transfers	48, 51	Not being rated in light of the two year compliance period provided by FATF.

Table 8. Summary of Effectiveness of AML/CFT Efforts for Each Heading

Heading	Assessment of Effectiveness
Criminal Justice Measures and International Cooperation	
I—Criminalization of ML and FT	The Isle of Man's framework for criminalizing money laundering is generally adequate. With respect to criminalizing the financing of terrorism, there is a gap relating to the limited scope of terrorist activities covered by the POTA and the inadequate definition of the financing of terrorism therein that will be remedied once the Anti-Terrorism and Crime Act has been implemented. The island needs to implement legislation to allow the UN Convention for the Suppression of the Financing of Terrorism, and the UN Convention Against Transnational Organized Crime (Palermo Convention) to be extended to the Isle of Man. The effectiveness of the existing framework would also be enhanced by expanding the statutory enforcement sanctions available to the FSC and IPA.
II—Confiscation of proceeds of crime or property used to finance terrorism	The framework for the confiscation of proceeds of crime or property used to finance terrorism is generally adequate. However the framework would be enhanced if relevant legislation provided for forfeiture of property of corresponding value in connection with terrorist activities and the authority to share assets other than drug assets with other jurisdictions. There is also some concern about the limited scope for civil forfeiture.
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels	Arrangements for receiving, analyzing, and disseminating financial information are generally adequate. The absence of a requirement for STRs to be submitted to the FCU is a potential weakness as is the inability of the FIU to access all government databases on a real-time basis.
IV—Law enforcement and prosecution authorities, powers and duties	The framework for powers and duties of law enforcement and prosecution authorities is generally adequate. The framework would however be enhanced if there were an explicit legal basis for the use of controlled delivery and other undercover operations.
V—International cooperation	The framework for international cooperation is considered to be adequate.

Legal and Institutional Framework for All Financial Institutions	
I—General framework	Although the framework is generally effective, the FSC does not have the statutory authority to regulate or monitor compliance for MSBs, which is the responsibility of Customs and Excise. This is considered to be a potential weakness.
II—Customer identification	Arrangements for customer identification are generally adequate. There are however some concerns about requirements related to satisfactory evidence of identity, the identity requirements for legal entities and reverification of existing customers.
III—Ongoing monitoring of accounts and transactions	Arrangements for the ongoing monitoring of accounts and transactions are generally adequate. The overall framework would be strengthened if the Notes broadened the focus of its guidance in respect of business relationships and transactions with persons from countries with inadequate AML/CFT systems. There are also concerns with respect to enhanced scrutiny to wire transfers and reporting of unusual or complex transactions.
IV—Record keeping	The framework in respect of record keeping is generally adequate.
V—Suspicious transactions reporting	The framework in respect of the reporting of suspicious transactions is generally adequate.
VI—Internal controls, compliance and audit	The framework for internal controls, compliance and audit is generally adequate but would be strengthened by a requirement in the Notes for institutions to test the compliance of AML/CFT systems against home and host country standards. There are also concerns about requirements for the designation of an MLRO and the application of AML/CFT standards to foreign branches and subsidiaries and the adequacy of screening of employees.
VII—Integrity standards	The legal framework is generally adequate except in respect of the need to expand the definition of "fit and proper" to include conviction for a serious crime.
VIII—Enforcement powers and sanctions	With respect to administrative sanctions that the FSC may impose, there are a number of gaps in coverage and uniformity as identified in the above-referenced description. The framework for enforcement is generally adequate but it is considered that it could be further strengthened by the addition of a range of administrative sanctions.
IX—Cooperation between supervisors and other competent authorities	The framework for cooperation with supervisory authorities is generally adequate. The FSC does not however have an adequate level of resources to cover AML/CFT as well as all other areas of risk.

Table 9. 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

Criminal Justice Measures and International Cooperation	**Recommended Action**
I—Criminalization of ML and FT	Implementing legislation, in particular the Anti-Terrorism and Crime Act, should be adopted or implemented by the Isle of Man so that the UN Convention for the Suppression of the Financing of Terrorism, and the UN Convention Against Transnational Organized Crime (Palermo Convention) may be extended to the Isle of Man. *The Isle of Man authorities should increase the staffing level in the FCU to its authorized strength. The authorities should also re-evaluate the organizational structure/functions of the FCU in order that resources are permanently dedicated to ML/FT operations/investigations , because their workload is too widespread i.e., they are required to investigate all financial related frauds etc. The appointment of an assistant to the dedicated legal officer in the attorney general's chambers should be pursued.*
II—Confiscation of proceeds of crime or property used to finance terrorism	The relevant legislation should be amended to provide for confiscation of assets of equivalent value in connection with the financing of terrorism. Consideration should be given to passage of a law establishing an asset forfeiture fund into which all or a portion of confiscated property will be deposited, and will be used in the management of seized and confiscated property, as well as for other appropriate purposes. Consideration should be given to amending relevant laws to explicitly provide for the authority to share assets other than drug assets with other jurisdictions along the lines of Section 63(4) of the Drug Act. Consideration should be given to the adoption of a civil forfeiture law for crimes other than FT.
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels	Consideration should be given to amending the relevant laws to require that the report be made directly to the FCU, and that it be made in writing on a form to be issued by the FCU. Consideration should also be given to amending relevant laws to permit the FCU to require the submission of additional information by reporting parties, and to provide expeditious or real-time access to public and nonpublic databases without the need for a court order. Consideration should be given to amending the relevant laws to provide explicit legal authority for the FSC to issue guidance notes. With respect to the IPA, consideration should be given to enactment of the Insurance (Amendment) Bill to explicitly provide for authority to issue binding guidance notes with explicit sanctions for

	noncompliance. *The operational structure of the Isle of Man FCU needs to be evaluated in order to prioritize and focus on the subject of ML/FT. The staffing levels should be increased to the authorized strength and in addition the financial investigation team of Customs and Excise could be amalgamated with the FCU in order to improve the effectiveness and streamlining of enquiries into ML/FT. The number of support staff working in the FCU should be increased in order that Law Enforcement personnel therein can dedicate themselves to the investigative process of ML/FT.*
IV—Law enforcement and prosecution authorities, powers and duties	Consideration should be given to passage of the existing bill to regulate undercover techniques in order to provide an explicit legal basis for controlled delivery and other undercover operations.
Legal and Institutional Framework for Financial Institutions	
I—General framework	Consideration should be given to rationalizing the existing regulatory arrangements for MSBs by enacting legislation under which the statutory responsibilities of Customs and Excise with respect to MSBs would be transferred to the FSC.
II—Customer identification	The relevant laws should be amended to explicitly require that customer identification procedures be followed by reporting parties. Consideration should be given to the imposition of a requirement for the re-verification of existing customers. Consideration should be given to amending the relevant laws to limit the availability of the AML exemption to those entities regulated in EU States rather than to entities covered under the EU AML Directive. The Notes should be amended to require licensees to exercise care in initiating transactions with companies that have nominee shareholders. The FSC has already undertaken considerable work to direct FIs towards the customer identification standards proposed by the Position Paper. It is nevertheless recommended that these efforts be redoubled to ensure a greater degree of consistency in the approach adopted by licensees.
III—Ongoing monitoring of accounts and transactions	Within the two-year period referred to by FATF, the relevant laws should be amended to require that accurate and meaningful originator information on funds transfers remain with the transfer through the payment chain, and that FIs give enhanced scrutiny to wire transfers that do not contain complete originator information. The Notes should be expanded to require financial institutions to give special attention to business relationships and transactions with persons from countries that do not have adequate systems to prevent money

Legal and Institutional Framework for Financial Institutions	
	laundering, in circumstances other than those related to correspondent banking.
V—Suspicious transactions reporting	Consideration should be given to providing the FCU with the authority to give instructions to reporting entities and to require FIs to observe instructions of the FCU.
VI—Internal controls, compliance and audit	Consideration should be given to the imposition of a requirement that all Isle of Man FIs apply Isle of Man legal and regulatory requirements in respect of AML/CFT to their branches and subsidiaries outside of Isle of Man. Consideration should also be given to ensuring that institutions test compliance of AML/CFT systems against home and host country standards. Consideration should be given to the imposition of a requirement to appoint or designate an MLRO for FIs other than banks. However, the authorities have indicated that the Code will be amended to require such appointment. Consideration should also be given to amending the appropriate laws to require banks and insurance companies to report any change in such position to the FSC and IPA, as is already required for trust and investment company businesses. Consideration should be given to amending the relevant laws to require all FIs to put in place adequate screening procedures to ensure high standards when hiring employees.
VII—Integrity standards	Consideration should be given to amending the Code to explicitly prohibit involvement of criminals in FIs and to define minimum standards for 'fit and proper,' in a manner consistent with Isle of Man human rights and other relevant legislation.
VIII—Enforcement powers and sanctions	With respect to explicit statutory enforcement sanctions available to the FSC and IPA, consideration should be given to adding the following to the legal framework: the power to remove or disqualify an auditor should be expanded to apply to all regulated FIs and not just collective investment schemes, and the regulations for such schemes should be issued by the FSC; the power to appoint a provisional or temporary administrator, with court approval if necessary; and the power to impose civil money penalties or administrative fines against individuals, such as directors, officers, and controllers; as well as legal persons. Consideration should also be given to empowering the FSC and the IPA to disqualify principal persons from regulated activities. In addition, the grounds for imposition of these sanctions should explicitly refer to ML and FT. Finally, the sanctions should be uniform across all financial sectors, so that the same rules apply to every FI.
IX—Cooperation between supervisors and other competent authorities	The level of resources in the FSC's Supervisory Division should be increased to ensure that all areas of risk related to the operation of licensed institutions are adequately

	covered.
Banking Sector Based on Sector-Specific Criteria	
II—Customer identification	The FSC should redouble its efforts to ensure a greater degree of consistency in the approach adopted by licensees with regard to the KYC issues addressed in the Position Paper.
Insurance Sector Based on Sector-Specific Criteria	
II—Customer identification	The FSC should redouble its efforts to ensure a greater degree of consistency in the approach adopted by licensees with regard to the KYC issues addressed in the Position Paper.
Securities Sector Based on Sector-Specific Criteria	
II—Customer identification	The FSC should redouble its efforts to ensure a greater degree of consistency in the approach adopted by licensees with regard to the KYC issues addressed in the Position Paper.

C. Authorities' Response to the Assessment

Criminal Justice Measures and International Cooperation	**Action Taken/To Be Taken**
I—Criminalization of ML and FT	• The Anti-Terrorism and Crime Bill has passed through all its parliamentary stages in the Isle of Man and Royal Assent was announced in June. The Act gives significantly more powers to combat FT. • Consideration will be given to the recommendation to amend the legal framework to enhance the FSC's statutory enforcement sanctions. With specific consideration of powers to: remove or disqualify an auditor, appoint a provisional or temporary administrator, with court approval if necessary; and power to impose civil money penalties (administrative fines) against individuals, such as directors, officers and controllers, as well as legal persons. • Under the Insurance (Amendment) Bill 2003, the IPA has included the power to remove or disqualify an auditor and the power to impose civil money penalties (administrative fine) against individuals, such as directors, officers and controllers, as well as legal persons. • The staffing level in the FCU has been increased to its authorized strength. • The organizational structure of the FCU has been evaluated with two staff dedicated to ML/FT operations/investigations.

II—Confiscation of proceeds of crime or property used to finance terrorism	• The Anti-Terrorism and Crime Bill has passed through all its parliamentary stages in the Isle of Man and Royal Assent was announced in June. The Act gives significantly more powers to combat FT and will enable the forfeiture of assets of corresponding value.
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels	• S4.01 of new Notes explicitly provide for the identification of complex and unusual transactions, and suspicious patterns of behavior. • Consideration is being given to amending relevant laws to clarify the legal authority for the FSC to issue guidance notes**.** • Explicit legal authority for the IPA to issue guidance notes and regulation on AML matters is included within the Insurance (Amendment) Bill 2003. • Legal clarification to provide an affirmative obligation that STRs must be submitted to the FCU will be considered as part of the review of the Code. • The obligation that STRs must be submitted to the FCU by all persons required to submit STRs is included within the CTP. • FCU authority to access all government databases. Still to be considered. • The organizational structure of the FCU has been evaluated with two staff dedicated to ML/FT operations/investigations. • The staffing level in the FCU has been increased to its authorized strength. • The Chief Officers of the Police and Customs and Excise Division have signed an MOU seeking to encourage a closer working relationship between the two organizations, not just covering ML/FT investigations but also on drugs and other law enforcement issues.
IV—Law enforcement and prosecution authorities, powers and duties	• New legislation regulating undercover techniques will be introduced in 2003.
V—International cooperation	No recommended action made by the IMF
Legal and Institutional Framework for Financial Institutions	
I—General framework	The Anti Money Laundering (Money Service Businesses) Regulations 2002 were introduced in August 2002. These provide for the registration and monitoring of all MSBs (bureau de change, check cashing, and money transmission services) operating from the Island, including powers to enter, inspect, etc., and also amend the AML Code 1998 to bring MSBs within its cover.

Legal and Institutional Framework for Financial Institutions (cont'd)	
II—Customer identification	• The points regarding amendments to the relevant laws concerning a specific requirement for reporting parties to carry out KYC and that referring to AML exemption to those regulated in EU States, will be considered under the review of the AML Code. • The language used in S3, S3.02, S3.03 and S3.04 of the new revised Notes, has been strengthened in the new Notes as suggested by the IMF team. • The language used in S3.07 regarding postal and telephone applicants will be reviewed. • In respect of higher risk customers, S3.16 of the Notes has been amended to require senior management or board level to review decisions to commence the business relationship and review on at least an annual basis. • Apart from PEPs, S.3.16 of the new Notes also provides that a license holder should not accept or continue a business relationship with other high risk customers if it knows or suspects that funds derive from corruption or a misuse of public assets. • Notes will be reviewed regarding the requirement to undertake periodic re-verification of personal customers under certain circumstances. • The IPA's requirement for the re-verification of existing customers is included within the CTP. • S4.04 of the Notes refers to the FATF recommendation to establish a requirement for the inclusion of originator information on funds transfer. The FSC accepts that there is a global problem of absence of originator information as a result of IT limitations. The new Notes require a license holder to conduct enhanced scrutiny of and monitor funds transfers that do not contain complete originator information. License holders should have a program in place to comply with FATF's recommendations in respect of outgoing fund transfers by December 2003. • S3.03 of the new Notes formally requires license holders to establish and verify the identity of beneficial owners of companies. • Initiatives to incorporate the provisions of the Overriding Principles Paper in respect of the treatment of professional intermediaries into the legal framework and the Notes will be completed in particular following a decision by FATF on its treatment of such persons.

Legal and Institutional Framework for Financial Institutions (cont'd)	
III—Ongoing monitoring of accounts and transactions	• Re; wire transfers. S4.04 of new Notes has been enhanced, recognising that compliance may only be 100% possible at a future date, as the ability to comply is based on international acceptance in this area. • Re: business relationships with countries that do not have adequate systems. This will be considered in the review of the Code. • S4.01 of the Notes has been rewritten to reflect the IMF's suggestions regarding the language needed to effectively communicate the standards required by the FSC.
V—Suspicious transactions reporting	• Will be considered as part of the review of the Code. • The IPA details the offence of tipping off within the CTP.
VI—Internal controls, compliance and audit	• The IPA specifies the requirement that Isle of Man institutions apply Isle of Man legal and regulatory requirements in respect of AML/CFT to their branches and subsidiaries outside of Isle of Man in the CTP. • A new section, S2.08, has been included in the new Notes to cover the requirement to impose standards of AML/CFT to branches etc outside Isle of Man. • The Banking Code requires the appointment of Compliance Officer. The AML Code requires license holders to appoint a Money Laundering Reporting Officer to whom suspicious transaction reports should be made by staff. This is also being considered in the review of Banking Code for the appointment of an individual responsible for AML/CFT compliance. • The IPA already has a requirement to appoint a Money Laundering Reporting Officer. A requirement already exists for insurance companies to report the appointment of an MLRO within 28 days of appointment. As Insurance Business must at all times have an MLRO the IPA considers that this meets the requirements for any change to be notified. • Consideration will be given to the recommended requirement for banks to implement systems for testing of AML/CFT compliance against home country KYC standards. This will be considered with a view of application to all license holders.

Legal and Institutional Framework for Financial Institutions (end)	
VII—Integrity standards	• The prohibition of involvement of criminals in FIs is already being applied in practice by the FSC through the application of the fit and proper criteria. However, further consideration of this issue will be given in a review of the Code and an amendment of the licensing policy. • The IPA considers the "fit and proper" status of persons connected with a firm is of wider significance than AML and so this issue is best dealt within more general regulatory provisions. Individual consideration is given to each prospective appointment.
VIII—Enforcement powers and sanctions	• The power for the IPA to impose civil money penalties or administrative fines, and to disqualify principal persons from regulated activities, is included within the Insurance (Amendment) Bill 2003. • Consideration will be given to further strengthening the FSC's enforcement sanction powers including; the power to impose civil money penalties or administrative fines, and powers to disqualify principal persons from regulated activities. Consideration will be given with a view of application to all license holders.
IX—Cooperation between supervisors and other competent authorities	• The IPA has undertaken to increase its complement of staff as necessary to ensure that adequate monitoring and supervision take place. • The FSC has undertaken to ensure that it has sufficient resources to undertake adequate supervision of its license holders and ensure the sustainability of comprehensive surveillance of all financial institutions with regard to all areas of risk, including AML/CFT. An increase of two supervisory staff has already been agreed with effect from April 2003. No recommended action made by the IMF.
Banking Sector Based on Sector-Specific Criteria	
II—Customer identification	• S3.01 of the Notes already advises of the risks of business relationships established prior to December 1998, this includes a need to review such relationships established prior to December 1998. The KYC issues relating to pre 1998 business addressed in the Position Paper will be further considered following a decision of FATF on this issue. • In respect of higher risk customers, S3.16 of the Notes has been amended to require senior management or board level to review decisions to commence the business relationship and review on at least an annual

	basis.
Insurance Sector based on Sector-Specific Criteria	
II—Customer identification	• Following the IMF visit the CTP were revised and the wording strengthened to communicate more clearly what is required.
VI—Internal controls, compliance and audit	• The CTP detail the requirement for an MLRO to be appointed and any subsequent appointment notified to the IPA. • The CTP require that as a minimum Isle of Man standards are applied in all branches and subsidiaries.
VII – Integrity standards	• The IPA considers each party connected with a business individually and applies the appropriate assessment of "fit and proper" status for the position concerned. The IPA does not consider that it is appropriate to prohibit persons from involvement automatically but will assess on a case by case basis.
Securities Sector based on Sector-Specific Criteria	
II—Customer identification	• S3.01 of the Notes already advises of the risks of business relationships established prior to December 1998, this includes a need to review such relationships established prior to December 1998. The KYC issues relating to pre 1998 business addressed in the Position paper will be further considered following a decision of FATF on this issue. • In respect of higher risk customers, S3.16 of the Notes has been amended to require senior management or board level to review decisions to commence the business relationship and review on at least an annual basis.

III. IAIS CORE PRINCIPLES

A. General

23. This assessment of the current state of the Isle of Man's compliance with the IAIS Core Principles has been completed as part of the IMF Offshore Financial Center (OFC) assessment program. The assessment was undertaken by John Darwood (Consultant MFD). Completion of a formal assessment serves several purposes. First, it benchmarks the current state of insurance supervision, recognizing that there have been extensive changes in the last years. Second, it suggests a number of further improvements or changes. Thus, this report provides a key input for the development of an action plan to move toward full compliance with the Core Principles.

