

Isle of Man financial review

Regulatory regime gets IMF 'thumbs up'

The International Monetary Fund - the most authoritative voice on world financial affairs - has commended the Isle of Man for its robust regulatory regime.

'The jurisdiction has a high level of compliance with all of the standards against which it was assessed,' says the IMF report.

'The authorities are to be commended for the attention they have given to upgrading the financial regulatory and supervisory system to meet international standards in banking, insurance, securities and anti-money laundering and combating the financing of terrorism, and the introduction of a comprehensive regime for the licensing of corporate service providers.'

The IMF singles out:

- The Island's comprehensive regulatory framework;
- Regulators' proactive approach to achieving high standards in the financial services sector;
- An off-site/on-site supervisory process that addresses key types of reputational risk.

The report also notes: 'The legal framework for company and trust service providers is fully consistent with the Offshore Group of Banking Supervisors Statement of Best Practices.'

The IMF was asked to carry out the inspection as part of its OFT programme that helps offshore financial centres to identify potential vulnerabilities in their financial systems.

'Positive endorsement'

Chief Executive of the Financial Supervision Commission, John Aspden, welcomed the report as 'a positive endorsement of the Island's regulatory arrangements'. The FSC is praised for its 'proactive stance in establishing high standards for banking and securities supervision in order to attract and maintain a reputable international finance centre.'



ISLE OF MAN
FINANCE

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ISLE OF MAN FINANCE

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'Prospectus' for Island's financial centre

The Isle of Man's positive and constructive approach to international pressures continues to serve it well. The invitation to the IMF to carry out what has been the most authoritative and rigorous review ever undertaken of the Island's regulatory regime is testimony to this.

The IMF visit was the culmination of more than five years of appraisals and assessments that began with the watershed Edwards Review of Financial Regulation in the Crown Dependencies in 1998. But rather than being diminished by the exercise, there is universal agreement that the Island has grown in terms of both strength and stature.

Quality goods and services

Witnessing the transition has been John Aspden, who took over as Chief Executive of the Financial Supervision Commission prior to publication of the Edwards Report. At the time, he said the Island had 'two big pluses' over other financial centres - the potential for growth and the high standard of its regulatory regime. The way of ensuring continued success, he added, was to build on the Island's strengths, the most important being the ability to provide quality goods and services in preference to simply relying on tax concessions.

Many a man taking over such an onerous position - and especially one with a distinguished background in the Bank of England as well as offshore - might have been reluctant to offer any hostages to fortune; five years down the line, however, his words seem not merely prophetic but have the ring of confidence in a regulatory structure that can withstand close scrutiny.

The IMF's evaluation was carried out as part of its OFC programme, which helps offshore financial centres to identify gaps and potential vulnerabilities in their financial systems. 'Without doubt, this report is the most authoritative that has ever been carried out on the Island's regulatory infrastructure - and the outcome amounts almost to a prospectus for the Isle of Man as a leading financial centre,' said Mr Aspden. 'As well as attracting new business to come here, most importantly it will allow Isle of Man institutions access into other markets. It provides a very solid platform from which the Government and the industry together can vigorously market the Island's services.'

Established international standards

The IMF's brief was to consider how the Island's regulatory regime complied with established international standards and assess the power given to it in law. The FSC follows principles set down by the Basel Committee and IOSCO - for banking and securities supervision respectively - and by the FATF for

the purposes of anti-money laundering and countering terrorist financing. The IPA follows standards established by the IAIS. Also, the OGBS has drawn up a statement of best practice relating to company and trust service providers, which was relevant for the assessment of corporate service provider licensing and supervision.

'Progress in the area of corporate governance has been particularly timely in the light of revelations of serious shortcomings in a number of major international conglomerates. These have raised some fundamental ethical and regulatory issues,' pointed out Mr Aspden in the FSC's recent annual report. 'Consequently they are likely to have a heavy influence on future checks and balances applied to boardroom responsibilities. The ethos of the Island's new licensing regime is to promote a high standard of corporate behaviour for the protection of clients, and as a result, the Isle of Man now has an enviable regulatory base from which to market its company services.'