Information on the methodology used for assessment

24. This assessment has been conducted by comparison of the standards and practices of insurance supervision with the Insurance Core Principles and Insurance Core Principles Methodology promulgated by the International Association of Insurance Supervisors (IAIS), of which the Isle of Man is a member. In addition meetings have been held with the various insurance market associations and some individual companies.

Institutional and macroprudential setting, overview

25. **The Isle of Man government Insurance and Pensions Authority (IPA)** is the responsible body for the supervision of all insurance activity on the Island with the exception of life insurance intermediaries who are registered with the FSC for life business only. The IPA Mission Statement is as follows:

> The IPA exists to maintain and develop an effective regulatory framework for insurance and pension business which will:
>
> - provide security for investors;
> - prevent and deter the Isle of Man being used for the purposes of financial crime;
> - preserve the international reputation of the Isle of Man;
> - ensure a flourishing environment for Isle of Man businesses.

26. **There are three major strands of insurance business carried on in the Island, international life business, captive insurance business and domestic general and life business**. These are described more fully below.

27. **International life business**; locally incorporated subsidiaries of mainly United Kingdom and other European companies write international business through a variety of international intermediaries who are usually outside Isle of Man regulatory purview. Since these companies are incorporated on the Isle of Man, the IPA is the home prudential regulator of them. The U.K. Financial Services Authority (FSAUK) is only directly involved if the company does business in the United Kingdom, or the U.K. parent does Isle of Man domestic business). Because of the strong links with the U.K. market, training, development and compliance tend to follow U.K. standards and cultures. In April 2002, the education subcommittee of the Manx Insurance Association issued "Best Practice Guidelines," which has been signed off by all members.

28. The original thrust of this life business activity was the U.K. expatriate market, but that has now broadened to embrace all persons interested in insurance/investment linked products. The major markets are the United Kingdom, Middle East, Far East (HK) and Latin America, not the EU or the United States. About 85 percent of products sold are single

premium type unit linked investments where the investment risk rests with the policyholder rather than the insurer.

29. The same 16 companies (the seventeenth has only just been licensed) have been writing this business for many years. Total funds are substantial, and steadily growing. Currently they are estimated to be around £14 billion with the largest company holding £3.2 billion of policyholders' funds.

30. **Captive insurers**: 165 captives are listed by the IPA; the number also includes a few companies not "captive" in the narrow sense but writing special reinsurance business or extended warranty business, and one locally incorporated general insurer writing business in the domestic market (see General Insurers below). The first captive was established on the Island in 1981; in common with other captive jurisdictions growth has fluctuated in sympathy with world insurance market conditions, the present state of which may be conducive to a stage of further growth. This business is of very good quality, being comprised mainly of subsidiary operations of major blue chip U.K. parents, and of considerable size. Total premium income of these captives in 2001 was approximately £1.05 billion.

31. Captive insurers rely for their operation on captive insurance managers, of whom there are 22 registered, although the bulk of the business rests with the top four or five of them. These again are mostly local subsidiaries of major international insurance broking and captive management businesses, one of which controls its entire worldwide captive operations from the Island.

32. **Domestic general and life business**: There is only one domestic general insurer, which estimates it has about a 25 percent market share. All other domestic business is served by U.K. authorized insurers that need to register with the IPA if they have a fixed place of business on the Island, i.e., branch operation – if U.K. authorized without a branch there is no need to register but in these circumstances business will usually be through a local registered intermediary.

33. For life business, the local community is served by registered intermediaries who place the business with a variety of U.K. life insurers or with representatives of U.K. life insurers. On-site visits are now the norm for these companies.

34. Intermediaries: Life intermediaries dealing in domestic business are registered only with the FSC for this business. The only general business intermediaries who need to be registered are independent persons or companies (i.e., not answerable under a written agreement to one or more insurers) dealing in domestic business. There are some 22/25 of these some of which may also be registered with the FSC for investment activity. On-site visits are now the norm for these companies also.

35. **Life supervisory issues:** Supervisory work has increased significantly due to prudential and compliance issues, including on site inspections, which spin off from anti-money laundering considerations. On site visits for AML will be on a two-year basis—13 of

the 16 companies have already been visited—but no regular system yet set up for other inspections, which have been on a focused "as needed" basis. Solvency problems, if any, have revolved around reserving policies and control of management expenses. In this respect business plans have to be carefully checked. Corporate governance is touched on during on site visits, and also when changes in control or directors occur. This issue was also discussed in some depth with the Manx Insurance Association and it is very apparent that all its members are aware of the need to attend to its considerations (also see reference in opening paragraph of Life Business above). Essentially it flows down from parent companies, which have high expectations in that regard, and fits in with compliance and internal risk management procedures, and the impact of external auditors.

36. **Insurance managers:** There were about 27 at peak, but consolidations and mergers have reduced the current number to 22. (There was also a cleaning out of some dormant companies following a recent increase in fees. Previously only one fee was paid on registration, now an annual fee applies.) These 22 managers are now subject to on-site visits and corporate governance is included.

37. The principal legislation is the **Insurance Act 1986,** as amended, and the associated Insurance Regulations 1986 (as amended) together with the Insurance Intermediaries (General Business Act) 1996 and Insurance Intermediaries (General Business) Regulations 1996. Also relevant are the Life Assurance (Compensation of Policyholders) Regulations 1991, Guidance Notes for Insurance Business and Guidance on the use of Derivative Instruments, April 2002.

38. The **Insurance (Amendment) Bill** is expected to come into effect by October 2003. This bill will reflect the outcome of an extensive review of the present legislation and powers in relation to the IAIS Core Principles, and should, when effected, enable almost all the principles to be fully observed.

39. As its name implies, the authority is also responsible for **pensions,** but since these are not covered by the IAIS Principles that aspect of its activity will not be addressed in this assessment.

General preconditions for effective insurance supervision

40. The preconditions for an effective insurance supervision in Isle of Man are given. The infrastructure is well developed because

- the legal system in place is functioning well;
- the applied accounting standards (internationally recognized standards)are comprehensive;
- the actuarial and auditing profession apply recognized standards;
- an efficient financial market (banks, investment funds) exists; and

- sound and effective macroeconomic policies are in place so that insurance companies can operate within a stable environment.

B. Detailed Assessment

Table 10. Detailed Assessment of Observance of the IAIS Insurance Core Principles

Principle 1.	**Organization of an Insurance Supervisor** The insurance supervisor of a jurisdiction must be organized so that it is able to accomplish its primary task, i.e., to maintain efficient, fair, safe, and stable insurance markets for the benefit and protection of policyholders. It should, at any time, be able to carry out this task efficiently in accordance with the Insurance Core Principles. In particular, the insurance supervisor should: • be operationally independent and accountable in the exercise of its functions and powers; • have adequate powers, legal protection, and financial resources to perform its functions and exercise its powers; • adopt a clear, transparent, and consistent regulatory and supervisory process; • clearly define the responsibility for decision-making; and • hire, train, and maintain sufficient staff with high professional standards who follow the appropriate standards of confidentiality.
Description	The Insurance and Pensions Authority ultimately operates under the umbrella of the Isle of Man treasury, which is the sponsoring department for insurance legislation. Notwithstanding this, the authority is an independent Statutory Board established under the Insurance Act 1986 with responsibility for the regulation of the insurance and pensions sectors in the Isle of Man. The treasury appoints Members of the IPA, subject to approval of Tynwald. The IPA is usually consulted in this process, although there is nothing in the legislation, which says they have to be. The members comprise a chairman and at least two other persons. The chairman is not required to be a member of Tynwald but to date always has been. Currently there are four other members, one of whom is the Chief Executive of the IPA; the others are experienced insurance professionals, two of whom are not resident on the Island but travel from the United Kingdom for regular meetings. The IPA has the relevant powers to fulfill its responsibilities under the Insurance Act and has a staff that is able to properly exercise those powers.
Assessment	Non-observed
Comments	All of the criteria which address the day to day operation and management of the IPA are well met. However, the political involvement at Board level must cast doubt on the "operational independence" of the IPA. The non-observance of the assessment turns almost entirely on this factor. The other factor is the "review of decisions" provision within S10 of the Insurance Act which allows decisions of the supervisor regarding licensing to be appealed to the treasury. This situation is being addressed within the proposed Amendment Bill. The revised legislation will place the appeals process in the hands of the council of ministers (via the chief secretary) which will then appoint a committee which will be independent of the treasury, the authority, the supervisor and the applicant. It is proposed that the Amendment bill will also transfer powers for making secondary legislation (regulations) from the treasury to the IPA.

	Recommendation: Steps should be taken to ensure that the IPA is distanced from any possible political influence. The board should not have any representation from Tynwald.
Principle 2.	**Licensing** Companies wishing to underwrite insurance in the domestic insurance market should be licensed. Where the insurance supervisor has authority to grant a license, the insurance supervisor: • in granting a license, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include proforma financial statements, a capital plan, and projected solvency margins; and • in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent.
Description	Licenses are granted under the provisions of the Insurance Act and Regulations and the due process; submission of documentation, examination of same, consequential enquiries/meetings is thorough and expeditious. The IPA issues guidance notes, which facilitate this process. These guidance notes are intended to be of assistance in the completion of applications, annual returns and other documents; however they do sometimes indicate that the provision of certain documents is mandatory. This provision arises by virtue of the Retirement Benefits Schemes Act 2000, schedule 3 of which gives the IPA the ability to give directions to the supervisor in exercise of his powers under the Insurance Act. General directions in this regard were in fact issued by the IPA on November 24, 1989. Companies are required to comply with the legal form as determined under the Island's Companies' Acts. Suitability of all relevant parties is assessed and the Business Plan (required of all applicants) is analyzed carefully since it becomes the foundational document for all future activity of the licensee.
Assessment	Observed.
Comments	This process is very thorough; new applicants usually discuss their plans with the supervisor well ahead of the actual filing, likely capital and solvency levels feature strongly in these discussions, with the result that the final application can be dealt with from the advantage point of a good understanding of the proposition.
Principle 3.	**Changes in Control** The insurance supervisor should review changes in the control of companies that are licensed in the jurisdiction. The insurance supervisor should establish clear requirements to be met when a change in control occurs. These may be the same as, or similar to, the requirements which apply in granting a license. In particular, the insurance supervisor should: • require the purchaser or the licensed insurance company to provide notification of the change in control and/or seek approval of the proposed change; and • establish criteria to assess the appropriateness of the change, which could include the assessment of the suitability of the new owners as well as any new directors and senior managers, and the soundness of any new business plan.
Description	The Insurance Act S20 covers Changes in Control in detail, "controller" is defined, and changes must be notified. Further, the Annual Returns also require confirmation of any changes. The suitability of new controllers and new business plans is reviewed on a case by case basis.
Assessment	Observed.
Comments	The importance of these criteria is well understood, sensitivity to reputational risk is high.

Principle 4.	**Corporate Governance** It is desirable that standards be established in the jurisdictions which deal with corporate governance. Where the insurance supervisor has responsibility for setting requirements for corporate governance, the insurance supervisor should set requirements with respect to: • the roles and responsibilities of the board of directors; • reliance on other supervisors for companies licensed in another jurisdiction; and • the distinction between the standards to be met by companies incorporated in his jurisdiction and branch operations of companies incorporated in another jurisdiction.
Description	The Insurance Act does not address this principle, so technically the supervisor has no responsibility. However, the Isle of Man Companies Acts have some bearing on the issue.
Assessment	Not applicable.
Comments	In practice the supervisor does take an interest in corporate governance and within his existing powers is able to make enquiry and set particular requirements, and will not authorize an insurer unless he is satisfied as to the role and responsibilities of the directors and senior management. A general statement as to the responsibilities of directors, countersigned by the company's independent auditor, is required as part of the statutory annual return. The annual return also includes a certificate, which is required to be signed by the directors and then endorsed by the independent auditor that the company has complied with the requirements of the Insurance Act and regulations. Nevertheless, the supervisor is at the same time reviewing developments of supervisory standards internationally in this area. The Amendment bill will include enabling provisions to allow the IPA to make regulations or statutory codes if appropriate in due course. Recommendation: This principle should be fully recognized within the legislation by way of development of appropriate regulations; firstly because of the present day very evident need of proper supervision in this area, second because several other planks in the present structure, e.g. internal controls, on-site inspections, will not be fully effective without it. It is recognized that this whole area needs somewhat cautious and detailed consideration Of relevance here is the work of the Offshore Group of Insurance supervisors, in which the Isle of Man is becoming more closely involved, which is in the process of developing its own guidelines on corporate governance which the supervisor may wish to take into account in formulating future policy.
Principle 5.	**Internal Controls** The insurance supervisor should be able to: • review the internal controls that the board of directors and management approve and apply, and request strengthening of the controls where necessary; and • require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investment and liquidity management.
Description	The Insurance Act S21 and 22 gives the supervisor wide powers of enquiry, the securing of information of any sort, and the taking of remedial action. It does not address Internal Controls as such. However, the issue is addressed as part of the On-site inspection program recently introduced. Some aspects of the criteria, recognizing potentially suspicious transactions for instance, are dealt with under published guidelines (Common Trading Practices).
Assessment	Largely observed.
Comments	As with the previous Standard, the supervisor recognizes the need for more specific reference within the legislation. This will be dealt with by new enabling provisions effected under the Amendment bill. It may be appropriate to also take into account the special nature of the international life insurers and insurance managers on the Island in as much that most of them

	are subsidiaries of major U.K. or international insurers or brokers, which have their own obligations in this regard, which should flow down to the subsidiary operations.
Principle 6.	**Asset** Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction. Where insurance supervisors have the authority to establish the standards, these should apply at least to an amount of assets equal to the total of the technical provisions, and should address: • diversification by type; • any limits, or restrictions, on the amount that may be held in financial instruments, property, and receivables; • the basis for valuing assets which are included in the financial reports; • the safekeeping of assets; • appropriate matching of assets and liabilities; and • liquidity.
Description	The Insurance Act and Regulations, which provide for full analysis of assets covering technical provisions, together with detailed annual actuarial valuations in respect of life companies, give an adequate framework for basic supervision. These have been further discussed with the authority's external actuarial consultants who, under the direction of the supervisor, review all the International Life Insurers both at application and then on an ongoing basis, and on other occasions as may be required by the supervisor.
Assessment	Largely Observed.
Comments	The supervisor has adequate tools to properly monitor the licensees on an annual basis, and the actuarial assistance provided in respect of the International Life companies is vital to the process. All companies are subject to annual external audit. Captive insurers rarely invest in other than short-term deposits, some may use investment managers. The criteria also call for the supervisor to be able to check on internal controls and procedures, including audit procedures on investment activities, and this is an area in which the authority will only be fully observant when on-site inspections are fully operational. The annual reporting procedure for Life companies is in the course of being up-dated and should be finished by mid 2003.
Principle 7.	**Liabilities** • Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. In developing the standards, the insurance supervisor should consider: • what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary; • the standards for establishing policy liabilities or technical provisions; and • the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectability.
Description	The Act makes the basic provision, supported by the regulations for the format of the annual accounts, including the identification and treatment of technical provisions. The actuary (see previous Standard) takes care of the Life companies' specific considerations. Companies are required to submit supplementary information on liabilities including claims development analysis over the years.
Assessment	Largely Observed.

Comments	Similar comments to those on the previous principle apply. In addition the criteria deal with credit for reinsurance. This is taken care of by way of the actuarial valuation of Life companies, and for Captives by way of a requirement that liabilities are reported both gross and net. In the latter case, since full details of reinsurers are also provided, any adjustments considered necessary can be implemented (also see Principle 10). As in the previous section the introduction of on-site inspections to back up the assessment of the adequacy of the technical provisions (policy liabilities) is not yet fully operational, and the up-dating of guidance notes is still under way, hence the broadly observed rating.
Principle 8.	**Capital Adequacy and Solvency** The requirements regarding the capital to be maintained by companies which are licensed, or seeking a license, in the jurisdiction should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity, and business risks of the company in the jurisdiction.
Description	The Act S17 requires solvency to be maintained at all times, and for life companies the actuary has to certify annually that the value of liabilities does not exceed that of the liabilities. The Act sets the provisions, the regulations set the minimum but more importantly the company, as indicated in the guidance notes for Insurance Business, is required to maintain the levels of capital and free reserves as agreed between it and the supervisor at time of registration or subsequent review. These levels will reflect the size, complexity, products and business risks (exposures) of the company. The supervisor has competent staff to conduct reviews of annual returns, which are facilitated by an initial automated review system, which highlights predetermined ratios and other factors. All assessments are on a stand-alone basis and all resources are brought to bear on each stage of the process, which, for Life companies, also includes a review by the authority's consulting actuaries.
Assessment	Observed
Comments	The whole process is well established and works well in practice; currently the staff is able to cope with the workload, and the consulting actuaries, although based in the United Kingdom, are able to attend meetings at the authority at short notice if required.
Principle 9.	**Derivatives and "Off-Balance Sheet" Items** The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form a part of the financial report of a company licensed in the jurisdiction. In setting these requirements, the insurance supervisor should address: • restrictions in the use of derivatives and other off-balance sheet items; • disclosure requirements for derivatives and other off-balance sheet items; and • the establishment of adequate internal controls and monitoring of derivative positions.
Description	The Act has no specific detailed provisions regarding derivatives. Nevertheless the supervisor is able to set any requirements on almost any respects of insurance business under the Act and has issued guidance notes (up-dated April 2002) for Life insurers which set out tests which must be applied before certain assets can be used, and products sold. Also the usual admissibility tests apply, and off-balance sheet items need to be disclosed.
Assessment	Materially non-observed.
Comments	The supervisor in practice has little difficulty in tracking this area. In the Life sector guidance has been given, and more detailed reporting requirements are being drafted, which will also deal with demonstrating appropriate levels of control in the use of derivatives. As an aside it can also be noted in this sector that U.K. parent companies will be under the FSAUK rules and this will assist awareness of this issue. At present captive insurance companies are not generally perceived as being active in the derivatives market, nevertheless the possibility of future involvement should be recognized and due provision made.

	Recommendation: The reporting requirements under the existing regulations should be expanded to take the principle fully into account.
Principle 10.	**Reinsurance** Insurance companies use reinsurance as a means of risk containment. The insurance supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them. The insurance supervisor should set requirements with respect to reinsurance contracts or reinsurance companies addressing: • the amount of the credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collectability of the reinsurance recoverable and may take into account the supervisory control over the reinsurer; and • the amount of reliance placed on the insurance supervisor of the reinsurance business of a company which is incorporated in another jurisdiction.
Description	The Act's definition of Insurance includes reinsurance; no regulatory or supervisory distinction is made between insurers/insurance and reinsurers/reinsurance, so insurers assuming reinsurance business, and insurers using reinsurance as risk containment practice, are all subject to the Act's regular provisions. It follows that insurer's reinsurance arrangements are fully disclosed, and assessed, at time of application and subsequently at annual review. The supervisor has access to a major rating agency's reports on-line. Depending on the extent of the company's dependence on it, a reinsurer in respect of which the supervisor was unable to secure satisfaction as to its suitability would not be acceptable. In this respect the supervisor is able to share confidential information with other supervisors with similar responsibilities.
Assessment	Observed
Comments	Insurer's reinsurance provisions are very strictly monitored; the potentially damaging effect of nonperforming reinsurance is fully appreciated. Concerning information sharing the forthcoming Amendment bill will broaden the supervisor's authority to include generally other supervisory authorities.
Principle 11.	**Market Conduct** Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills, and integrity in dealing with their customers. Insurers and intermediaries should: • at all times act honestly and in a straightforward manner; • act with due skill, care, and diligence in conducting their business activities; • conduct their business and organize their affairs with prudence; • pay due regard to the information needs of their customers and treat them fairly; • seek from their customers information which might reasonably be expected before giving advice or concluding a contract; • avoid conflicts of interest; • deal with their regulators in an open and cooperative way; • support a system of complaints handling, where applicable; and • organize and control their affairs effectively.

Description	This principle is covered by both the Insurance Act and the Insurance Intermediaries (General Business) Act 1996 and respective regulations, together with the Common Trading Practices. Life insurance intermediaries who offer advice on investment matters and market investment related products are registered with the FSC rather than the IPA. General insurance intermediaries representing U.K. insurers to whom they are directly answerable are not required to be registered, provided that the insurers recognize in writing their responsibility for their agents' action. The remaining intermediaries (some 22, being independent persons or companies not answerable to one or more insurers) are registered with the IPA, and if dealing in life insurance, also with the FSC. Another layer of supervision comes through the introduction of the Financial Services Ombudsman Scheme in January 2002 and the guidance to licensed entities issued by the Office of Fair Trading and endorsed by the IPA, which satisfies the customer complaints criteria. Once registered these intermediaries are required to have at least £250,000 Professional Indemnity in place and to act in a business-like fashion including acting honestly, with diligence and organizing and controlling their affairs in an effective fashion. Customer care and their proper treatment in an integral part of supervisory expectations. As part of this assessment in addition to the meetings with the IPA other meetings with market practitioners and associations were held, including the Manx Insurance Association and the Manx Insurance Managers Association. Of interest in this area is the relationship some participants have with the U.K. regulatory system: one major intermediary (life and general), for instance, claims to operate within the United Kingdom GISC (General Insurance Standards Council – currently being merged into the FSAUK) code of conduct, although it is actually the parent which so complies; and the MIA, through its Education sub-committee, when publishing in April 2002 a very comprehensive "Best Practice Guidelines," liaised with the FSAUK on U.K. marketing issues. The issue of staff training has also been reviewed. The level of expertise in the market place seems satisfactory; the life companies offer internal training (see above), and the government sponsored business school also offers courses on related subjects. The U.K. Chartered Insurance Institute has a local branch, which offers occasional lectures and the IPA itself participates in educational programs arranged by different professional bodies. The IPA also organizes training for its license holders on specific topics from time to time (for example, anti-money laundering issues).
Assessment	Largely observed.
Comments	The separation of supervisory responsibilities has been in existence for some time and, as a practical matter, seems sensible. The two supervisors liaise on day to day issues and no problems have been identified. The market does conduct itself well and that element of supervision exercised by the IPA is effective. It is interesting to note that just two intermediaries account for 70 percent of all local general business. The criteria also include the capability of the supervisor to carry out on-site inspections in respect of which see comments on Principle 13. It is anticipated that the forthcoming Amendment bill will provide the supervisor with more specific powers in this area, for example disclosure to the customer and procedures to deal with conflicts of interest which may also be addressed in a new code of practice. The fact that most of the parents of local insurers and intermediaries are responsible to the FSAUK's also

	provides a stabilizing influence. Once the above measures have been introduced the IPA should become Observant of the principle.
Principle 12.	**Financial Reporting** It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis, supported by information obtained through special information requests, on-site inspections, and communication with actuaries and external auditors. A process should be established for: • setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports, actuarial reports, and other information; • setting the accounting requirements for the preparation of financial reports in the jurisdiction; • ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and • setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction. In so doing, a distinction may be made: • between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared for the insurance supervisor; and • between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in another jurisdiction.
Description	Good financial reporting requirements and the ability to adequately assess reports in a timely fashion are the backbone of an effective supervisory system. The Insurance Act provides for the requisite reports and the regulations spell out the forms and other detail. The reports to be filed by authorized insurers are comprehensive, including audited annual accounts, and intermediaries file audited annual accounts and confirmation that their PI cover is in place; insurance managers are exempt. All returns are subject to an external audit and life companies must submit an actuarial valuation and report also. The supervisor is also able to call for any other information by way of on-site inspections, discussions with controllers, management, actuaries, auditors and any other professional parties who may be connected with the insurer. There is a six month (from the end of the companies' financial year) deadline for filing but most are filed earlier. The present supervisory staff is well able to cope with the review process, aided by the MISS automated analyzing system. Two and a half staff, supplemented by the authority's consulting actuary, are able to deal with the 17 international life insurers and another two with the 165 general (mainly captive) insurers. A sampling of working files in each of these areas was reviewed during the assessment, and the consulting actuary was interviewed.
Assessment	Observed.
Comments	The allocation of resources between the life and the captive sectors is interesting and indicative of the much more complex review process necessary for signing off the life returns. The consulting actuary's input in that process is vital; some discussion with the supervisor

	took place regarding the possibility of using an in-house actuary rather than the external one as at present, and the point was made that the use of an external firm gave access to a higher level of input and back up resources if needed. The six months deadline might be thought rather generous, but the point is made that most companies do in fact file earlier, so it may not be a real issue. The exemption of insurance managers from the reporting process is of concern. It is appreciated that there are only a small number of active managers and that their activities can be easily tracked by the supervisor. Nevertheless, it is recommended that they should be required to file annual returns for their own business by way of audited accounts and lists of managed companies.
Principle 13.	**On-Site Inspection** The insurance supervisor should be able to: • carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates; and • request and receive any information from companies licensed in its jurisdiction, whether this information be specific to a company or be requested of all companies.
Description	The Insurance Act Ss 21/2 empower the supervisor to obtain whatever information he may require and to inspect and investigate as may be necessary. The supervisor may appoint any person to assist, and information may be sought from not only the licensee but also related parties such as auditors, bankers or insurance managers. The proposed Amendment bill will address and update some of these areas more specifically. Given the appropriate powers, the assessment will focus on the practical implementation, which is in the process of development. On-site inspections are already conducted to deal with specific issues which may arise in individual companies, also a regular program of visits to International life insurers in respect of anti-money laundering procedures is in place. The program has recently been extended to include general insurance intermediaries and captive insurance company managers.
Assessment	Largely observed.
Comments	The ability of the IPA to adequately manage these recently extended inspection programs needs to be demonstrated over a period of time. They will make substantial demands on staff resources which are currently adequate but which will likely need strengthening in the medium term. Once the whole system is proved to be operating effectively the principle will be fully observed.
Principle 14.	**Sanctions** Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The insurance supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered. The legislation should set out the powers available to the insurance supervisor and may include: • the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions; • the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice; and • the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the license of a company or imposing remedial

	measures where a company violates the insurance laws of the jurisdiction.
Description	Most of the sanctions referenced in this principle are provided for within the Insurance Act; licenses may be revoked, remedial actions may be taken and conditions may be imposed. A company in such unsound state that a recovery plan may be required must submit a short-term financial recovery plan within 30 days. Section 26 of the Companies Act allows proceedings
Description	Against directors and schedule 3 of the Insurance Act contains full insolvency and winding up provisions for life companies. A company unable to pay its debts would be deemed insolvent under S 162 of the Companies Act. However there are a few areas within the broad range of possible sanctions mentioned which are not fully covered, including civil penalties and fines for breaches of regulations. Again the proposed Amendment bill will introduce powers to deal with these.
Assessment	Largely observed.
Comments	In practical terms the authority has a range of powers which should be adequate for dealing with most situations which can be foreseen. There are few criteria which refer to sanctions such as imposing conservatorship and forced transfer of portfolio which are rather foreign to the Island in respect of which more familiar alternative forms of sanctions may need to be considered. Once the proposed Amendment bill is in force the Principle will be fully observed.
Principle 15.	**Cross-Border Business Operations** Insurance companies are becoming increasingly international in scope, establishing branches and subsidiaries outside their home jurisdiction, and sometimes conducting cross-border business on a services basis only. The insurance supervisor should ensure that: • no foreign insurance establishment escapes supervision; • all insurance establishments of international insurance groups and international insurers are subject to effective supervision; • the creation of a cross-border insurance establishment is subject to consultation between host and home supervisors; and • foreign insurers providing insurance cover on a cross-border services basis are subject to effective supervision.
Description	The Insurance Act is all embracing in its scope; all persons (S 3) carrying on insurance business on the Island need to be licensed and to comply with ongoing reporting requirements. Consequently all foreign companies, local subsidiaries of foreign companies and intermediaries representing same are covered. Branches of U.K. insurers do enjoy certain exemptions from detailed reporting requirements; others file full returns and are subject to on-site inspections. New subsidiaries and branches seeking establishment on the Island are always subject to consultation between the respective supervisors. All information exchanged in the process is treated confidentially.
Assessment	Observed
Comments	All aspects of this principle appear to be in place and working effectively

Principle 16.	**Coordination and Cooperation** Increasingly, insurance supervisors liaise with each other to ensure that each is aware of the other's concerns with respect to an insurance company that operates in more than one jurisdiction, either directly or through a separate corporate entity. **In order to share relevant information with other insurance supervisors, adequate and effective communication should be developed and maintained.** In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor: • is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (i.e., insurance, banking, or securities) to share information or otherwise work together; • is permitted to share information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors who have agreed, and are legally able, to treat the information as confidential; • should be informed of findings of investigations where power to investigate fraud, money laundering, and other such activities rests with a body other than the insurance supervisor; and **is permitted to set out the types of information and the basis on which information obtained by the insurance supervisor may be shared.**
Description	The supervisor is able to liaise with other supervisors and has agreements in place with the FSAUK and is party to the general information sharing MOU with other members of the IAIS. Membership of the Offshore Group of Insurance Supervisors also facilitates the exchange of information between its members.
Assessment	Observed.
Comments	Information is able to be shared both formally and informally, and the supervisor works with and liaises with other jurisdictions. The Amendment bill will update some specific powers.
Principle 17.	**Confidentiality** All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections. The insurance supervisor is required to hold confidential any information received from other insurance supervisors, except where constrained by law or in situations where the insurance supervisor who provided the information provides authorization for its release. Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and jurisdictions where information received from another insurance supervisor cannot be kept confidential, are urged to review their requirements.
Description	Section 24 of the Act provides a general confidentiality umbrella, and some gateways which, in the light of present world events, are considered to be not entirely adequate. There are no freedom of information provisions which override the basic confidentiality provisions.
Assessment	Largely Observed
Comments	Although there have been no cases where information has had to be withheld the Island is reviewing the present provisions and planning to up-date them as part of the proposed Amendment bill. Once this is in place the principle will be Observed.

Table 11. Summary Observance of IAIS Insurance Core Principles

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Observed	7	CP2, 3, 8, 10 ,12, 15, 16.
Largely observed	7	CP 5, 6, 7 11, 13, 14, 17.
Materially non-observed	1	CP 9.
Non-observed	1	CP 1.
Not applicable	1	CP 4.

Table 12. Recommended Action Plan to Improve Observance of IAIS Insurance Core Principles

Reference Principle	Recommended Action
Organization of an Insurance Supervisor i.e., CP 1	Steps should be taken to ensure that the IPA is distanced from any possible political influence. The board should not have any representation from Tynwald. The proposed Amendment bill should be reviewed in the light of this assessment to ensure that any outstanding issues are dealt with.
Corporate Governance and Internal Controls i.e., CPs 4–5	This principle should be fully recognized within the legislation by way of development of appropriate regulations; firstly because of the present day very evident need of proper supervision in this area, secondly because several other planks in the present structure, e.g. internal controls, on-site inspections, will not be fully effective without it. The proposed Amendment bill should be reviewed accordingly.
Prudential Rules i.e., CPs 6–10	The on-site inspection procedures should be carefully reviewed to ensure that all the appropriate checks are covered. The reporting requirements under the existing regulations should be expanded to take the principle fully into account.
Market Conduct i.e., CP 11	Consideration should be given to bringing all intermediaries within the scope of the Act.
Monitoring, Inspection, and Sanctions i.e., CPs 12–14	Staff resources should be carefully monitored as these programs are developed.

C. Authorities' Response to the Assessment

Reference Principle	Action Taken/To Be Taken
Organization of an Insurance Supervisor i.e., CP 1	• The treasury has undertaken to review the question of Tynwald representation on the board of the IPA. • In addition, the Amendment Bill sets out a clear statement of the IPA's regulatory objectives and the division of responsibilities between its board and executive. • The appeals process will be revised by the provisions of the Insurance (Amendment) Bill 2003 and the treasury will be removed from it. Under the Bill the power to make secondary legislation will also be transferred to the IPA.
Corporate Governance and Internal Controls i.e., CPs 4–5	• The Insurance (Amendment) Bill includes enabling provisions to allow the IPA to make regulations or statutory codes as appropriate in this area and update the IPA's powers of inspection and investigation and the range of sanctions available.
Prudential Rules i.e., CPs 6–10	• Noted and accepted.
Market Conduct i.e., CP 11	• The IPA will give consideration to this matter, taking into account current developments in the UK market (to which the Island's domestic insurance market is very closely linked in this area) and also the development of regulation in this area in the EU.
Monitoring, Inspection, and Sanctions i.e., CPs 12–14	• Noted and accepted.

IV. IOSCO Objectives and Principles of Securities Regulation

A. General

41. **This report has been prepared in the course of a formal assessment by the IMF of the regulatory and supervisory arrangements of the Isle of Man for its financial sector, and the extent to which these arrangements conform with known international standards and statements of best practice**. The assessment was undertaken by John Farrell (Consultant to MFD). In the report the mission reviews the rules of law and practice about the regulation of securities and investments, and assesses whether the Isle of Man has implemented the IOSCO Objectives and Principles of Securities Regulation. The FSC as a member of IOSCO adopted these objectives and principles in September 1998.

Information and methodology used for assessment

42. In essence the assessment was undertaken by analyzing the rules of law, the statements of best practice, and the evidence of current practice and evaluating them against the 30 IOSCO Principles. The mission was required to decide in the case of each principle whether it was (a) implemented;(b) broadly implemented; (c) partially implemented; (d) not implemented; or (e) not applicable. In the course of this assessment, the mission made a number of judgments. We report on these in Table1 to the report.

43. The mission reviewed many background documents before or in the course of the assessment. These included the IMF's own guidance notes on assessment process and procedures, various IOSCO reports and resolutions, relevant publications of OECD, selected Isle of Man legislation, regulations, orders, codes and guidance notes, various documents on the FSC website, the IOSCO self-assessments prepared by the FSC and various operational documents of the FSC. In reviewing this material the mission paid close attention to the explanatory notes accompanying the IOSCO statement of Objectives and Principles. It also considered the MFP Transparency Code. The mission had extensive discussions with representatives of the government, the FSC, professional bodies and industry associations, and a number of supervised firms that were representative of the various categories of firms licensed to undertake securities and investment business. In the time available the mission did not have the opportunity to confer with independent commentators.

44. There were no factors that impaired the assessment process other than the limited time available to complete the work. The mission received extensive briefings from FSC staff on relevant matters and helpful answers to its many questions. The FSC has a great deal of useful written material available, both on its website and in hard copy. The law, regulations, codes and guidance notes were readily accessible. FSC staff organized an extensive program of visits for team members.

Institutional and macroprudential setting, market structure

45. **The core Isle of Man rules of law about the regulation of securities and investments relate to**:

- the functions and powers of the FSC;
- the licensing and supervision of those who undertake investment business, in particular, those who deal in investments, arrange deals in investments, manage investments belonging to others, give investment advice, or operate or administer a collective investment scheme (CIS);
- the authorization and supervision of CIS's;
- the offer of securities and investments to members of the public and others.

46. These rules of law are administered and enforced by the FSC. However, the prosecution of criminal offences under the Companies Acts is a matter for the attorney general.

47. The term "investment" is defined to include the full range of securities and investment products. The principal investment products, which are the subject of regulation, are interests in CIS's. There are also life insurance policies, which have the character of investments but are regulated as insurance products. These are dealt with elsewhere in the mission's report. Isle of Man people may also invest in overseas listed securities.

48. A CIS may be an authorized scheme, a recognized scheme, an international scheme or an exempt scheme. Interests in an authorized scheme are available for offer to the general public in the Isle of Man. Authorized schemes, which meet certain requirements of U.K. law, may be offered to the general public in the United Kingdom. Comparable arrangements apply on a reciprocal basis with a limited number of other jurisdictions. A "recognized scheme" is one, which is established outside Isle of Man but is "recognized" by the FSC for marketing within the Island. The international schemes are intended for offer to more experienced or professional investors and, in practice, are not offered to the general public in the Island. Funds under management in CIS's as at June30, 2002 were £5.12 billion. In addition, there were £3.5 billion in funds under discretionary management. There were 87 investment business licenses current.

49. There is no stock exchange in the Island and any listing of securities in Isle of Man based schemes or companies will be in another jurisdiction**.**

General preconditions for effective securities regulation

50. Andrew Edwards, in his 1998 review of the U.K. crown dependencies, writes of the substantial constitutional independence of the U.K. offshore finance centers in domestic affairs, their political stability and their willingness to adapt to changing world conditions. He adds that the substantial independence has enabled them to offer considerable tax advantages. It has also enabled them to establish their own legislative frameworks and their own financial market development policies.

51. The FSC has adopted as its mission statement, "To promote and secure high standards of integrity, solvency and competence within the Isle of Man financial services industry, to protect investors' and depositors' interests and to engender an environment in which financial institutions provide quality products and services for the economic benefit of the Island."

52. Market access is determined by reference to the securities regulatory system and the decisions of the FSC. The mission is not aware of any particular barriers to the entry or exit of market participants other than those which are incidental to the operation of the regulatory system. The Isle of Man has explicit rules of statute law about competition. It is the team's impression that there is a diversity of market participants engaged in investment business.

53. **The Isle of Man has a conventional framework of general business law including a common law system**. Securities law is backstopped by rules of law about contract, tort and property, and about serious fraud and other crimes involving fraud and deceit. Securities law is also dependent on mature rules of law about the constitution of entities which issue securities for subscription, company law, partnership law, and building society law and so on.

54. **A key determinant of success for the Isle of Man as an international finance centre is its reputation.** We routinely encountered a general understanding in this context of the importance of the regulatory system and broad support for the regulatory policies of the authorities.

55. **The Isle of Man depends for its ability to develop as an international finance centre on the quality of its regulation, the expertise of its people, the cost of doing business there and its tax regime**. It has encountered criticism in the past, particularly from neighboring countries, about its tax regime. The authorities consider it all the more important in the circumstances to have and to be seen to have soundly based law and procedures for the supervision and regulation of market participants and to cooperate and to be seen to cooperate with equivalent authorities in other jurisdictions.

56. **The Isle of Man also depends for its ability to develop as a finance centre on its willingness to cooperate more generally with others on regulatory matters**. In this context it is noteworthy that, despite its status as a U.K. crown dependency, it works directly in its own right with such organizations as the OECD and the UN. It is a party to tax information agreements with other countries. In addition the FSC has direct bilateral relations with the FSAUK, the SEC in the United States and several other regulators in overseas jurisdictions under MOUs on cooperation in the regulation of financial markets and institutions.

57. **It is against the background of these general comments that we proceeded to examine the extent to, which the Isle of Man had implemented the IOSCO Principles**.

Principle-by-principle assessment

58. **The Isle of Man has implemented or broadly implemented 20 of the IOSCO Principles**. **It has partially implemented three Principles**;

- Principle 1: the responsibilities of the regulator should be clear and objectively stated
- Principle 2: the regulator should be operationally independent and accountable in the exercise of its functions and powers.
- Principle 24: 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.