*In addition, new initiatives are being explored to enhance the attractiveness of this important sector. A review of company and insolvency legislation is expected to draw on a wide body of expert opinion to ensure the development of the most effective framework. Meanwhile, amendments to the Companies Acts will shortly come into force and a new licensing and supervisory regime for trust service providers will be commencing its passage through the legislature. At the same time, a parallel project will begin to consolidate existing financial services legislation.



Finance District, Douglas



Jon Aspden

Member of IMF team

In a further demonstration of how seriously the Isle of Man takes its international responsibilities, FSC Chief Executive John Aspden has himself been part of IMF inspection teams carrying out regulatory reviews of other jurisdictions during the year.

Also, the Island attended the International Conference of Banking Supervisors and meetings of IOSCO and the OGBS, where it helped draw up a statement of best practice for the supervision of company and trust service providers. Talks continued with Jersey and Guernsey on the development of a pan-island approach to the prevention of money laundering and building on the statement of Overriding Principles for a Revised Know Your Customer Framework. A joint presentation with the Channel Islands was made to the Committee of European Securities Regulators on how the Island's regulatory regime complied with the EU Directive on Insider Dealing and Market Manipulation (Market Abuse).

Cooperation being vital to international regulation, the Island holds regular meetings with other Crown Dependencies to ensure a consistent approach to combating financial crime. Memoranda of Understanding have been signed with several countries covering a diverse area of supervisory issues.

coverage of anti-money laundering and terrorist financing legislation to be extended. In most cases, the latter is to reinforce the supervisory requirements already being applied in practice.

'The report does not contain anything unexpected - nothing has come at us out of the blue,' concluded Mr Aspden. 'There are areas in law, for instance, where the Treasury could direct the FSC, but these are powers which have never been used.' However, Mr Aspden anticipates that these and related issues will be examined by the Treasury in the months ahead.

Important insurance sector receives positive verdict

Further recent enhancement of the Isle of Man's regulatory arsenal to fight financial crime has resulted in a very positive IMF write up for the Island's important insurance sector.

The 17 companies that comprise the life industry account for the largest tranche of global single premium business in the international market, representing in the region of £17 billion under management. The captive market has also witnessed a recent resurgence with 15 new companies being formed and interest further boosted by the progression of Protected Cell Companies legislation.

The Insurance and Pensions Authority follows principles set down by the regulators' 'trade' body, the International Association of Insurance Supervisors, of which it is a member. Additionally, updated guidance on anti-money laundering procedures, which enhances that already in place for customer identification and reporting of suspicious transactions, came into effect in March and the IPA is currently offering assistance to companies on the most effective means of putting the measures into operation.

Praising the Island's proactive approach to regulation, the IMF report says the IPA has 'achieved a high degree of compliance with IAIS principles' adding that 'a small but competent office regulates the insurance sector smoothly.'

Mature and sophisticated market

With a membership of over 100 jurisdictions, the IAIS is the established standard setting body for the insurance industry and the association's Core Principles were used as a template for the IMF assessment. 'The IMF has recognised both the current standard of regulation we have in place on the Island and the very good awareness within the industry itself,' pointed out David Vick, who took over as Chief Executive of the IPA 18 months ago. 'The IMF's very positive findings are therefore not just a pat on the back for the regulators, but for the industry itself - we have a very mature and sophisticated market in the Isle of Man.'

The IMF's approach, he explained, was one of precision when it came to assessing the legal framework supporting the Island's supervisory procedures: 'The report fully acknowledges what we are actually doing in this regard. Therefore, many of the recommendations relating to AML and other supervisory matters concern where specific powers should be more clearly stipulated or strengthened to avoid any ambiguity in practice.'

'The IMF team, which included practising regulators and enforcement officers from other jurisdictions as well as their own personnel, was very thorough and spent a great deal of time going through the legal detail with the FSC, IPA, Attorney-General's office and Customs & Excise. It would be impossible, therefore, to go through an exacting exercise like this and not find areas where things could be improved upon.'