59. **The mission has made three recommendations on these Principles**:

- that the government and the FSC secure by statute a clear, complete and authoritative statement of the FSC's responsibilities;

- the government and the FSC review the relevant rules of law, policy and practice with a view to providing for the FSC to become a more independent and more accountable financial services regulator and supervisor;

- the government secure the enactment of rules of law for dealing with the failure of a market intermediary.

60. **The mission has also made recommendations on operational matters**. These are recorded in the appropriate place in the detailed assessment in Table 1 and summarized in Table 3 Recommended Actions.

61. **The remaining seven Principles do not apply either because there is no secondary market or because there are no Self-regulatory Organizations (SROs)**.

B. Detailed Assessment

Table 13. Detailed Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation

Principles Relating to the Regulator	
Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	The FSC was established by the Financial Supervision Commission Order 1983. This Order requires the FSC to take « such steps as appear to it to be necessary or expedient for the effective supervision of the private financial and commercial sector in the Island, but with the exception of the insurance industry ». The FSC's responsibilities are supplemented by other statutory provisions, in particular, for the purposes of this report, those relating to investment business and CIS's. In addition the FSC holds the responsibilities of the Registrar of Companies, a statutory office, under the Companies Acts and various other Acts « relating to the registration and regulation of companies, partnerships and other entities. These were transferred to the FSC by the Companies (Transfer of Functions) Act 2000. We consider that to meet the needs of Principle 1 a statement of responsibilities should be authoritative, that is, it should be in statutory form. We think that the provisions of the Transfer of Functions laws described above give a general indication of the work of the FSC. However we do not think that on their own they give a clear or complete statement of the diversity of FSC responsibilities. It is not immediately clear for instance that the FSC is responsible for making recommendations to the government for reform of the laws which it administers, or that it is committed to cooperation with other regulators including the tasks of obtaining and communicating to others information on activities within its jurisdiction. There are a number of reasons why this statement of responsibilities should be readily available in an authoritative form. The FSC has extensive powers of regulation which touch upon the reputation of those who deal with it. They are entitled to have a statement in this form. The commissioners and staff need to be constantly aware of the nature of the FSC's

	responsibilities as well as the terms of the Mission Statement. It will, the mission considers, assist the FSC in its annual negotiations with the treasury on funding that there is a clear, complete and authoritative statement of responsibilities. The mission does not consider that the Isle of Man has fully implemented Principle 1.
Assessment	Partially implemented
Comments	We understand that the government and the FSC are committed to a review of statute law administered by the FSC. We recommend that the opportunity be taken to establish a clear, complete and authoritative statement of the FSC's responsibilities.
Principle 2.	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	The FSC has been established on the basis that it is operationally independent and fully accountable for its actions. It nevertheless relies on the government for a number of things: • to secure the enactment of appropriate rules of law about its establishment and constitution and about the regulation of markets and institutions; • to appoint and remove commissioners; • to secure appropriate sources and levels of funding; • to afford the FSC as an expert body which is continuously engaged with the private sector the opportunity to make recommendations on the laws, which it administers and to receive and consider these recommendations; • as the primary stakeholder to be concerned for the reputation and good standing of the FSC and for this purpose to ensure that the FSC is able to maintain appropriate standards of independence and accountability. The policies and procedures pursuant to which the commissioners are appointed or removed and their remuneration is determined are also relevant. We consider that they should be transparent. In addition we consider difficult questions arise on any proposal to appoint a person as a commissioner who is a member of Tynwald or of the treasury or its professional staff. Both Tynwald and the treasury have responsibilities under the laws which the FSC administers and, to the extent practicable, need to be independently accountable in discharging their responsibilities. Moreover, we think that serious questions arise about the independence of the FSC in relation to its powers over those engaged in investment business. We draw attention in particular to the following: • the treasury power to give directions on licensing matters, generally and in particular cases (section 3(12) of the Investment Business Act (IBA) ; • the treasury power to give directions on inspection and investigation matters, generally and in particular cases (IBA section 8(6)) ; • the council of ministers' power, at least to the extent that it applies in particular cases, to appoint a Review Committee to review a decision of the FSC (IBA section 15); • the council of ministers' power to give directions as to the exercise of the FSC's functions in relation to a public interest matter and the power to require the FSC to supply information (Statutory Boards Act Schedule 2 clause 12). We consider that these matters put the FSC's independence at risk. In addition they create, expressly or as a necessary consequence, a gateway for the disclosure of confidential information, whether of the license holder or of its clients, to the government. Section 24 (1) and (2) of the Financial Supervision Act 1988 (the FSA) specifying exceptions to the disclosure restrictions seems relevant to this. We query whether any of these powers are

	appropriate or even necessary for an effectively running FSC. We note that we also address this matter in the context of our assessment of the banking and other sectors. We are not clear on what basis the responsibilities for the making of regulations, regulatory codes, orders or exemptions under the IBA or the FSA are allocated as between the treasury and the FSC. We think it might be helpful to restate the policy on this and to consider whether the powers under the law adequately reflect this policy. We think this is material to the core policy of the government that the FSC should be and should be seen to be independent. We also consider it important for the government to review its policies on the accountability of the FSC. At present the FSC publishes an annual report. However it is not required to do so. The report covers the activities of the FSC for the year. It contains a great deal of useful information and is well presented. However it provides very little information on its financial performance and what there is we have found confusing. We think a Commission in the position of the FSC should be required to produce and publish an annual report to the standard expected of the best and most reputable supervised entities. It might include statements of financial performance, financial position, cash flows, stakeholders' equity and service performance. It might include comparative figures for prior years and budget figures for the year under review prepared as at the beginning of the year under review. It might also include a statement on the qualifications, experience and principal interests of the individual commissioners. This report would be produced well within the time frames expected of supervised entities. It might be presented to the treasury and tabled in Tynwald and then released publicly. There may be other matters which need to be taken into account in a review of the independence and accountability of the FSC. Whether or not this is so we consider it should be undertaken as a priority. We consider it may help resolve some of the questions which we have raised on independence if higher standards of accountability can be achieved. We believe the government and the people of the Isle of Man will be much more confident to entrust the FSC with the making of decisions on such matters as licensing and inspections, subject to review by the Court, without the potential for intervention by the treasury if the FSC is required to be more extensively and more publicly accountable for its performance as a regulator. This will be all the more so if the procedures for the appointment of the commissioners are transparent and designed to reassure the community that the commissioners are appropriately independent. In addition, we consider that the present arrangements about independence and accountability may be material to the annual discussions between the FSC and the treasury on funding. If the treasury does not have an overarching responsibility for the decisions of the FSC and if the FSC and its commissioners are more fully and more publicly accountable for financial management the treasury may be better placed to exercise independent judgment on the financial needs of the FSC. The IBA section 15A confers on the FSC and its staff an indemnity for acts done in the exercise of its functions under the IBA, the FSA, the Companies Acts and the Banking Act. We note nevertheless that the Statutory Boards Act 1987 Schedule 2 clause 11 is not consistent with this in respect of the liability of FSC officers. This does not seem appropriate. Clause 11 in its own terms does not provide adequate protection for FSC officers. We consider that the application of the Statutory Boards Act to the FSC in this respect and, we imagine, in other respects should be reviewed. While we have reservations about a number of rules of law relating to the independence of the FSC we record that we have no reason to consider that there is a problem at the practical level in the day to day dealings between the FSC and the financial sector on conflict of interest matters. There is a code of conduct for commissioners which was formally approved at a meeting of the Board. There are equivalent provisions in the Staff

	Handbook applying to all staff. There are procedures for ensuring adherence to these. The Board has powers of delegation and has delegated certain of these to the chief executive. The chief executive is required to report back to the Board on the exercise of delegated powers and does so regularly. Notwithstanding this we do not consider that the Isle of Man has fully implemented the IOSCO principle on operational independence and accountability, Principle 2.
Assessment	Partially implemented
Comments	We recommend that the government and the FSC jointly review the relevant rules of law and the relevant policies and practices with a view to providing for the FSC to become a more independent and more accountable financial services regulator.
Principle 3.	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	The FSC has powers to: • issue or refuse to issue an investment business license to any person; • suspend or revoke the license; • impose conditions and add to vary or revoke conditions; • exempt any person or class of persons from any provision of the IBA (the Investment Business Act) and withdraw the exemption; • make regulatory codes, subject to approval by Tynwald; • make regulations to provide for money held by a permitted person as defined to be held on trust, subject to approval by Tynwald; • inspect books, accounts and documents and investigate the transactions of a permitted person; • require a person to attend before the FSC and produce documents, subject to authorization by a justice of the peace; • enter and search premises and take possession of documents, subject to the issue of a warrant by the Court; • make recommendations to a permitted person or issue directions to secure that effect is given to any recommendation; • direct that a person shall not be appointed or shall not continue in office as a director or principal officer of a permitted person; • require that assets be transferred to a trustee; • apply to the Court for an order to remove or replace a manager or trustee; • issue public statements concerning a person; • enter into mutual assistance agreements with recognized regulators, whether in the Isle of Man or offshore; • use its powers to obtain information for the benefit of recognized regulators; • apply to the Court for an injunction or restitution order; • request the Attorney General to initiate regulatory or criminal prosecutions; • publish information or give advice on the law including the rights of investors, the duties of permitted persons and the steps to be taken to enforce those rights.

	The FSC has the following divisions: operations, enforcement, policy, companies and supervision. None of these divisions is exclusively responsible for securities and investments work and the FSC's work in this area must be seen in the wider context of its work more generally. The FSC has an approved staff establishment of 58.5 and currently employs 56.5. Some 8.4 percent of the FSC's total resource is allocated to securities and investment work. The work of the Commission may be supplemented by assistance from professional firms, for example, the regulatory unit from an accountancy firm for some of the technical supervisory requirements applying to some stockbrokers. Lawyers and accountants from both inside and outside the Island are also appointed as inspectors to conduct investigations on behalf of the FSC. The arrangements for the funding of the FSC are described elsewhere in this report. The FSC relies on appropriation of funds each year by Tynwald on the recommendation of treasury. It is our impression that while there may be pressures in other areas the commitment of staff and resources to securities and investment matters allows for an adequate program of work under the IBA and the FSA. The forward program of work of the FSC as described to us by the divisional staff may be adequate for the jurisdiction. The Companies Acts contain the rules of law about the offer of company securities to the public, in particular, shares and debentures issued by Isle of Man public companies. The Companies Acts contain powers of intervention during the securities offering period applying to the issuer and the company as distinct from a license holder. They are not as extensive or as effective as the equivalent powers in the IBA and FSA. There are 134 Isle of Man public companies. There were 8 public offerings in 2001 and there has been no public offer to date in 2002. In addition the FSC has said that it will be undertaking a review of company law. We think this is very timely, not only because much of the law is very old but also because the responsibilities are new to the FSC and the FSC is in a position to bring its own traditional skills to bear as a securities and investments regulator. In whatever way the company law reform work is programmed we think it will be a major task and special resources will need to be applied to it. We believe the FSC is well aware of this. The mission has met with a number of people in the financial services industry. It is our impression that the efforts of the FSC are by and large well supported in the community, reinforcing its capacity to perform its functions and exercise its powers effectively as a securities and investments regulator.
Assessment	Implemented
Comments	The IBA contains provision for the FSC to be able to impose fixed penalties. The treasury has power to make an order to give effect to this. It is not yet in force. The FSC has informed the mission that the government is reviewing the IBA provision in the context of a proposal to give the FSC a more general power to impose administrative penalties. There may be some delay in implementing the power under the IBA. Nevertheless the mission considers that, even in the absence of such a power, the FSC has complied with Principle 3 in its capacity as a securities and investments regulator. The company law review project is a major one. The quality of company law is very important for investors and market professionals in deciding whether to undertake business in a jurisdiction. The government needs to ensure that the project is adequately funded.

Principle 4.	The regulator should adopt clear and consistent regulatory processes.
Description	The FSC is empowered under the law to issue regulatory codes, orders and regulations for a variety of purposes, subject to approval by Tynwald in each case. The FSC has made extensive use of this power. There are regulatory codes in force in respect of: • financial resources and reporting; • clients' money; • clients' investments; • conduct of business; • audit requirements; • general requirements; • advertising. There are Orders and Regulations, including those relating to: • clients' money; • financial supervision (promotion of unregulated schemes); • financial supervision (authorized persons); • financial supervision (authorized collective investment schemes) (international collective investment schemes) and (scheme particulars); • exemptions from the law. The FSC has a general power to publish information or give advice on the operation of the law, its own functions or any other matter where publication is for the protection of any person. The FSC has the practice of preparing guidance notes on policy, process and operational matters. These guidance notes provide the FSC with an excellent vehicle to record and publicize the regulatory processes which it has adopted and the consequences to license holders and others of noncompliance with the law. The FSC has published very extensive On-line Handbooks for investment businesses and collective investment schemes covering financial supervision and bringing together the statute law, regulations and orders, regulatory codes, guidance notes, and more general material such as an introduction to licensing, the procedure for making applications and the application forms. In formulating its policies and regulatory processes, the FSC aims for international best practice following extensive industry consultation. Any person who is aggrieved by a decision of the FSC on designated matters relating to the administration of the Law may apply to the Court on a Petition of Doleance which, as we understand it, is equivalent to judicial review in other common law systems. In addition as noted above there is provision in the law for the council of ministers to appoint a Review Committee to review certain decision of the FSC relating to licensing. We consider that the FSC has implemented Principle 4.
Assessment	Implemented
Comments	
Principle 5.	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	All staff are required to comply with the staff handbook as a condition of their employment. The handbook contains rules about confidentiality, security, conflicts and personal dealings/investments. Any person who discloses restricted information as defined in the FSA without the consent of the person to whom it relates or for the purpose of discharging functions under the law is

	guilty of an offence. In addition FSC staff are subject to an Official Secrets Act. FSC staff must disclose to the Secretary of the FSC any significant relationship with a license holder or applicant and holdings of shares and related investments. Staff are not permitted to hold shares and "related investments" in an organization regulated by the FSC. Where a commissioner has any direct or indirect relevant personal interest in the outcome of the deliberations of the Commission on any matter: • the commissioner shall disclose the nature of the interest at a meeting of the Commission in person or by means of a written notice brought to the attention of the Commission,; and • the commissioner shall withdraw from any deliberations of the Commission in relation to that matter and not vote upon it. This obligation arises under the FSC's Code of Conduct for the management of conflicts of interest of commissioners. The FSC Staff Handbook sets out procedures to be followed by the FSC and the staff for handling conflicts. Policies are also in place to cover gifts and hospitality. No stock exchanges or other securities trading systems operate in the Isle of Man and many investment operations in the Island are small parts of international groups. It is the mission's view that the FSC adheres to and enforces its policies on confidentiality and conflicts, and related matters.
Assessment	Implemented
Comments	
Principles of Self-Regulation	
Principle 6.	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 FSC considers that this principle does not apply. We agree.
Assessment	Not applicable
Comments	
Principle 7.	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 FSC does not consider that this principle applies. We agree.
Assessment	Not applicable
Comments	
Principles for the Enforcement of Securities Regulation	
Principle 8.	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	The FSC may inspect and take possession of "the books, accounts and documents" of a permitted person and investigate its transactions. It has a power of entry for this purpose. The FSC may with the authority of the Court require any person who is under investigation in relation to investment business, whether or not a permitted person, to attend before the FSC to answer questions and to produce documents. This power is most likely to be used in circumstances where a person is suspected of carrying on unauthorized investment business. The FSC may under the authority of a warrant of the Court enter and search premises and take possession of documents, using force if necessary. Similarly this power is most likely to be used where a person is suspected of carrying on unauthorized investment business.

	The FSC may make recommendations to a permitted person and issue directions to secure that effect is given to them. The FSC may request a permitted person to provide information and may issue directions to secure that effect is given to the request. The Court on the application of the FSC may appoint inspectors to investigate and report on the affairs of an operator, manager or trustee of a CIS. An equivalent power is available under company law in relation to a company. The manager of an authorized scheme must give notice to the FSC of any alteration to the scheme or any proposal to replace the trustee. The mission considers that the FSC has comprehensive inspection, investigation and surveillance powers and that Principle 8 has been implemented.
Assessment	Implemented
Comments	
Principle 9.	The regulator should have comprehensive enforcement powers.
Description	The FSC may issue a direction to a permitted person to secure that effect is given to a request or recommendation of the FSC to that person. The FSC may withdraw or suspend an investment business license or revoke a CIS authorization. It may also direct that an overseas scheme shall cease to be recognized. The FSC may withdraw an exemption granted to a permitted person. The FSC may direct a CIS operator to cease the issue or redemption of units. The Court may on the application of the FSC appoint inspectors to investigate and report on the affairs of the operator, manager or trustee of a CIS. The FSC may with the consent of the Attorney General prosecute a person for the offence of furnishing false or misleading information. The FSC may prosecute a person for the offence of making misleading statements or engaging in conduct which creates a false or misleading impression as to the market, price or value of investments. The FSC may impose a requirement that assets of a person carrying on investment business or of investors are transferred to and held by a trustee. The FSC may issue a public statement about any person. The Court may on the application of the FSC issue injunctions and restitution orders. The mission notes that the provisions in the IBA for empowering the FSC to impose summary penalties have not been implemented while the government and the FSC undertake a more general review of this type of power. It also notes that it is necessary for the FSC to obtain the consent of the attorney general to bring a prosecution. It nevertheless considers that the FSC has a wide range of enforcement powers and is satisfied that the Isle of Man has implemented Principle 9.
Assessment	Implemented.
Comments	
Principle 10.	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	The FSC's Supervision Division supervises each holder of an investment business license and each authorized CIS. The aim of the Division is to ascertain whether license holders comply with the law, primary and secondary, and the conditions of the license and, if they do not, to take appropriate follow-up action. As part of its program of work the Commission conducts on site inspections, manages off-site reporting (monthly, quarterly,

	annual returns, audited accounts, etc) and receives complaints which are taken into account in planning its compliance programs. The Supervision Division also undertakes surveillance work in respect of permitted persons and CIS's more generally. The Supervision Division has a staff of 15 persons of which 13 are professional officers. A total of 7.5 full-time equivalents (FTEs) is committed to securities and investment work. The Supervision Division has developed a risk profile for each of the license holders. It regards each license holder as low, medium or high risk. It has set a target of visiting every low risk license holder every two years, every medium risk holder every 18 months and every high risk holder every year. The Division informs us that it is achieving this target. On the basis of this work and its initial consideration of all license and authorization applications it considers that it has a good understanding of all supervised business in the Island. The Division continues to refine its risk-based approach to supervision, taking into account the relative materiality of the functions performed by supervised persons and their compliance record. The Head of Supervision does not expect any reduction in the resources available for investment business although we understand that there may be increased pressures on other areas within his responsibility, in particular, banking. We think it may be wise for the FSC to describe its proposed program of supervision work for each budget year more fully in its business plan. The Division at present undertakes supervision work in respect of 55 general investment businesses, 6 stock broking firms, 22 CIS managers, 4 third-party fund administrators (providing services to CIS managers), 59 banks, and 2 building societies. On certain specialist work, for example, the supervision of a U.K. stock exchange member firm, the FSC will be assisted by an outside professional firm. The FSC aims to ensure that work will be undertaken on a basis consistent with U.K. regulatory practice. The FSC retains full responsibility for the supervision. The mission has reviewed the format of the standard site inspection report. This is a very important document. It contains the framework for reporting on matters that may have a profound effect on the reputation and standing of license holders and others. An inspection report may be sent to the license holder, the trustee, the auditor, the holding company and an overseas regulator. The views of the FSC may be subject to challenge. It is important that the purpose of the inspection report be clearly and accurately stated. We consider that the FSC should review the template. The Enforcement Division takes enforcement action against regulatory breaches. It describes its mandate as "patrolling the perimeter." In practice this represents reacting to information received from the Supervision Division, other regulators in the Isle of Man and elsewhere, in particular, other financial sector regulators, the Police, members of the financial services industry, complaints from the public, internet sweeps and, in appropriate cases, initiating or promoting prosecutions. The FSC also assists regulators overseas in their investigations, particularly where these involve entities in the Isle of Man. The Enforcement Division has a complement of 5 professionals. Some 40% of its work relates to investigation of unauthorized investment business. Like all the Divisions it reports regularly to meetings of the commissioners. We consider it has an active program of work. The Office of Fair Trading has informed us that, in administering the Financial Services Ombudsman Scheme, it can encounter difficulty in determining the relative responsibilities and the relative fault of the fund manager and the independent financial adviser (IFA **)**