'The most important point is that the IMF report confirms our core principles and practices are sound,' said Mr Vick, who added that some points raised in the IMF's initial findings had already been addressed in new legislation and this was recognised in the final report.

The IPA fully recognises the cost of compliance - both in terms of money and customer perceptions - particularly for the depressed life industry. But Mr Vick believes it is crucial that business concentrates on the long-term benefits of maintaining the Isle of Man as a reputable jurisdiction that complies with recognised international standards.

Demonstrating real commitment

'Regulation of insurance sector business has developed considerably in recent years and the nature of the IMF's assessment reflects this. For instance, before 9/11 much of the assessment template concentrated on prudential supervisory aspects rather than anti-money laundering and terrorist financing. Things have changed considerably in a relatively short time frame and the Island must continue to be able to demonstrate real commitment to international standards whilst acknowledging that it is not in anyone's interest to make life so difficult that business dries up,' stressed Mr Vick.

* The IAIS was formed in 1994 to promote cooperation among insurance supervisors and regulators in other financial sectors. It develops principles and standards on insurance supervision and is active in promoting their implementation. Membership comprises insurance supervisory authorities from over 100 jurisdictions and 70 observer organisations and individuals. They represent professional associations, insurance and reinsurance companies, international financial institutions, consultants and other professionals.

In Brief

MONEY LAUNDERING STILL BIGGEST GLOBAL THREAT

The chief threat posed to the global banking system and financial institutions remains that of money laundering - compounded post 9/11 by the financing of terrorism. Therefore the steps - commended in the IMF report - being taken by the Isle of Man to develop a strong anti-crime culture stand it in very good stead at a time when international standards demand increased vigilance.

On-site inspections

On-site inspection visits by the FSC and IPA impress upon individual licence holders the risks involved in undertaking business without thorough due diligence - including client relationships begun in the past. These visits examine the measures taken to check out new clients and source of funds, monitor transactions and train staff. Any deficiencies are discussed with the licence holder and corrective action sought within an agreed timescale.

'Anti-money laundering measures are not compliance for the sake of it,' said FSC Chief Executive John Aspden. 'There is a clear market expectation that all participants should have appropriate due diligence procedures in place. Where procedures are found to be lacking by subsequent events, the reputational and other consequences can be serious.'

'By the same token, knowing one's customer is not just about completing identity checks. It embraces an understanding of the whole business relationship and nature of the transactions being undertaken - I fully realise the ongoing monitoring of transactions is a difficult task, but it is the area where most attention needs to be given.'

Risk assessment

'Best practice would also dictate that an institution should form a view at the outset of the risk ascribed to a particular association. A basic assessment of risk given to broad categories of business relationships can provide a guide to the level of monitoring required.'

'The Isle of Man now has a much more compliant culture,' added Mr Aspden. 'Broadly speaking, the IMF is happy with what we are doing in practice while pointing out a number of places where the underlying law could be tightened. For instance, a new draft anti-money laundering code is more specific on customer identification and reporting of suspicious transactions. What is being recommended, therefore, is a sharpening up process that would give greater legal force to what we are doing already.'

Interestingly, Mr Aspden points out that major institutions are also demanding appropriate due diligence standards from those with whom they do business - in other words, the market is setting standards for itself to ensure its good reputation.

Praise for quick action

The Isle of Man's swift response to some concerns flagged up in the IMF's initial findings is given particular credit in the report.

The Isle of Man authorities expected there would be some recommendations arising from the assessment, especially given the comprehensive nature of the inspection exercise. They relate to the independence and accountability of the FSC and IPA; the need to apply more robust supervisory tools in selective areas of the banking sector; the adequacy of supervisory and investigative resources; some weaknesses in the legal framework for anti-money laundering measures, and the need to implement the licensing regime for trust service providers.