	almost always where the IFA is offshore. It seems to the mission that the most significant challenge to international confidence in the funds management industry today, to the extent that it involves non-expert investors in well regulated jurisdictions, is concern about possible mis-selling. The FSC should consider whether there is anything more it can do to promote the release of timely, balanced, clear and accurate information and advice to the offshore investor. The mission considers that the Isle of Man has implemented Principle 10.
Assessment	Implemented
Comments	We recommend that the FSC review its template for on site inspection reports and ensure that the purpose is clearly and accurately stated. We also recommend that the FSC review its procedures for inspecting the practical arrangements existing between the scheme manager and the IFA, in relation to the supply and use of offer documents and promotional material and consider whether they are adequate for ensuring that the offshore investor is well informed and advised.
Principles for Cooperation in Regulation	
Principle 11.	The regulator should have authority to share both public and nonpublic information with domestic and foreign counterparts.
Description	The FSC has power under the IBA to enter into mutual assistance agreements with authorities, whether in the Island or overseas, exercising functions corresponding to those of the FSC under the IBA or the FSA. The FSC may exercise its powers to obtain information in the Island including its powers of supervision, inspection and investigation to obtain information for the purpose of assisting these authorities in the exercise of their functions. The FSC has power under the FSA to share with other authorities any information which it has obtained in performing its own functions under the IBA and the FSA. The power of the FSC to obtain and to share information is limited in one particular respect. It does not apply unconditionally to customer information. Broadly speaking the FSC's powers to obtain information under the IBA and the FSA do not apply in respect of the affairs of any particular customer except as may be necessary for an inspection and investigation of the license holder. The power of the FSC to share customer information is subject to the approval of the chief minister who must be satisfied that disclosure is in the public interest. This limitation seems consistent with the basic purpose of the two Acts as they currently relate to the regulation and supervision of license holders and others who carry on investment business. The FSC is able to obtain and share information about the source of customer funds under anti-money laundering law and the above limitation does not apply. This is dealt with elsewhere in the mission's report. The limitation does not apply under the Insider Dealing Act. The FSC and the treasury, which administers this law, may share this information with other authorities. In addition the treasury is explicitly empowered to investigate where circumstances suggest that there may have been a contravention of the laws of another country. The FSC has informed the mission that the chief minister's consent under the IBA has very rarely been needed because of the other gateways and powers. In the FSC's recollection consent has never been withheld. We are informed that the FSC is not eligible to become a party to the IOSCO multilateral MOU on cooperation because of the above limitation in the IBA. The Government will need to review the powers of the FSC under the IBA and the other Acts if the FSC is to participate in the MOU. The mission considers that the Isle of Man has implemented Principle 11.
Assessment	Implemented.
Comments	

Principle 12.	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	As noted above the FSC has power to enter into mutual assistance agreements. To date it has entered into MOUs with • Bermuda; • Guernsey; • Ireland; • Jersey; • South Africa; • United Kingdom. The FSC is at present preparing to become a party to the IOSCO multilateral MOU concerning Consultation and Cooperation and the Exchange of Information. The Isle of Man is a member of IOSCO, the Enlarged Contact Group of Collective Investment Scheme Supervisors, the International Association of Insurance Supervisors, the Offshore Group of Insurance Supervisors and the Offshore Group of Banking Supervisors. We understand that policies and practices for cooperation are discussed in these groups. Domestically, the FSC appears to have very close and effective relationship with the treasury, the Insurance and Pensions Authority, the Office of Fair Trading and the Police on financial sector matters. There is a formal agreement between the FSC and the Financial Crimes Unit. The mission considers that the Isle of Man has implemented Principle 12.
Assessment	Implemented
Comments	
Principle 13.	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.
Description	For the purpose of assisting a "recognized regulator" including a foreign regulator the FSC may among other things. • inspect the books, accounts and documents of a permitted person and for this purpose exercise powers of entry and access; • with court consent require any person who may have been carrying on investment business to attend at the FSC, to answer questions and to produce documents and, with a court warrant, to enter and search; • make recommendations and issue directions to a permitted person. The powers and policies of the FSC in assisting foreign regulators in their inquiries are also referred to under Principles 11 and 12 above. It seems well able to give assistance. We consider that the Isle of Man has implemented Principle 13.
Assessment	Implemented.
Comments	
Principles for Issuers	
Principle 14.	There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.
Description	As observed in the introduction to this table the offer of securities to the public in Isle of Man is principally, if not exclusively, the offer of interests in CISs. The treasury may make regulations • requiring the keeping of records with respect to the transactions and financial

	position of a scheme; • requiring the preparation of periodical reports with respect to a scheme and the furnishing of those reports to participants and the FSC; • requiring a scheme operator to prepare and submit scheme particulars, or amended scheme particulars, and publish or make them available to the public. In addition the FSC may make regulatory codes on • the form and content of advertisements; • the disclosure of the amount or value of commissions or inducements in connection with investment business; • the financial statements and returns which are to be submitted. The treasury and the FSC have made various regulations and codes. They provide for detailed regulation in respect of financial and other information about CIS's. Various exemptions are available in respect of the International Schemes, the Experienced Investor Schemes and the Professional Investor Schemes. Nevertheless in our view the FSC retains a regulatory role in respect of these. We think minimum standards on the quality and timeliness of financial and other information should be maintained. We understand that the FSC has set its requirements for the type of information. We think there should be a deadline for reporting to the FSC. If all is going well the manager can be expected to report promptly, but possibly not when things are not going well. The Companies Act 1931 regulates the offer of company securities, in particular, shares and debentures issued by public companies. There is a requirement to register a prospectus for any such offer although there is no other requirement to publish it. The FSC may decline to register the prospectus for good reason. The Act prescribes the information to be contained in the prospectus. Certain exemptions are available for offers to existing shareholders and for the offer of securities of a class which are listed on a prescribed exchange, namely at present, the London and Hong Kong exchanges. The powers of the FSC to intervene where it considers that a prospectus is false or misleading or does not comply with the law appear to be quite limited. This may not be a problem at present as there have been very few registered prospectuses in recent times. We consider nevertheless that the government and the FSC should look at this matter in the course of their review of company law. The Companies Act also sets the periodic reporting requirements of Isle of Man companies. It is our impression that the FSC is active in securing compliance with these. However we observe that the law provides for the financial statements to be filed within nine months. This seems far too long. We suggest that this requirement be reviewed. We consider that the Isle of Man has broadly implemented Principle 14.
Assessment	Broadly implemented
Comments	We recommend that the Isle of Man review the powers of intervention in the Companies Act in respect of a registered prospectus. We also recommend that the FSC review the reporting requirements which they at present apply to International, Experienced Investor and Professional Investor Schemes. We recommend that the Isle of Man review the annual reporting procedures under the Companies Act.
Principle 15.	Holders of securities in a company should be treated in a fair and equitable manner.
Description	The Isle of Man has no secondary market for trading securities and the FSC considers that there is no need for legislation, codes or rules to cover listings, continuous reporting, takeovers, or the change in control of a listed company or a change in substantial shareholding interests. If securities of Isle of Man companies are listed or traded publicly,

	for example, in the United Kingdom, Ireland, Luxembourg or Guernsey, trading is subject to regulation in that jurisdiction. Nevertheless the Isle of Man generally has mature rules of law about companies, investments and intermediaries, providing for regulation and supervision in respect of the rights of investors and the orderly transaction of business. The prospectus rules provide for disclosure of information about the identity of the promoter and offeror and, in the case of CIS's, the functionaries. The mission considers this an important pre-condition to fair and equitable treatment. The Office of Fair Trading operates the Financial Services Ombudsman Scheme. The scheme is based on a two step approach, mediation and adjudication. A Scheme adjudicator may require the payment of a sum of money up to BP.100,000. The Scheme is funded by the government. Managers of authorized schemes are also required to be party to the compensation arrangements provided for in Compensation Regulations. The arrangements are for the purpose of compensating investors where authorized persons are unable to satisfy civil claims. The maximum amount payable in respect of any claim is BP.48,000. The scheme is funded by the contributions of authorized persons. We consider that the Isle of Man has implemented Principle 15.
Assessment	Implemented
Comments	
Principle 16.	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	Under the Companies Acts 1931 and 1982, public companies are required to file and publish audited financial statements on an annual basis. These statements must be filed with the Registrar of Companies within nine months of a company's year end. The auditors' report must state whether in their opinion the financial statements have been properly prepared in accordance with the law and whether they provide a "true and fair" view. Isle of Man companies will normally adopt generally accepted accounting principles (GAAP) in the United Kingdom and the audit will be conducted on this basis. However it is recognized that the financial statements of companies incorporated other than in the Isle of Man may need to be drawn up to comply with other standards, for example, United States GAAP or International Accounting Standards. Under the Companies Act 1931, a report by the company's auditors must be included in any prospectus. Under the Companies Act 1982 the auditor of a public company must be a member of: • the Institute of Chartered Accountants in England and Wales; • the Institute of Chartered Accountants in Scotland; • the Chartered Association of Certified Accountants; • the Institute of Chartered Accountants in Ireland; • the Chartered Institute of Public Finance and Accountancy; or • the Association of Authorized Public Accountants. We understand that each of these entities has set audit standards including standards about independence. We understand that nearly all accountants undertaking audit work in the finance sector are members of ICAEW. There are special provisions about the audit of CIS's, including the appointment of the auditor and the contents of the audit report. The Isle of Man does not have its own accounting or audit standards. There has been some consideration of this in recent times, particularly in the context of evidence of

	unsatisfactory practice overseas. The FSC should continue to review policy in this area. For the present the mission believes it may be possible for the Island to maintain satisfactory standards through the present institutional links and the links between some firms and their affiliates in the United Kingdom and elsewhere. The mission considers that the Isle of Man has implemented Principle 16.
Assessment	Implemented
Comments	The authority for financial reporting and audit standards and for the review of auditor performance is under careful review internationally. We consider that the government and the FSC should continue their consideration of this matter.
Principles for Collective Investment Schemes	
Principle 17.	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	It is an offence under the IBA to carry on investment business without a license. Investment business is defined to mean • deals in investments; • the arrangement of deals in investments; • the management of investments; • the giving or offering of advice to investors or potential investors; • the operation and administration of CISs. When considering an application from a person for a license to operate a CIS the Commission is required to be satisfied that the applicant is a fit and proper person to carry on investment business as described in the application. The FSC considers that three broad criteria should be applied in considering this: • competence; • integrity; • solvency. The FSC has said that it expects license holders to have a transparent corporate structure and a proven track record. The license holder is required to comply with regulatory codes on: • financial resources requirements and financial reporting; • clients' money; • clients' investments; • conduct of business; • audit requirements; • general requirements; • advertising. License holders are also subject to ongoing supervision by the FSC. The FSC expects to carry out visits on average once every two years and more frequently for those who are considered to be medium or high risk. The FSC aims to investigate suspected breaches of the law, review license conditions and take remedial action where appropriate. The mission considers that the FSC sets standards for the eligibility and regulation of license holders. It considers that the Isle of Man has implemented Principle 17.
Assessment	Implemented
Comments	

Principle 18.	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	The treasury may make regulations about: • the constitution and management of authorized schemes; • the constitution, powers and duties of the operator and trustee; • the powers and duties of the directors of the operator; • the rights and obligations of the participants. A variety of regulations are in force under the authority of this provision. In particular the constitution of an authorized CIS must comply with the Financial Supervision (Authorized Collective Investment Schemes)Regulations 1988. The offering documents for the CIS must comply with the Financial Supervision (Scheme Particulars) Regulations 1988. The regulations prescribe the detailed matters to be covered and disclosed in the constitutional documents. The trustee (who will be an Isle of Man banking license holder and will be independent of the operator) holds the scheme assets in trust. Equivalent regulations apply in respect of international CISs although in this case the trustee may be licensed in a prescribed territory (Guernsey, Jersey, the United Kingdom). There are client money regulations. There are also regulatory codes about client money and client assets. The mission considers that the Isle of Man has implemented Principle 18.
Assessment	Implemented
Comments	
Principle 19.	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	Regulation 3 of the Financial Supervision (Scheme Particulars) Regulations 1988 specifies that certain information (detailed in Schedule 1) must be included in a statement of 'scheme Particulars." This document is equivalent to a scheme prospectus. The detailed information that must be disclosed in Schedule 1 covers details on the scheme's service providers, the constitution and objectives of the scheme, the sale and repurchase of units and the valuation of the scheme's assets. The FSC may make regulatory codes about the form and content of advertisements and a code is in force. The mission has reviewed statements of scheme particulars. It considers that the regulations require disclosure which is necessary to evaluate the suitability of a CIS for a particular investor and the value of the investor's interest. The mission considers that the Isle of Man has implemented Principle 19.
Assessment	Implemented
Comments	
Principle 20.	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	Paragraph 9 of Schedule 1 to the Financial Supervision (Scheme Particulars) Regulations 1988 requires disclosure of the frequency and basis of the valuation of assets in an authorized scheme. Paragraph 10 deals with disclosures on the sale and purchase of units. Part 7 of the Financial Supervision (Authorized Collective Investment Schemes) Regulations 1988 requires that asset valuations take place at least twice-monthly and the bases for the conduct of asset valuations are outlined. Investors must receive half-yearly and annual reports from the manager giving detailed information on the constituents of the scheme and its performance in accordance with Schedules 3 and 4 of the Financial Supervision (Authorized Collective Investment Schemes) Regulations 1988.

	The mission considers that the Isle of Man has implemented Principle 20.
Assessment	Implemented
Comments	
Principles for Market Intermediaries	
Principle 21.	Regulation should provide for minimum entry standards for market intermediaries.
Description	Section 3 of the IBA sets out the criteria that must be met by an applicant for a license under the IBA. These include a "fit-and-proper person" test on the integrity, solvency and competence of the applicant, its directors and senior managers. Section 3 of the Financial Resources and Compliance Reporting Code sets out the minimum capital requirements that must be met and Section 6 outlines the various categories of license that are available. Licenses can be issued subject to conditions and failure to meet these conditions can result in enforcement action up to and including revocation of the license. The mission considers that the FSC has implemented Principle 21.
Assessment	Implemented
Comments	
Principle 22.	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	Five categories of investment business license are available with differing levels of minimum capital required depending on the nature of activities and the risks to be undertaken. The detailed reporting requirements and the methodology used in calculating the capital required depends on the category of firm. The details are contained in the Financial Resources and Compliance Reporting and the Stockbrokers Regulatory Codes. The detailed requirements about capital adequacy for licensed firms were updated in 2002 to take account of developments internationally and some of the prescribed minimum amounts were increased. The mission considers that the Isle of Man has implemented Principle 22.
Assessment	Implemented
Comments	
Principle 23.	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.
Description	The detailed internal control and operational requirements to be met by license holders are contained in Regulatory Codes issued under the IBA. These include conduct of business rules, rules in relation to the holding of client money or investments, financial resources and compliance reporting and audit. The Conduct of Business Regulatory Code, in particular, deals with issues of integrity of the firm and its employees in dealing with clients, conflicts of interest and proprietary or employee trading. Responsibility for these matters is placed with the directors and senior managers of the license holder. The mission considers that the Isle of Man has implemented Principle 23.
Assessment	Implemented
Comments	
Principle 24.	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	The FSC has extensive powers to undertake on-site and off-site supervisory work. In addition, the FSC has a close supervisory relationship with all license holders and aims to become aware of potential problems before they arise. Client money and client assets are protected under the regulations and regulatory codes. There is an Investor Compensation Scheme in place for the benefit of investors in authorized collective investment schemes. Moreover the FSC has extensive powers to give directions to license holders and others. There are however no formal and explicit procedures in the law for dealing with the failure

	of a market intermediary. The FSC is at present preparing a proposal for statutory powers related to the appointment of a manager or administrator. This follows the coming into force of the Corporate Service Providers Act 2000. In the meantime the mission does not consider that the Isle of Man has fully implemented this Principle 24.
Assessment	Partially implemented
Comments	We recommend that the government secure the enactment of rules of law for dealing with the failure of a market intermediary.
Principles for the Secondary Market	
Principle 25.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	There is no stock exchange or other trading system in the Island. The Isle of Man does not consider that Principle 25 and Principles 26, 27, 29, and 30 apply. The mission agrees.
Assessment	Not applicable
Comments	
Principle 26.	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	
Assessment	Not applicable
Comments	
Principle 27.	Regulation should promote transparency of trading.
Description	
Assessment	Not applicable
Comments	
Principle 28.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	While there is no stock exchange or other trading system in the Isle of Man a licensed broker in the Island may be a member of the London Stock Exchange or the Channel Islands Stock Exchange in Guernsey. Such a broker is subject to supervision. Questions about market manipulation and unfair trading on an overseas market may arise. An offence of insider trading is provided for in the Insider Dealing Act 1998. The treasury administers this law. The treasury has wide-ranging inspection and investigation powers under this law, including the power to obtain written and oral explanations and to require the production of documents. These powers may be exercised where there may have been a contravention of the laws of another country relating to insider dealing. The treasury is able to communicate to an overseas authority information which is in its possession. The law does not apply to market manipulation. Although the government may not regard this to be a risk area for the Isle of Man we think it should consider whether to establish an offence of market manipulation and extend the powers of prosecution and investigation to this. To the extent that Principle 28 applies, the mission considers that it is broadly implemented.
Assessment	Broadly implemented
Comments	The FSC has gained the impression that the burdens of proof for the regulator in bringing a prosecution under this law are great and it may well be very difficult to secure a conviction. It is not clear to the mission why the law is administered by the treasury rather than the FSC with its rather more general skills as a regulator. We recommend that the law be

	reviewed.
Principle 29.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	There is no stock exchange or trading system in the jurisdiction. Generally the firms which are licensed by the FSC as stockbrokers do not take principal risk in a stock market. Where they do, they are required to have capital to cover for such positions. This matter is addressed under Principle 10 above. The FSC considers that this principle is not applicable. The mission agrees."
Assessment	Not applicable
Comments	
Principle 30.	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	
Assessment	Not applicable
Comments	

Table 14. Summary Observance of the IOSCO Objectives and Principles of Securities Regulation

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

Recommended actions

Table 15. Recommended Plan of Actions to Improve Observance of the IOSCO Objectives and Principles of Securities Regulation

Reference Principle	Recommended Action
Principles Relating to the Regulator (CP 1–5)	Principle 1: That the government and FSC secure by statute a clear complete and authoritative statement of the FSC's responsibilities. Principle 2: That the government and FSC review the relevant rules of law, policy and practice with a view to providing for the FSC to become a more independent and more accountable

Reference Principle	Recommended Action
	financial services regulator and supervisor.
Principles for the Enforcement of Securities Regulation (CP 8–10)	Principle 10: That the FSC review its template for its on-site inspection report and ensure that the purpose is clearly and accurately stated. That the FSC review its procedures for inspecting the arrangements between the scheme manager and offshore IFAs in relation to the supply and use of offer documents and promotional material, and consider whether they are adequate for ensuring that offshore customers are well informed and advised.
Principles for Issuers (CP 14–16)	Principle 14: That the government and FSC review the powers of intervention in the Companies Act in respect of a registered prospectus. That the FSC review the reporting requirements for international, experienced investor and professional investor schemes. That the FSC review the annual reporting procedures under the Companies Act. Principle 16: That the FSC continue to review its policies on the authority for financial and audit standards and the review of auditor performance.
Principles for Market Intermediaries (CP 21–24)	Principle 24: We recommend that the government secure the enactment of rules of law for dealing with the failure of a market intermediary.
Principles for the Secondary Market (CP 25–30)	Principle 28: That the government and the FSC review aspects of the insider dealing law.

C. Authorities' Response to the Assessment

Reference Principle	Authorities Response
Principles Relating to the Regulator (CP 1–5)	Principles 1 and 2 • The Isle of Man Treasury is currently undertaking a full review of the Island's regulatory bodies (scheduled for completion by June 2004). The scope of the review has full regard for observations concerning independence, accountability and will identify any changes required to the legislative framework including any clarification of the Commission's statutory responsibilities.
Principles for the Enforcement of Securities Regulation (CP 8–10)	Principle 10 • The FSC is currently reviewing its template for its on-site inspection reports and the comments made will be taken into account in this process. • The Commission has an established regime of detailed on-site inspections for FSC regulated IFAs. Any generic issues relating to IFAs will be the subject of half-yearly meetings with the Insurance Brokers Association which has agreed to take responsibility for the IFA industry.
Principles for Issuers (CP 14–16)	Principle 14 • The Commission will consider powers of intervention in the Companies Acts 1931–1992 and related legislation in respect of a registered prospectus as part of a fundamental review of Company Law to be commenced shortly. • The FSC is currently drafting revised reporting procedures relating to international, experienced investor and professional investor schemes. • The Commission will consider annual reporting procedures under the Companies Acts as part of the forthcoming review of Company Law referred to above. Principle 16 • The Commission is currently considering the question of financial and audit standards and auditor performance. Any required changes will be progressed in line with the forthcoming consolidation legislation. Regular meetings with the large audit practices have been instigated to explore synergies between the FSC and the external auditors.

Reference Principle	Authorities Response
Principles for Market Intermediaries (CP 21–24)	Principle 24 • The Commission intends to consider the question of rules of law for dealing with the failure of a market intermediary within the forthcoming consolidation legislation. • The Commission will also develop guidance for the industry in this area.
Principles for the Secondary Market (CP 25–30)	Principle 28 • As part of the review of the Island's regulatory bodies, referred to above, the question of insider dealing legislation will also be considered.

V. Review of Compliance with OGBS Statement of Best Practice for Trust and Company Service Providers

A. General

62. In August 2002, a Working Group established by the Offshore Group of Banking Supervisors ("OGBS") produced a draft 'Statement of Best Practice" (Statement) for trust and company service providers (CSP). The Fund agreed with the Commission that the Statement will be used for the assessment of trust and corporate service providers in the Isle of Man.

63. The mission is extremely grateful to the chief executive and staff of the FSC and, in particular, the staff of the Companies Supervision Division for the assistance and cooperation they provided with this assessment.

Methodology

64. The OGBS Working Group did not develop a methodology to accompany the Statement. The methodology used here was developed by reviewers working for the Fund who use the Statement in their work.

65. The Statement has been drafted to be applicable to trust and company service providers whether or not they are based in a jurisdiction that has a formal licensing and supervisory regime. In the circumstances, unlike the principles applicable to banking, insurance and securities, the Statement does not require that trust and company service providers are licensed or that they are subject to ongoing supervisory or enforcement procedures.

66. Even though the Isle of Man has chosen to license and supervise trust and corporate service providers, the mission concluded that, to ensure consistency between this and future reviews of other jurisdictions, some of which may not have a formal system of licensing and

regulation in place, it was not appropriate to review issues such as the independence, accountability and resources of the regulator, the licensing process, ongoing supervision or enforcement except to the extent necessary to review compliance with the Best Practice Statement. Furthermore, the mission has had to make certain assumptions in the way that it has interpreted the Best Practice Statement.

67. The Best Practice Statement is expressed as a set of general principles rather than as a set of detailed criteria. In the circumstances, the mission has provided an indication of how the Isle of Man compares with the Best Practice Statement but has not attempted to provide a specific measure of compliance as it has in respect of the Basle, IAIS and IOSCO Principles.

68. The OGBS Best Practice Statement includes the following:

- fit-and-proper criteria;
- conduct of business;
- the holding and sharing of information;
- cessation of business;
- misleading statements.

Additional issues

69. The assessment team has examined the regulation of trust and company service providers as undertaken in the Isle of Man. Although the report contains recommendations to the Commission, it should be appreciated that it is not, and should not be considered to be, an assessment.

70. With respect to Trust Service Providers (TSPs) the regulatory regime is not yet in place, but the framework for the regulation and supervision of CSPs provides a good framework on which to build. The FSC intends to proceed with the licensing of these under a new Fiduciary Services Bill (FSB) that will be introduced in the next session of the legislature. The mission recommends that every effort should be made to have this legislation in place as quickly as possible. Since the regulation of TSPs is not currently within the formal remit of the FSC and the proposed regime is not yet in place, the detailed assessment against the Statement of Best Practice was carried out only with respect to the CSP regime, except in relation to Principles which relate only to trusts or trust service providers.

B. Detailed Assessment

Table 16. Detailed Assessment against the OGBS Statement of Best Practice for Trust and Company Service Providers

Definition of Trust and Company Service Business	
Principle 1.	**The scope of trust and company service business should be adequately defined**.
	1.1 The scope of activities subject to the requirements of a jurisdiction should cover at least the following (when provided in the course of business): Company service provider is: • acting as company or partnership formation agent; • acting as (or arranging for another to act as) a director or secretary of a company or a partner of a partnership; • providing a registered office, business address or accommodation, correspondence or administrative address for a company, partnership or for any other person; • acting as, or arranging for another to act as, a nominee shareholder or unit holder for another person. Trust service provider is: • acting as (or arranging for another to act as) a trustee of an express trust.
Description	In the Isle of Man, a "company service provider" is referred to as a Corporate Service Provider (CSP) and is defined as a person who, by way of business, undertakes any of "the regulated activities" listed in Schedule 1 (CSP Act, s1). "Regulated activities" include: • the provision of services with respect to the formation of companies; • the sale, transfer or disposal of companies; • acting as, and arranging for others to act as director, alternate director or secretary and within the meaning of the Limited Liability Companies Act 1996, the company's manager and the registered agent; • the provision of premises for use as a registered office for a company; • the provision of accommodation address facilities for a company; and • providing a registered office or accommodation address for an Isle of Man nonresident company within the meaning of s.2 (1) of the Non-resident Company Duty Act 1986. With reference to the last point, in April 1999, Tynwald approved placing a moratorium on Isle of Man companies making non-resident declarations (for tax purposes). However, any company which became non-resident before that date may continue to be non-resident but is required, as a result of the CSP Act, which renders the provision of registered offices a licensable activity, to have its registered office provided by a CSP. This places responsibilities on the CSP and thereby ensures a degree of control over the activities of such companies.
Comments	The definition of company (corporate) service provider should include the role of "partner in a partnership." The mission understands that this omission will be remedied in the FSB that is currently being drafted.

	Additional criteria 1.2 Many jurisdictions provide that companies must appoint a registered agent. It is desirable that in such jurisdictions acting as registered agent is incorporated within the definition of company service business
Description	The Island's company law places responsibility for the management and control of a company's affairs on its directors and, with reference to more administrative matters, on the company secretary who reports to the board of directors. The Companies Acts 1931 to 1993 do not therefore include the concept of "agent" to act for an Isle of Man incorporated company. However, a foreign company which establishes a place of business in the Isle of Man (**"**F Company**"**) is required, under Part XI of the Companies Act 1931 **(**CA 1931), to register with the Companies Registry, which is part of the FSC. Information about F Companies is held on the public record at Companies Registry. An F Company is required to appoint a registered agent, who must accept service of documents and notices on behalf of the company (CA 1931, s.313 (c)). The FSC noted that the Companies (Amendment) Bill will introduce a requirement for an F Company to file an annual return, so as to record changes in the information that must be held on the public register. Furthermore, the function of a registered agent for an F Company, whose name is on the public record, includes certain of the company administration functions and he is therefore covered by the regulated activities. (Para 28, Schedule 1, Companies (Amendment) bill adds a new s.313(1)(d) to CA 1931 s.313). Limited liability companies ("LLCs") are governed by the Limited Liability Companies Act 1996 ("LLCA"). They are constituted as a separate legal entity but with the characteristics of a partnership. The members of an LLC are responsible for its management unless they appoint a manager. An LLC must also have a registered agent (LLCA, s.5). Acting as a registered agent or manager of an LLC is a regulated activity (Schedule 1, Para 6(c)).
Comments	
	1.3 The trust law of many jurisdictions recognizes enforcers, protectors and custodians. It is desirable that the provision of these services is, as far as necessary, also covered by the definition of trust service business.
Description	The definition of "trustee" in the draft FSB includes an enforcer within the meaning of s.1(1)(d) of the Purpose Trusts Act 1996, and a protector, being a person who, under the terms of a trust, has fiduciary or personal powers vested in him and to which the trustee is subject (draft FSB, Schedule 1, Para 2). The role of a custodian is specifically included in the definition of regulated activities.
Comments	This is addressed in the draft FSB and will be consistent when the FSB comes into force.
	1.4 It is also desirable for the definition of trust business to include the provision of trust management and administration services, insofar as those activities are not otherwise regulated.
Description	The activities defined as "regulated activities" in the draft FSB include: • the provision of trust administration and management services in relation to an express trust, but not restricted to the keeping of accounting records; and • the preparation of trust accounts; • the preparation of trust instruments or other documents relating to an express trust; • the administration or management of, or the investment, transfer, disposal or other dealings with, the assets of an express trust; • the distribution of the assets of an express trust; • the payment of expenses or remuneration out of a trust; and • the provision of services with respect to the creation of express trusts

Comments	This is addressed in the draft FSB and will be consistent when the FSB comes into force.
	Explanatory Note Countries and jurisdictions may provide for limited exceptions to the requirements set out in this Methodology in respect of company service providers that do not provide director or nominee shareholder services and that do not handle or manage client assets or funds. The exceptions could include lesser standards covering; • the span of control covering the number of persons engaged in the business; • the level of qualifications/experience of the persons engaged in the business; • the capital/professional indemnity insurance requirements; and • the audit requirements. FSC's Comments A few licensees who are exempt from full regulatory requirements fall into the category of: "A CSP which is not a body corporate and acts only as a director or alternate director of companies and does not undertake any other regulated business."(Corporate Service Providers (General Requirements) Regulatory Code 2000 ("the GR Code") para 3(2). There are currently six such entities and four applications are outstanding. These "Category 2" license holders are vetted for integrity and competence to the same standard as directors and key staff of other license holders and are required to have Professional Indemnity Insurance cover. The only exceptions to the normal regulatory regime are: • There is no four-eyes requirement. This would be inconsistent with the nature of their business, which is solely to act as director; a four-eye would be liable to become a shadow director under company law; • There is only a general solvency requirement, as Category 2 license holders are natural persons and are not allowed to hold client money; and As they are individuals, there is no audit requirement.
Fit-and-Proper Criteria	
Principle 2.	**All countries/jurisdictions should require that those individuals holding key positions in a trust or company service provider ("key persons") should be fit and proper**.
Description	The license application procedure addresses these criteria at an early stage by means of the answers to the personal questionnaires (PQs) and the checking of references and other information. These processes are described in more detail below. Where it is indicated to be necessary in order to form a view as to fitness and propriety of an applicant, a pre-license visit will be carried out. Otherwise the information gathered during the application process is verified after licensing by visits to the license holder and other evidence gathered during ongoing supervision. Visits are arranged on a risk-prioritized basis and are targeted to address any issues of concern that have arisen during or after licensing.
Comments	With respect to CSPs, the legislation and codes provide for a regime that is consistent with all aspects of the principle. There are a few areas where some fine-tuning is necessary and the FSC has already identified these and is addressing them. These include definitional matters relating to partners in a partnership and unit-holders. With respect to the application of the principle, the FSC has introduced a licensing regime for existing service providers and new applicants. The FSC appears to have handled the application process well. However, in the short term there are still a number of CSPs operating under "transitional provisions." Although these companies and individuals have all applied for licenses and are covered by enforcement provisions of the CSP legislation, some have not yet been licensed because the license process is not yet fully complete. In

	the meantime the existing CSP Codes have been extended to the CSP applicants with effect from 1st May 2003 so that all CSPs including transitional cases are now subject to the requirements. There are inherent risks associated with the current transitional nature of the licensing process in that there may be businesses operating to a standard not acceptable for a licensed entity. However, these risks are expected to be removed when the licensing process is complete. A deadline has been imposed for the completion of the licensing process by July 31, 2003.
	2.1 In assessing whether a key person is fit and proper, the country/jurisdiction should consider his: • honesty, integrity and reputation; • competence and capability; and • financial soundness. This will require a consideration of all relevant matters including the specific criteria set out in principles 2.2, 2.3 and 2.4.
Description	The principle does not specify who key persons are. However, in relation to applications for a CSP license, the CSP Act (s.3) states that: The FSC shall not issue a CSP license unless it is satisfied that: • the applicant is a fit and proper person; and • any controller, director, chief executive or manager of the applicant is a fit and proper person to act as such; and • in the case of an application by a partnership, each of the partners, is a fit and proper person to act as such; and • such other persons as appear to the FSC to have significant powers or responsibilities with respect to any regulated activity undertaken by the applicant are fit and proper persons;." The expressions "chief executive, controller, director, manager" are defined in the CSP Act (s27). The GR Code (para 1(2) goes further and defines the expression "key staff:" • as in the case of a CSP who is a sole trader, the CSP himself; • in the case of a CSP which is a body corporate, any controller, chief executive, director, or manager; • in the case of a CSP which is a partnership, each of the partners; and • in all cases, any person described in section 3(3)(d) of the Act. The GR Code also requires that all key staff must remain fit and proper, (para. 6) and. that every CSP must give the FSC 28 days' notice in advance of the prospective appointment of key staff (para. 12). Thus, in addition assessing the fitness and propriety of key staff in relation to an application for a CSP license, all future appointments to key staff positions require the FSC's approval. The FSC has published "Guidance notes on licensing policy for corporate service providers." ("CSP Licensing Policy") (under CSP Act s3.8) The key areas of the fit and proper test are integrity, competence and solvency (going concern).

	In order to assess fitness and propriety the FSC requires each key person (as defined above) to complete and submit a Personal Questionnaire ("PQ") and Banker's Questionnaire ("BQ"). Providing false information in a material particular is a criminal offence (CSP Act s 20). The FSC makes every effort to verify the information by contacting former employers, professional bodies, other regulatory authorities, the Isle of Man Police records and searching its own and other databases as appropriate. The information collected is summarized on a checklist and reminders are sent until all available references have been collected.
Comments	See comments under Principle 2 above.
	2.2 In the case of the person's honesty, integrity and reputation, the following matters are relevant and should be considered: (a) any criminal offence of which he has been convicted or any criminal charges outstanding, particularly where the offence concerned is an offence of dishonesty or an offence relating to financial crime or committed under any financial services legislation.
Description	The FSC license application requires the applicant to provide information with regard to: • any conviction by a court in the Island or in another jurisdiction; and • any failure to comply with a direction or order of a court in the Island or in another jurisdiction; As an ongoing requirement a licensed CSP, is required to notify the FSC of: • any legal proceedings against the CSP, including civil proceedings in connection with the conduct of CSP business in any jurisdiction, where the amount claimed or disputed exceeds or is likely to exceed £10,000, and criminal proceedings triable on information against the CSP or any group company of the CSP.(GR Code para 12(3)) • the conviction of the CSP or any group company of the CSP or any of its employees or professional associates for an offence relating to fraud or dishonesty, financial crime, or committed under any financial services legislation. (GR Code para. 12(4)) • the conviction of the CSP or any group company of the CSP or any of its employees or professional associates for any offence under the Companies Acts 1931 to 1993 or legislation having similar effect in any country or territory outside the Isle of Man or any offence relating to the formation, management or administration of companies in any jurisdiction; or insolvency. (GR Code para. 12(4)). The Personal Questionnaire (PQ) requires disclosure of: • any outstanding litigation and details of any current proceedings (question 19) any judgments (question 20). • any findings by a court of civil liability in respect of fraud, misfeasance or other misconduct (question 31) • any body corporate, partnership or unincorporated institution with which the person was associated and which has ceased to trade or made an arrangement with its creditors and has not paid its creditors in full (question 32).
Comments	See comments under Principle 2 above.
	(b) any adverse finding, settlement or fine in civil proceedings, particularly in connection with a company or a financial services business;
Description	The FSC, in determining a person's fitness and propriety must have regard to: • any refusal by a regulator of the relevant licensable activity, whether in the Island or elsewhere, of an application for an investment business license, banking business license, corporate service provider license, trust service provider (fiduciary) license or

	any similar license in any jurisdiction (CSP Licensing Policy Para 2.7.4); and the CSP must notify the FSC of: • the service of a notice concerning the affairs of either the CSP or any of its client companies in respect of a suspected offence involving serious or complex fraud; • any criminal proceedings that have been instituted against the person outside the Island and the act would constitute on offence in the Island; • an investigation into drug trafficking; • an investigation of terrorist activities). The GR Code (para 12.7) requires a CSP to: • notify the FSC where criminal proceedings triable on information are brought against any client company or officer or beneficial owner of a client company. The personal questionnaire requires disclosure of • any investigation by a governmental, professional or other regulatory body into the person, or into any body corporate, partnership or unincorporated institution with which they are or have been associated. (question 24) • any past applications to a regulator for a license, whether successful or not; this facilitates regulator-to-regulator checks (question 21) The FSC noted that its Findex record system would highlight known connections to individuals of companies covered by the paragraphs above and the FSC would consider such associations on a case by case basis.
Comments	See comments under Principle 2 above.
	(c) any association, past or present, with a firm, company or other person that is or has been the subject of a regulatory investigation or disciplinary or enforcement proceedings; (d) any disciplinary, enforcement, disqualification or similar proceedings to which he has, or may be, subject or any professional or administrative reprimands;
Description	The CSP Licensing Policy requires the FSC, in determining an individual's or an organization's fitness and propriety, to have regard to: any disqualification under section 26 of the Companies Act 1992 or section 31 of the Companies Act 1982 or any equivalent legislation in any jurisdiction (Para 2.7.4); • any expulsion from membership, disciplinary finding against or similar form of censure of the individual by a professional body (Para 2.7.4); and • personal references from previous employers and professional bodies (Para 2.7.4). • personal references from previous employers and professional bodies (Para 2.7.4). In addition, the GR Code requires a CSP to: • notify the FSC of any application for disqualification or any disqualification relating to conduct • that in the opinion of the Court makes that person unfit to be a director or secretary; liquidator, receiver or manager of a company's property; or in any way directly or indirectly to be concerned or take part in the promotion, formation or management of a company. (Companies Act 1992 s.26) • as a director of a company which was insolvent at the time of its liquidation, which, in the opinion of the Court, makes him unfit to be a director or in any way involved in

	the management of a company.(Companies Act 1982 para 12.5) A CSP must inform the FSC of: • serious disciplinary action it takes against any of its key staff (GR Code para 12(8)). • any disciplinary enquiry and the standard request for a reference asks former employers a similar question.(PQ question 25) • any disqualification from acting as a director of a company or from acting in the management or conduct of the affairs of any company, partnership or unincorporated association. (PQ question 28).
Comments	See comments under Principle 2 above.
	(e) any previous regulatory breaches committed by him or by a person with whom he is or has been associated and any complaints made against him; and
Description	The CSP Licensing Policy requires the FSC, in determining an individual's or an organization's fitness and properness, to have regard for: • information received from law enforcement or other supervisory agencies under established "gateways" equivalent to those established under section 24 (5) of the Financial Supervision Act 1988; • any refusal of a personal application by a regulator of the relevant licensable activity, whether in the Island or elsewhere, on the grounds that the applicant was not considered a fit and proper person to act as a controller, director, chief executive, secretary or manager of a licensed investment business, banking business, corporate service provider, trust service provider (fiduciary) (Para 2.7.4). A CSP applicant is required to disclose: • any past applications to a regulator for a license, whether successful or not; this facilitates regulator-to-regulator checks.(PQ question 21) • any investigation by a governmental, professional or other regulatory body into the person, or any body corporate, partnership or unincorporated institution with which the person is or has been associated.(PQ 24) • censure, discipline or public criticism by a professional body or trade association (PQ questions 23 and 25) • whether they have ever been suspended from office or asked to resign (PQ question 26) or dismissed from any office or employment or barred from entry to a profession or occupation(PQ question 27) In addition, complaints made about a CSP to the FSC are noted and raised with the applicant or license holder as part of the licensing or ongoing supervisory procedures. See also principles 2.2 c and d above.
Comments	See comments under Principle 2 above.
	(f) whether he has been candid and truthful in his dealings with the Director and/or any other regulatory body.
Description	The FSC's licensing policy requires an applicant to: • complete any form or supply information to the FSC in an honest manner and that all those connected with an applicant or CSP license holder should cooperate in an open and honest manner with the FSC or any other regulatory body to which they are accountable and should keep them promptly informed of anything relevant to the regulator's task (Paras. 2.7.7 and 2.7.8).
Comments	See comments under Principle 2 above.