But at the same time, the IMF points out: 'These weaknesses have not been a major concern to date. However, they are likely to become a more significant issue going forward as the Isle of Man's financial sector continues to develop.'

And noting the action that has already been taken in several important areas, the report goes on:

- 'To upgrade the on-site inspection process, a major project has been completed to implement a new approach to supervisory techniques. This includes the issuance to banks of a consultative paper on corporate governance and safety and soundness issues, to be followed by a full programme covering all banks, such as credit risk, market risk, etc.
- 'The Anti-Money Laundering Code, 1998, has been comprehensively revised to include a number of the mission's recommendations for amending the legal framework on AML/CFT (anti-money laundering and combating the financing of terrorism). The revised draft Code was issued for consultation on the Isle of Man at the start of July 2003:

A 'good corporate neighbour'

The Isle of Man's stance of 'a good corporate neighbour', not merely cooperating but playing a constructive role in its dealings with important global institutions, could be a model for how small, independent nations handle their international responsibilities. There is always the proviso, however, that any legislative change must pass the ultimate test - that it is in the best interests of the Isle of Man's economic well-being.

The Basel Committee

The Basel Committee sets standards on all aspects of banking supervision known as the Basel Core Principles. Reporting to a joint committee of central bank governors and heads of supervision from the G10 countries, the committee works under the auspices of the Bank for International Settlements - the world's oldest international financial institution and principal centre for international central bank cooperation. Established to handle reparation payments following the First World War, the BIS soon became focused entirely on cooperation among central banks and other agencies in pursuit of monetary and financial stability.

FATF

The Financial Action Task Force was formed to meet mounting concern over money laundering and its threat to the banking system. Convened in 1989 from the then G-7 Member States, European Commission and eight other countries, the FATF widened its brief in 2001 to include countering terrorist financing. It recommends the action needed to fight financial crime and monitors how member countries and other jurisdictions are behaving. It also works with the UN, the International Monetary Fund and the World Bank to identify countries requiring help in putting the measures in place. Although based at the OECD in Paris, the FATF itself is independent. The FATF has recently revised its Core Recommendations.

IMF

The IMF is the principal forum for discussing not only national economic policies in a global context, but also issues important to the stability of the international monetary and financial system - including the design of internationally recognised standards and codes. The IMF was conceived at a United Nations conference in 1944 when 45 governments agreed on a framework for economic cooperation designed to avoid a repetition of the disastrous economic policies that had contributed to

the Great Depression of the 1930s. Its OFC programme, which has begun following a report by the Financial Stability Forum, helps offshore financial centres identify gaps and potential vulnerabilities in their financial systems.

IOSCO

What the Basel Committee means to banking, the International Organisation of Securities Commissions represents for the investment world. IOSCO is the leading international grouping of securities market regulators with a membership comprising regulatory bodies from 90 countries that have responsibility for securities regulation and the administration of securities laws. Globalisation has brought about increasing interdependence amongst regulators and members work together to promote effective regulation at both domestic and international level in order to maintain just, efficient and sound markets. IOSCO has established regulatory standards for supervisors to follow.

OECD

Born from a grouping set up to administer European aid after the Second World War, the OECD now offers a forum for countries to 'negotiate the rules of the game of international cooperation.' Globalisation has seen its remit widen from working to strengthen member economies to encompassing a range of economic, social and environmental issues. Its focus offshore has been primarily on delivering more uniform business taxation. A helpful and flexible attitude gained the Isle of Man an influential seat in the global forum tasked with drawing up the draft model convention on exchange of information.

OGBS

The Offshore Group of Banking Supervisors was formed in 1980 so offshore centres could define their common ground more clearly. It also provides a base from which to participate in the defining and implementation of international standards for cross-border banking supervision and to make a coordinated response to other supervisory authorities seeking assistance in the effective supervision of international banks. As well as working closely with the Basel Committee, the Offshore Group is represented on working groups set up by the FATF on money laundering and terrorist financing. It has also drawn up a 'best practice' statement on the regulation of corporate and trust service providers.