	2.3 In the case of the person's competence and ability, the following matters are relevant and should be considered: (a) the extent of that person's relevant experience; and (b) where the person is an individual, his or her knowledge and professional and other relevant qualifications
Description	The CSP Licensing Policy states that • key staff should possess appropriate experience, and/or academic and/or professional qualifications relevant to the CSP's business, with particular reference to company law, company secretarial practice, company management and accountancy. • where key staff do not hold relevant academic and/or professional qualifications, they must be able to demonstrate that they have accumulated sufficient pertinent knowledge through relevant work experience, normally over a period of five years. • the organization is assessed as a whole and a key staff member who himself lacks the relevant qualifications and experience, might be considered to be competent if he receives adequate technical support from other staff members (Paras 2.8.2, 2.8.5, 2.8.6, 2.8.7 and 2.8.8). • appropriate training is important for all staff whose responsibilities include the performance of any of the regulated activities to enable them to understand and fulfill their responsibilities competently (Para 2.8.4). The FSC's assessment of competence includes consideration of: • the controls, systems and procedures of the organization, including its maintenance of records, documentation of actions taken and instructions received and whether they are sufficient to facilitate the CSP's compliance with statutory obligations under any relevant law with regard to a client's affairs. • the business resumption/contingency arrangements are also considered in relation to its competence to provide services to its clients. (Para 2.8.1). In addition, the GR Code requires that • all key staff of a CSP must be fit and proper (para 6). • a CSP shall organize and control its internal affairs in a responsible manner, shall take all such steps as are reasonable to ensure that the client companies for which it provides regulated activities comply with the statutory and common law obligations relevant to the particular service provided, and shall ensure that its key staff carry out their duties in a diligent and proper manner. (para 9) The guidance note to paragraph 9 states that • if a CSP is unfamiliar with the relevant law, it is its responsibility to obtain legal advice on the interpretation of its statutory obligations. • failure to comply with relevant laws may be considered by the FSC to be an indication of lack of competence and/or integrity. • all staff understand and comply with the CSP's systems and procedures. The achievement of this will depend on the size and complexity of the business. A central source of reference (i.e., procedure manual) may be a means of accomplishing this. Where a CSP engages in the regulated activity of providing directors for a client company, it must take reasonable steps to ensure that those individuals have suitable competence for that office (GR Code para 10). The guidance to this requirement states that an individual

	should not hold a greater number of directorships than he can competently undertake. In assessing the competence of the institution the FSC considers: • information about the past experience of the institution and of its key staff. • how long it has been established, • how many companies it serves, • the size of the staff and • the experience and qualifications of management and key staff. In relation to individuals, all controllers, directors, managers and key staff of the applicant are required to complete a PQ and BQ, which request information from previous employers relating to whether the person: • behaved with integrity and honesty at all times • fulfilled their duties and responsibilities in a competent and satisfactory fashion was the subject of any internal or professional disciplinary proceedings and • was diligent in observing internal and external rules and regulations at all times. The FSC also enquires into all academic qualifications at degree level or above, all professional qualifications and any membership of professional bodies, and may interview the applicant.
Comments	See comments under Principle 2 above.
	2.4 In the case of a person's financial soundness, the following matters are relevant and should be considered: (a) any insolvency proceedings that have been instituted against the person.
Description	The requirements relating to the financial soundness of a CSP are several: • a CSP must satisfy the FSC that it meets the going concern requirement (CSP Licensing Policy para 2.9, GR Code para 11). • the FSC requires audited accounts in the case of a corporate CSP. In the absence of independently verified accounts, the FSC will generally require that £10,000 be placed in a segregated bank account, which must be maintained free of any charge or encumbrance or right of set-off. • a CSP must notify the FSC if it is no longer able to meet the going concern requirement.(GR Code, para 12.11) • a CSP must have professional indemnity insurance cover to insure against extraordinary risks (GR Code para 16) • the FSC may also take into account any judgment obtained against the CSP, which should be disclosed as part of the application process. (CSP Licensing Policy, Para 2.9.8). • an individual is required to disclose any past or present bankruptcy and any money judgments that have not been paid in full. (PQ questions 29, 30).
Comments	See comments under Principle 2 above.
	(b) where the person is an individual, any adverse credit rating.
Description	The BQ asks the bank: • whether it considers itself to be the person's principal bank, • how long the relationship has been maintained and • whether the account has been maintained in a satisfactory manner.

	If the bank does not answer that the relationship has been in place for five years and "yes" to the other two questions, the matter is pursued further, for example by interviewing the person, or identifying a previous bank and sending them a BQ.
Comments	See comments under Principle 2 above.
	Additional Criteria
	2.5 It is also desirable for jurisdictions to require that those persons who hold an interest in a service provider, whether legal or beneficial, should be fit and proper applying the criteria set out in paragraphs 2.1 to 2.4 above, with suitable modifications where the person is a corporate body.
Description	The definition of "controller"(CSP Act s.27) includes: • an individual in accordance with whose directions or instructions one or more of the directors of a CSP act and • an individual who either alone or with any associate(s) is entitled to exercise or control the exercise of 15 percent or more of the voting power at any general meeting of the CSP or of another body corporate of which it is a subsidiary. A controller must be a fit and proper person (CSP Act s.3) and must be vetted and reported on to the FSC in a similar manner to directors and key staff. In determining who is a controller The FSC looks through intermediate structures such as holding companies. • whatever type of ownership structure applies, the FSC must be able to look through the structure in order to ascertain who controls, and/or has significant influence over the management of and/or is the ultimate beneficial owner (CSP Licensing Policy Para 2.2.1). • the FSC's prior written approval is required in respect of any proposed change thereto (Para 2.2.2). • where a trust is involved, the FSC vets all relevant parties, including the trustees and all persons having influence on the trustees. • if the trustees are corporate trustees, the directors of the corporate trustee will be vetted. • persons of influence could include the settlor, or anyone else whose opinion the trustees would normally take into account. The beneficiaries are normally identified and may be vetted, depending upon their identities and perceived influence (for example children are generally not vetted).
	Conduct of Business
Principle 3.	**All countries/jurisdictions should require that those providing the service of trust or company service provider exhibit evidence that their business will be or is being conducted in accordance with the proper corporate governance, customer due diligence, conduct of client business, financial soundness, and systems and controls requirements**.
	Corporate Governance
	3.1 Trust and company service providers should comply with recognized standards of corporate governance in respect of both the business itself and clients' corporate vehicles, trusts and other legal entities.
Description	There are a number of codes affecting CSP business: • The FSC can make codes concerning a number of specific matters including "the conduct of business by a CSP."(CSP Act s.6)

	• The GR Code governs the general conduct of a CSP business and • the Corporate Service Providers (Clients' Money) Regulatory Code 2000 ("the Clients' Money Code") governs the handling of and requirements to segregate clients' money from moneys belong to the CSP. [Similar codes, adapted to take account of the special nature of TSP business, are proposed for TSPs.] More specifically, CSPs are required to • avoid conflicts of interest and to deal appropriately with those, which do arise (GR Code, para 4) • enter into client agreements or to ensure that clients are aware of the terms on which services are supplied.(GR Code para 5) • meet a 4-eyes test and/or to have a locum who can step in to run the operation in the absence of the owners. An exception is made for Category 2 license holders (GR Code, Paras. 7 and 8). • organize and control their internal affairs in a responsible manner.(GR Code para. 9(1).ensure that each client company for which it provides regulated activities, complies with such statutory and common law obligations under any relevant law as are applicable to the particular regulated activity being provided. (GR Code para 9.2) Directors of both CSPs and of Isle of Man incorporated client companies of CSPs are subject to: • the Isle of Man Companies Acts 1931-1993 and to general principles of corporate governance in the same way as any other director. • a guidance note on the responsibilities and duties of directors issued by the FSC. In respect of client companies that are incorporated in jurisdictions other than the Isle of Man, the FSC requires CSPs to take responsibility for the competence and diligence of the persons that it supplies. (GR Code para 10) The guidance notes to para 10 make it clear that the inappropriate delegation of the powers of such directors is not acceptable. The standards of corporate governance in both CSPs and their client companies is addressed by: • supervisory visits, which include examination of the minutes of the general meetings and board meetings for both the license holder and its client companies. • Companies Registry and the CSP team both of whom seek to identify CSPs which have a poor record in filing the statutory returns of client companies. Some failures have been addressed on visits by putting in place programs for remedial action and staff training.
Comments	See comments under Principle 2 above.
	3.2 Trust and company service providers should comply with the FATF Recommendations concerning money laundering and the financing of terrorism.
Description	All CSPs are required to: • comply with the Anti Money Laundering Code 1998, as amended by the Anti-Money Laundering (Amendment) Codes 1999 and 2001 ("AMLC") and Anti Money Laundering Guidance Notes (AMLGN) issued by the FSC for its license holders. In determining whether a person has complied with the law, a Court may take account of

	a person's adherence to Guidance issued by the FSC. • identify their client in each case and to identify the beneficial owner of each client company. This includes identification of the ultimate beneficial owner.(GR Code para 4) Question 16 of the application form asks, "Does your business comply with the Anti-Money Laundering legislation, including paragraph 4 of the Code?." Verification of compliance is subsequently obtained in the course of on-site visits. During the application process, the FSC enquires about the jurisdictions from which business is drawn and looks for additional due diligence procedures for business from higher risk jurisdictions. During compliance visits, FSC staff check a representative sample of client company files for compliance with the KYC requirements, including: • eligible introducer certificate (if introduced business); • evidence of customer identity; • evidence of customer address; • appropriate references; • evidence of source of funds; • nature of business and expected turnover; • reason for establishing the business; • presence of the client agreement. And that ongoing monitoring has been evidenced by: • checking the source of funds at the time of accepting the business and of any additional funds received subsequently; • actual turnover being in line with the expected figure; • actual turnover being compared with the level indicated to the CSP; • file reviews by the CSP, to ascertain whether the nature of the client company's activity is in line with the original description; • minutes and/or correspondence demonstrating that the nature of the activity is in line with the stated reason for establishing the business; and • bank statements, which should be reconciled. During visits staff use standardized checklists to record whether the information is "present," "missing" or "present but deficient" and cross-reference to detailed comments.
Comments	The AML/CFT assessment discusses weaknesses with respect to beneficial ownership. However, the overriding obligation on CSPs to identify its customers and underlying beneficial owners under the CSP (GR) Code is consistent with FATF requirements.
	3.3 Trust and company service providers should comply with any relevant financial regulatory standards.
Description	The FSC requires: • for a CSP that is a body corporate and has previously traded, that the application be accompanied by audited accounts (CSP Licensing Policy, para 2.9.2). • the Annual Compliance Return to be accompanied by audited accounts (GR Code, para 11(2)). • sole traders or partnerships to supply financial statements accompanied by a reporting accountant's report (CSP Licensing Policy, para 2.9.3 and GR Code, para 11(3)). The accounts are examined for solvency using a review checklist.

Comments	See comments under Principle 2 above.
	3.4 Trust and company service providers should comply with all relevant domestic statutory obligations, for example the legislation governing the formation and administration of companies.
Description	During compliance visits, the FSC checks the presence and accuracy of certain documents that are relevant to statutory obligations, including: • minutes of general meetings and board meetings for recurring and one-off events; • registers of members and directors; • bank mandates; • filings of Manx companies with Companies Registry; • powers of attorney (which should be specific and for a limited period); • the presence of accounting records; maintenance of which is a statutory requirement for Isle of Man companies; • declarations of trust in respect of nominee shareholdings. In addition: • Companies Registry draws to the attention of the CSP team those CSPs that have an unusually high rate of documents rejected by the Registry due to inaccuracy. These reports have so far instigated two supervisory visits in 2002. Both visits identified underlying problems in the systems of the CSPs and made recommendations for improvement. • the FSC may investigate the standards applied by a CSP if complaints give rise to concerns and visit applicants because of past incidents that have cast doubt upon the standards of KYC or corporate governance of client companies. See also the comments under Para 3.1 above.
Comments	See comments under Principle 2 above.
	3.5 Trust and company service providers should comply with recognized standards in respect of the responsibilities of directors and trustees.
Description	CSPs must take responsibility for the competence and diligence of the persons that it supplies to act as company officers for client companies (GR Code para 10) See also the comments under 3.1 above. Where the FSC has doubts as to the qualifications or suitability of a member of key staff who is to be a director of client companies, the person is interviewed and during compliance visits, the FSC checks the presence and accuracy of key documentation evidencing compliance with recognized standards. (see 3.4 above) The visit team also looks at general performance of duties in the management of the client companies, for example, to identify who is responsible for and monitors the performance of investments held by a client company which owns a securities portfolio.
Comments	See comments under Principle 2 above.
	Additional criteria
	3.6 Trust and company service providers should have adequate internal controls that provide at least 4 eyes control.
Description	The FSC requires that • all CSPs meet the "four-eyes" criterion (i.e., that the business shall be conducted by at least two individuals who are key staff, who must be resident in the Island). (GR Code para 7) The "four-eyes" are sent a letter, which they are required to sign and

	return, setting out the responsibilities of the "four-eyes" role; • if the four-eyes criterion cannot be met, the CSP must have appropriate locum arrangements in place to ensure that the regulated activities it provides to its clients can continue without interruption. (GR Code para 8); • the FSC must approve the locum arrangement and a locum is treated as key staff, and must be approved as a fit and proper person. The applications process establishes the basic structure of the CSP. Visits establish how it is operating in practice by examining procedures and comparing them against what actually happens in the selected sample of files. (See also comments under paragraph 3.1 above.)
Comments	See comments under Principle 2 above.
	Customer Due Diligence
	3.7 Trust and company service providers should be required to satisfy standards equivalent to those set out in the Basel Committee's CDD Paper, published in October 2001, to the extent that the recommendations in that paper are relevant to non-banks.
Description	CSPs are also required to undertake "retrospective" KYC in respect of clients taken on before December 1998 by requiring them to know the beneficial owner of all client companies for which services are provided. (GR Code para 4) This requirement is backed up by supervisory visits.
Comments	
	3.8 Customer due diligence procedures should cover the following: (a) customer identification; (b) verification of identity of customer (c) risk profile (e.g., politically exposed persons); (d) source of wealth; (e) source of funds; and (f) ongoing monitoring
Description	The requirements of the AMLC and the GR Code encompass all the matters listed above with respect to CSPs. It is intended that similar emphasis will be placed on the identification of settlers, protectors, beneficiaries and other influential parties in relation to TSP business. In both cases compliance with the requirements is examined during visits.
Comments	
	Conduct of client business
	3.9 Trust and company service providers should be required to have systems and procedures in place for the conduct of client business covering: (a) the identification and segregation of clients' assets from the assets of the business;
Description	The Clients' Money Code requires that clients' money (para 2) must be: • held on trust (para 3); • identified (para 5); and • segregated (para) 4. The FSC: • enquires whether clients' money accounts are to be maintained; • at what banks; and • requires a letter from the bank(s) confirming that the accounts are being held for the CSP as trust accounts and are not subject to any claims or rights of offset (Clients' Money Code para 5.1.c)

	Clients' accounts: • are examined during visits by the FSC and audited - the auditor is required to certify whether the CSP has maintained systems to comply with the Clients' Money Code, whether it has in fact complied and whether it has conducted reconciliation of its clients money account at least monthly.(CSP Act s.24 and GR Code para 11.4
Comments	See comments under Principle 2 above.
	(b) the effective handling of clients' assets, which should include both safe custody and proper management procedures;
Description	The effective handling of clients' money and proper management procedures in relation to Clients' Accounts are covered in the Clients' Money Code para. 5. The provision of safe custody services is covered by the general duties of the CSP in relation to its client companies and the duties of the officers provided by it to client companies
Comments	See comments under Principle 2 above.
	(c) the maintenance of adequate and orderly accounting records of clients' affairs;
Description	The maintenance of adequate and orderly accounting records of clients' affairs (money) is covered in the Clients' Money Code para 5 and, insofar as this refers to the records of client companies for which a CSP provides services, the GR Code para 9.2. Compliance is examined during visits.
Comments	See comments under Principle 2 above.
	(d) the maintenance of adequate client documentation (e.g. trust deeds);
Description	A CSP must ensure that its clients are made aware of the CSP's terms of business or enter into a written client agreement (GR Code para 5). Where shares in a client company are held in a nominee capacity by a nominee provided by a CSP, there must be a nominee agreement in place (GR Code, para 5.4). See also the comments in (c) above. The obligations of company directors in relation to the administration and accounts of the companies of which they are directors are also relevant. (guidance notes for directors para 7) Compliance with these requirements is examined during visits.
Comments	See comments under Principle 2 above.
	(e) the appropriate authorization and handling of all transactions and decisions by persons with the knowledge, experience and status required to effect such transactions or make the required decisions according to the nature and status of the transactions/decisions involved.
Description	A CSP must: • organize and control its internal affairs in a responsible manner and have in place documented control systems and procedures.(GR Code para. 9) • ensure that its client companies comply with their legal obligations and that the staff who perform the regulated activities carry out their duties in a diligent and proper manner (GR Code 9.2 and9.3). • ensure that the directors it provides are competent.(GR Code para. 10) The guidance notes to Para 10 deal with delegation of the powers of directors and make it clear that ultimate control of the affairs of the company should remain with the directors. The presence of sufficient, competent and qualified staff is established during the applications process and examined upon receipt of notification of staff changes and the Annual Compliance Return. The CSP's procedures, signature mandates and the way in which transactions are handled in practice, are examined during visits.
Comments	See comments under Principle 2 above.

	Explanatory Note. Examples of the type of issue raised by paragraph (e) are set out below: • where discretion is exercised for or in relation to clients, all reasonable steps should be taken to obtain sufficient information in order to exercise that discretion or other powers in a proper manner and such discretion should only be exercised for a proper purpose; • any actual or perceived conflict of interest should be avoided or, where conflicts arise, such conflicts should be covered by disclosure, internal rules of confidentiality, rules on when or when not to act, or otherwise as appropriate; • all business (including the establishing, transferring or closing of business relationships with its customers) should be transacted in an expeditious manner. **FSC's comments** The issues are covered as follows: • GR Code para. 10 and guidance notes cover these issues generally; • KYC requirements (GR Code para 4); • visit procedures to check compliance (see principles 3.2, 3.7 and 3.8 above); • avoidance of conflict of interest (GR Code para. 14); • general day-to-day duties of CSPs to operate properly and efficiently.(GR Code para 9.3); • the termination and transfer of business relationships (GR Code para. 17).
	Financial Soundness
	3.10 Trust and company service providers should be required to: (a) maintain adequate and orderly accounting records of their business and their clients' affairs;
Description	During the licensing process: • the FSC obtains independently verified accounts for CSP applicants (CSP Licensing Policy. Para 2.9.1). Thereafter: • CSPs that are bodies corporate must provide audited accounts with their annual compliance return, which is due within 4 months of their year end.(GR Code para. 11); • A sole trader or partnership must either submit independently verified accounts or otherwise satisfy the FSC that it is a going concern.; • client companies must comply with relevant statutory and common law provisions.(GR Code para 9.2); • Visits check whether accounts are kept for each company.
Comments	See comments under Principle 2 above.
	(b) maintain adequate financial resources including adequate paid up capital and adequate liquid capital to enable the business to continue and to enable clients' affairs to be managed properly for an appropriate period;
Description	Solvency is monitored through the financial information submitted. This includes:

	• audited annual accounts for all CSPs that are bodies corporate; • unaudited, but independently verified, accounts for other CSPs (GR Code, para. 11); • a declaration of solvency annually for all CSPs; • notifying the FSC of the inability to meet the going concern requirement.(GR Code para 12); • notifying the FSC of events that could impact upon solvency (GR Code para 12), including legal proceedings against the CSP and any criminal proceedings against the CSP, its staff or its client companies. Where a sole trader or partnership CSP is unable to provide independently verified accounts, it may instead maintain the sum of at least £10,000 in a segregated bank account for the purpose of ensuring an orderly winding up of the business in the event of insolvency (GR Code, para 11.3.b and CSP Licensing Policy, para 2.9.4).
Comments	See comments under Principle 2 above.
	(c) comply with any relevant financial regulatory standards and international accounting standards;
Description	CSPs that are bodies corporate provide audited accounts with their annual compliance return, which is due within 4 months of their year end. (GR Code para 11) FSC staff review the audited accounts. Late Annual Compliance Returns are chased. Generally auditors in the Isle of Man are U.K. qualified accountants and apply the U.K. standards. The FSC expects a recognized international standard to be used would enquire into the application of any other standard.
Comments	See comments under Principle 2 above.
	(d) maintain adequate professional indemnity insurance cover.
Description	All CSPs must maintain PII cover appropriate to the nature and size of their business.(GR Code para 16) Guidance sets out an expectation of cover of 2.5 times turnover (minimum cover £250,000) and an excess of not more than 3 percent of turnover. Guidance-is used because a rigid formula would not always be appropriate and might, for example, leave a fast-growing business under-insured. The FSC: • Obtains documentary evidence of cover at the time of application and annually thereafter with the Annual Compliance Return; • examines any limitations upon the territorial and jurisdictional scope of the PI cover, with a view to ensuring that the CSP does not have customers that are excluded from cover (typically in North America); • where CSPs are owned by a large bank and covered by a group policy, examines any limitations upon the territorial and jurisdictional scope of the PI cover, with a view to ensuring that the CSP does not have customers that are excluded from cover (typically in North America). In these cases, a letter of comfort from the parent organization is accepted. The recent tightening of the PII market has meant that smaller CSPs have found it difficult to comply with the 3 percent of turnover guidance on excess. Cover with a low excess has either been unavailable or uneconomic. In these circumstances, the FSC reviews the financial resources of the organization and, where appropriate, requires an injection of capital, for example a subordinated loan in order to ensure that the excess on any claim or claims may be met without putting the solvency of the business at risk.

Comment	See comments under Principle 2 above.
	Systems and Procedures
	3.11 Trust and company service providers should be required to: (a) have in place effective compliance functions which include the designation or appointment of an appropriately skilled and experienced person as compliance officer;
Description	CSPs must have compliance systems and procedures in place (GR Code para. 9) and these are checked during visits. The regime does not include a requirement to have a designated post of Compliance Officer as this would be inappropriate or impossible for small operations. However, larger applicants are expected to have a designated compliance function as part of their organization. In smaller operations the directors are held responsible.
Comments	See comments under Principle 2 above.
	(b) have in place effective reporting requirements which include the designation or appointment of an appropriately skilled and experienced person as an anti-money laundering reporting officer
Description	The AMLC requires CSPs to have an MLRO who is an "appropriate" person in terms of the AMLC. The FSC checks the identity and competence of the MLRO. Applicants are required to change their MLRO if the FSC is not satisfied that the nominated person is sufficiently qualified. During visits the FSC examines the register of disclosures to the Financial Crimes Unit.
Comments	See comments under Principle 2 above.
	(c) have in place an effective complaints handling system which should include the maintenance of a record of complaints and the actions taken to resolve them;
Description	CSPs are required to have a complaints procedure, the details of which are set out in the GR Code paragraph 13. Compliance with the Code is checked on visits, including whether the complaints procedure includes a decision point for notifying the CSP's PII insurers of claims.
Comments	See comments under Principle 2 above.
	(d) maintain adequate, orderly and up to date records of all business transactions and instructions at an appropriate location in the jurisdiction, including: • accounting records of the business; • accounting records of clients' affairs; • records of the internal organization and risk management systems; • client documentation (e.g. client requirements);
Description	All Isle of Man companies are required to maintain accounting records (Companies Act 1982, s.1) that are subject to audit in respect of all bodies corporate and an accountant's report in respect of partnerships and sole traders the statutory accounting records must be maintained at the registered office and if they are not so kept, copies of accounting information sufficient to enable the company to comply with its statutory obligations must be sent to the registered office (Companies Act 1982 s.1.6, s.1.7, s.1.8). Visits examine bank statements and brokerage accounts of client companies and check whether accounting records are being kept. At this stage, visits do not check the accuracy of accounting records of client companies. CSPs are not specifically obliged to have a designated risk management system. However, they are required to have: • sufficient and suitably qualified staff (GR Code, Paras. 6and 9); • a disaster recovery plan (GR Code, para 18);

	• complaints procedures and a complaints register (GR Code, para 13); • records of staff training, both for anti money laundering and professional development purposes (GR Code, para 9, guidance note); • customer identification and examination of proposed and ongoing business, including enhanced scrutiny of business that carries politically exposed person risk (GR Code, Paras. 4 and 9, guidance Note) CSPs must enter into terms of business with their clients or notify clients of their terms of business (GR Code, para 5).
Comments	See comments under Principle 2 above.
	3.12 Trust and company service providers should be required to retain records for a period appropriate to the business and in line with relevant legal obligations.
Description	There is no specific requirement in the CSP legislation relating to the retention of records, however, there are statutory requirements relating to the retention of records for Isle of Man companies (Companies Acts 1931-1993) and a requirement to comply with the statutory obligations under the relevant law in respect of client companies for which the CSP provides services. (GR Code para. 5) There is a statutory requirement for record retention under the Anti Money Laundering Code. Visits check standards of record keeping for live files and recently closed files (closed within the last six months).
Comment	See comments under Principle 2 above.
	3.13 Trust and company service providers should be required to maintain a manual of appropriate policies and procedures; including business take on procedures, and documenting systems and procedures intended to safeguard the business and clients' assets and ensure that any authorized and proper transactions are undertaken.
Description	CSPs are required to have compliance systems and procedures in place (GR Code para. 9). The guidance notes relating to paragraph 9 include a list of the procedures the FSC may wish to examine. These include procedures to deal with assets held by client companies, anti-money laundering procedures and clients' money. The presence of these procedures is checked during visits and rated as part of the visit report.
Comments	See comments under Principle 2 above.
	3.14 Trust and company service providers should be required to ensure: (a) that they have an adequate span of control with a sufficient number of appropriately skilled and experienced persons able to exercise independent judgment; and (b) that those engaged in the business have a minimum relevant experience and qualifications.
Description	The four-eye criterion (GR Code para. 7) indicates that the individuals must be key staff who are required to meet the FSC's fit and proper test including the competence requirements. Minimum competence levels are set out in the CSP Licensing Policy and are discussed in principle 2.3 above. The issues are covered during the licensing process and changes to key staff are notified to the FSC (GR, Code para.12.1 and their impact is monitored. If a problem arises it is reported to the Board of commissioners.
Comments	See comments under Principle 2 above.
	Explanatory Note Exceptions may apply to this criterion in respect of sole practitioners where, for example, an individual trustee function is controlled by the Court. **FSC's Comments** A CSP sole practitioner must have locum arrangements approved by the FSC to deal with

	CSP business in his absence. Court appointed trustees will be exempted from TSP licensing requirements under the FSB (Schedule 1, Para 2 – Part 1A, Para 8).
	3.15 Trust and company service providers should be required to ensure that professional development requirements are satisfactorily met.
Description	Staff training and professional development is covered by the competence element of the fit and proper test under the licensing policy. FSC staff examine the training log to establish what training has been carried out.
Comments	See comments under Principle 2 above.
	3.16 Trust and company service providers should be required to ensure that their officers and staff have a full understanding of the duties arising under the laws relevant to the affairs of client corporate vehicles, trust and other legal entities for which they are acting in the jurisdictions in which they are carrying on business and in which the assets being handled/managed are held.
Description	A CSP must ensure that its key staff and other employees carry out their duties in a diligent and proper manner (GR Code para. 9.3) and the guidance states that it is important that all staff understand and comply with the CSP's systems and procedures (GR Code para 10). FSC staff examines the training log to establish what training has been carried out.
Comments	See comments under Principle 2 above.
Holding and Sharing of Information	
Principle 4.	All countries/jurisdictions should ensure that there is proper provision for the holding, having access to and sharing of information.
	4.1 Information on the ultimate beneficial owner and/or controllers of corporate vehicles, and the trustees, settlor, protector/beneficiaries of trusts should be known to the service provider.
Description	In addition to the requirements under the Anti Money Laundering Code, a CSP is required to identify its client and the beneficial owner of each of its client companies (if not the same person as the client) (GR Code para. 4). FSC staff examine client company files to establish what information has been recorded and retained.
Comments	None
	4.2 Any changes of client control/ownership should be promptly monitored, particularly where a service provider is administering a corporate vehicle in the form of a 'shelf" company or where bearer shares or nominee share holdings are involved.
Description	In addition, the requirement for a CSP to identify the client/beneficial owner is a continuing obligation. Any change of control represents a new customer and must be handled in accordance with the CSP's new customer take-on procedures. The above requirements apply equally to 'shelf" companies. When a company is sold the new controllers are new clients and must be handled as such. The beneficial owner must be identified. Where the client company has issued share warrants to bearer, the obligation to know the beneficial owner continues. In practice the CSP may need to require that the warrants be held in safe custody in order to enable the CSP to comply with the GR Code. The FSC noted that the Companies (Amendment) bill contains provisions that will effectively lead to the abolition of share warrants to bearer. Where nominees hold shares and the nominees are provided by the CSP the latter must enter into nominee agreements in writing and must retain copies in its records(GR Code para 5.4)). Even if the nominees are not provided by the CSP, the CSP must know the identity of the ultimate beneficial owner in order to comply with the GR Code. FSC staff examine client company files to establish what information has been recorded

	and retained.
Comments	None
	4.3 There should be an adequate, effective and appropriate mechanism in place for information to be made available to all the relevant authorities
Description	With respect to access to information for regulatory purposes, the FSC has powers to inspect CSPs, to request and require information and to conduct searches. (CSP Acts s10–13), and exercises its powers on a regular basis to undertake supervisory visits. The expected number of visits on the basis of present staffing levels is 35 in 2002, 60 in 2003 and 80 in 2004. It has also exercised its powers under ss.11 and 12 for enforcement purposes.
Comments	None
	4.4 There should be no barrier to the appropriate flow of information.
Description	The release of information obtained by the FSC generally requires the consent of the person to whom it relates. However, the CSP Act 2000, s.24 allows disclosure for defined purposes to relevant authorities thereby removing the barrier to the appropriate flow of information. Sub-section (5) specifies to whom information may be disclosed, commonly referred to as the FSC's "gateways."
Comments	The principal area of difficulty at present is in relation to the exchange of information in relation to TSPs. Since the disclosure provisions depend on reciprocity of regulation, the FSC is unable to share TSP related information until TSPs are regulated. This will be addressed when the FSB is passed.
	4.5 Information regarding the clients of the service provider should be kept in the jurisdiction in which the service provider is located.
Description	The FSC has not encountered any barriers to obtaining information that is required for regulatory purposes. However, there is a difficulty in sharing TSP information because of the current lack of reciprocity. This is to be remedied by the FSB.
Comments	None
	4.6 There should be no legal barrier to the flow of information or documentation necessary for the recipient of business from a provider who is an acceptable introducer to satisfy itself that adequate customer due diligence has been undertaken in accordance with the arrangements set out in the Basel customer due diligence paper.
Description	A CSP must keep identification details on its clients in the jurisdiction and retain them for five years after the relationship ceases, unless the client has been introduced by an "eligible introducer" who is regulated in a FATF member or EU country, in which case the verification of identity may be carried out by the introducer and details provided to the CSP on request. (FSC's Anti Money Laundering Guidance Notes). In the case of multi-national CSPs, this point is carefully checked prior to licensing and a license is not issued until acceptable procedures, which comply with the Anti Money Laundering Guidance Notes are in place. The AMLC requires any eligible introducer arrangement to include an undertaking that the customer information will be made available. FSC staff examine client company files to ensure that the correct information has been recorded and retained. A visit identified an instance in which an introducer did not give the appropriate undertaking and the FSC took action.
Comments	See comments under Principle 2 above.

Audit and Compliance Reviews	
Principle 5.	All countries/jurisdictions should require proper provision to be made for audits and compliance reviews.
	5.1 External auditors with relevant experience and appropriate track record should be appointed to carry out a full audit of the trust and company service providers' businesses in accordance with international standards.
Description	The accounts of an applicant for a CSP license and a CSP license holder must be audited (in the case of a CSP, which is a corporate body) or independently verified (in the case of a sole trader or partnership CSP). (CSP Licensing Policy and GR Code). Auditors of Isle of Man companies must be appropriately qualified in accordance with the Companies Acts (CA 1982, s.14). In practice they must be accountants qualified to practice in the United Kingdom or must be approved by the FSC.
Comments	None
	5.2 External auditors should have the statutory authority and protection necessary to report to the competent authorities any breaches of relevant legislation or other material concerns.
Description	Auditors of CSPs are required to report breaches of the CSP Act, the CSP Codes and any license conditions or directions or requirements of the FSC and in doing so they have a statutory protection contained in s.24(2) of the Act.
Comments	None
	5.3 Adequate procedures should be implemented to ensure that regular independent reviews are conducted of compliance with the statement of best practice
Description	The FSC undertakes supervisory visits in its own right and has the power to appoint reporting accountants (CSP Act s.25). The FSC undertakes visits to examine the compliance of CSPs with their obligations under the CSP Act and the GR Code, the Clients' Money Code and the AMLC. An outline of the scope of visits is given in the response to principle 3.
Comments	None
Cessation of Business and Misleading Statements	
Principle 6.	All countries/jurisdictions should have proper provisions for the ceasing of business and for prohibiting misleading statements.
	6.1 The interests of customer/clients should be able to be adequately safeguarded when the service provider is no longer able to carry on the business for any reason.
Description	Where there is a reasonable likelihood that any person (which includes persons other than a CSP or former CSP) will contravene any provisions of the Act, any conditions placed on a CSP license, a regulatory code or any direction given by the FSC, the latter can apply to the High Court for an injunction restraining the contravention.(CSP Act s.15). The legislation provides that: • the FSC may issue public statements if it has reasonable grounds for believing that a person is acting or holding himself out to be a CSP in contravention of the Act or of any regulatory code, any condition on his license or any direction given by the FSC (CSP Act s.14). • the auditor of a CSP, if in the course of his work he becomes aware of any matter which gives him reasonable cause to believe that the CSP may be in contravention of the Act, any regulatory code, any condition on a license or any direction or requirement imposed under the Act, he must report it in writing to the FSC (CSP Act s.24). • where the FSC has particular concerns about any aspect of a CSP's business, it may service notice on a CSP requiring the CSP to provide the FSC with a report by an accountant or other person with relevant professional skill on any aspect of, or any

	matter relating to the affairs of the CSP.(CSP Act s.25). • the FSC can petition the High Court for the appointment of a receiver and manager in respect of the affairs, business and property of a CSP or former CSP.(CSP Act s.16). • in relation to the cessation of business, the CSP must give the FSC not less than 28 days notice before the decision is implemented giving details of the arrangements to be made to ensure an orderly winding up or transfer of its clients' business (GR Code para. 12.10). In practice, the FSC can also: • obtain an undertaking from a CSP that the business would be wound down in an orderly manner. This would normally be used where a CSP is part of a larger regulated institution with ongoing business or has an ongoing business other than as a CSP; • issue a direction as to how the business is to be wound down. CSP Act s.7.2) This might be appropriate where there are grounds to believe that a CSP might fail to arrange an orderly disengagement; • apply to the Court for the appointment of a receiver and manager under section 42 of the High Court Act. (CSP Act s.16) This has been used in one case run by the Enforcement Division in relation to unlicensed CSP business.
Comments	None
	6.2 All countries/jurisdictions should ensure that trust and company service providers do not provide false or misleading information (including advertisements.
Description	Any advertisement the CSP publishes must not damage the good image of the Isle of Man and must contain a fair and accurate indication of the services the CSP provides. (GR Code para 15). The FSC's Enforcement Division searches the Internet for key words, which may indicate the carrying on of unauthorized business, which is, or holds itself out as being, from the Isle of Man. Appropriate warning notices are then posted on the FSC's website. See for example the warning notices on GAP and PEG, Secure Solutions. The CSP team also draws doubtful cases to the attention of Enforcement for investigation.
Comments	None

Table 17. Action Plan

Principle	Recommended Action
Principle 2 – All countries/jurisdictions should require those individuals holding key positions in a trust or company service provider (key persons) should be fit and proper	The FSC should ensure that the July 31deadline for completion of the licensing process for CSPs is met. The island should also enact quickly the Fiduciary Services Bill to extend the regulatory and supervisory regime to TSPs.
Principle 3 – All countries/jurisdictions should require that those providing the service of trust or company service provider exhibit evidence that their business will be or is being conducted in accordance with the proper corporate governance, customer due diligence, conduct of client business, financial soundness and systems and controls requirements	Same as above.